Executive Economic Outlook And Summary

Spring/Summer 2018

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Have you noticed the financial reporting in the news lately? On one network Chicken Little is telling us that the sky is falling, then we turn the channel and Mickey Mouse is telling us it's another wonderful day in Disneyland. While the daily news certainly dominates our perspective (and most often adds confusion) on the day-to-day movements in the stock market, it's the economy which ultimately drives the quarter-to-quarter and year-to-year performances. Take the past 12 months for example; the Dow Jones Industrial Average was at 20,896 a year ago and even after the recent market correction we are sitting at 24,843 -- that's an 18.9% return. During that time, we have seen numerous terrorist attacks both domestic and global, a nuclear threat from North Korea, a potential trade war with China, rising interest rates domestically, natural disasters, political uncertainty and the list goes on. Despite it all, the economy and the stock market have remained quite resilient.

Our U.S. economy slowed in the first quarter as consumer spending grew at its weakest pace in nearly five years, but a surge in wages amid tightening labor market conditions along with lower tax rates suggested the setback is likely temporary. The Labor Department reported that wages and salaries shot up 0.9 percent in the first quarter. That was the largest increase since the first quarter of 2007 and followed a 0.5 percent rise in the fourth quarter.[1]

Many economists expect growth will accelerate in the second quarter as more households feel the positive impact of the Trump administration's $1.5 trillion income tax package on their paychecks; the tax cuts came into effect in January of this year. US GDP[2] report showed the Personal Consumption Expenditures (PCE) price index excluding food and energy, increased at a 2.5 percent rate, the fastest pace since the fourth quarter of 2007[3]. The core PCE price index rose at a 1.9 percent. The Federal Reserve has signaled it intends to continue gradually raising interest rates this year in light of our strong labor market and economy. Current expectations are for two additional rate hikes in 2018.

Here are a few economic figures we believe are worth noticing:

- **The S&P/Case-Shiller Index** reports that national home prices have steadily increased since 2012 with the index sitting at 209.29 in February.
- **The Conference Board Consumer Confidence Index ®** increased in April, following a decline in March. The index now stands at 128.7, up from 127.0 in March.
- **The Institute for Supply Management's PMI ® Index** reported at 57.3% in April, demonstrating a 2.0% decrease from the March reading of 59.3%. Manufacturing expanded in April, indicating strong growth in manufacturing for the 20th consecutive month.
- **The Commerce Department** reported that personal consumption expenditures have increased $61.7 billion or 0.4% in March continuing the positive trend in consumer spending. Additionally, the increase in personal income was primarily due to increases in wages and salaries, social security benefits, and dividend income.
- **The Bureau of Labor Statistics** reports that the official unemployment rate (U-3) seasonally adjusted in April was 3.9, little changed from a year earlier. The U-6 unemployment rate, a more comprehensive measure of unemployment, was 7.8% which is down 0.8% from April 2017, a year prior.
- **U.S. Real Gross Domestic Product** increased at an annual rate of 2.3% in the first quarter of 2018, according to the "advance" estimate released by the Bureau of Economic Analysis. The increase in real GDP primarily reflected positive contributions from nonresidential fixed investment, personal consumption expenditures, federal government spending, and exports, among a few others.
- **CBOE Volatility Index (VIX)** has experienced quite a bit of volatility in 2018 with a significant spike in early February, closing at its 52-week high at 37.32. Recently, in May, the index sits at 12.59.

[1] https://www.bls.gov/opub/ted/2018/real-average-weekly-earnings-up-0-point-9-percent-over-the-year-ended-in-march-2018.htm
[2] https://www.reuters.com/article/us-usa-economy/u-s-economy-slows-in-first-quarter-but-wage-growth-accelerates-idUSKBN1HY1PT
[3] https://fred.stlouisfed.org/series/DPCCRV1Q225SBEA.

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- **Playing in the oil patch.** Oil prices over the past few months have rallied, driven by geopolitical concerns of possible supply disruptions in the short term, with plunging Venezuelan production and a potential loss of some Iranian oil barrels with the reintroduction of the U.S. sanctions on Tehran. Crude oil currently sits at $71.76/barrel and was at $51.47/barrel 12 months ago.

Emerging Markets have seen declines recently largely due to concerns about rising corporate debt levels however despite a recent uptick in earnings and stock prices, emerging markets price to earnings (P/E) ratios remain low. The MSCI index, a broad based international index, now trades at a P/E ratio of 15.6. That's up from 10.9 at the end of 2015, but it's still more than a 50 percent discount from a decade ago.[4] Investors are becoming increasingly concerned about corporate debt levels in emerging markets. Those worries seem overdone, too. The debt to equity ratio of the MSCI index has risen to 99 percent from 73 percent at the end of 2007, and a rising dollar would hurt companies with dollar-denominated debt.[5] At the same time, the S&P 500's D/E ratio is 113 percent and U.S. interest rates are creeping higher, but investors aren't complaining about that.[6]

To help gauge the life expectancy of our current expansion we need to look at pertinent resources. One resource to consider is "The Business Cycle", which tends to proceed in five phases: initial recovery, early upswing, late upswing, slowdown and recession. In our opinion we appear to be moving through the late upswing, a phase known for its low unemployment, accelerating inflation, high confidence, and restrictive monetary policy that tries to keep the economy from overheating. How long will this expansion last? In a recent survey by The Wall Street Journal, 59% of private-sector economists predicted (and Multop Financial agrees) that the US expansion will likely end in 2020. Only 22% predicted that it will end in 2021. The remaining minority of 19% were outliers, predicting other random years.

In our previous Economic Outlook we cautioned investors of an impending market correction, and advised to remain calm and fully invested. That turned out to be quite accurate when looking back over the past six months. As we mentioned in our previous article, corrections come and go, but the market has always been resilient over time.

What does all this mean to your investment portfolio now? While we believe investment portfolios should continue to remain fully invested, we are doing so with a watchful eye. Domestic equities remain a viable investment during this current economic cycle but bonds continue to appear unattractive given the forecast for higher interest rates. For those with a higher risk tolerance, international and emerging markets may also be appropriate. Overall, we believe the domestic and global economic pictures appear stable and investors should approach volatility during these times as something to be expected. If you are currently one of our valued clients your portfolio already reflects this philosophy. With regards to "risk tolerance" we will be reviewing each client's level during our annual review appointments coming up over the summer months, and we advise investors in general to update your goals, tolerance, and overall plans at least annually to be confident about your positions in the market.

If you are not yet a client and would like to get access to these strategies, please contact our team for a complimentary consultation and review of how we may be of service. The summarizations and outlooks presented here are to be used for overview purposes only and are prepared according to the opinions of Phillip Multop and Multop Financial. Specific portfolio recommendations should be made after careful advisement and advice with your personal financial advisor. Past performance is not a guarantee of future results. Investors cannot invest directly in indexes. The performance of any index is not indicative of the performance of any investment and does not take into account the effects of inflation and the fees and expenses associated with investing. Phillip Multop is a Certified Financial Planner with a Master's Degree in Taxation. Please browse our website to learn about our recent awards and recognitions as well as the firm's client objectives and investment philosophies.

[4] https://www.bloomberg.com/view/articles/2018-05-22/emerging-markets-shouldn-t-panic-investors
[5] https://www.bloomberg.com/view/articles/2018-05-22/emerging-markets-shouldn-t-panic-investors
[6] https://www.bloomberg.com/view/articles/2018-05-22/emerging-markets-shouldn-t-panic-investors