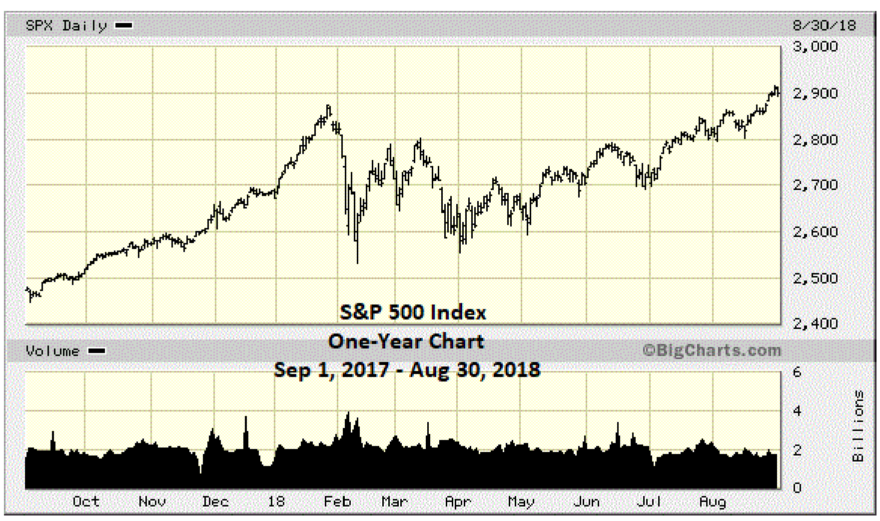
American Heritage Financial

September Update **September 5, 2018**

Endless Summer

Its September, Labor Day is over and school has resumed, but the temperature—as well as future forecasts—gives no indication of an end to this great summer! (At least it has been great for those of us who like heat!) Temperatures have been high—the Beacon Journal reports that the average daily temperature this summer was about four degrees warmer than the 70° "normal" and 2018 was the second hottest summer on record (second to 2016 when the temperature averaged 74.2°). Fortunately, there wasn't a string of terribly hot, record setting days. The reason for the high "average" is nights have been warmer than normal. And, helping to keep conditions pleasant, we have enjoyed sufficient, consistent rain without excessive damaging storms.

It has been a great summer for the stock market too with the Dow and S&P 500 gaining 6.3% and 7.3%, respectively, over the past three months while the red-hot NASDAQ surged by 9.0%. Technically, this rally began in April when both the Dow and S&P inched up by 0.3%, but the momentum increased with the summer temperatures and August marked the fifth straight monthly advance and marked new record highs for the S&P 500 and NASDAQ. (The Dow remains about 2% lower than its previous record high set in January.) Just for the sake of statistics, August gains were: Dow +2.2%, S&P 500 +3.0% and the NASDAQ +5.7%.



Typical of the market, ***the great 2018 summer rally overcame a massive wall of worry that developed in May***. Recall the mayhem that surfaced in late May: most of it relating to international woes such as softer growth in Europe and China, crumbling global stock markets and weakening emerging economies and currencies. Italy was suddenly on the verge of collapse and the escalating trade war was just beginning to take a toll. At home, increasing interest rates and higher inflation were adding to the anxiety of perpetually nervous investors.

It's not that all those worries evaporated under the hot sun. Some concerns diminished, many continue to rumble along in the background and a few (especially trade and interest rates) remain critical. What went wrong for anyone fixated on the May mayhem or Presidential tweets was the stock market stayed focused on surging U.S. profits and the strong economy. Corporate profits boomed in the second quarter, boosted by tax cuts and stronger growth than initially expected. The Commerce Department reported its broadest measure of profits (across the entire U.S. economy) rose 16% in the second quarter while S&P 500 earnings, according to Wells Fargo Advisors, grew by nearly 25% in the period. Lower taxes helped boost bottom lines (taxes were down by 33% according to the Commerce Department) but ***very strong revenue growth was probably the biggest positive surprise***: top-line revenues increased by 10.1% in the second quarter, the best revenue growth since 2011 according to Wells Fargo

The surge in earnings reflects the strong economy. The economic recovery is old news—the economy has been in an upswing since March 2009, making this the second longest expansion in history at 113 months. But it has also been a frustratingly weak expansion with slow growth, low inflation and low wage growth—until recently. GDP growth had rarely exceeded 2% in recent years, but it perked-up to the 3% area in late 2017 and popped to 4.2% in the second quarter 2018. While the risk of a strong economy is high interest rates and/or inflation, rates have not risen to uncomfortable levels (yet) and while inflation recently moved above the Fed's 2% target, neither the Fed or most economists are concerned about inflation becoming a problem.

Of course, like the summer, ***the bull market and the economic expansion will not really be "endless."*** Many investors are concerned that September, historically a weak month for the market, could bring a break in the string of monthly gains and, if you take a contrarian approach, it is easy to see too much complacency and too few concerns on the part of investors.

Market leadership over the past few years has been all about FANG (Facebook, Amazon, Netflix and Google). Valuations of those (and similar stocks) are now at extremes and their market dominance has faltered—off and on—in recert months. Another sign of the aging of the FANG phenomenon might be signaled in its ever-expanding acronym; a recent Barron's article referred to the FAANMG stocks—including Apple and Microsoft in the elite club.

Many market strategists believe smaller stocks, value stocks and foreign markets will soon outperform. Those areas certainly offer more reasonable valuations, but investors don't appear ready to let go of their lust for dominate growth just yet. Perhaps we will see some change of leadership, higher interest rates or general backing and filling in the overall market over the next few months but, so far, it is hard to see a sunset on the horizon of this endless bull market.

Best regards,

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Questions or comments?
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