Economic & Market Commentary
September 2017

The stock market continued its rise during the quarter ended August 31, 2017 even though stocks were essentially flat for the month of August. For the three-month period, the Dow Jones Industrial Average was up 4.47%, the S&P 500 increased 2.48%, and the NASDAQ Composite rose 3.71% on a prices-only basis. Those same indices are up 11.06%, 10.40%, and 19.42% respectively for the year-to-date.

The market's rise has been remarkably steady despite the following challenges:

- Geopolitical risks have increased, with further nuclear tests by North Korea exacerbating tensions and raising the possibility of more serious confrontation. Concerns over Russia, the Middle East, Venezuela, terrorism, and the contentious negotiations over Brexit implementation have not diminished.
- The damage from Hurricane Harvey and potentially from Hurricane Irma is disruptive to the economy, transportation, and energy supplies, and will require additional government spending.
- The Federal Reserve raised short-term interest rates twice earlier this year and has indicated that there is a strong chance it will also begin reducing its bond holdings as early as this month. Stubbornly low inflation has injected an element of uncertainty as to the pace of future Fed rate increases, but if the move toward more normal interest rate levels becomes more aggressive than expected, it would be challenging for equities. Other global central banks have signaled that they too are closer to winding down exceptionally loose monetary policies.
- Expectations have diminished significantly for near-term implementation of the administration's pro-growth agenda in the form of tax reform and infrastructure spending as the result of disagreements even within the administration's own party and the distraction of political controversies in Washington. As the support from exceptionally accommodative monetary policies subsides, some investors are questioning whether there will be a hand-off to fiscal policy stimulus that can keep the economy and markets moving ahead.
- Federal budget negotiations are likely to be contentious. Even if the debt ceiling is temporarily raised beyond the end of the September 30 fiscal year deadline, Congress also needs to raise the debt ceiling on a longer-term basis so as to avoid a government shutdown and to keep the Treasury from running out of cash.
- Although market volatility picked up slightly in August, it has still been eerily low and reflects a level of complacency that easily could be disrupted. For U.S. equities in 2017 to date, there have been only four days in which the market has fallen by more than 1% from the previous day's close, far less than was the case in 2016 in which such declines occurred 22 times.
- Stock valuations are elevated by many measures.

Investors thus far have shrugged off many of these concerns, focusing on these more positive factors:

- The U.S. economic expansion continues at a steady pace with the most recent report of second quarter GDP coming in at an improved 3.0% growth rate.
- A rebound in corporate earnings has become the most credible underpinning of the market's advance. First quarter earnings rose 14% year-over-year, and with almost all S&P 500 earnings reports now released, earnings grew at 10.3% in the second quarter.
- There are increasing signs of a synchronized global economic expansion that has helped bolster stocks prices around the world. All but four of the thirty largest global markets are up this year.
- Global interest rates are still low and inflation has not reasserted itself in a meaningful way.
- Liquidity has been an important support to the markets. In addition to still-low interest rates, increased earnings provide companies with the wherewithal to reward shareholders with dividend increases and share buybacks, thus contributing to the liquidity that has helped propel the markets.
- While progress has slowed, the administration remains committed to its pro-growth initiatives.

The post-election stock market rally has proved resilient thus far; however, the lack of volatility seems to have lulled investors into complacency. We are in the ninth year of a bull market, and the market seldom has risen for so long without a major setback. We recognize that the uncertainties of what is still a period of transition could become more pronounced and lead to a bumpier path than investors have experienced recently. Thus, in our equity holdings, our focus remains on companies with strong balance sheets and ample cash, coupled with a balanced portfolio approach that includes fixed income obligations and cash that provide some buffer should the stock market become more volatile.