

## **Tariffs, Tax Reform & Temper Tantrums**

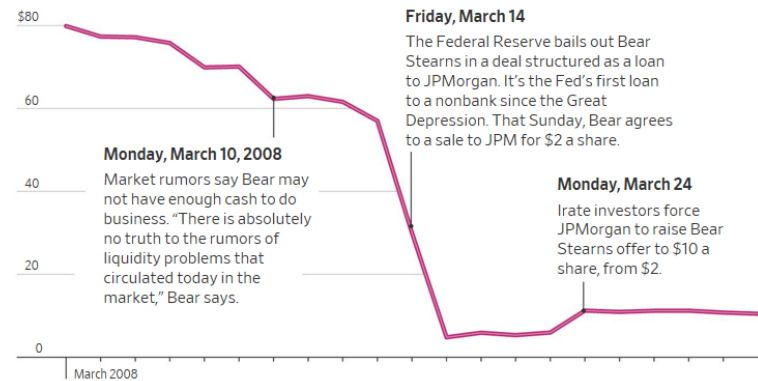
### **First Quarter 2018 Economic Overview**

**Ten Years Ago:** In early March 2008, Bear Stearns, one of the most legendary investment banking giants, traded for \$80 per share. Ten years ago, the seemingly infallible firm, stood at the brink of bankruptcy.

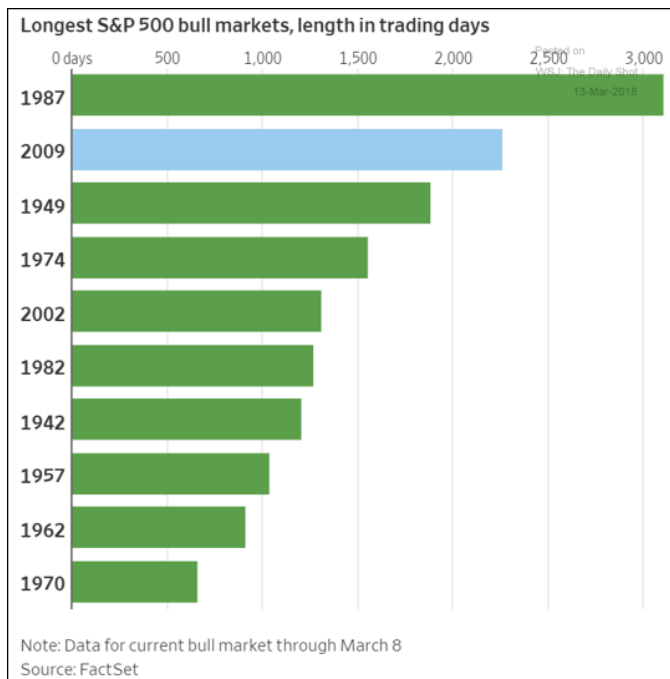
Because of large bets backed with massive amounts of leverage, Bear plummeted forcing a takeover by JP Morgan at \$10 per share. Bear was not the only firm in this predicament. Lehman Brothers, AIG and Merrill Lynch all made similar bets which served to push the stock market down by more than 45% over the next year.

#### **Fallout**

Bear Stearns's share price in March 2008 and key events in the crisis that took down the bank.



Source: FactSet



**Trading At Record Levels:** The ongoing bull market for the S&P 500 reached 9 years in length as of the close of trading on Friday 3/09/18, having achieved 202 all-time closing highs during the 9 years. In comparison, the index's 9 ½ year bull from October 1990 to March 2000 had 308 record closing highs.

