VAN LEEUWEN & COMPANY, LLC

VOLUME 2, ISSUE 2, JUNE 30, 2017

KEY POINTS

- S&P best gain since 2009
- Federal Reserve raises interest rates AGAIN
- Amazon buying the world
- Macron elected

MARKET COMMENTARY

We saw continued strength in the 2nd quarter for the market as well-run businesses are being rewarded for strong earnings, while weaker companies are being punished. This is contrary to where we were at the end of 2016 where company stock prices increased regardless of their financial strength. The economy continues to grow stronger with business and consumer confidence gaining strength throughout the first half of 2017.

The Federal Reserve (Fed) followed through on its anticipated rate hike schedule, raising interest rates twice in just over a 3-month period. This move reflects the Fed's increasing confidence that the economy is moving in the right direction, and now we have economic data to support rising rates.

As we look toward the end of the year and beyond, we will be paying close attention to several factors which will have a significant impact on our improving economy:

- ✓ Will earnings continue to be strong?
- ✓ Will there be a 3rd interest rate increase?
- ✓ What role will the political landscape play in the Administration's agenda?
- ✓ How will international relations effect the economy?

These are all questions, that with time, we will have the answers.

As has been the case for much of the year, politics continue to add some uncertainty to the markets. The major domestic concern has been the Republican effort to reform healthcare, which has stalled. To add to the uncertainty, the fate of wide-ranging tax reform is partially tied to the success of the Administration's healthcare efforts. Republican lawmakers are looking to use savings from healthcare reform to offset potential revenue losses from corporate and personal tax cuts. At this point, expectations continue to be low. It is important to acknowledge that despite these developments, U.S. equity indices have managed to progress through the first half of 2017 either at or near all-time highs.

Moreover, signs of financial stress and market volatility remain absent even with fiscal policy on standby. The return to business fundamentals, such as renewed corporate earnings growth, can now act as a market catalyst. The Fed will still have its role to play, but monetary policy is powering down as the driver of financial market strength.

US Stock

The S&P posted its best gain since 2009 with the quarter up 3.09% for a total gain of 9.34% for the 1st half of the year. In the 2nd quarter of 2017, we saw a shift in factors driving market performance. The initial boost, based on anticipated changes that the administration promised, began to subside and company fundamentals, along with a growing economy, began to take over. There was strong economic and corporate earnings reported driving stocks to new highs again in recent months.

Federal Reserve raised interest rates for the 2nd time this year and U.S. wage growth was flat despite unemployment rates declining in May to 4.3%. According to Federal Reserve Chair Janet Yellen, "Our decision…reflects the progress the economy has made and is expected to make." The U.S. has continued to see economic growth and job creation as indicators for an improving economy. However, low inflation and wage growth are still a concern and it is anticipated that the Federal Reserve will move cautiously in the 2nd half of 2017. For U.S. consumers, interest rate increases traditionally lead to increased costs for borrowing, which may lead to increased bank profits and a stronger dollar. Strong job creation was seen in manufacturing, construction, healthcare, professional and business sectors. In addition, government jobs were created in both the federal and local levels. Retail also saw an uptick in employment despite four consecutive months of layoffs. The temporary work force and portions of the hospitality industry also had a hand in adding nearly 100,000 new jobs this quarter. Unfortunately the auto industry did not experience the same growth as others because of slow sales and swollen inventories forcing a slowdown in production and therefore cut jobs for three consecutive months.

Amazon buys Whole Foods. This is about more than just supermarkets—this impacts all of retail. For weeks, Amazon dominated the news with its acquisition of Whole Foods. This is the largest acquisition the market has seen for some time. The immediate impact on the food business has yet to be defined. While home delivery for groceries remains economically problematic, this acquisition is Whole Foods' 430+ stores with multiple distribution centers, which can provide greater access to consumers. However, this strategic endeavor remains expensive and challenging. At the end of the day, Amazon just gained a very large and convenient network. Supermarkets are scrambling under great pressure to reinvent the way they do business. The big question that remains is where will Amazon dominate next? The distribution network that Amazon has, along with the increase in online shopping from consumers, means that no retailer is safe. Traditional retail companies must adapt or die. This will likely trigger an increase in future mergers and acquisitions activity as the next chapter is written. We have witnessed a deal that will forever change retail.

US Bond

Bloomberg Barclays Aggregate Bond Index posted a gain 1.45% for the 2nd quarter and is up 2.4% for the 1st half of the year. While the Federal Reserve (Fed) has been raising short-term interest rates since December, the bond market hasn't gotten the memo. The longer-term rates that are set through bond market trading have, not seen the same level of increases in rates. The disconnect, is a sign that bond investors believe economic growth and inflation is still weak and the Fed's actions are premature. The Fed may pause in raising short-term rates, which could cause a temporary increase in bond prices. On the other hand, the bond market could get on board and yields can begin to rise substantially and drive prices of bonds down. This would be far more likely if inflation began to surge.

