Market Commentary

Given the slow but steady improvement in economic conditions for many world economies in the first half of 2017, second quarter results were still surprising in a number of ways. In Late June both the U.S. and European central banks announced they would not be "as easy" in managing the supply and outlook for the world's currencies. In addition, a number of incidents and political statements in some of the largest countries (particularly in France, the UK, and the U.S.) shook up the expectations for an improvement in the economies as well as the political practices of many of the governments. In spite of these jolts, financial markets continued their improvement in the second quarter.

The now clichéd "Trump Bump" in the U.S.—which was based on the presumption of a resurgence of "animal spirits" and a major improvement in economic policies proposed by the new Republican administration—morphed into the "Trump Slump" as it has become apparent that neither new tax policies nor the speed of their adoption is going to be as easy and timely as expected. The outlook for the domestic economy was downgraded due to the uncertainty regarding these beneficial changes, and it is believed that the U.S. GDP growth will have a difficult time accelerating from the 2% rate we have been stuck in for the past seven years. Interest rates retraced much of the post-election rise and incipient price inflation pressures faded. As a result, sectors in the market with commodity-price exposure or cyclical sensitivity reacted negatively in the quarter.

Yet the Trump Slump appeared to have run its course by the end of May, and in June, Large-Cap Value benchmark returns improved relative to Large-Cap Growth as some of the most popular, most richly-valued growth technology stocks saw short-lived but sharp periods of price decline. Interest-sensitive stocks like utilities also weakened, whereas economically-sensitive stocks strengthened again.

At this point in the year the Federal Reserve Board's policy seems clear—expect another rate hike later in 2017. It is also clear that the Fed is determined to adhere to its change in money supply/dollar stance, as reflected in its discussion of the timing of the planned reduction in the Bank's balance sheet, rather than continuing to focus on micro managing Fed policy with its large holdings of securities. The greatest surprise for U.S. and European bond markets was the statement by the ECB's Mario Draghi that the risk of deflation in Europe was considerably reduced. Bond prices sold off and yields rose dramatically as investors understood that the long period of extraordinary monetary ease in Europe might be coming to an end.

Overall, the stock market's current valuation no longer looks inexpensive, particularly among the high-growth tech companies and many perceived safe havens. Investors are in a "show me" mood which indicates it will take more than hope to drive the market significantly higher. Corporate decisions not to invest in new plant and equipment are a negative for more robust domestic economic outlook therefore it looks like "real" positive change on regulation and tax policy. In other words, fiscal policy will be needed to create more confidence in the economy for the balance of the year.

Amid all of this noise, the wide swings in stock markets around the world widened valuation spreads among sectors. Our emphasis on the quality of companies selling at reasonable prices seems appropriate to continue to meet our clients' needs. The consensus seems to be torn between hoping for strengthening in the U.S. without triggering a round of higher inflation. This would be reason for optimism for investors IF the political/social issues facing many economies don't re-emerge. It would be nice if both Wall Street and Main Street here in the U.S. could be celebrating as the year progresses.

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