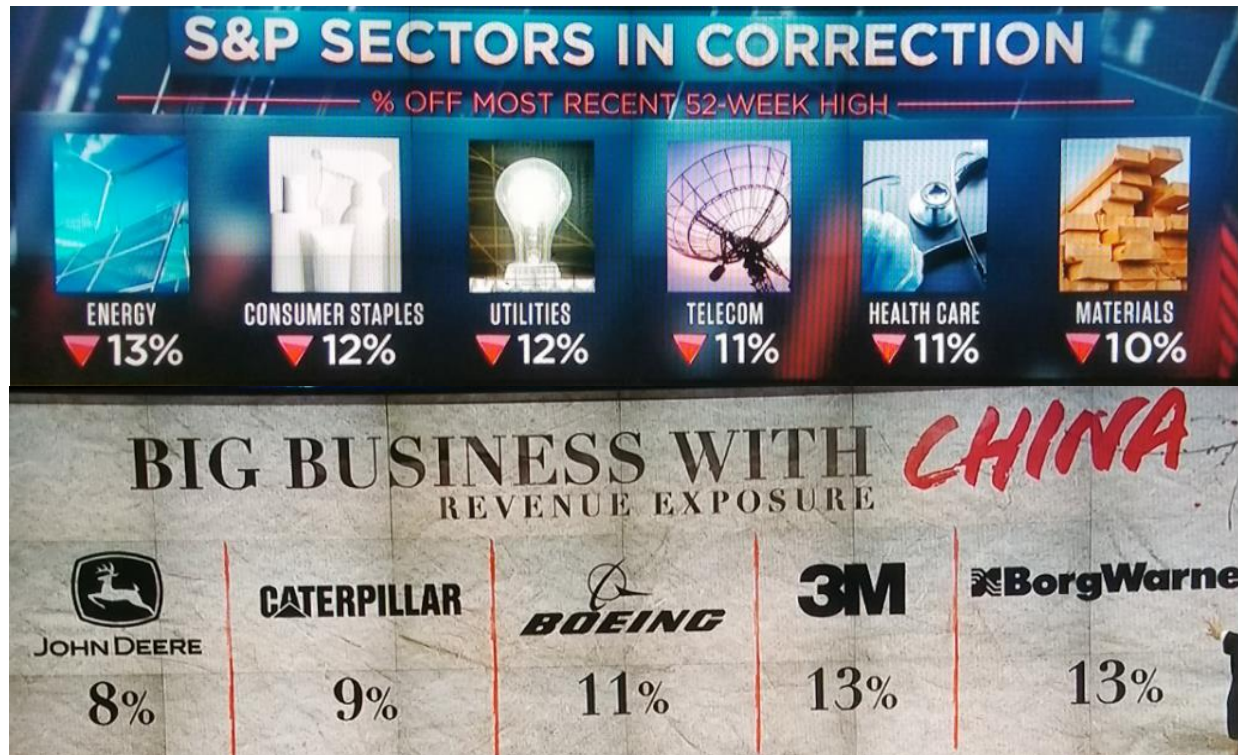
During the current bull market, the S&P 500 has gained +398%. The 2 best years (out of the 9 years) for the S&P 500 were the 1st year (up +72.3%) and the 5th year (up +23.7%). The 2 worst years (out of the 9 years) were the 7th year (down 2.2%) and the 3rd year (up +6.1%). Each of the annual returns are total return results which include the impact of reinvested dividends.

This bull market is getting old, but analysts expect it to keep going for a while.

**Volatility Returns:** Statistically, the stock market experienced a brief correction during the first week in February. In the 75 years from 1943-2017, the S&P 500 had 28 declines of at least 10% but less than 20% or once every 2.7 years. A correction is defined as a stock market decline of at least 10% but less than 20%.

The last "10% correction" for the S&P 500 was a 13.3% drop over the 3 months that ended 2/11/16, or approximately 2 years ago.

**Not All Sectors:** The S&P 500 was up more than 4% through March 14, 2018. However, sector breadth has been weak. The median of the 11 groups, materials, is up less than 1% for the year. Technology has been the best performer, with a gain approaching 11%, while utilities are off negative 7% to lead the five negative sectors.

