Market Commentary

Financial markets have historically been discounters of the economic effect of consumer expectations, general business conditions and governmental regulations worldwide. In the first quarter of 2017 the stock and bond markets experienced an unprecedented reaction to the new regime in Washington. However, it was a difficult period for non-traders of stocks who saw their portfolios whiplashed in terms of winners and losers. While the S&P 500 stock index posted its largest quarterly gain in the past five quarters, unless one was heavily weighted in technology, total portfolio performance was likely not as robust.

The election in the U.S. resulted in a vast turnover in the Federal government population as Republicans took hold of both houses of Congress and loudly proclaimed a plan to cut taxes and encourage the ability for domestic economic growth. The stock market's response was a major shift in risk taking toward the tech sector which jumped 12% over the quarter. The initial exuberance dissipated in the final month of the quarter as infighting in Washington casted doubt on the achievement of the new administration's economic expansion plan. Arguments surrounding immigration, voting irregularities and looser regulations—along with the failure of the program to repeal and replace Obamacare—further put into question the effectiveness and cohesiveness of the new administration. The upshot was a slowdown in March for the U.S. stock market which was also affected by negative surprises in the energy sector, where OPEC revised its willingness to cut production, and by general concern about trade negotiations. It is likely, however that oil prices will rise over the next few years and the U.S. is well on its way to becoming a net exporter of oil and natural gas which is positive for the industry and economy.

Another positive development is that consumer confidence continued its relative strength with numerous signs from leading and coincident indicators suggesting a strengthening in the U.S. economy, and most company managements are expecting good 2017 earnings. In particular, the job market continues to show a revival in the employment outlook. There are still areas of weakness, especially in the retail area which is undergoing a major restructuring due in part to the to the emergence of e-commerce making significant inroads into this traditional retail store market.

While interest rates have risen modestly, the continuing saga of when and where the Fed will raise again this year continues. However, it seems as if a policy of a further series of small increases is likely this year. The bond market was nervous about these increases and weakened late last year but has recovered somewhat recently as bond yields reacted only modestly to the Fed's well-telegraphed March Fed Funds rate increase. We believe that some further increase in rates is not a negative for the overall economy. What would be a problem is a further shortage in skilled labor causing even further delay of infrastructure spending which would result in a spike upwards in the rate of domestic inflation.

The real boogey man, however, lurks in the shadows of international turmoil resulting from nations battling over territorial, immigration or trade disputes, including potential saber rattling responses to perceived threats by other countries. Yet the odds of the outlook for the domestic economy either "booming or busting" appear low over the coming year. What is clear is the rising acrimony in Washington and the eventual success/or failure of growth initiatives. Although it may be a better year in domestic financial markets, our long held policy of investing in high quality, low risk and diversified securities has paid dividends since 1989.
