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Market Review & Update

SUMMER 2018

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We're getting close to the middle of 2018. The S&P hit a high point in January. Since then we have seen an increased level of market volatility that seems to be tied to a myriad of metric laden tug of wars.

Growth vs slowing?

Inflation or not?

Fed hikes rapid or slow?

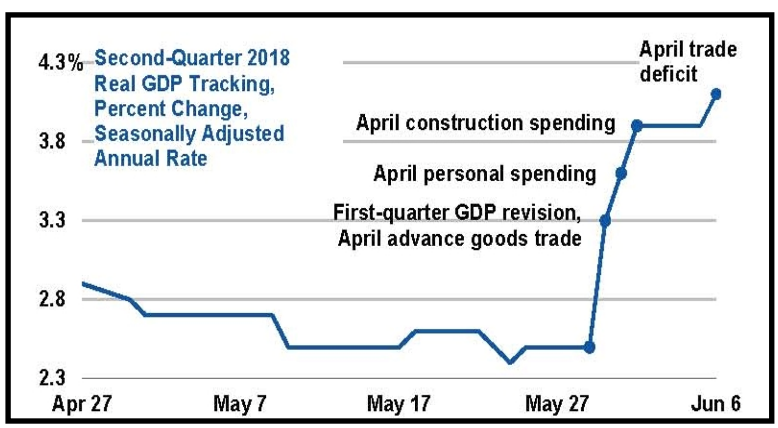
Trade war or "negotiating strategy?"

Heightened military tensions or Nobel prize?

Let's chat about a couple of these… At the risk of proving them wrong, many analysts have bandied about the term "sweet spot" for where we find ourselves economically. The recent May jobs figures were one of the prime catalysts to perk up equity markets. The NASDAQ is now at a new all time high, and the small cap Russell 2000 index has followed suit. The latter tied very closely to the tax benefits delivered by corporate tax reductions, as smaller companies invariably pay a higher average tax rate than their large cap brethren. Jobs came in at 223k for the month of May, well ahead of the anticipated 188k. This put unemployment at an 18 year low of 3.8%. That number earns an asterisk though, as it was goosed by yet another decline in the participation rate, down another tenth to 62.7%. All in all, the data was good, and the inflationary aspects of it were quite muted.

GDP came in at 2.8% and is expected to head toward 2.7% in 2019. One caveat here is that we have a chance of hearing more about potential infrastructure investment. If that were to occur in any meaningful way, we could see GDP flirt with levels above 3%. Inflation is still in a very comfortable range around 2.2% which gives the Fed some room to not get too speedy with rate hikes as long as that inflation number keeps from spiking. Earnings, as we spoke about in the Spring issue, are spunky due to strong business results globally, coupled with the added kicker of corporate tax cuts boosting profits by about another third. And, we have seen an uptick in stock buyback activity and dividend hikes tied directly thereto.

Near Term GDP Trend



One question about earnings growth that we need to focus on as we move forward is that growth will definitely continue into 2019, but the rate of earnings growth will definitely not be at the same level we are currently encountering. Goldman had projected '19 to be closer to 8% growth as opposed to our now upper teens rate. So, we can't call this peak earnings for the cycle, but history may mark this as the peak earnings growth rate for this recovery, absent some wondrous impact from infrastructure dreams (recall here the Obama “shovel-ready” nightmare). Will this be digested well by the markets? That infrastructure caveat should again be raised here, more delivery on this front could alter forward earnings projections in a number of sectors.

Those tug of wars over the vector and amplitude of the metrics have been part of the volatility story. In addition to the various equity markets, Treasuries have been trying their best to manifest an opinion as well. The 10 year barometer breached 3% for a bit recently, causing a volatility ripple but soon backed below that range as other volatility inputs, in summary, shut up. We’ll get more info about these over the course of the month as trade and other international discussions proceed. Over the decades, we have heard the terms “sweet spot”, “goldilocks”, etc., used to describe the then current environment which often makes participants feel at ease, comfortable and safe (or “just right” as the fable goes…), but we should always remember to remain vigilant as what surrounds these goldilocks periods is reliably not so sweet…

Steve Gattuso, our head of investment strategy was a recent guest on NASDAQ Tradetalks, here’s a link to that interview: https://youtu.be/dnUmKST1Pfk

You’ve heard the term, Universal Basic Income, an idea floated to provide a basic cash flow to all citizens, primarily to offset the impacts to those displaced by automation. Finland was one of the first to experiment and ended the program which now requires recipients to do some work every quarter to get a check. Autonomous robotics are the catalysts for these notions, becoming an inevitability, with drivers being among the first in line to see the future. Approximately 4 million folks in the US drive for a living. On a related note, let me introduce you to Flippy, here’s a link to watch “him” in action (https://youtu.be/ZiD_6ex2ptY). The California restaurant had to close soon after Flippy’s arrival to re-train genetically based employees so that they could keep up with Flippy’s output. Recall Pogo’s warning, “we have seen the enemy and they is us…”

The aforementioned “sweet spot”, absent aberrant interruptions, should trend us well into the second half of the year. Enjoy a lovely summer.

We’ll talk to you soon…