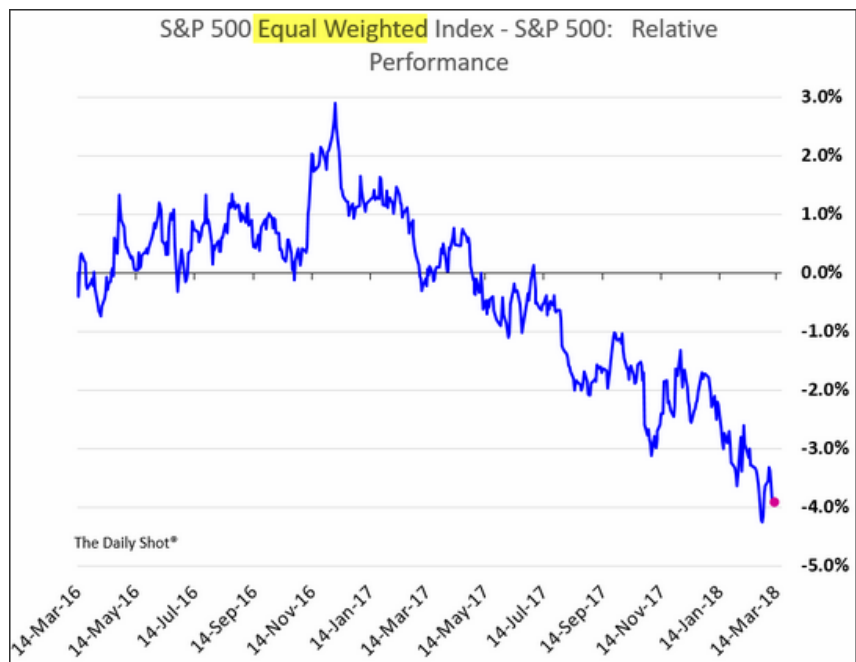


### Market Cap Weighted Versus

**Equal Weighted:** The S&P 500 is a Market Capitalization Weighted Index meaning the largest companies count much more for the index's performance. In comparison, an Equal Weighted Index of 500 companies would give .2% to each holding.

As of mid-March, the S&P 500 is up 4%, while the Equal-Weighted Index is **negative** 4%.

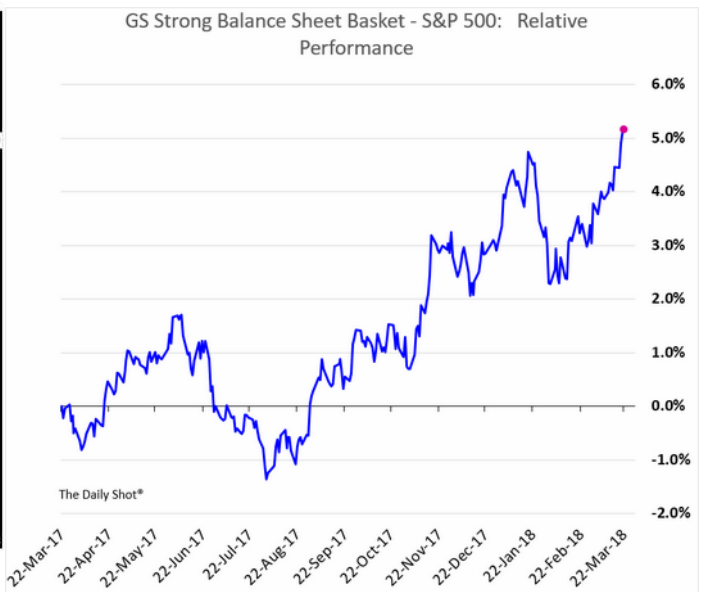
The conclusion is that the largest companies (mainly technology) have been driving the returns this year.



