KAPUSTA FINANCIAL GROUP

www.kapustafinancial.com

July 12, 2016

Today’s Economic and Financial Disconnect

July 11, 2016, the Dow Index closed above the 18,000 level for the eighth time this year. The problem is the longest the market has stayed at that level was for a one 3-day stretch. The market has basically gone nowhere since the end of 2014 and it’s hard to see how it’s going to move forward without better economic growth. There are pockets of growth in our economy – consumer discretionary spending and residential housing to name two. A troubling fact, however, is that company earnings simply don’t match up with current stock valuations. More importantly, when we look at the macroeconomic picture, we see a gradual slow down that’s been in place since mid-2015. Continuing falling commodity prices, tumbling global trade, a flattening yield curve, weakening industrial production, and the continued lack of substantial monthly job creation all point to an economy headed into contraction.

It took one and a half years to bring the U.S. economy out of the Great Recession that officially began in December 2007. Additionally, the Federal Reserve (Fed) added a $3.7 trillion increase to its’ balance sheet plus a 5.25% cut in interest rates to pull us out of the 2008 economic abyss. On the monetary side, the Fed has very little ammunition left to keep this current market rally alive. They are unwilling to add additional debt to their balance sheet and have virtually no room to decrease interest rates further without going into negative territory. On the fiscal side, Congress has been unable and unwilling to work together with the last two incumbent presidents in adding incentives for economic growth (i.e. reduced corporate taxes, a reduction in the vast amount of federal regulations, and to provide tax relief for consumer spending). It seems unlikely that this trend will change even after the November elections.

The stock market is currently priced for perfection and is not prepared for a period of minimal to no economic growth that may already be underway. History has taught us that it takes a combined plan of both monetary and fiscal policies to help grow the economy out of a major recession. With no new fiscal policy from Washington and the Fed having done everything within their power, we feel that this has led to our current situation; a severe disconnect between the pace of the U.S. and global economic growth versus the valuation of our equity markets. As we have reiterated for the last 15 months, it is our opinion that a defensive and cautious investment allocation continues to be most prudent at this time.