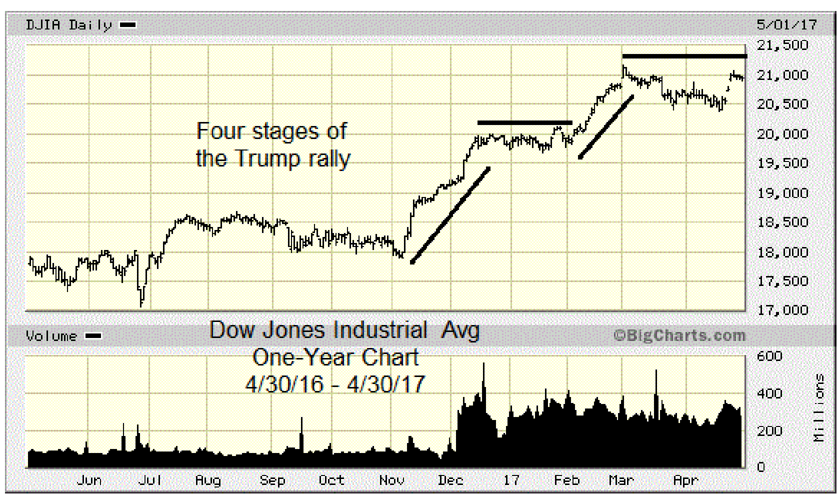
May Update May 1, 2017

One Hundred Ways

It has been impossible to avoid media commentary over the past few weeks on the first 100 days of the new administration. Everyone has an opinion on the initial days of the Trump presidency and, of course, those opinions are as polarized—and predictable—as one's political leaning. We aren't offering any political opinions here but we can extend the concept to 100 ways (or more!) that the stock market might be affected—significantly—by ongoing economic, political and global events.

The current bull market passed its eighth birthday in March and has advanced by about two and a half times (258%), plus dividends, since the dark days of 2009. It is the second longest bull market since WWII, according to Sam Stovall of CFRA who goes on to say this market is also the second most expensive, with stocks trading about 25 times trailing earnings. The longest bull market was the one from December 1990 to March 2000 which rose by 380% and topped out with a P/E of 30, according to Stovall.



The age and valuation of the market are reasons for concern but they definitely are not reasons for wholesale market adjustments because it is impossible to predict how high prices or valuations might go in a bull market. By many measures, this market is not overheated and there are potential positive catalysts that could drive prices much higher as well as serious risks that could take it down. Prices have flat-lined since the Dow and S&P 500 hit new all-time record highs on March 1st because ***investors are reassessing the market*** relative to the ever-evolving outlook for the economy, earnings growth, action by the Federal Reserve and, of course, the impact of changes which may or may not come from Washington. We have condensed the major issues which may drive prices—higher or lower—and they fit three broad categories: Earnings, the Fed and Washington.

Earnings: First quarter 2017 earnings are now being reported and this is the third consecutive quarter of positive earnings growth after an "earnings rescission" from early 2015 to mid-2016. Most encouraging, according to David Lebovitz of JP Morgan, the first quarter results, so far, are showing a 20.7% year-over-year increase in profits. Earnings expectations were high for the quarter but results are nearly 6% better than the optimistic estimates. Further, according to FactSet Research, the earnings growth rate is the best it has been since 2011 while the forward P/E ratio for the S&P is 17.6, above both the five year P/E average (15.1) and the ten year average (14.0). While high margins, the end of the recovery in energy earnings and higher wages and interest rates all will dampen future earnings growth from this quarter's high rate, the strong upward momentum of earnings and the economy could justify continuing higher stock prices. Yet, one can easily see the risk due to high valuations should future earnings growth fails to materialize.

The Federal Reserve: The Fed has propped up asset prices ever since the financial crisis with low interest rates and "quantitative easing" (its program to inject money into the economy, mostly by buying bonds). Now that the economy is gaining traction and seeing wage and inflation growth, there are expectations that the Fed could increase rates significantly in coming months as well as work to reverse the impact of quantitative easing.

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. Actions by the Federal Reserve might be difficult for most investors to appreciate but many economists warn that a miss-step by the Fed is one of the greatest risks to future economic health.

Washington: The ultimate impact of the new administration could be the biggest wildcard of all for stock prices and the economy. There is potential for positive change which could bring about a new economic era and unleash growth and prosperity, or there is the risk of utter chaos destroying our economic system. The promises that Donald Trump was elected on had an amazingly positive effect on business confidence and stock prices. Expectations remain high that Trump's pro-business agenda will ultimately succeed but the new administration has now experienced more setbacks than victories. They have gone back to the drawing board to rework initial proposals but the administration is still far from achieving material success on economic proposals and risks are rising. On the other hand, if there was a lesson of the long 2016 presidential election, it was "never underestimate Trump," so the jury is still out on whether the pro-business promises will produce positive results.

These three broad issues are over-simplification; each contains endless possible alternative scenarios and details which may result in positive or negative consequences for the market—and we haven't even included many positive and negative cross-currents from the global economy. Take all of the potentially huge drivers of stock prices together and it is easy to understand why the market has flat-lined since March. We expect uncertain market conditions to continue until we get more clarity on some of the issues discussed above. We will continue to monitor these issues and use this period to determine any adjustments which might be needed in the future to help you continue to meet your financial objectives.

Best regards,

Ted Ingraham

EGI Financial, Inc.
American Heritage Securities, Inc.

Questions or comments?
Email us at: ahs@egifinancial.com or call 330-535-0881. Visit us at www.EGIFinancial.com