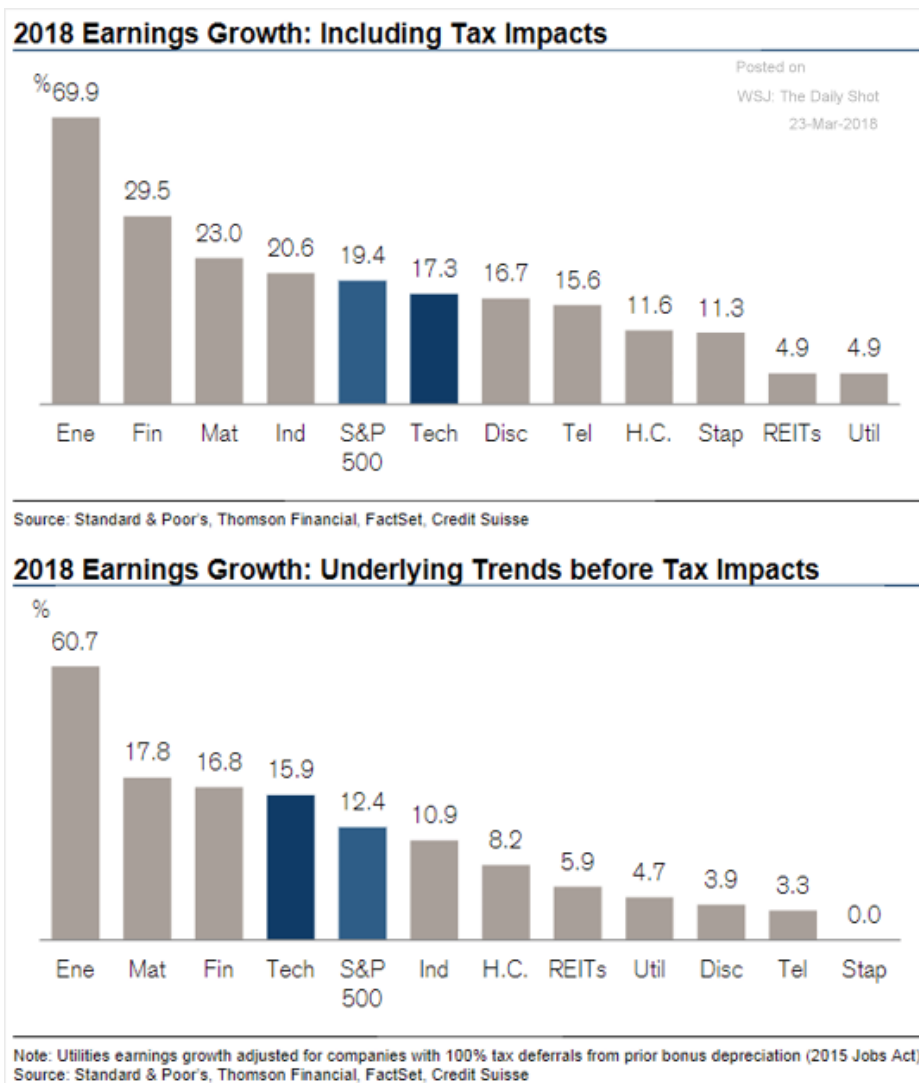
During the downturn, the market as a whole has become cheaper. However, companies with strong Balance Sheets have performed better.



Source: Bloomberg



What is the impact of the new tax law on the US corporate earnings growth (by sector)?



Although there is a dispersion in stock price performance between large and small companies, there is a general boom in business earnings.

The green arrow should draw your attention to the boost associated with tax reform.

