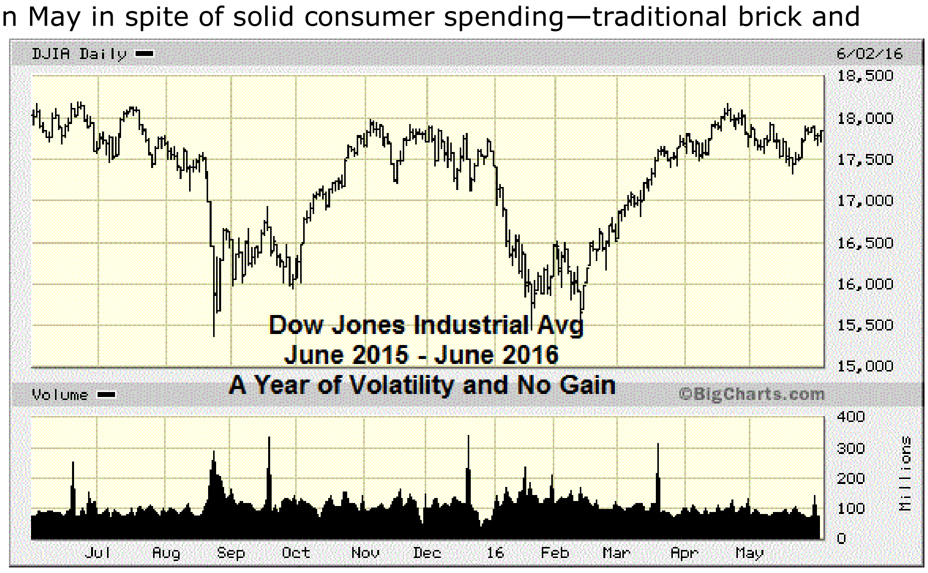
American Heritage Financial

June Update **June 2, 2016**

Reasons to Believe

Last month we wrote about the ***Wall of Worry***, a phrase which describes the concerns and frustrations investors are facing in 2016. We discussed how markets have been roiled by mixed economic signals, wild swings in commodity prices, weak first quarter earnings, soft retail sales and unsettling political choices. Investors have had to deal with heavy volatility in a stock market which has generated no real net gain for the year.

May didn't bring any great change. The stock market had a solid rally over the last two weeks of the month but that just brought broad market returns to only about 2% for the year. Concerns about global growth continued with Japan adding the most recent clouds as their negative interest rate policies seem to be having little positive effect. Retail stocks burned many investors in May in spite of solid consumer spending—traditional brick and mortar stores, generally, suffered while spending has been refocused into online purchases, "experiences" and housing. Meanwhile, the economy and inflation both showed sufficient strength to suggest the Fed may make their second interest rate hike in June.



In many ways, the ***Wall of Worry*** seems as insurmountable as ever, yet, there are some significant positives as we look forward to the rest of the year—reasons to believe the financial markets may yet reward investors. The first and most important positive for investors to hang their hats on is the **strength of the U.S. economy**. As mentioned above, economic progress has been inconsistent throughout this long recovery but, over the past month or so, signs that the economy is both healthy and sustainable have been unmistakable. The most positive economic signals relate to the U.S. consumer—and since consumers account for 66% of the economy, if the consumer is healthy, the overall economy usually follows. Positive signs include Consumer Sentiment, which up-ticked to a reading of 95.8 in May from 89 in April. **Consumer spending** also registered a year over year gain of 3.0%. There has been a recent small decline in the robust auto sales but automobiles are still selling near record high 17 million annual units and the **auto sector is enjoying boom times.** Housing is another area consumers are showing their confidence and financial health. **Existing home sales continue their long, slow climb** and are now in the mid-five million annual rate while prices are up, depending on the region, from 5% to 15% over a year ago. New home sales for the most recent report period (April) are up a whopping 23.8% over last year while the median price for a new home is up 8.3% from last year to $321,100. Of course, consumer health and spending is being sustained by the low **5.0% unemployment rate** and job growth that has been exceeding the growth of the working population.

A reason for investors to cheer these impressive economic statistics is that history shows the stock market rarely performs poorly when the economy is growing. ***Barron's*** financial magazine did a cover story May 28 discussing the relationship of bull markets, bear markets and recessions. The article pointed out that the past four recessions were preceded by a stock market crash and reasoned that the current healthy economic outlook should continue to support higher stock prices.

Briefly, here are other reasons that markets should perform well over coming months:

- Equity valuations are not excessive. Yes, as measured by the price to earnings ratio (p/e) stocks are not cheap at 17.2 times current earnings but considering the alternative of ultra-low interest rates, an average dividend yield of 3.2% on the 1,400 stocks that pay dividends and the overall strength of corporate balance sheets, stocks are "reasonably" priced.
- Earnings are positioned to surprise to the upside. While analysts have been busy lowering estimates of future earnings for over a year, a softer dollar and the rebound in energy prices should add wind to the earning sails after the past two years of headwinds.
- The oil rout appears to be over. It is unlikely oil prices will soar anyplace near the $90 level that was common prior to mid-2014 but supply has been reduced while demand is firming and oil prices should stay at levels which are not destructive for the energy industry while still attractive for consumers.
- Investor sentiment is still lousy. (Or, said another way—*you don't believe a bit of this!*) Even with the dramatic rebound from the market lows in February, investors are not feeling the love—and that is a good thing for future prices. Investors remain defensively positioned and holding large amounts of cash. Improving economic conditions and earnings growth will eventually drive them back to the equity markets and help support higher stock prices.

So perhaps all this will help ease your anxieties and let you enjoy the rapid onset of summer (and the chirping of cicadas)! As you enjoy the warm weather, be assured that we continue to weigh the many various risks as well as this more positive outlook and we will continue to work to best position your investment portfolio to meet whatever new challenges we face.

Best regards,

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Questions or comments?
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