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Market ignores White House drama to reach new highs

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For months in this column, we have urged our readers to ignore the headlines and focus instead on market fundamentals. That strategy has paid off. The White House hi-jinx have continued to make the news, but the market has moved up in an almost steady manner.

U.S. equities are up 11.59 percent from the beginning of this year through July 31, 2017, continuing the long recovery since the Great Recession. On March 6, 2009, the Dow struck its low of 6,443. It has now more than tripled in value to over 22,000, more than making up the loss. Patient investors benefited.

Three years ago we moved our assets into U.S. equities because "they were the best house on a bad block." U.S. stocks have been the best performing asset class in the world in those three years.

As of this writing, current earnings reports show that more than 70 percent of S&P 500 companies report having beaten their estimated earnings. Their earnings have been up a robust 11 percent, with earnings now on track to grow by double digits for two quarters in a row. So, although the market is fully – even more than fully – valued, earnings growth is justifying that high multiple of trailing 12 months earnings.

There are many reasons the market keeps hitting records; certainly U.S. earnings reports are one, but other factors are at play. The global economy is recovering; this is good because a rising tide raises all boats. Companies in the S&P 500 get nearly 30 percent of their revenue overseas.

The U.S. dollar has weakened. After an initial flurry of strength after the Trump election, the dollar has dropped dramatically as investors have doubts about the ability of the administration to implement its programs. Large investors, like Hedge funds, have abandoned the dollar. A cheaper dollar makes American products and services less expensive in the world market, and buoys our export numbers. This of course will narrow our balance of payments deficit, which has so worried President Trump. It should be noted that three of the top performers in the market this year are Boeing, McDonalds and Apple; each of them sell more that 60 percent of their products cross border.

U.S. interest rates have remained low. In a corollary to the weak dollar, investors have sought a safe haven investment, and that has been U.S. Treasures; so in spite of efforts by the Federal

Reserve to raise interest rates, rates have remained low by historical standards. Rates will likely remain low as the market now thinks the expected December rate increase less likely to happen. However, the stronger than expected jobs report gives the Fed some cover for a rate increase. The European Central Bank will likely raise rates soon, and the Bank of England has signaled a rate increase of 25 basis points by next summer.

Are we in a new “Goldilocks” economy? Very low volatility numbers, the so called VIX index, would suggest we are. The two lowest VIX readings since 1990 are quarters one and two of 2017. Even threats of international conflict and an unstable White House have not disturbed the lassitude of the market. The Fed’s cautious efforts to raise interest rates also support a strong economy. But when investors behave as if there are no risks, surprises can follow.

What can go wrong? The Chinese debt bubble could burst after years of worrying about it. Political calm in Europe could come to an end. Erratic U.S. foreign policies could light a match. The U.S. economy could slow down. Geopolitics is impossible to predict.

So when the fundamentals are strong, go with the fundamentals. Stay with what is working. The unknowns we can’t do much about. Stay invested in equities for the long term.

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