The Investment Counsel Company
Investment Management Consultants

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Investors are trying to rationalize why the stock market should or should not currently be at an all-time high. Some were already uncomfortable even before the Dow Jones Industrial Average gained over 1,500 points since President Trump's inauguration. All three major asset classes - stocks, bonds, and real estate - have surprised many by ignoring pressures from political conflict, including a federal presidential investigation, little progress in health care and tax reform, deregulation, infrastructure spending and four interest rate increases from the Federal Reserve. Adding to the suspense of stellar performance of financial markets, daily market price swings (volatility) are at their lowest in over 50 years.

Attempting to relate stock market behavior to politics is often a losing proposition because financial markets move in counterintuitive ways. Consequently, stocks have risen at a faster rate when our economy has grown slowly rather than robustly, and political tensions were high rather than low. This disconnect is explained by slower economic growth, which offers corporations the opportunity to grow profit margins without increased expenses from inflationary pressures (rising labor wages and manufacturing materials). Meanwhile, skeptics have anxiously waited for a stock market correction stemming from so much global uncertainty, believing that a significant drop in prices is imminent, which would afford them the opportunity to buy at lower prices. However, the U.S. stock market's current streak without a five percent correction is one of the longest on record.

So why has price volatility been far lower than anticipated? One explanation cited by *The Wall Street Journal's* "Heard on the Street" columnist, Justin Lahert, is that financial market volatility has paralleled broad domestic and global economic growth volatility. In other words, over the past three years the change in economic productivity from quarter to quarter has been the most stable on record. Other economic factors that historically have demonstrated higher levels of change such as U.S. job growth, corporate profits, and government spending are also revealing historically consistent results.

Looking ahead, when stocks have performed as well as in the first half of 2017, most often the upward trend continues through the second half of the year. Valuations have yet to become a threat to the global bull market, supported by the improving trend in corporate profits. <u>The key to continued market growth is that profits need to rise faster than stock prices.</u> Furthermore, central banks around the world have implemented unprecedented policies to accelerate the global economy. Whether these policies can successfully overcome the inherent longer-term risks of extreme public and private debt levels, slower population growth and restrictive immigration policies is a momentous challenge.

Financial markets continue to present unique challenges and evolve along with strategies and tactics employed to protect and grow investors' capital. Our firm regards these challenges as opportunities to improve our ability to meet the needs and satisfy the expectations of our clients at a faster rate and to a greater degree than our peers in the financial services industry. We look forward to discussing topics important to you in upcoming meetings and wish you a wonderful summer season.

Sincerely,

Randy A. Garcia
Chief Executive Officer
& The Investment Counsel Company Team