Market Update
February 2017 Review

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"Has the Market Gotten Ahead of Itself?"

While the U.S. remains very divided politically, the stock market continues to reach new highs based on expectations that the new administration will enact tax reform, regulatory relief and fiscal spending. But as investors continued to show enthusiasm in February, members of Congress seem to have put the legislative agenda on hold over disagreements on timing and specifics. This raises the question as to whether all of this optimism could be overstated and whether investors may be pricing in all the positive aspects of Trump's agenda without taking into consideration the potential negatives.

Equity markets have increased since the U.S. presidential election primarily based on two reasons: optimism over Trump's pro-growth agenda and improving economic data. With only one month in office, the new President has instituted a number of executive orders and has communicated the intent of a tax overhaul and an increase in defense and infrastructure spending. However, there are some components of his legislative agenda that investors may be overlooking, like scale and timing. For instance, the proposed fiscal policies are estimated to increase our national debt to GDP ratio from 77% to 105% which may be a concern even for some Republican members of Congress. In addition, markets may be pricing in a quicker implementation of policies than what is being suggested in recent weeks. Health care reform and trade renegotiations seem to be taking higher priority, bumping the pro-growth policies further down on the political agenda. Therefore, the political landscape may not be as market friendly as what investors believe today.

Another concern is that from a valuation perspective, the U.S. stock market seems to be looking more expensive. For example, the forward looking P/E ratio of the S&P 500 has almost doubled since the Obama administration eight years ago. This measure alone is not necessarily accurate though, as companies are holding large amounts of cash on their balance sheets which is clouding profitability and distorting valuations, making these companies look more expensive than they really are. In fact, factoring this in, markets are trading near their historical levels. So technically markets may still have a little bit more room to grow, as indicated by the continued rally in February. After a healthy 12% return in 2016, the S&P 500 Index has added another 5.9% gain year to date. The Dow Jones Industrial Average also had a strong February posting a 5.2% return while the NASDAQ was up 3.8% and has posted the largest gain so far this year at 8.2%.

	February 2017	YTD
DJIA	5.17%	5.82%
S&P 500	3.97%	5.94%
NASDAQ	3.75%	8.22%
MSCI EAFE	1.43%	4.37%
MSCI Emerging Markets	3.06%	8.70%
Barclays Aggregate	0.67%	0.87%
Barclays Corp High Yield	1.46%	2.93%
	2/28/2017	1/31/2017
US 10-Year Treasury Yield	2.36%	2.45%

In contrast to the optimism about political change in the U.S., investors have been very sensitive to a growing populist sentiment in Europe. Countries like France, Germany and the Netherlands are preparing for elections and if we see another Brexit-like situation, this could significantly shake up international markets. Despite political uncertainty, valuations look more attractive in Europe. The Eurozone is in its early stages of an economic expansion and the unemployment didn't peak until 2013 at 12.1%, and while it has dropped to 9.6% recently, further declines in this number could mean higher growth rates in the future. The MSCI EAFE posted a 1.4% return in February and is up 4.4% year to date. Emerging Markets also continue to post healthy gains and the MSCI EM Index has been up 8.7% year to date.

Fixed income markets are also positive so far this year as the Federal Reserve hasn't acted on raising interest rates yet. However, given the rising inflationary pressures and continued economic growth, it is expected that the Fed may raise rates at the next meeting in March, which could lead to some volatility in this sector. In fact, if the Fed continues to raise rates at a gradual pace this year, this could be the catalyst for higher market volatility going forward.

So while investors are reacting to the prospects of pro-growth policies and betting that a Republican sweep will make it easier to pass new legislation, it remains to be seen if markets will also be resilient to potentially tighter monetary policy in the near future.

For previous market commentaries please click here.

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An index is a measure of value changes in a representative grouping of stocks, bonds, or other securities. Indexes are used primarily for comparative performance measurement and as a gauge of movements in financial markets. You can not invest directly in an index and, for comparative purposes; they do not reflect the effect of the various fees inherent in actual investment vehicles.

The S&P 500 Index is a market value weighted index showing the change in the aggregate market value of 500 U.S. stocks. It is a commonly used measure of stock market total return performance.

The Dow Jones Industrial Average is a price weighted index comprised of 30 actively traded blue chip stocks; primarily industrial companies, but including some service oriented firms.

The NASDAQ Composite Index is a market-value weighted index that measures all domestic and non-U.S. based securities listed on the NASDAQ Stock Market.

Gross Domestic Product (GDP) is the market value of the goods and services produced by labor and property in the U.S. It is comprised of consumer and government purchases, net exports of goods and services, and private domestic investments. The Commerce Department releases figures for GDP on a quarterly basis. Inflation adjusted GDP (or real GDP) is used to measure growth of the U.S. economy.

The MSCI Europe and Australasia, Far East Equity Index (EAFE) is a market capitalization weighted unmanaged index developed by Morgan Stanley Capital International to measure approximately 1,100 securities in 21 major overseas stock markets. It is a commonly used measure for foreign stock market performance.

The Barclays Capital U.S. Aggregate Index covers the U.S. Dollar denominated investment grade, fixed-rate, taxable bond market of SEC-registered securities.

The Barclays Capital U.S. Corporate High Yield Index covers the U.S. Dollar denominated, non-investment grade, fixed income, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's Fitch, and S&P is Ba1/BB+/BB+ or below.

The MSCI Emerging Markets Index (EM) is a free-float-adjusted market-capitalization index developed by Morgan Stanley Capital International. It is designed to measure the equity market performance of 26 emerging market countries.

The 10 Year Treasury Yield is the interest rate the U.S. government pays to borrow money for a 10-year period. In addition to influencing how much the government pays to borrow over this timeframe, the 10-year Treasury Yields also determines how much investors earn by investing in this debt and it is a good indicator of investor sentiment. The higher the yield, the better the economic outlook.

The S&P Case Shiller Index is a group of indexes that tracks home prices in the U.S.. It seeks to measures the value of residential real estate in 20 major U.S. cities.

Michigan Consumer Sentiment Index is a survey of consumer confidence conducted by the University of Michigan. The Michigan Consumer Sentiment Index (MCSI) uses telephone surveys to gather information on consumer expectations regarding the overall economy.

Conference Board's Consumer Confidence Index an index by the Conference Board that measures how optimistic or pessimistic consumers are with respect to the economy in the near future.