MARKET AND ECONOMIC
REVIEW & OUTLOOK

AN UPDATE FROM THE ADVISORS AT GASKIN ASSET MANAGEMENT ***CHARLOTTE, NORTH CAROLINA***

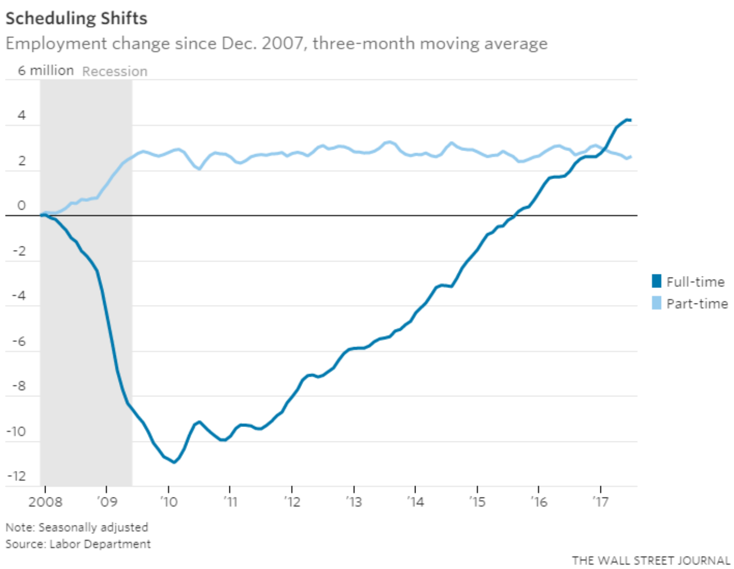
Along with vine ripened tomatoes and peach ice cream, one of my favorite things about summertime is afternoon thunderstorms. They remind me of those carefree summer days of childhood when the storms would offer a break from the relentless heat. This was in the days before cable television, video games and iPads. Maybe you remember those days too. Much to Mom's delight, we stayed outside all day if the sun was shining. Thunderstorms were a break from the monotony of those hot summer days. The wind would pick up and the stifling summer humidity would give way to cooler air. There was an eerie calm before the thunder, lightning and rain commenced. The storm had not yet arrived but we knew it was coming. All the indicators, clouds, wind, and changing temperature, pointed to only one possible event – a thunderstorm. And then like an advancing army, the low rolling rumbles of distant thunder would soon follow. With the storm's approach, we would seek safety on the porch and anxiously await the cracks, booms and lightshow soon to follow. Sometimes the show would be brief and distant while other times it would seem almost deafening and even a bit frightening as it occurred right on top of us. Then, as if on cue, the rain would pour down like applause for a good show as the storm passed over our little spot of earth. What a glorious experience!

We believe many investors are looking at the stock market that way these days. Things seem calm, even nice. The Dow Jones Industrial Average* keeps hitting new highs. In fact, the Dow breached 22000 for the first time ever on August 3rd.[i] Some investors reason that maybe this is the calm before the storm. The political landscape is anything but calm. With all the turmoil and apparent dysfunction in Congress and the White House, it seems that Washington is in the midst of a storm of catastrophic proportions. Many investors and strategists wonder if this apparent dysfunction will spread north to Wall Street. Believe it or not, the Federal Reserve Bank of Philadelphia actually tracks our perceptions of this political strife through the Partisan Conflict Index[ii]. I know, an index for everything. Go figure. The index measures and tracks political disharmony by counting the number of news articles which use words such as "veto", "gridlock" and "filibuster". You surely won't be surprised to hear that this past June the index was 24% higher than two years ago as the presidential campaign was kicking off. The creator of the index, Marina Azzimonti, states that her years of research have demonstrated that high partisan conflict can actually depress corporate investment decisions and mute the pace of an economic recovery. Yet the rise from last November to the writing of this letter, commonly known as the "Trump bump," keeps pressing forward.

At Gaskin Asset Management, we prefer to stay focused on the evidence while leaving the hype to others. After all, the markets tend to reflect not only current corporate profitability but also anticipated profits. So, what are the markets and the economy telling us? Is the barometric pressure changing? Are clouds forming on the horizon? If we have a storm, will it wash us all down the hill? Or will it pass by on the edge of town leaving us mostly dry? In spite of what many prognosticators might try to tell us, this is surely more art than science since we simply cannot predict the future. We can, however, look at the indicators in an effort to gain a better idea of what's in store for the markets. There are too many indicators to examine in this short letter so we have pulled a few that we find to be both interesting and relevant.

