July 2017

Market Index	July Change	Year-to-Date
Standard & Poor's 500	2.1%	11.6%
Dow Jones Industrial Average	2.7%	12.3%
NASDAQ	3.4%	18.6%
Russell 2000 (small company)	0.7%	5.8%
MSCI EAFE (international)	2.9%	17.5%
Barclays Aggregate Bond Index	0.4%	2.7%

Monthly Update

Earnings, Economic Growth, and Weak Dollar Boost Stocks

The S&P 500 Index enjoyed its ninth-consecutive monthly gain as a supportive fundamental backdrop outweighed the negative political headlines. Stocks are grinding higher with minimal disturbances. According to BTN Research, the index has gone 324 calendar days without a 2% or greater one-day drop, the longest stretch without a decline of 2% or more since February 27, 2007, or nearly 10 ½ years ago. Away from Washington the big news driving the market was a slew of healthy earnings reports. Strong earnings growth is being supported by a global economy that has seen accelerating growth abroad, and slow-but-steady growth in the U.S. In addition, the U.S. dollar has been weak of late, which boosts the revenues and profits of multi-nationals with significant overseas sales. And finally, central banks are still posturing in a way that is supportive of markets, even as some, most notably the Federal Reserve in the U.S., have begun to withdraw stimulus.

The gains in 2017 are in double-digits for the large cap indices, while mid and small cap stocks have lagged substantially. International stocks have boomed (up more than 17% year-to-date), particularly in emerging markets (up more than 25%). In the U.S. large cap space, the double-digit gains in 2017 have been fueled by earnings growth that has also been in the double digits. As a result, valuations have remained mostly steady even as market prices have made nice gains.

Growth Outperforming Value

This has been a great year for growth stocks, which are so-called due to their above-average projected earnings growth rates. The rally in growth stocks has far outpaced that of value stocks, known for their below-average valuation metrics (e.g., price-to-earnings, price-to-sales, or price-to-book values). Investors are placing a premium on the ability to grow, as the S&P 500 Growth Index has outperformed the Value Index by a wide margin (10% through July 31st).

Monthly Update (continued)

The outperformance of growth stocks has in some cases been a sign in the past that the rally in stocks could be coming to an end, as it did in both 2002 and 2007. The reason for the disparity has to do with investors' desire to own shares of companies with growth potential in an overall environment where earnings growth is hard to find in shares of value companies. Recently investors have punished shares of companies who have reported lackluster earnings growth. But it is too soon to say whether that means the bull market is coming to an end. This dynamic, along with others investors try to use to predict when the bull market will end, has in the past persisted for several years before the market turned.

Fed, Politics Will be in Focus as Summer Turns to Fall

August is historically a lackluster month in terms of stock performance and could turn out to be yet another quiet month devoid of volatility. Looking ahead to the remainder of 2017, there are a handful of developments with the potential to move the market and bring volatility back to a more normal level.

As has been the case since the depths of the financial crisis, central bank policy will be in focus this fall. Rumors have begun to swirl regarding Trump's intentions related to Fed personnel, with some speculating he will fire Janet Yellen and appoint Gary Cohn to the positon. Either way, at the moment the Fed is not in any rush to take action, as is clear from its patient approach to raising rates. Still, the Fed does plan to continue moving in a more hawkish direction. Expectations for a rate hike before year-end are low. It is possible that more clarity will come in the September press conference regarding plans to reduce the balance sheet in the near future. Global central banks are also considering taking steps to remove accommodative policies, but are also moving slow. Inflation, one of the key measures central banks focus on, remains low in most countries.

Washington will continue to be under the microscope. While Congress has tried (and so far failed) to make progress on health care and tax reform, a couple of familiar but unwelcome terms have returned to the headlines: the debt ceiling and government shutdown. Congress has about two months to act to raise the debt ceiling and to agree on a budget (or at least pass a temporary continuing resolution). Brinksmanship over these issues led to a downgrade off the U.S. credit rating and a market selloff back in 2011, but there were other contributing factors including the European financial crisis. With the recent defeat of Republican efforts to reform health care, the focus will shift to taxes when Congress returns from its August recess. Details on tax plans are still light, and expectations for material tax reform have come down, as is evidenced by the underperformance of stocks that would benefit most from a reduction in corporate tax rates. Still, it will be important to watch how the debate unfolds and whether or not any actual changes to the tax code are implemented.

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