2017 Second Quarter Review

Happy summer and welcome to TLA's second quarterly review of 2017. As the seasons change, and we greet the longer days of the summer months, we pause to reflect on the many changes experienced in the second quarter of 2017, and, also, much of which has stayed the same.

During the second quarter of 2017, the trajectory of major domestic and international indices continued, trading higher, although at a slower pace than the first three months of the year. Euphoria for fiscal policy stimulus in the beginning of the year was positively overshadowed by a strong fundamental recovery in earnings growth, as companies reported a sharp rebound in profitability. Political partisanship and scandal ridden headlines coming out of Washington brought the reality that any fiscal policy stimulus would be difficult to pass before the end of 2017. The Federal Reserve (Fed) raised interest rates by 0.25% to a targeted 1.00-1.25% band in June. Investors were prepared for this interest rate hike, given continued tight labor markets and inflation close to the Fed's 2.0% target.

International markets are experiencing real positive economic developments in contrast to what seems like a constant stream of negative political media. Recall that the European Central Bank's (ECB) monetary policy of quantitative easing is lagging that of the Fed. European markets are beginning to enjoy a pickup in earnings growth on the back of stronger macroeconomic data. The June Global Purchasing Managers Index (PMI) came in higher than that of the US PMI, evidence of growth picking up across the world in a diversified manner.

The current eight-year expansion continues, characterized by low single digit GDP growth, relatively low interest rates, tame inflation, and positive earnings growth. Institutions have proven stable, and more predictable than the volatile political climate. While we would not be surprised to see a market pull back, the duration of this economic expansion could exceed all other expansions on record. Recent expansion and contraction data shows a trend in expansionary periods becoming longer, and softer in magnitude.

Second Quarter 2017 Market results:

- S&P 500 index* +3.1%
- MSCI International EAFE Index* +6.2%
- MSCI Emerging Markets Index* +6.1%
- Barclays Capital Aggregate Bond Index* +1.5%

2017 Q2 Economic & Geo-Political Highlights

- **Domestically**
    - 0.25% increase in Fed Funds Rate to a target of 1.00% - 1.25%
    - Equity markets move higher on solid earnings results and a positive macro-economic backdrop
    - Headline CPI for May pulls back to 1.9%, with Core CPI falling to 1.7%, also in May
    - Donald Trump's presidency continues to be noisy with pollical partisan conflict stalling the president's proposed policy agenda

- **Internationally**
    - European Central Bank (ECB) monetary policies continue to be supportive of stimulative growth
    - Currency weakness versus the dollar is no longer acting as a headwind to international equities, and is becoming more of a tailwind
    - Modest global reflation is lifting global nominal GDP growth
    - UK is feeling the effect of Brexit, with growth at lower levels than that of the Eurozone

Domestic Commentary

Markets & the Economy

U.S. equity markets (S&P 500) rose 3.1% in the second quarter. The U.S. bond market (Barclays AGG) rose 1.5%, over the same time period, in spite of the Fed's third rate increase since December 2016.

The first quarter final estimate of annual gross domestic product (GDP) came in at 1.2%, down from 4Q 2016 GDP of 2.0%. GDP growth of 2.0-2.5% may be the new norm of full growth for domestic markets, due to structural issues of slowing population growth and aging baby boomers.

Unemployment of 4.4% is at the lowest level in 17 years, remaining consistently tight. Inflation has been revised down to 1.9%, as measured by headline CPI, slightly lower than expected in light of recent loose monetary policy. Wage growth is hovering around 2.5%, adjusted for inflation.

The ISM Non-Manufacturing PMI Index came in at 57.4 for June. The figure for ISM Manufacturing PMI Index was 57.8 in the same month. A reading over 50 generally indicates an expanding economy.

US corporate earnings rebounded sharply in the first quarter, driving markets higher.

Valuations also have moved higher, though in the context of still low interest rates and tempered inflation, equity markets look favorably valued to other asset classes.

Politics

Washington has become more divisive and polarized over a major healthcare overhaul initiative, and partisan agendas. It is difficult to conceive that the President's policy agenda of tax reform, regulatory reform, and an increase in infrastructure spending will be able to be passed, even if modified, before year end.

Interestingly, investors no longer seem to anticipate or are pricing in a near term positive boost from fiscal stimulus.

Fortunately, corporate earnings growth is prevailing in providing proper footing for market behavior.

International Thoughts

Markets & the Economy

International developed and emerging equity markets outperformed the U.S. domestic equity markets in the second quarter. The Eurozone experienced strong industrial activity, with a June PMI report of 57.4, dragging global private sector growth above that of the US. Greece contributed to positive industrial activity, with a PMI report slightly above 50.0. Developing labor markets are stabilizing, and unemployment is trending down. We witnessed a turnaround in cyclical sector stocks, and growth is beginning to come from the European consumer, both of which are positive signals for the Eurozone.

Emerging equity market growth is picking up and currencies are stabilizing. The headwind of the strength of the dollar appreciation is slowly becoming a tailwind. Commodity price stabilization should help emerging markets in the latter half of the year.

We are closely watching developments overseas, assessing firming economic and earnings trends in light of attractive valuations.

Investment Committee Update

As the markets continue to move higher, we are taking proactive rebalancing steps to keep portfolios aligned to appropriate risk asset and capital preservation allocation targets. This strategy allows us to capitalize on reallocating assets from strong performing investments to other opportunities which now look more attractive from a risk/reward perspective. **

Summary

We are encouraged by quite favorable economic conditions emerging not only in the US, though around the globe. The US economy is on firm footing. Continued disciplined monetary policy and the unwinding of the Fed's bond holdings will be closely watched, as the Fed is carefully evaluating keeping asset prices in check. Another rate hike may be likely before year end. Corporate earnings growth will be on full display again as companies begin to report second quarter results in the coming months. Those earnings reports will be important in validating current market levels. Economic growth and stabilization overseas are showing favorable improvement, as Eurozone digests the impact of Brexit.

Our focus continues to be on remaining disciplined, and adhering to maintaining a diversified approach to portfolio construction over a given period of time. As strategic investment managers, we are committed to the long-term growth of assets, and avoid tactical timing of markets. We are here to answer questions and consistently provide sound financial planning and investment advice to help you stay focused on achieving your financial goals.

We are grateful for the opportunity to partner with you in this endeavor.

TLA Wealth Advisory Group

*Indices mentioned are unmanaged and cannot be invested in directly. Past performance is not a guarantee of future results.

** As a reminder, our firm's Investment Committee meets twice monthly to monitor economic indicators as well as review and assess our investment models. Our monthly economic review meeting has us follow approximately 90 data points for the US and global economies. At our monthly portfolio meeting the Investment Committee reviews and assesses our investment models and their underlying holdings.