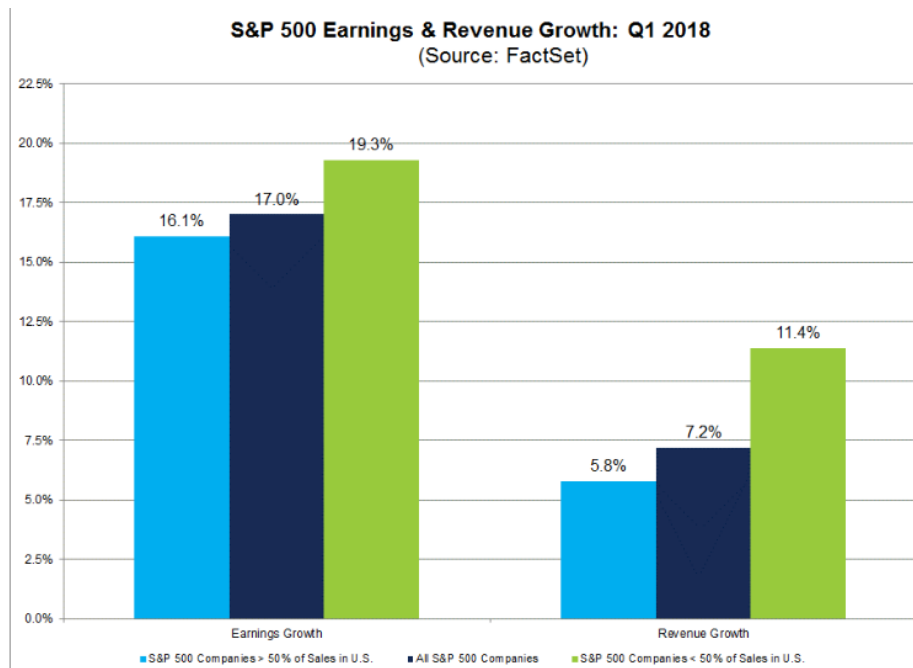


↑ 8.2%

The S&P 500 reported revenue growth of 8.2% for the fourth quarter – the highest growth since Q4 2011.



**Global Performance:** Furthermore, multi-national or global companies are doing better than companies that only sell in the U.S.



Estimated earnings growth rate for the S&P 500 for Q1 2018 is 17%.

For companies that generate more than 50% of sales inside the U.S., the earnings growth rate is 16.1%.

For companies that generate less than 50% of sales inside the U.S., the earnings growth rate is 19.3%.

The estimated sales growth rate for the S&P 500 for Q1 2018 is 7.2%.

For companies that generate more than 50% of sales inside the U.S., the sales growth rate is 5.8%. For companies that generate less than 50% of sales inside the U.S., the sales growth rate is 11.4%.

“The world economy will continue to strengthen over the next two years, with global GDP growth projected to reach almost 4% in both 2018 and 2019.” –OECD Interim Economic Outlook (March 13)



**Dividends Provide Increasing Income:** With tax reform and strong earnings, corporations are sharing the wealth in the form of significant dividend increases. Estimates indicate the companies in the S&P 500 will increase average dividends per share by nearly 14% between 2017 and 2019. Furthermore, just in the month of January 10% (51 companies) of the S&P 500 have increased their dividend payouts.

COUNT OF S&P 500 DIVIDEND ACTIONS	INCREASES	INITIATIONS	DECREASES	CESSATIONS
2018 (YTD)	51	1	0	0
2017	351	5	9	2
2016	344	7	19	2
2015	344	7	16	3
2014	375	8	8	0
2013	366	15	12	0
2012	333	15	11	1
2011	320	22	5	0
2010	243	13	4	1
2009	151	6	68	10
2008	236	5	40	22
2007	287	11	8	4
2006	299	6	7	3
2005	306	10	9	2

