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# ECONOMIC AND INVESTMENT FORECAST
## June 2017

Whether measured by the overall health of the global economy or by returns earned by stock and bond investors, the first half of 2017 is shaping up to be very strong with good momentum going forward. U.S. stocks benefited from a 12% increase in earnings per share in the first quarter, which was better than expected and contributed to a 9% rise in the S&P 500 Index. Internationally, equities have appreciated by 16% over the same five-month period. The fundamentals of the U.S. economy couldn't be stronger, with unemployment at a multi-decade low, GDP growth accelerating, wages on the rise, and measures of both housing prices and auto sales at or near record levels.

Much investor and media attention has been focused on U.S. political developments and related controversies of late. The ongoing discussions around the major policy goals of President Trump have been spirited, with the outcomes of those debates on healthcare, tax reform, government regulations, and infrastructure spending sure to impact the future direction of financial markets. Regarding tax policy and infrastructure, both initiatives should be pro-growth in nature, which would have positive implications for corporate America. However, they also appear, by design, to be deficit-funded, meaning that the lower tax revenues and cost of infrastructure spending would be financed by additional government borrowing. The increase in U.S. government debt would not be anything new, but, in conjunction with other fiscal stimulus, could prove to be inflationary and propel interest rates higher.

Bond investing, which typically plays an important role in generating income for investors, will continue to be a challenging endeavor in the months ahead given the low level of interest rates. Looking back 35 years to the Volker-led Federal Reserve, bonds have enjoyed a mostly uninterrupted bull market, with 10 year U.S. Treasury interest rates falling steadily from around 15% to a recent low of 1.35%. Some economists have attempted, prematurely, to predict a reversal of that downward trend in rates. To further confound investors, key rates in Japan and Europe have moved into negative territory during recent times of economic stress. Looking ahead, Fed Chair Janet Yellen and the Federal Open Market Committee (FOMC) are widely expected to increase the Fed Funds rate by .25% in June, and by a similar amount later in 2017. Their goal is to move interest rates higher to a more "normalized" level, as they feel their dual mandates of full employment and moderate inflation have been met.

With most asset prices at or near all-time highs, and the U.S. bull market stretching for ten years in length, we are cognizant that all economic cycles do eventually end. While the pillars of the global economy appear in good shape, monetary policy tightening by the major Central Banks have the potential to snuff out this economic expansion. Finally, we also know from market history that "black swan" events can unexpectedly occur in the form of a military crisis, terrorism, or some other unpredicted negative surprise. Putting it all together, our emphasis continues to be on stability and risk management, as the outsized equity returns in prior years will be difficult to replicate.