KAPUSTA FINANCIAL GROUP

April 2017

Looking into the Summer – a Tale of Two Markets

Each day the national news seems to be filled with more information than we can digest. There certainly exists a major "tug of war" going on in corridors of our government. For most of us, I think it's fair to say it is difficult on a day to day basis to make sense of it all.

The same can be said for Wall Street and the financial markets. As you know, it's really not possible to separate, for any length of time, the activities of Wall Street from Washington & vice versa. Also, it sometimes is very easy to forget Wall Street and the U.S. economy are not the same entity. So as investors, what news should we be focusing on?

Surveys of both consumers and business leaders show an extreme level of confidence in the future growth of the economy. Earlier this year, consumer confidence surged to its highest level since 2000, fueled by strong job growth and wage growth, lofty stock prices and cheap gasoline. The Philly Fed Index, a survey that gauges the sentiment of manufacturers, hit its highest level since 1984.

Corporate bottom lines are also getting a "thumbs up" for strong performance. As earnings season approaches in mid-April, S&P 500 companies are expected to report a quarterly earnings increase of 9.1 percent, the best year-over-year performance since 2011 when earnings grew 18 percent.

Business leaders are betting on tax cuts, infrastructure improvements, and the abolishment of onerous regulations. Will that happen and if so, when? These are important questions that will certainly influence the markets.

On the other side of the discussion, there are a number of statistics that history has repeatedly correlated to that of an upcoming stock market correction. The Schiller Index, a very popular method for calculating equity valuations, has only reached its current level three times in the past: 1929, 2000, and 2007. The two major stock indexes – the S&P 500 and the Dow Jones Industrial Average – haven't gone this long without at least a 1% drop since 1993. The stock market is old and expensive. There hasn't been a significant correction in 8 years – the second longest "bull" market in history. The Federal Reserve (Fed) is beginning to raise interest rates.

Historically, this usually happens when the stock market peaks. The revised GDP growth for all of 2016 was only 1.6%. First quarter growth is expected to come in somewhat below the Fed's estimate.

So the question becomes, can the markets continue their upward trend based upon their current historic valuations and the very optimistic assumptions coming out of Washington? In our opinion, these two points are inexplicably tied together.

With President Trump's surprise election last fall, Wall Street became ecstatic. Stock prices rose to new highs based upon what was coined the "Trump Trade". Currently, the values of securities are "priced to perfection." Simply put, Wall Street has already reacted as if all of President Trump's policies and campaign promises have been enacted into law.

Recently, the "Trump Trade" bounce has lost steam. In addition, we cannot ignore the political climate. We are still a nation deeply divided. And with the focus now on the Trump Administration and its policies and plans – whether it's the failure to pass health care reform or the upcoming battle over tax cuts – uncertainty in the nation's capital affects Wall Street. Recently, investors have become more skeptical about President Trump's ability to cut taxes and boost infrastructure spending after the healthcare bill failed in Congress last month.

We continue to monitor events on a daily basis. It's important in our opinion to be neither overly optimistic or pessimistic when it comes to how the rest of 2017 will unfold. As we closed out the first quarter of 2017, one thing is certain: all eyes are on Washington and Wall Street.

We will continue to provide the most honest and unbiased investment advice as we can. As always, we thank you and appreciate your trust in our services.

110 Fort Couch Rd., Suite 108, Pittsburgh, PA 15241 - 1030
Tel: 412.851.1400 Email: kfg@kapustafinancial.com
www.kapustafinancial.com

Kapusta Financial Group is a Registered Investment Advisor