Investment Management Perspectives

Mid-Year Economy and Market Review

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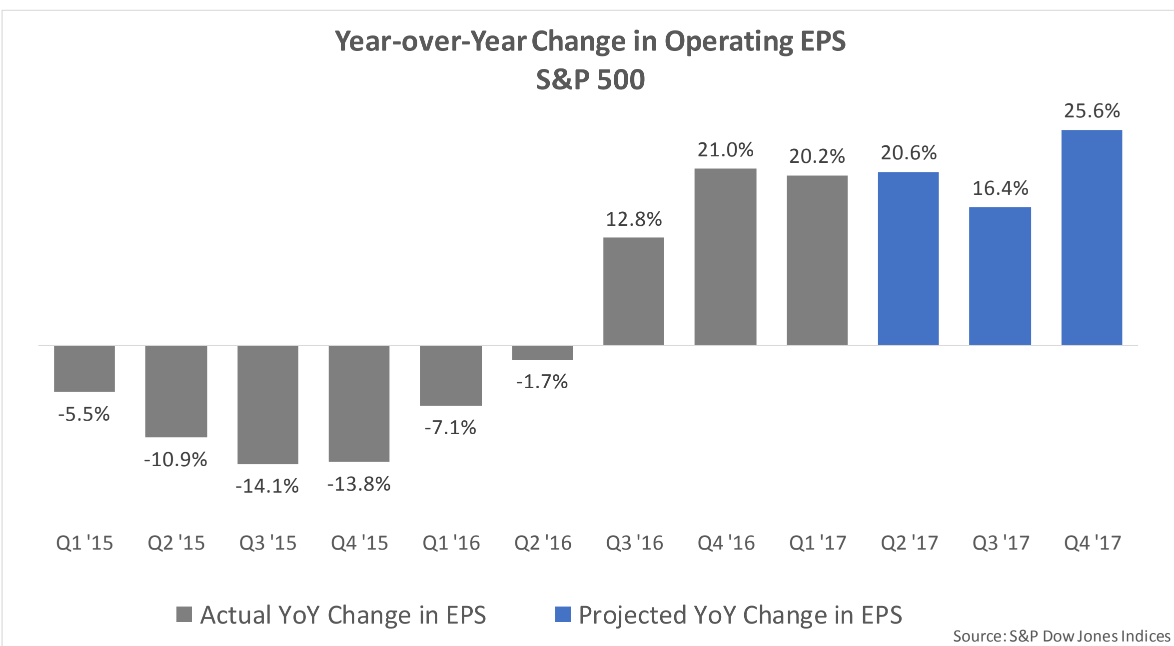
Economy

The global economy continues to show signs of strength. According to research from Fitch Ratings, global growth in 2017 will improve to 2.9% from 2.5% in 2016. This is the best global GDP growth since 2010 and well above the average of 2.5% since 1990. The improvement is driven by significant gains in Eurozone economies (2.0% 2017 growth vs. 0.3% growth in 2016) and emerging market economies (4.9% in 2017 vs. 4.3% in 2016).

US GDP growth rates are still stuck around 2% but the employment market is healthy and inflation seems well contained. Our analysis suggests US economic growth will continue at a similar pace as the past 6 years (1.5% - 2.5% growth). Possible upside could come from tax reform with downside risk coming from the Federal Reserve removing monetary stimulus too quickly.

Earnings

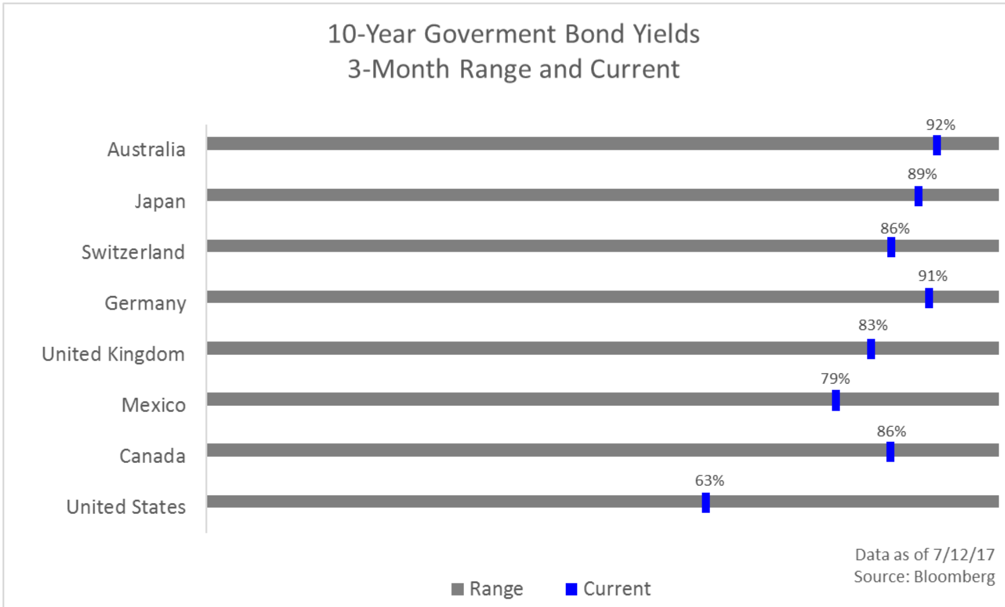
Companies will begin reporting 2nd quarter earnings this week. First quarter growth was up 20% compared to last year[1] and 2nd quarter expectations call for 21% year-over-year growth. The current estimates for full year 2017 show growth of over 20% and 14% in 2018. In our opinion, this is the largest driver of the strong returns the S&P 500 has had over the past 12 months (+17.9% for the 12 months ended June 30, 2017). When reported earnings are growing significantly and the market believes this is likely to continue, then stocks tend to go up (or at least not down).



[1] For all earnings analysis we use S&P 500 Operating Earnings as reported on Standard & Poor's website.

Interest Rates

It appears that monetary stimulus will be shrinking globally. In the US, the Fed is very likely to hike its short-term rate one more time this year and will also begin to shrink its balance sheet. In Europe, the ECB has signaled that they are comfortable with economic growth and are examining when to stop expanding their balance sheet. In the past few weeks there has been a steady increase in 10-year bond yields, with the current yield in many countries at the high-end of their 3-month range.



Investment Outlook

We believe that investors are not being adequately compensated for the risks in longer duration corporate credit. With this in mind, in the first half of the year we scaled back our holdings of US corporate credit (especially high yield bonds) and increased our holdings of investment grade short duration bonds. We also believe that easing bank restrictions and overseas growth will continue and have increased US Financial stocks to an overweight position and maintained our overweight in non-US stocks.

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