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MARKETCOMMENTARY

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Confidence Continues to Rise

By Daniel Wildermuth

October has generated another strong month of equity market returns with equity markets accelerating at an even faster pace than this year's average. Good news from multiple sources has not only driven the market higher, but also contributed to an unusually steady rise. Through October 30, the S&P 500 had gone a record 247 trading days without a 3% decline, breaking the previous 21-year-old record set January 9th, 1996.

Hopes of tax reform continue to buoy markets, and data from multiple sources demonstrate the ongoing strength of the U.S. economy. In spite of two hurricanes, the U.S. economy logged its best six-month stretch of growth in three years. Gross domestic product (GDP) – the broadest measure of goods and services made in the U.S. – expanded at a 3% annual rate in the third quarter, according to the Commerce Department, after posting a 3.1% growth rate in the second quarter. The economy last strung together two quarters of at least 3% growth in mid-2014.

During the eight-year expansion, the U.S. has reached a 3% quarterly annualized growth rate numerous times only to repeatedly fall back to its mundane 2% trend. This time, there may be enough strength to keep growth elevated, and some economists are already predicting 3% growth for the fourth quarter in addition to a sub-4% unemployment rate.

Confidence among consumers and business owners continues to rise. A measure of consumer sentiment hit its highest level since 2004, riding high on low employment, cheap energy, low inflation and the booming stock market. Consumer spending rose 2.4% in the quarter, which was much stronger than expected given that storms prevented many Americans from spending on shopping or eating. Businesses are also acting on their increased confidence and demonstrating much greater willingness to invest in long-term projects through spending on equipment, plants and people. Because these outlays contribute to future productivity, they should also boost future profits. U.S. exports were also up 2.3% helped by an expanding global economy and a weaker dollar. The GDP increase also comes in spite of a decline in government spending at a 0.1% rate.

> *"A measure of consumer sentiment hit its highest level since 2004"*

Not surprisingly, quarterly corporate results are expected to outperform, and several reporting technology companies have already posted very strong results.

Part of the driver behind the growth and resulting profits stems from a juggernaut of deregulation unleashed by the Trump Administration. While Trump has seemingly struggled to push much of his agenda forward and also alarmed investors with threats of trade wars and dissolution of economic treaties, he has delivered on removing a surprising number of shackles holding back the U.S. economy. The U.S. Chamber of Commerce lists an impressive 29 executive actions that reduce regulatory requirements. In carrying out Trump's directives, executive-branch agencies have issued an additional 100 directives that eliminate regulations or start the process to eliminate or shrink them. The Republican Congress has used the hardly known 1996 law, the Congressional Review Act, to repeal executive-branch regulations within 60 days after they are finalized, which has enabled Trump to overturn 14 Obama administration regulations obviously enacted just as Obama was leaving office. Regulatory changes rarely rate big news coverage, but improvements can potentially kick off huge productivity.

Consumers may have more dry powder too. In recent years, they have been spending less of their wealth generated through increases in housing prices and the rising stock market. As U.S. household net worth has hit a record $96.2 trillion in the second quarter, up from the pre-recession high of $68.2 trillion, the wealth-to-income

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ratio hit a new high of 670%. Greater resources and reserves likely mean U.S. consumer spending can continue to power the economy forward while also providing a deeper financial base should the economy slow.

Given the recent strength in the economy, it appears more likely that the Federal Reserve will raise its interest rate at its December meeting, but like the last increase, the move should be viewed as a vote of confidence rather than a cause for concern.

Outside of the U.S., the global economy continues to pick up speed, recording its fastest growth since the brief 2010 post-crisis recovery. Growth is also accelerating across nearly all the world's major economies and is more broad-based than it has been at any time since the global recession. Inflation remains muted and investor expectations of restrained central bank activities should continue to boost confidence. The International Monetary Fund raised its forecast for growth to 3.6% for 2017 and 3.7% for 2018, both estimates up substantially from last year's 3.2% pace.

Europe seems to finally be breaking free its post-crisis daze. World-wide investment spending by eurozone-based corporations, excluding banks and insurance companies, increased 7.2% from the year before and is up 5.7% through the first half of this year.

European confidence in its own prospects are also improving. After spending billions on expansion across the globe, particularly in emerging economies, European firms are investing more within their own borders. German companies, often the European leaders of business, provide a great example with Daimler AG (Mercedes), property giant Unibail-Rodamco, and laser-equipment maker Trumpf GmbH all building new facilities in Germany.

> *'The Organization for Economic Cooperation and Development is forecasting 2.1% growth for 2017'*

Eurozone consumer confidence recently hit its highest level since the financial crisis according to the European Commission. The Organization for Economic Cooperation and Development is forecasting 2.1% growth for 2017 for the 19 countries on the euro. While the growth rate is hardly stellar, it is about the same pace that the U.S. has been on post-crises and is much better than the near recession pace endured for much of the last decade.

Investors now face a challenging environment. Decent and likely improving U.S. economic growth, potential tax reform, strengthening global economies, low inflation and more could continue to propel stocks forward and possibly launch stock prices into territory that could be construed as a bubble. Or, one could focus on less positive issues such as valuations that require strong earnings growth to justify. Fed tightening, inflation that is starting to pick up, tax reform challenges, and a uniquely aged economic expansion all pose challenges. Investing seems to require either a disregard for inflated prices or courage that unknown future events will somehow justify prices – or perhaps both. Still, in the broader investment universe, equity markets continue to represent a relatively attractive investment opportunity given the challenges that various other investments are also facing.

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