“Still going up”

D2 Capital Management
Mid Year 2017 Client Letter

Standard & Poor’s 500 (January to June 2017)

The Standard & Poor’s 500 posted its strongest first half of a year since 2013, boosted by solid corporate earnings and investors’ expectations for improving economic growth. The S&P 500 index was up 8.9% at mid year, with 24 record highs achieved.

Additionally, stocks are having one of their quietest periods in history, despite the unsettled politics and uncertain direction of policy in both the U.S. and abroad. The maximum pullback this year never exceeded 2.8%, which makes this the second smallest first-half drawdown in 89 years. History suggests that starts to a year as quiet as this one tend not to generate nasty surprises in the second half of the year.

This upward stock market movement is not limited to the U.S. as global stocks are also enjoying their best opening half-year in years. Investors attribute the broad breadth of the rally to strengthening corporate earnings, improving economies and continued support from central banks.

Corporate earnings growth has been a vital driver of global gains this year. In the U.S., first-quarter earnings from S&P 500 companies increased 14% from 2016, which is the best since 2011. Analysts now forecast double-digit profit growth into 2018, according to the research firm FactSet.

U.S. economic expansion also remains on track as the post-financial crisis recovery prepares to enter its ninth year. Gross domestic product, the broad measure of the goods and services produced across the U.S., expanded at an annual rate of 1.4% in the first quarter. Inflation is at a moderate 2.2%. Unemployment is at the lowest rate in a decade and gas prices are stable. All are good indicators of positive economic growth and stock price appreciation.

Volatility has disappeared from the stock market but low volatility isn't a new normal and won't last. The remainder of 2017 should offer some negative and unpredicted surprises leading to increased volatility. While the ride so far this year has been uncommonly smooth, the market offers no guarantees of comfort or satisfaction.

In spite of the steady grind upward, doubt and cynicism increases the higher the market goes and anxiety mounts over a cluster of issues that could derail the rally. So far stock prices are supported by improving corporate balance sheets but limited in their upside by already high prices.

Strategists believe the U.S. and global economies should continue to accelerate modestly, providing a tailwind for corporate earnings, profits and stock prices. As such, stocks could move higher over the next 6 to 12 months, but will deliver more modest returns than in recent years.

When recently polled, 64% of key Wall Street analysts predict the S&P 500 will rally at least another 5% from today's levels. That means the S&P 500 could hit a record 2,550 by year-end. Despite worries about a correction, most analysts don't see a full-blown bear market or a recession as being imminent.   Most feel the U.S. economy is fundamentally sound and despite the market's new heights, investors have few other places to go to make money with bank interest rates and bond yields still very low.

So, sit back, enjoy the Summer and stay cool.

As always, your investment plan is designed around your goals. Should those goals change or if life circumstances demand changes, we standby to redesign your investment strategies.

(Info as of 1 July 2017 derived from multiple sources)

Prepared by: Charles R Armstrong, M.A., M.S