THE ECONOMY

The U.S. Labor Department reported on Friday, August 4th that U.S. employers added 209,000 jobs to payrolls in July which helped push the unemployment rate down to 4.3%.[iii] In spite of the sluggish 2.0% annualized GDP growth, this expansion in employment has lasted for six years and 10 months which is nearly three years longer than the second-best growth streak that occurred from 1986 to 1990. There has been much talk regarding the quality of the new jobs in light of the Affordable Care Act (ACA) and the sluggishness of the recovery. During the recession, full-time employment dropped dramatically as part-time work opportunities rose. It is worth noting, as illustrated in the nearby chart, that full-time job growth has recently eclipsed part-time work.



Another positive indicator for the economy is home ownership growth. Despite rising prices, first-time home buyers are increasingly planting roots in a permanent residence. 33% of all new home purchases for the month of May were made by first-time home buyers which is up from 30% a year earlier.[iv] This activity is critical to the housing market because these buyers represent new demand which allows current home owners to trade up for larger homes. Much of this buying is done by young people, as evidenced by a survey of Chase's mortgage-origination volume, which found that 36% of their loan origination for 2016 was made up by borrowers under the age of 35. This is also an indicator of consumer confidence as young people increasingly are making the decision to commit to a community, a job and a mortgage.

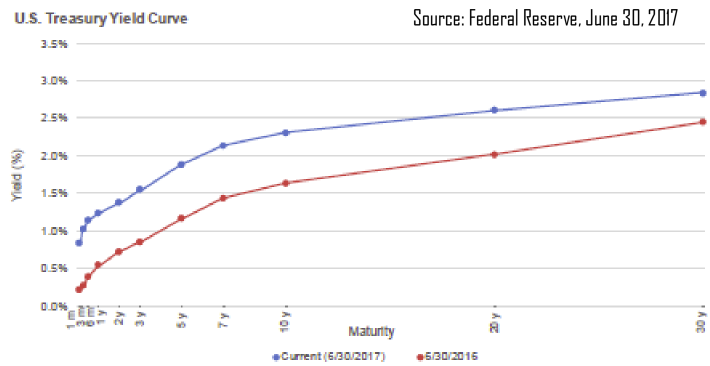
Stock prices can be calculated, justified or projected based on many factors. Ultimately, they will tend to reflect their underlying profitability over time. So corporate profits are the key component of stock prices going forward over the long-term. As of July 31st, U.S. large capitalization companies were tracking toward posting two back-to-back quarters of double-digit profit growth for the first time since 2011.[v] According to Thompson Reuters, earnings of S&P 500** companies are expected to rise 11% in the second quarter after a 15% increase in the first quarter. This earnings growth is happening in the midst of Washington gridlock.

THE STOCK MARKET

The Dow Jones Industrial Average gained 20% in only 183 days following President Trump's election on November 8, 2016. Interestingly, it never gained 20% throughout Jimmy Carter's entire presidency and it required 586 days to gain 20% from the date of President Reagan's election.[vi] Investors tend to place credit or blame on the current occupant of the White House. Sometimes we can see a link to the actions, words and policies of the Executive Branch and the underlying economic conditions in the U.S. At other times, changing financial conditions more likely reflect the natural ebbing and flowing of global economic cycles or maybe the result of changes in productivity or other overarching economic factors. At the outset of the current market run following President Trump's election, many forecasters argued that the rise in prices was in anticipation of Trump's promised deregulation regime, lowered taxes and replacement of the ACA. While President Trump has made some progress toward achieving his campaign promises, most of the big ticket promises remain on the drawing board with highly questionable prospects given a Senate that appears reluctant to act. Yet as of this writing, the market still clings to its gains. According to Barron's Associate Editor, Randall Forsyth, this is only the sixth time since 1950 that the S&P 500 has gone 12 straight months without at least a 5% decline and this is the longest period without that level of pullback since 1995.[vii] So it really isn't a matter of "if" we will experience a market correction but "when". But then again, isn't that always the case?

