

Market Update & Economic Outlook

April 2017

First Quarter 2017 Recap: “Trump Rally” Continues...Sort Of

During the quarter, global equity markets continued their ascent with several U.S. equity market indices reaching new record highs. The financial media anointed “Trump Rally” that unexpectedly began after the surprise election of Donald Trump to the U.S. presidency has been “huge.” However, upon deeper analysis, while the storyline of the “Trump Rally” has captured widespread attention, the underlying causes of the global rebound in stock prices during this time appears to be largely driven by a different set of fundamental factors that are powerful in impact but that lack the breaking news characteristics that largely capture the attention of consumers of financial media. Said differently, these fundamental factors have gone largely under-reported in the mainstream media because they lack story appeal; however, in our opinion, they have been the primary driver of the rise in global equity markets over the past year, which predates the election of Donald Trump.

Q4 2016 to Q1 2017...A Tale of Two Stock Market Rallies

The narrative behind the “Trump Rally”, as told by the financial media, is that the Trump proposed “pro-growth” economic policies, including: tax reform, infrastructure spending, pro-America trade policies, and a roll-back of Obama-era business regulations, would be the necessary catalysts to lead the U.S. economy out of its multi-year malaise. The capital market reaction in the weeks following the U.S. election in the fourth quarter of last year seemed to indicate that these proposed “pro-growth” policies were indeed behind the broad-based rally in stock prices and corresponding sell-off in bond markets. During this time, U.S. equities and the U.S. dollar rallied strongly while the stock and currency markets of our international counterparts, especially emerging markets, along with fixed income assets were largely left behind. Further, small capitalization and value-oriented U.S. stocks were strong outperformers as these segments of the U.S. equity market were expected to benefit most from Trump’s proposed economic policies.

As we entered the first quarter of 2017, U.S. investor optimism continued to rise in anticipation of the inauguration and anticipated policy changes of President Trump. As we now know, several of the policy proposals met immediate and staunch resistance, notably immigration policies and healthcare reform, which led investors to question the timing and implementation prospects of the “pro-growth” policies described above. Despite the setbacks on the policy front, global equity markets, including in the U.S., continued to rally in the first quarter. Further, the nature of the capital market response was markedly different in the first quarter, when compared to the fourth quarter, with international equity and currency markets, notably emerging markets, outperforming their U.S. peers and large capitalization and growth-oriented stocks strongly outperforming their small capitalization and value-oriented peers.

From our perspective, the disconnect between capital markets in Q4 2016 and Q1 2017 signals the “Trump Rally” is mischaracterized and that the real drivers have been factors outside of the Trump agenda.



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Authored by the Freedom Capital Management Strategies® Investment Committee

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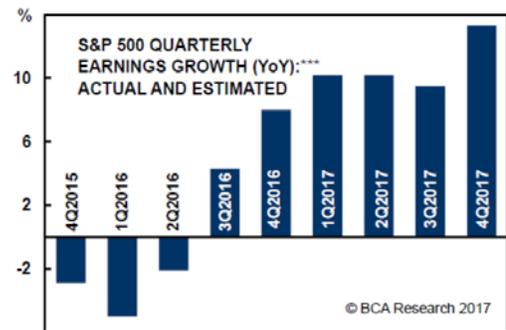
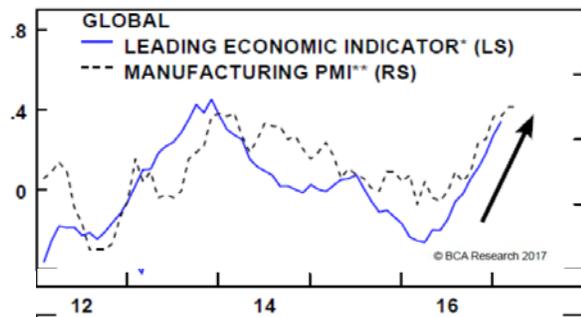
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Fundamental Factors: Accelerating Economic Growth & Rebounding Corporate Earnings

A year ago, global equity markets had just begun to recover after the S&P 500 posted its worst start to a year in history in the early weeks of 2016 (Financial Times). Since the lows of February 2016, stock prices have rebounded strongly on a global basis with the MSCI All-Country World Index, a widely followed global equity benchmark, posting total returns of 15% for the one-year period ending March 31, 2017 (Morningstar). If the global equity market rally began over a year ago, when most political analysts considered the probability of a Trump presidency remote at best, what have been the true drivers of the rebound in global stock prices during this time?

Our analysis indicates that there have been two fundamental factors that have been the primary drivers of the stock market rally over the past year: (1) a broad-based acceleration in global economic growth and (2) a recovery in corporate earnings. The chart below left displays recent trends in global leading economic indicators and global manufacturing, both of which have rebounded strongly since early 2016. The chart below right demonstrates the recovery in corporate earnings of S&P 500 companies that has taken place in recent quarters and that is expected to continue through the remainder of the year.



Looking Forward

We believe two primary factors drive long term capital market returns: fundamentals and valuation. As expressed above, global economic growth and corporate earnings have been on an improving trajectory, which we believe will continue to be supportive of global equity markets from a fundamental standpoint. While equity market valuations, especially in the U.S., have risen in recent years, we do not yet find current equity valuation levels a cause for concern, especially when considering the historically low level of interest rates on a global basis. We remain globally diversified within equities given our view of relatively attractive valuations in international markets relative to the U.S. We also remain broadly diversified within fixed income in an effort to proactively manage risk in the current low yield environment.



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