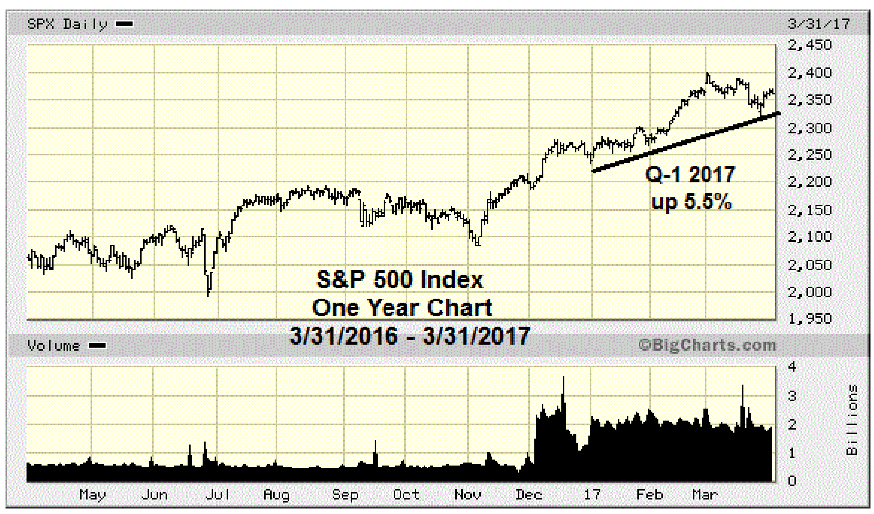
American Heritage Financial

April Update **April 3, 2017**

A Month Too Long

The first quarter of 2017 may have been one of the most benign ever for investors. U.S. stock markets continuously hit new record highs and **the S&P 500 Index gained a solid 5.5% in the three months.** The gains and record highs were achieved in a calm environment: not the overheated frenzy often typical of record-setting markets and also without the wild volatility that can unsettle investors. The lack of frenzy can be seen in the AAII (American Institute of Individual Investors) poll showing only 30.2% of respondents are currently bullish on the market, well below the historical average of 38.5%. Low volatility is reflected by the fact that, as of March 31, there has been only one day registering a decline of 1% or more in the S&P 500 in the past 119 trading days (there was a 1.2% slide on March 21). And, the U.S. market was not the only game in town last quarter. For the first time in many quarters, most foreign markets outperformed: foreign developed markets rose 7.4% and emerging markets gained 11.5%, according the *MSCI EAFE* and *MSCI EM* indices, respectively.



Although you might not have felt the love from a political perspective—especially if you channel surf the most hotly partisan cable TV networks—the good vibes in the stock market were a reflection of positive economic news. First, investors increasingly anticipate **strong S&P 500 earnings for the current quarter**. Building on a revival in earnings that began last year, based on a March 29 Bloomberg.com story, analysts are expecting companies will make good on forecasts for 10 percent growth for the quarter. The strength in earnings is due, mostly, to **stronger GDP growth**. After strengthening in the final two quarters of 2016, the advance estimate for economic growth for the first quarter was recently increased to 2.1%. Meanwhile, **employment remains strong** with unemployment at 4.7% in February. The overall positive economic conditions can best be summarized by the Conference Board's **Consumer Confidence Index** which increased a sharp 9.8 points to 128.6 in March—**the highest reading on the index since December 2000!**

The only flaw in the rosy review of Q1 stock market activity is the fact that the market hasn't made any net gain for the past month. Stocks surged 1.4% on the first day of March—the S&P hit 2,400 and the Dow touched 21,169, respective all-time highs—but lost those gains throughout the remainder of the month (statistically, the S&P 500 had a 0.0% change and the Dow gained 0.1%) Granted, 1.4% isn't much of a pull-back and low volatility continued but the flat market in March reflects three major issues; each inflating like a large balloon which has the potential to burst or continue to float to the sky and take stock prices up even higher.

First: The economy and earnings expectations. Yes, we just mentioned, earnings expectations are high for the first quarter and earnings have strengthened for the past two quarters. There is certainly the possibility that earnings will continue this strength and propel stock prices much higher. Yet, after many years of lethargic growth since the financial crisis, any rational investor has to worry that what could go wrong will go wrong.

With record high stock prices and high valuations, stocks must see continued earnings growth to maintain current levels or go higher.

Second is the Federal Reserve. Students of the economy understand that the Fed has propped up asset prices since the financial crisis with low interest rates and other "innovative" monetary policies. Now that the economy is gaining traction, the Fed has increased rates twice and there are expectations that rates could rise two to three more times in 2017. If the Fed raises rates too high and/or too fast it could damage economic growth, earnings and asset prices (i.e. stocks). On the other hand, if the Fed fails to tighten, it could mean asset prices continue to be artificially inflated.

Last and possibly most important is **the future of what has become known as the Trump Trade.** No matter what your opinion of the man or his policies, there is no denying, the promises that Donald Trump was elected on have had an amazingly positive effect on stock prices and business confidence. Expectations remain high that Trump will ultimately succeed—at least to a degree—in reducing taxes, removing burdensome regulations, increasing infrastructure spending and, possibly, even improving national healthcare policies. March saw the first significant failures of the new administration and many see it as just the beginning of the unravelling of the biggest con ever. On the other hand, 2016 was a long lesson on "never underestimating Trump," so the jury is still far from out on whether he will actually "Make America Great" again.

Put all these potentially huge drivers of stock prices together and it is easy to understand why the stock market is in pause mode—and it will continue until we get more clarity on the conflicting potential outcomes. We will continue to monitor these issues and use this "pause" to determine any adjustments which might be needed in the future to help you continue to meet your financial objectives.

Best regards,

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Questions or comments?
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