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Economic & Market Summary
July 2018

The US economy continues to be supported by a robust labor market. At 4.0%, the unemployment rate is at an 18 year low and job openings actually outnumber job seekers. This dynamic is luring people back into the workforce as evidenced by a steady rise in the prime age labor force participation rate. It also propels consumer spending which has steadily accelerated since 2016. On a more cautionary note, government, corporate, and consumer debt levels are rising. Usually this is worrisome, but low interest rates have kept debt payments manageable so far. A potential trade war is the most significant near-term risk to an otherwise healthy economy. The Trump administration's hardball negotiating tactics are causing consternation among friends and foes alike. The European Union, Mexico, Canada, and other close allies are being treated like economic adversaries rather than crucial trading partners. The fate of NAFTA is uncertain and a harmful tariff skirmish with China is underway. This environment creates uncertainty which could force businesses to defer capital investments, potentially dampening economic growth. While certain "fair trade" arguments seem valid, especially regarding intellectual property in China, protectionism is a lose-lose proposition, and we find the current situation troubling. While we continue to anticipate 3% real GDP growth in 2018, we are less confident that this pace is sustainable.

US monetary policy is turning less accommodative. The Federal Reserve intends to steadily raise short-term interest rates even if inflation temporarily exceeds its 2% target. An inflection point will likely be reached in the middle of 2019 when monetary policy transitions from stimulative to neutral/restrictive. Bond market reaction to this has been mixed so far. Skepticism that inflation will meet the Fed's expectations is likely keeping long-term yields in check. Against this backdrop, the risk of a policy error is escalating. If the Fed overtightens, it increases the odds of a recession. Higher interest rates are contributing to US dollar strength. This makes servicing dollar-denominated debt more challenging for debt-laden emerging market governments and companies. The Fed's rate-raising cadence could slow if a crisis develops which spreads to the broader financial system. Barring such an incident or an inflation surge at home, we see little change to the Fed's policy.

After an atypically calm 2017, volatility has normalized this year. The S&P 500 is up a modest 2.7% through the second quarter despite strong earnings growth. The PE ratio on 2018 earnings is 17.6x, down from previously elevated levels but not yet in bargain territory. One notable feature of the current bull market, particularly over the past year, has been the significant divergence in performance between "growth" and "value" stocks. The Russell 1000 Growth Index returned 23% over the last 12 months while its value counterpart managed only 6%. Our approach emphasizes balance among "core growth" (companies that generate predictable earnings growth, are financially strong, and carry reasonable valuations), "emerging growth" (younger, faster growing companies), and dividend-oriented "value" stocks. Chasing popular stocks late in the cycle is usually a recipe for disappointment. Adhering to a time-tested process rewards patient, long-term investors.

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To request our SEC Form ADV Part II, please contact Michael L. Wise, Chief Compliance Officer, at the address above.