<u>Commentary July 1st, 2017</u>

Global stock markets collectively had their strongest opening *half-year* in years, as all but 4 of the 30 major indices representing the world's biggest stock markets by value have risen this year, a record of performance unmatched since 2009. In the past 20 years, only 4 first half rallies have been as widespread as the current surge. Benchmarks from South Korea to Spain put up double digit gains for the period, and in the U.S., the Dow Jones Industrial Average and S&P 500 Index were up 8.0% and 8.2%, respectively. (Wall St. Journal July 1st 2017)

Investors attribute the rally's breadth to strengthening corporate earnings, improving economies and continued support from central banks. While the U.S. has raised short term interest rates 4 times since the end of 2015, the European Central Bank and Bank of Japan have mostly remained accommodative, helping juice asset prices. Fears that central banks would unwind years of easy money policies rattled global markets on Thursday June 29th, prompting a sharp sell-off in equities, one of the few in a tranquil 2nd quarter. (NY Times June 30th 2017)

While some analysts are confident the rally in stocks will continue, others point to a *flattening yield curve* as evidence of a potential recession and trouble looming ahead for the stock market. In bond market jargon, a *flattening yield curve* means short and long term interest rates are moving closer to parity. Short term rates are usually lower than longer term rates, as investors demand a yield premium for tying up their money for extended periods. While short term rates, controlled by the Federal Reserve, are rising, the longer rates that the bond market sets are dropping. Falling interest rates denote skepticism about Fed policy and more importantly, the health of the economy. The benchmark 10 year Treasury note has declined by more than 50 basis points since March, and the Federal Reserve's preferred inflation gauge, the price index for personal consumption expenditures, has fallen to its lowest level in six months. (Barron's July 1st 2017)

In January, investors pushed stock prices upward in anticipation that President Trump's election victory would trigger lower taxes, less regulation and more spending on infrastructure. So far, the President has not enacted major changes to fiscal policy or taken significant protectionist measures. For those worried that Trump's behavior will upset the markets, "the risks don't lie with potential charges of obstruction of justice or even impeachment", says James Stack, president of Wall St. research firm InvesTech Research. "For political mayhem to upset the economic apple cart, it has to irreparably damage confidence at the consumer and business level". (NY Times June 30th, 2017)

Fortunately for stock market investors, there is scant evidence of erosion in either consumer or business confidence at the present time.

Peak quantitative easing may indeed be behind us, and it appears the world is ever so slowly moving away from the easy money that has helped propel the 8 year bull market in stocks. Central bankers recent turn to a more conservative approach should not be seen as a surprise, and it is probable that they will consider valuations in the capital markets when weighing their next rate increase. Policy choices ahead are difficult, and for investors, there is, as always, ample reason for caution. A re-balance is suitable for those whose stock allocations have drifted higher than their target mix.

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