The OmniVest Market View

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July Market Commentary

US equities eked out a gain in June of about half a percent while European shares took a breather, trading lower by nearly 2.5%. The S&P 500 has now not experienced a correction of over 5% since the fall of last year. Technology stocks in the US have continued to lead the market all year, and are now up nearly 17% year to date. The healthcare and consumer discretionary sectors follow next up nearly 15% and 10% respectively. Telecom and energy shares remain in the red down almost 12% and 14% respectively. Financial stocks in the US have been a laggard, up 6% year to date, but most of that performance has occurred in the past month, up 5.6%, following both an expected rate hike by the US FED, and a series of positive stress test reports, allowing a number of large money-center banks to increase shareholder returns by significantly boosting dividend payouts.

Markets did not react much to the FED's decision to boost rates by 25 basis points in mid- June. In fact, the yield on the 10-year Treasury actually fell following news of the decision. Two issues impacting bond yields in the US include a recent drop in inflation, and continued high demand for yield globally. May's CPI fell 0.1% against expectations of a flat read, and core CPI fell to 1.7% year over year from 1.9% in April. Brick and mortar retail sales figures have been weak recently as competition from online retailers has forced stores to drop prices. The recently announced deal by Amazon to buy Whole Foods will also likely force pricing lower as Amazon's distribution, and fulfillment techniques allow Whole Foods to compete better at lower price points.

We are still on the side of further FED action this year if for no other reason than to add ammunition to the FED's ability to counteract a potential slowdown later next year. Also, Fed Chairwomen Yellen herself has qualified monthly changes in CPI as "noisy." Furthermore, the US economy is at full employment which should add to wage pressures for the balance of 2017 and into next year, although wage growth has recently stalled out. Clearly the US bond market has decided that the Trump agenda is on hold into 2018, and that inflation will remain tame, despite the FED's talk of beginning to reduce their balance sheet while remaining on a planned rate-hike schedule. In fact, strategists have been pointing to a decidedly weak bond market as sign that a recession may be closer at hand than many think. While the yield curve has been flattening for some time, the real risk is that an inverted yield curve may signal an upcoming recession as it did leading up to the credit crisis in 2008. On the other hand, a number of technical factors have clearly helped pressure longer dated yields, such as low relative yields globally. Even so, a recent softening of inflation coupled with sub-2% economic growth demand that investors at least consider the possibility of a recession over the next year.

The IMF seems to have chosen the side of the US bond market, at least for now. The IMF cut its outlook for US GDP growth in late June to 2.1% from 2.3% for 2017 and to 2.1% from 2.5% in 2018, an update from its April forecast. The IMF cited a lack of progress on the Trump growth agenda, an aging population, an already full labor market, and low overall productivity growth. In its recently revised forecast the IMF also suggests that the US FED allow inflation pressure to build, and even modestly overshoot its targets to protect against ongoing disinflationary pressures.
In Europe, investors continue to speculate over a possible reduction in bond purchases by the ECB earlier than what has been previously discounted in equity and currency

markets. The euro has continued to strengthen even in the face of a small correction in European equity shares during the month. ECB Chairman Mario Draghi recently pointed to a better political climate and rising consumer confidence as reasons for increased consumer activity and business investment. Most strategists agree that the ECB will remain cautious and that policy changes will come gradually, despite the recognition that concerns over ongoing deflation and slow economic growth have now passed.

Politically Europe is fast coming to the realization that they need to fend for themselves to a greater degree. The Trump Administration has proven to be unpredictable, and European confidence in the long lasting former US foreign policy towards Europe is now shaken. How this change plays out economically is an open question, but investors in Europe should be prepared for policy shifts that reflect a changing relationship between the US and the euro zone.

Our investment conclusions remain unchanged from last month. We are pleased to see financials begin to perform better after a slow start to the year. We are positive on European real estate today as a recovery play following stronger economic activity in the first half of 2017. In the US value stocks seem to be making some headway over growth as the spread in performance to date begins to compress. Much of this is likely the result of rebalancing following the end of Q2. We remain market weighted towards growth technology stocks in the US.