Source: Standard & Poor's. As of February 2, 2018

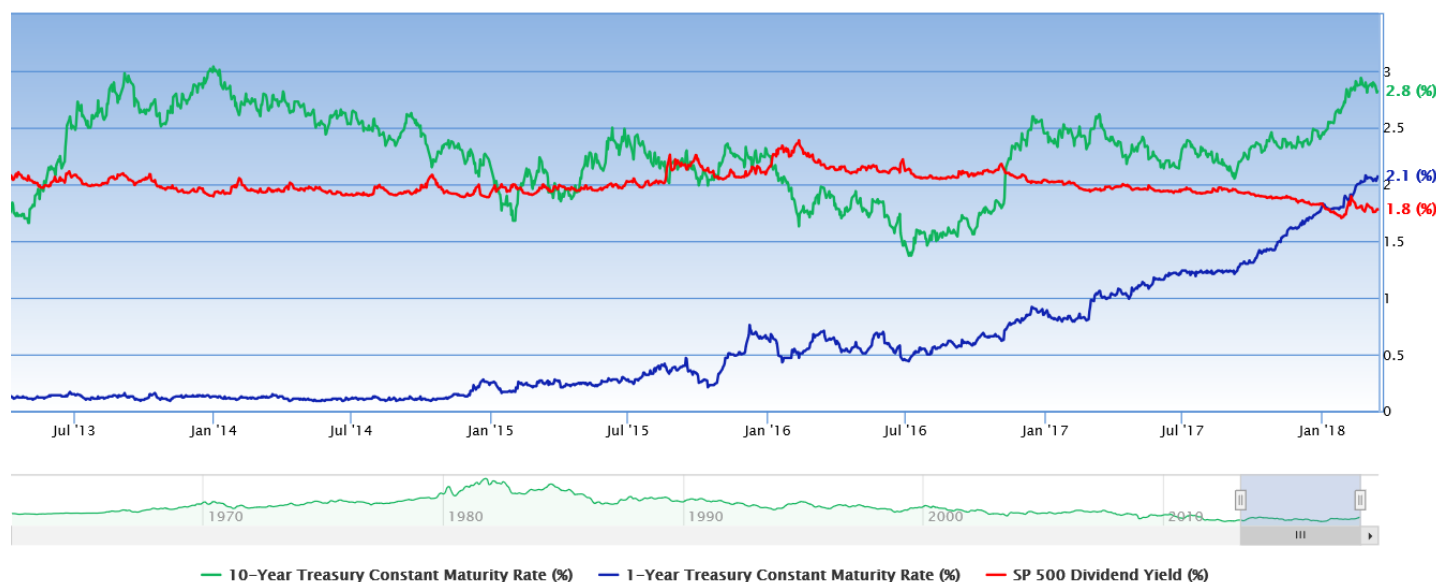
S&P 500 DIVIDENDS PER SHARE	
2019 (Est.)	\$57.24
2018 (Est.)	\$53.00
2017	\$50.47
2016	\$46.73
2015	\$43.49
2014	\$39.44
2013	\$34.99
2012	\$31.25
2011	\$26.43
2010	\$22.73
2009	\$22.41
2008	\$28.39
2007	\$27.73
2006	\$24.88
2005	\$22.22

Source: Bloomberg. As of 2.8.18

**Interest Rates:** It came as no surprise that new Federal Reserve Chair Jerome Powell hiked short rates by .25% at his first meeting. What was a little surprising is that the Fed gave guidance that they anticipate two more (.25% each) rate hikes this year, instead of the previously indicated three hikes.

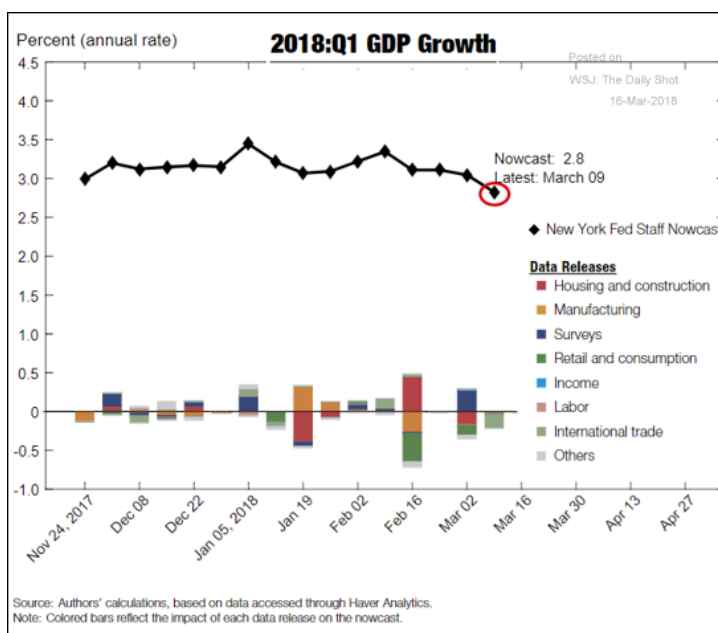
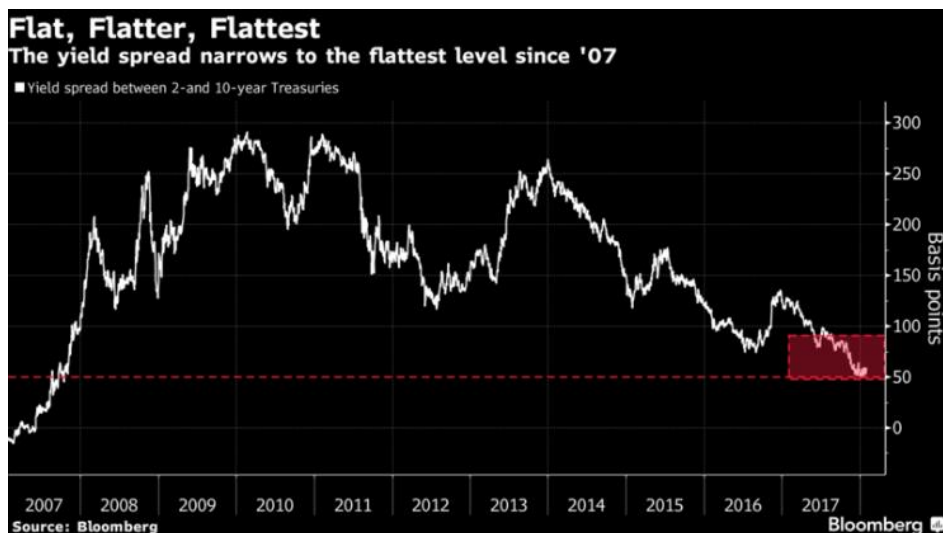
Over the last dozen years, the Fed implemented 4 rate hikes in 2006, 1 in 2015, 1 in 2016 and finally 3 more rate hikes in 2017.