INTEREST RATES

In a recent interview for CNBC, former Federal Reserve Chairman Alan Greenspan stated that, when adjusted for inflation, long-term government bond rates continue to trade at levels not seen since Alexander Hamilton was Secretary of the Treasury[viii]. In Greenspan's judgement, rising inflation will surely burst the bubble in long-term bond prices. This is a position we have shared for several years. However, rates have been much slower to rise than expected as inflation has remained muted. Low rates continue to negatively impact private savers and institutions who depend on low-risk fixed rates to provide steady income to meet cashflow objectives. As noted in the nearby chart, rates have risen slightly from their lows of 2016 but still remain well below long-term averages. Federal Reserve Chair Janet Yellen in a recent speech before Congress indicated that rate hikes would be gradual unless inflation picks up beyond the current pace.[ix] Low rates have also influenced the U.S. dollar which is down about 7% since the beginning of the year and has declined for the last five months.[x] A weak dollar makes U.S. goods cheaper in foreign markets which improves sales for exporters. Low rates have also impacted U.S. stock prices as investors have considered stocks to have more upside value than bonds given the likelihood of a pullback in long-term bond prices and low yields. As stated earlier, we share Greenspan's view that the long-term bond market is overvalued and due for a correction. Like the stock market, however, it is impossible to know exactly when the correction in bonds will happen.



NEXT STEPS

Is there a market thunderstorm on the horizon this summer? If so, will it pass quickly with little damage? Or will it leave its mark on our economy? The indicators provide conflicting information. The economy continues to grow at a slow but sustained pace. Corporate profits are increasing. Interest rates are low and the Fed appears likely to maintain an accommodative policy until inflation picks up. The dollar is weak thereby making U.S. goods more attractive in foreign economies and unemployment rates continue to decline. We believe the fundamentals remain in place for continued economic growth, corporate earnings growth and additional expansion in equity valuations. There appears to be more upside potential to this market. However, given the time that has passed since the U.S. market's last 5% or more pullback, we would not rule out a correction at this point. Given historical averages, we are arguably past due and few investors would be surprised if one came soon. However, if a correction does come this year, we believe it may provide a buying opportunity rather than justification to allocate away from stocks as the economy appears fundamentally stable and growing at this point. This may be a good time, however, for investors to reevaluate asset allocation strategies in light of the recent runup in stock prices in order to ensure the proper asset allocation strategy is in place given the current outlook for both stocks and bonds.

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**S&P 500 Index – [a registered trademark of the McGraw Hill Companies] is an unmanaged index of common stocks representing 500 industrial, utility, transportation and financial companies of the US markets (mostly NYSE issues).

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[i] Otani, Akane & Eisen, Ben (2017, August 3) "Dow Hits 22000, Powered by Apple". *The Wall Street Journal*. p. A1
[ii] Kimelman, John (2017 July 17) "The Index of Partisan Bickering – Partisan Conflict Quantified", *Barron's*, p. 10
[iii] Morath, Eric (2017 August 5-6) "Record Jobs Run Fuels Economy", *The Wall Street Journal*. p. A1
[iv] Kusisto, Laura (2017 July 15-16) "First-Time Buyers of Homes Reappear", *The Wall Street Journal*. p. A3
[v] Francis, Theo & Gryta, Thomas (2017 July 31) "Company Profit Growth Heats Up", *The Wall Street Journal*. p. A1
[vi] Otani, Akane & Eisen, Ben (2017, August 3) "Dow Hits 22000, Powered by Apple". *The Wall Street Journal*. p. A1
[vii] Forsyth, Randall (2017 July 17) "The Perils of Bliss", *Barron's*. p. 7
[viii] Moyer, Liz (2017 August 4) "The Bubble Is in Bonds, Not stocks" *CNBC Online* Retrieved from https://www.cnbc.com/2017/08/01/alan-greenspan-the-bubble-is-in-bonds-not-stocks.html?recirc=taboolainternal
[ix] Racanelli, Vito J. (2017 July 17) "Dovish Yellen Spurs Soaring Stock Market", *Barron's*. p. M3
[x] Iosebashvili, Ira (2017 August 8) "Weakened U.S. Dollar Powers Market's Rise", *The Wall Street Journal*. p. A1

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