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Market Update: August 2017

Stock markets registered only slight gains for the month of August, while declining interest rates continued to support strong global bond returns. Foreign investments this year have benefited from a declining dollar, with the Euro alone up 13% against the dollar. Year-to-date, U.S. and international equities have gained 11% and 19%, respectively. The 10-year U.S. Treasury note now yields 2.1% … after starting the quarter at a 2.3% rate. More importantly, inflation remains surprisingly low.

> **It's hard to see inflation taking off to the upside.**
>
> **Julien Scholnick, Western Asset Management – WSJ 8/31/17**

For the first time in over a decade, all 45 countries tracked by the Organization for Economic Cooperation and Development are on track for growth this year. This synchronized growth is attributed to years of low-interest rate stimulus by central banks and the fading effects of the global financial crisis. The International Monetary Fund projects global economic growth at 3.5% for 2017 and 3.6% for 2018.

> **It's not a particularly fast or thrilling beat, more plodding and methodical, but it's getting the job done.**
>
> **Josh Feinman, Deutsche Asset Management – WSJ 8/23/17**

The U.S. economy is producing some conflicting signals. Gross domestic product (GDP) rose at an annual rate of 3% during the second quarter, consumer spending is on the rise, and the economy is technically at full employment. On the other hand, inflation remains weak. The Federal Reserve's preferred inflation gauge, the price index for personal-consumption expenditures, measures only 1.4% … well below the 2% annual target. This complicates the Fed's plans for future rate hikes.

> **Indeed, the current central-bank debate is really about the beginning of the end of extraordinary monetary-policy measures. It is only in the last few quarters that global growth has become more synchronized. Inflation has remained low, allowing central banks to take a very gradual approach.**
>
> **Richard Barley – WSJ 8/10/17**

August officially marked the 10th anniversary of the global financial crisis. On August 9, 2007, BNP Paribas suspended three funds which triggered liquidity strains on money markets. From that point on, global central banks have been providing liquidity to the financial markets. The end result: balance sheets of the European Central Bank, the U.S. Federal Reserve, and Bank of Japan have grown to a combined $14 trillion.

> **Advanced-country politicians today still seem to be ignoring the limitations of an economic model that relies excessively on finance to create sustainable, inclusive growth. A decade after the start of the crisis, advanced economies still have not decisively pivoted away from a growth model that is overly reliant on liquidity and leverage – first from private institutions, and then from central banks.**
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> **Mohamed A. El-Erian – Project Syndicate 8/17/17**

Remember, economic growth (GDP) is simply a product of *hours worked* and *productivity*. Demographic influences and declining labor participation are reducing the supply of labor. Productivity growth has been hampered by the lack of corporate investment … as corporate America seems content to use their excess liquidity for dividends and share buybacks as opposed to significant capital investments.

Stock valuations remain high, with all the standard valuation methodologies at or around *nose-bleed* levels. Is there a mismatch of expectations vs. reality? Is there a basic asymmetry … meaning that current market risks far outweigh potential market returns? Or, to put it another way, are investors attempting to pick up nickels in front of steamrollers? Still, relative to the current interest rate environment, stock valuations could appear quite reasonable.

Apparently, investors believe that inflation will remain low, central banks will be slow to raise interest rates, and high corporate profits will persist. If investors are right, future returns will be lower. If they are wrong, the markets will naturally correct to reflect the changing fundamentals.

> **Of course, just because markets are priced for perfection doesn't mean bad stuff will happen. The danger is that investors are complacent to an extraordinary degree, lulled into a false sense of security by the extraordinary calm markets. There is no margin for error, and if investors turn out wrong it will be a nasty shock.**
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> **James Mackintosh – WSJ 8/11/17**

Everyone seems to get a little nervous during September, which over the past 100 years has statistically been the worst month for stock performance. Still, the economy continues to plod along. The jobs report for August (announced on September 1) shows job growth remains on pace, and the next Fed rate hike probably won't happen until December at the earliest.

> **The economy is going well, but it's not necessarily taking off. We're on an even keel. The labor market continues to hum along.**
>
> **Laura Rosner, Macro Policy Perspectives – WSJ 9/1/2017**

While stock market volatility picked up somewhat in August, our *plow horse* economy continues to move forward. Sure, there are plenty of things that could go wrong, such as China's debt bubble, Eurozone issues, or North Korea. We will remain disciplined … as always.

Our thoughts and prayers go out to so many of our families and friends impacted by Hurricanes Harvey and Irma. Let us know if we can be of any help.

Daniel G. Corrigan, CPA/PFS, CFP®