**Comparing Cash Flows:** What is interesting is that the dividend yield from the S&P 500 is now less than the yield on a One Year US Treasury for the first time since the 2008-2009 financial crisis.



**Compressed Yield Curve:** However, as the Federal Reserve has continued to raise or normalize short-term interest rates, long-term (10 Year) rates have not moved much.

As such, the spread between the 2 Year and the 10 Year Treasuries is continuing to compress. As such, fixed income investors are not being rewarded for extending maturities.

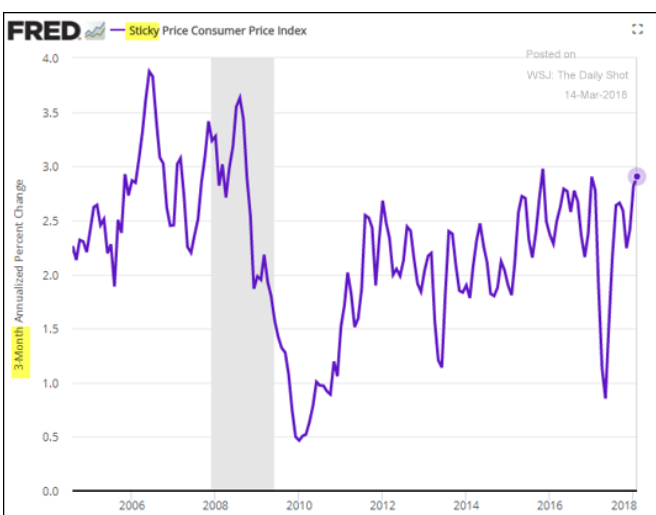
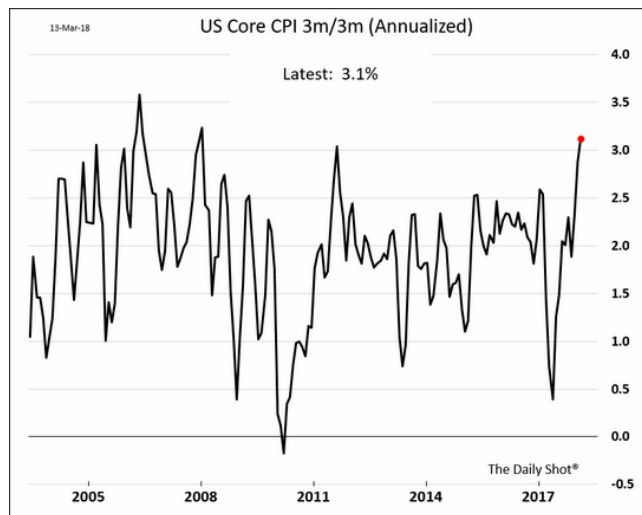


**GDP:** General economic growth has slowed a bit from 3% estimates down to the mid 2% range.

Just as we saw with the Atlanta Fed's GDPNow, the NY Fed's Nowcast model is also downgrading the Q1 GDP growth.

