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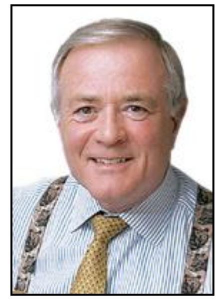

William Rutherford

Strong U.S. Economic Uptrend Continues

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As U.S. equity markets powered onward, the Federal Reserve called the economy fundamentally strong and hinted at two more rate hikes this year and perhaps three hikes next year.

Earnings have been strong, with almost all of the S&P 500 results released. So far, reported earnings increased nearly 25 percent year on year. Eighty of the companies have beaten estimates. The proportion with rising earnings is a record 62 percent. No doubt, if we did not have trade conflicts, we would be doing even better.

Trade talks between the Trump administration and China have stalled. The president is threatening further tariffs; China is responding by weakening the yuan. The spread between dollar value and yuan value is widening, so the dollar is rising against other currencies as well. While a strong dollar has benefits for importers, it makes it harder for exporters to sell goods. For those wishing to narrow the trade deficit, it is a self-defeating strategy. Import more, sell less abroad and complain about the widening gap. The logic is hard to understand. Most economists do not agree with the strategy.

Domestic unemployment continues in the low range. According to the latest measurements, 219,000 jobs were created last month. There are now more employment positions available than there are people to fill them.

Some industries, such as construction, are feeling a severe shortage of available workers. Overall, there are jobs for everyone who wants one. Companies are lowering their educational requirements. People with disabilities can get jobs. People with criminal records are getting jobs. Immigration policies are shrinking the workforce.

Wage pressure, and therefore inflation, will surely follow, but for now the Fed is happy with the rate of inflation and economic growth. The Fed is pushing interest rates in the direction of “normal” rates. If they don’t get too aggressive, the economy can remain strong without tipping over.

The yield curve, the difference between short-term interest rates (generally set by the Fed) and long-term rates (generally set by the market), has been narrowing and possibly even inverting. An inverted yield curve is generally considered bad for the economy and a forecast of a recession. It does not always work that way, but it is a worrisome sign.

There are other worrisome signs. In addition to trade conflicts, there are conflicts over foreign policy, especially NATO conflicts with our allies, the rise of right wing political activities, Brexit and more. All of these things are worrisome, but the upcoming midterm elections could bring some clarity … or not. If the Republicans and Trump triumph, we can expect more of the same, only worse. If the Democrats prevail, we can expect more of the same, only worse. However, remember that the economy is fundamentally strong. Headlines are just that – headlines; the economy has been powering ahead in spite of headlines. The market climbs a wall of worry, and that is healthy because too much enthusiasm can lead to bad results.

Stay fully invested in a diversified portfolio in the best sectors.

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