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MARKETCOMMENTARY

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Corporate America's confidence continues to increase

Much to cheer about in almost all markets

For the first half of 2017, the market delivered very strong and steady performance with the S&P500 up 9.34%, delivering about a 20% annualized return. Internationally, markets have performed even better. Developed markets are up nearly 15% on the year and emerging markets are up just a bit more, notching better than 15% gains through June 30. Surprisingly, even the Barclays Aggregate Bond Index is up 2.27% on the year in spite of two Federal Reserve rate increases. Strong returns from nearly all markets give investors much to cheer about.

The reasons for the gains are fairly simple. While politics, at least in the U.S., remain contentious and volatile, the U.S. and global economies have not only been relatively devoid of turbulence, they are generally strong and improving. Within the US, nearly all indicators reveal solid and generally upward trends, and across the globe, nearly all the world's major economies are not only growing, but gaining momentum.

Corporate America's confidence continues to increase, and as businesses digest the raft of regulations foisted on them in recent years, the lack of new requirements is enabling firms to focus on innovation and development rather than regulatory compliance. As a result, even very late in a long and albeit tepid economic expansion, growth looks to be strengthening rather than fading.

By Daniel Wildermuth

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Jobless claims for the third week of June came in at 238,000, marking the 120th consecutive week that claims have been below 300,000, the threshold associated with a strong labor market. The string is the longest stretch that claims have remained below that level since 1970.

In mid-June, the U.S. Federal Reserve raised interest rates by a quarter percentage for the second time in three months, and Fed comments indicate a likely rate hike later this year. The lack of impact of the hikes on confidence surveys, the economy and US equity markets suggests the economy really has strengthened as the Fed asserts.

Outside the US, Europe is finally notching more solid growth, and many indicators ranging from increased borrowing to more positive Purchasers Managers Indices signal more good news to come. With the recent election of Emmanuel Macron as President of France, Europe's feared lurch away from capitalism and integrated markets has largely ended, and the threat that various countries would emulate Britain's EU exit has essentially dissipated. Now, Mr. Macron is seeking to retool more than 3,000 pages of labor regulations widely blamed for lower employment and slower growth. Moribund European equity markets have noticed and shot up over 13% in the first half of the year.

China is also stabilizing after a difficult 2016, contributing to a stronger Asian rate of growth. Gross domestic product grew 6.9% from a year earlier, reaching its highest level since the third quarter of 2015. China continues to evolve quickly from a manufacturing based economy towards a more modern service based economy. The evolution will likely hit some significant speed bumps over time, but the transition remains impressive and suggests that an abrupt implosion of their economy remains unlikely.

Meaningful and promising devel-

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opments continue to emanate from India as the government institutes major reforms. While the most recent and ambitious plans to overhaul the country's complex and antiquated tax structure have triggered strikes, protests, and various other opposition, the moves illustrate the resolve of Narendra Modi, India's Prime Minister, to reform the country's economic infrastructure.

Mr. Modi's recent actions are particularly remarkable given the political fallout resulting from last November's crackdown on corruption, which voided close to 90% of the country's cash in an attempt to curb black market activities. While the effort appears successful, in the short term it decelerated growth by 0.9% to 6.1%, which for the first time in two years put India's growth below China's. Yet, the short-term pain is expected to pay significant dividends in the future and further drive growth across the region.

While none of these efforts will dramatically affect the U.S. economy, continued growth of a major global economy should provide spillover benefits to the region and the globe. As a whole, global growth is the strongest it's been in a decade, which should benefit the U.S. and the Fed as it seeks to wind down its $4.5 trillion balance sheet created as part of the mammoth stimulus effort during the financial crisis.

Linked to increased global growth, trade picked up sharply in the first quarter with 5.7% year-over-year growth in March the highest in six years, according to the CPB Netherlands Bureau for Economic Policy Analysis. April data was a bit weaker, but remained solid. Trade acceleration is good news for the economy and investors, as more globalization means faster economic growth and better use of existing assets.

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Given all of President Trump's rhetoric against trade, fears persist that Trump could reverse or hinder ongoing globalization, which has powered economies forward at record rates since World War II. Yet, few investors appear to believe that Trump wants a trade war or will likely start one. For instance, shortly before and after the election, the Mexican peso plunged. Yet, the peso is now stronger than it was before the November election, and the first tariffs Trump imposed were on Canada, hardly seen as a rogue trade partner. Trump's recent visit to Germany, a country which exports far more to us than it imports in spite of very similar skills and resources, hardly elicited any trade comments much less threats. To date, most of the administration's trade actions have been bluster, reports commissioning, and enforcement of current rules rather than substantive and damaging actions.

As we head into the second half of the year, economic measures are prevailingly positive. The political environment may be combative and global geopolitical risk continues to warrant attention, yet most typical risk indicators remain below historical averages. All the good news, or lack of bad news, has pushed equity valuations up leaving less room for future returns, yet prices could be justified given ongoing economic developments. If Trump is able to deliver on expectations regarding tax and regulatory overhaul, valuations may be fine, but a significant failure or change in expectations, either up or down, could propel markets in very different directions. As is normally true, equity markets offer much opportunity, but a longer-term perspective remains invaluable.