CURBSTONE
FINANCIAL
MANAGEMENT
CORPORATION

From the Curb

Letter to Clients

Quarter Ending June 30, 2017

Most of us have heard the phrase, “Just the facts, ma’am.” The catch phrase is typically credited to Detective Sargent Joe Friday of the TV series Dragnet. However, it was Stan Freberg, an American author, radio personality and voice actor, who in a parody of Dragnet created the one liner. With all the fake news, hyperbole and information overload, perhaps that simple statement can help ground us as we try to make sense of what’s happening in the markets.

Hard data and facts still matter and can help explain why markets have, for the most part, ignored the activity in Washington and chugged higher. Let’s start at the top and work our way down through some of the data that we think is important to making an investment decision:

- According to the OECD’s (Organization for Economic Co-Operation and Development) Composite of Leading Indicators (CLIs), global expansion remains stable, although growth in the U.S. and United Kingdom may be slowing. The outlook from the International Monetary Fund confirms the OECD data and in April they raised their year-over-year target for World Growth to 3.5% for 2017 versus 3.1% for 2016, with a slight uptick for 2018 from the current year number. GDP for the U.S. seems to be stable in the 2% to 2.5% range.
- World-wide deflationary pressures are giving way to higher inflation. In the U.S., the Federal Reserve Bank has “tapped the brakes” on economic growth by raising the Federal Funds Rate twice in 2017, with the chance for a third increase later this year. Estimates for U.S. CPI have the index moving from 1.3% in 2016 to about 2.0% in 2017, a level that is also expected to be experienced by Euro Zone countries.
- Interest rates remain low, although off their historical lows. There is some concern that the U.S. yield curve is flattening; meaning that there is not a big difference between short term and long-term interest rates. This is a result of the Fed pushing short-term rates higher while long-term rates have declined slightly from their post-election highs.
- Equity markets have realized strong returns on a year-to-date basis, leading one to expect excessive valuations. Depending on the valuation method, stocks look very expensive to inexpensive. Using forward P/Es, the S&P 500 has a price earnings ratio of just under 18 times, which when compared to a fair value range of 15 to 17 times earnings, makes the current level slightly overvalued.

741 Chestnut Street, Manchester, New Hampshire 03104 603-624-8462 FAX: 603-624-8274

So where do these facts lead us? In our view, the data is telling us that global economies are stable and growing albeit at tepid rates. Inflation has picked up, but isn't so strong that economies will overheat, causing central banks around the world to raise interest rates meaningfully. Borrowing costs are relatively low, making it attractive for businesses and consumers alike to continue to use credit to fund capital investment and home purchases. And finally, stock prices may be sustained at current levels provided that earnings and revenue growth remain positive.

Clearly the backdrop is favorable. However, in addition to the facts some of the current chatter does matter. We are paying attention to several headline topics that we believe have the ability to impact markets. Specifically we are following:

- The healthcare debate in Washington has our attention. Putting aside the social aspects of healthcare reform, there are positives and negatives to what is being proposed. Reducing or eliminating the Medicare excise tax of 3.9% on high income earners could increase economic growth provided that the savings is spent on goods and services. Cost controls would likely have a negative impact on a broad range of healthcare companies by potentially reducing revenue and profits.
- Another Administration policy change that would impact corporate America and U.S. taxpayers is tax reform. Many believed that this change would occur in 2017; however, due to the lack of agreement on healthcare reform, along with the inability of the Republicans to build a consensus within their own majority, it would appear that any reform will be delayed until 2018.
- Socio-political events, including the activity in North Korea, have many countries and their people on edge. The uncertainty would have a greater impact on investor confidence versus economic or financial gains but would be negative nonetheless.
- U.S. and global central bank policy changes may increase market volatility as they move toward normalization.

These factors, along with other developing issues, lead us to conclude that while markets are in decent shape, there are risks and the possibility of a pullback exists. For that reason, we continue to favor the low to mid-point of our equity ranges. Portfolios remain broadly diversified and overall asset quality remains extremely high. Although domestic large-cap issues have led the way, we see continued strength in developed international markets. Our bond maturities favor the low end of the intermediate range, reflecting the higher interest rate bias and relatively flat yield curve.

Thank you for partnering with us and for allowing us to assist you with your overall wealth management needs. We welcome your thoughts, comments and questions.