International

In France, Emmanuel Macron won the presidency and his party won an absolute majority in the assembly. As the youngest Presidential candidate ever to run in France, Macron's victory surprised many analysts. For now, the fear of an exit by France from the European Union has been thwarted. Some feel that Macron's victory brings enormous relief to those who want the European Union to survive, this does not resolve Europe of its problems. France continues to be divided economically, politically and socially. In addition, there are many skeptics who feel that Macron is not up for the job. While labor reforms are high on Macron's agenda, it is anticipated he will face challenges executing them given the conflicts with the trade unions. Macron is expected to aggressively position France as an attractive destination for London-based financial services firms to relocate their operations and headquarters following Brexit. Macron wants to capitalize on this optimism and change the perceptions that France is a bad place to do business because taxes are high and regulations are too burdensome. As far as U.S. and France's relations, Macron's victory at 1st sight doesn't offer much optimism. President Trump and President Macron differ on several issues, including, climate change and trade issues. However, it is expected that they will find common ground fighting terrorism.

European markets soared, with the FTSE index posting a gain of 8.44% for the 2nd quarter contributing to the 17.28% gain overall for the 1st half of the year. After a sluggish start in April, the European equity markets moved upward throughout May. Market volatility could still arise from upcoming Italian election results and a worsening of the situation with North Korea. European stocks and bonds did not react well to recent speeches that suggested the European Central Bank (ECB) could soon begin reducing its quantitative easing (QE) program and the Bank of England might raise interest rates this year. This reduction in monetary stimulus could continue to put pressure on government bond markets over the next 12 months. One of the key questions for the remainder of the year will be the extent to which these markets can withstand a gradual reduction in monetary stimulus, which has helped to support markets in recent years. Eurozone consumer confidence, as a whole, is the highest since 2001. Businesses are also upbeat about the economic outlook, and manufacturing. Against this healthy economic backdrop, the outlook for European corporates earnings should remain positive, unless the removal of central bank stimulus leads to a very large and sharp upward adjustment in corporate borrowing costs. Our expectation is that the adjustment in borrowing costs will be gradual enough for European equity markets to continue to make positive progress.

Declining crude oil prices. The energy sector lost ground as oil prices fell due to rising oil and gas inventories along with a rising U.S. rig count. American oil production has become more efficient and more U.S. oil rigs are able to operate even as the average price per barrel of crude has stayed below $50. We see oil prices staying within a range due to an increase in efficiency and technology. Oil rigs are able to be shut down in days, instead of months, when prices get too low. On the other hand, companies can also bring rigs online within a matter of days when prices become more attractive. This creates a floor when prices fall, but also creates a ceiling when prices rise. Most of the large oil and gas companies can remain profitable in the current price range.

OPEC has agreed to cap production in an attempt to stabilize prices, but non-OPEC countries continue to produce at will. Even with the agreement in place, international surplus crude inventories continue to increase.

Looking Ahead

As we close the 1st half of 2017, we are entering into the third longest economic expansion in U.S. history which began June 2009. Many investors are concerned whether this expansion is sustainable or are we headed for a significant pullback. It is our opinion that the U.S. economy is in a strong position entering the 9th year of the recovery as earnings growth continues to accelerate in the U.S. and around the world. We continue to see signs of an improving economy as manufacturing data and job creation is resilient. Going forward we are expecting steady economic growth, lower than usual inflation, and rising interest rates.

The tax reform and infrastructure revitalization which President Trump pledged to address during his first 100 days appears to be delayed as late as 2018, if at all. Roughly 4 in 5 members polled by the National Association for Business Economics said they don't expect to see an infrastructure spending package enacted until next year or later.[1]

In our opinion, the markets have somewhat priced in the delay of healthcare and tax reform. Any movement on the political agenda would be seen as a catalyst to move stocks higher. As the year progresses we think revenues and earnings will grow and improve as compared to 2016.

Healthy consumer spending, during the 2nd quarter, global GDP growth, and a rebound in industrial production will continue to support the U.S. economic growth.

With over 30 years of experience in investing, we have the capability to understand uncertain markets and the opportunities they present. There are always events that may bring volatility to the markets, and we will be watching closely for to seize opportunities that may exist.

[1] Schoen, J. (2017, June 5). Economists don't expect tax reform, infrastructure boost to happen this year. [CNBC]. Retrieved July 6, 2017, from https://www.cnbc.com/2017/06/05/economists-dont-expect-tax-reform-infrastructure-boost-to-happen-this-year.html