Quarterly Outlook

JULY 2017

Second Quarter 2017

Equity markets worldwide continued to reward investors in the second quarter of 2017. Domestic stocks built on first-quarter gains with the S&P 500 posting a total return of 3.09%, bringing the year-to-date total return to 9.34%. Performance was largely diffuse across economic sectors as first-quarter trajectories were mostly maintained. The Energy and Telecommunications sectors declined steadily throughout the first half of 2017, while the Information Technology and Healthcare sectors climbed upward to post double-digit positive returns. The remaining six economic sectors all posted single-digit positive returns in the first two quarters of 2017.

Tandem expects the US economy to continue its trend of slow, steady growth in the second half of 2017.

The US equity market's performance appears to be strongly correlated with investors' earnings expectations. First quarter S&P 500 earnings rose 13.5% on a 7.2% sales increase compared with the first quarter of 2016, and another 5.8% increase in earnings growth is expected for the second quarter[1]. These data along with favorable job market dynamics (unemployment rate of just 4.4% as of June), a weakening US dollar (down -4.71% in the second quarter) and positive market sentiment continue to push indices to historic new heights.

Despite inflation falling short of its 2% target, the Federal Reserve Open Market Committee increased the target federal funds rate by 0.25% to a range of 1.00-1.25% at its June meeting – the fourth increase since beginning to raise rates in December of 2015. With interest rate normalization well underway, the Fed's next task is to address its nearly $4.5 trillion balance sheet of US Treasuries and government-supported mortgage-backed securities purchased under quantitative easing. Committee members' comments at the June meeting outlined their plan to address this issue by allowing a number of Treasuries to mature without reinvestment on a monthly basis beginning later this year.

Overseas, the European Central Bank carried on with its asset purchase program but cut the pace from €80 billion to €60 billion per month in April. After a promising start to the quarter, European equity markets pulled back in June in response to the possibility of further reductions as well as talk of shutting down the program in early 2018, evincing investors' skepticism about the readiness of European economies to prosper without the aid of quantitative easing measures. However, most major European equity indexes managed to finish slightly positive for the quarter.

Energy stocks continued to disappoint in the second quarter as the world's oil producers outpaced global demand, overall. To the surprise of some, OPEC members largely stuck to their planned production cuts, with reported estimates of near 90% conformity. However, these efforts failed to influence oil prices meaningfully as production continued to increase in the US, Libya, and Nigeria.

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[1] Source: Zacks Earning Trends – 05/31/2017

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Going Forward: Tandem's Outlook

Tandem expects the US economy to continue its trend of slow, steady growth in the second half of 2017, with the possibility of a modest uptick in pace towards the end of the year. Global economic expansion also appears likely to continue, particularly in the Eurozone which has begun to accelerate since late 2016. A weakening British Pound should continue to help the UK weather the storm associated with their upcoming exit from the European Union.

International equities continue to be a big theme this year, as improving economic conditions paired with decreased political risk supports European equity markets. However, anemic GDP growth, ultra-low interest rates, and a 10% unemployment rate (as of 12/31/2016) all detract from the long-term European equities outlook. In addition, the winding down of the asset purchase program by the European Central Bank is likely to be accompanied by higher levels of volatility in Europe.

Performance in the Energy sector will continue to rely primarily on global supply and demand; higher oils prices will require either an increase in demand or a decrease in supply. Other factors that could potentially influence Energy sector performance include global energy conservation efforts and regulations as well as geopolitical tensions.

Tandem continues to monitor economic and market conditions at home and abroad to apply our disciplined investment approach to clients' portfolios.

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