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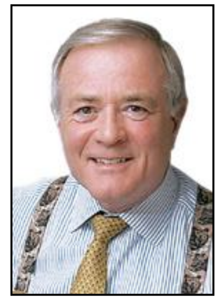

William Rutherford

Worrisome headlines dominate otherwise strong Fundamentals

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Headlines last month were dominated by the White House with various scandals, investigations and withdrawal from the Paris climate accord. With the penchant for this White House to generate distracting news, we can expect there will be more headlines to digest.

In the past I have said that it is better to look at market fundamentals than headlines. Indeed the headlines could give you indigestion, but the market has continued its march to new highs. Other than the market, what's up?

Market participants still believe in the Trump agenda of less regulation and a pro-business approach. This includes tax reform/cuts and a revision of Obamacare. However, the prospects for this agenda grow dimmer and dimmer, and in some cases may not happen. Still the market marches on. Gross domestic product is barely growing, at less than 2 percent annually, and shows signs of faltering. The Federal Reserve promises several rate increases, perhaps as many as three, this year; yet market interest rates barely budge, with the 10-year bond about where it was when the Fed announced its previous rate increase. The dollar strengthened on the Trump election and the likelihood of interest rate increases, but the dollar has now settled down to less than it was at the time of the election in November. What gives? Interest rates go up, but they go down!!?? Banks briefly rallied after the Trump election, but have now lost all their gains as bond interest rates decline. The bond market and the equity markets are at odds. Or are they? Mr. Market can't be wrong.

Even as we are in the ninth year of this economic recovery, and even as the market reaches new highs, skepticism abounds. This market recovery has never been liked; investors have questioned it at every opportunity. Such skepticism is good for the market as it climbs this wall of worry; the lid is kept on, and we are less likely to have undue optimism. When the inevitable correction occurs, it is more likely to be the result of a policy accident than too much exuberance. But the correction will be that much harder to predict.

Market interest rates are down because investors are seeking security and buying bonds. Investors are rethinking their asset allocation. Formerly they were optimistic about the dollar, but clearly they are moving from dollars into euros and yen. A few months ago, the dollar was reaching higher ground and the euro and yen were lower. So, as the Trump agenda slips, investors are hedging their bets.

But equities are increasing in value. With earnings up 13.5 percent in the past quarter, it is not hard to see why investors are optimistic about equities. The earnings increase was fairly broad-based, not narrow, even as consumer discretionary and utilities suffered while transportation and industrials were the best performers. It is not hard to see why consumer stocks suffered, as stores closed and bankruptcies surged. Amazon is winning the day. Over the next five years, hundreds of malls and thousands of stores will close as shoppers move to online shopping.

New employment numbers disappointed and the manufacturing index slipped, even as construction employment increased by 37,000 workers in the month. The economy is bumping up against a ceiling. There are not enough workers. Six million jobs are going unfilled in the U.S. We need talented and skilled workers. We need workers at all levels. At 5.4 percent unemployment, the lowest rate in 16 years, we are at virtually full employment. Where are these workers to come from? Immigrants would be possibilities. Without a growing labor force the economy will be limited.

It appears that we are entering a phase where the economy is slowing. How can it slow much more when it is already slow? If so, the market will not do as well as it has. Market interest rates will be under pressure as investors seek security. Economic numbers do not portend a collapse, but do seem to forecast slowing. A market correction could be in the offing, but we can’t sit out of the market. Keep in mind that on a calendar-year basis, the market goes up 73 percent of the time. If your team won 73 percent of the time you would be happy. Remain fully invested.

William Rutherford is the founder and portfolio manager of Portland-based Rutherford Investment Management. Contact him at 888-755-6546 or wrutherford@rutherfordinvestment.com.