However, the economy continues to expand. As such, there is no recession on the horizon.

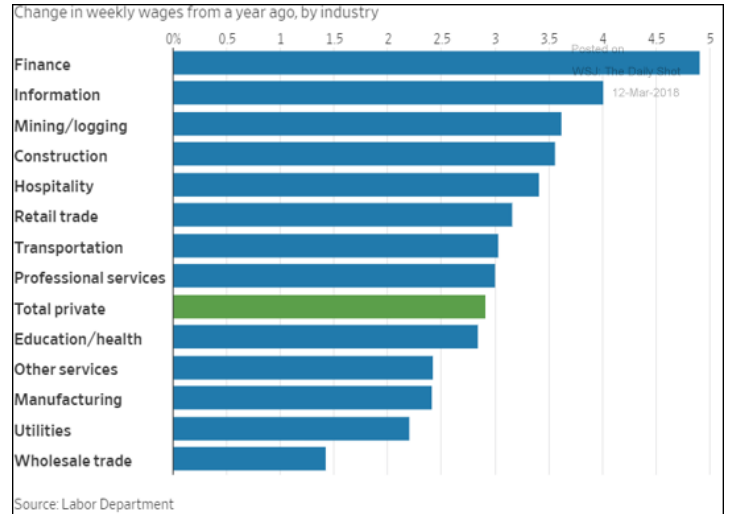
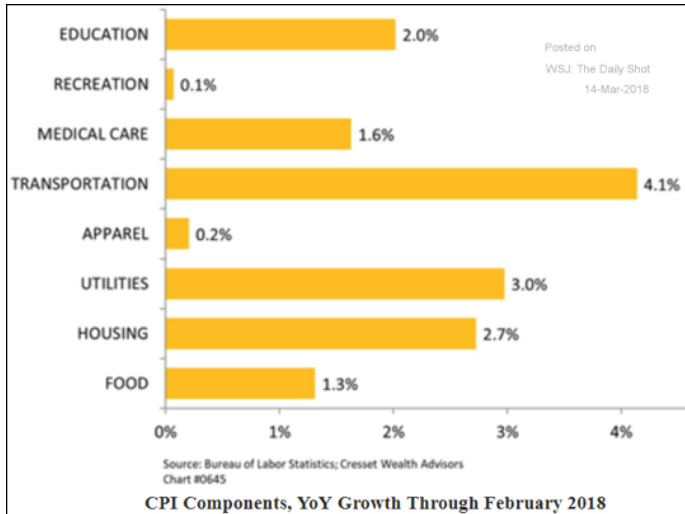
**Inflation:** With slowing GDP growth, inflation remains modest at approximately 3%. However, it is interesting that inflation is running faster than GDP growth.



**CPI:** The chart below shows the Consumer Price Index breakdown by major components.

It is interesting to observe that the inflation categories that are most modest (Recreation and Apparel) are also ones that are more discretionary. Items we must purchase just to live, like Transportation, Utilities and Housing, all continue to run above average.

Total professional wage increases are up nearly 3%.



**Personal Debt** -The 4 largest retail banks in the United States suffered \$12.5 billion in defaulting credit cards in 2017, up from \$10.5 billion in 2016.

There are more open credit card accounts today (488 million) in the United States than there are citizens (327 million).

Total outstanding American credit card debt reached \$1.023 trillion in November 2017, a record high. This exceeds the previous record high of \$1.021 trillion from April 2008.

**Anniversary Party:** *On Thursday April 26<sup>th</sup>, we will celebrate our 19<sup>th</sup> anniversary. To say thanks to everyone gracious enough to employ us and support us, please join us for drinks and snacks at Fossati's Delicatessen located at 302 S. Main St.*

Let us know what questions or comments you might have.

Sincerely,

*Dave Warren*

Dave Sather, President Warren Udd, Vice President

