Investment Management of Virginia

October 4, 2016

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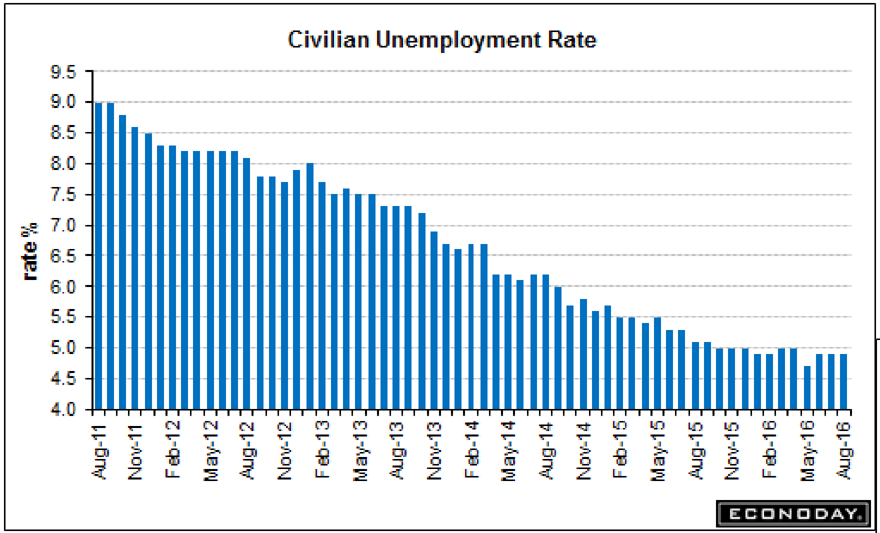
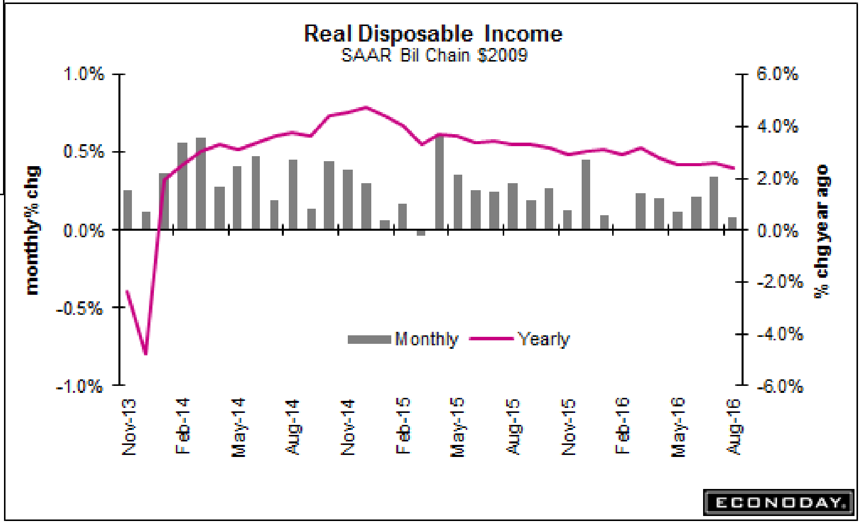
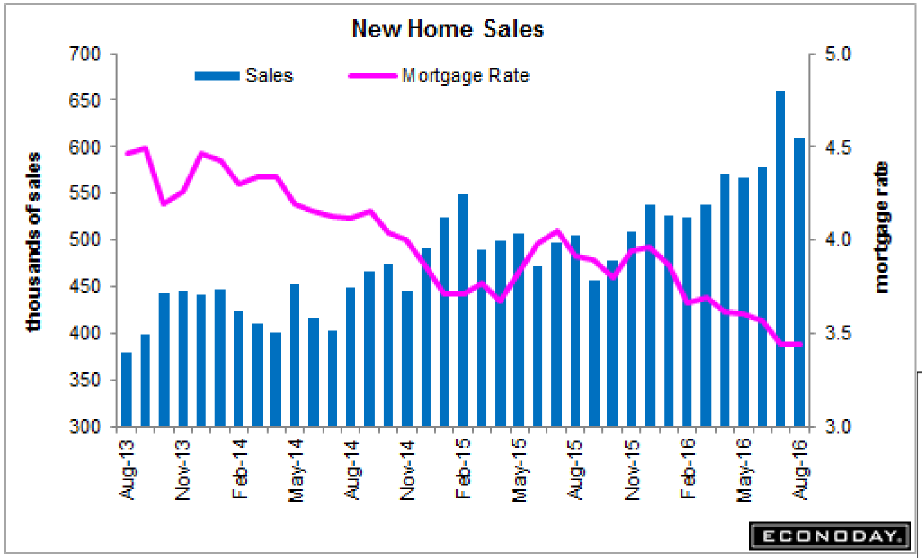
Interesting Charts
and
Additional Commentary

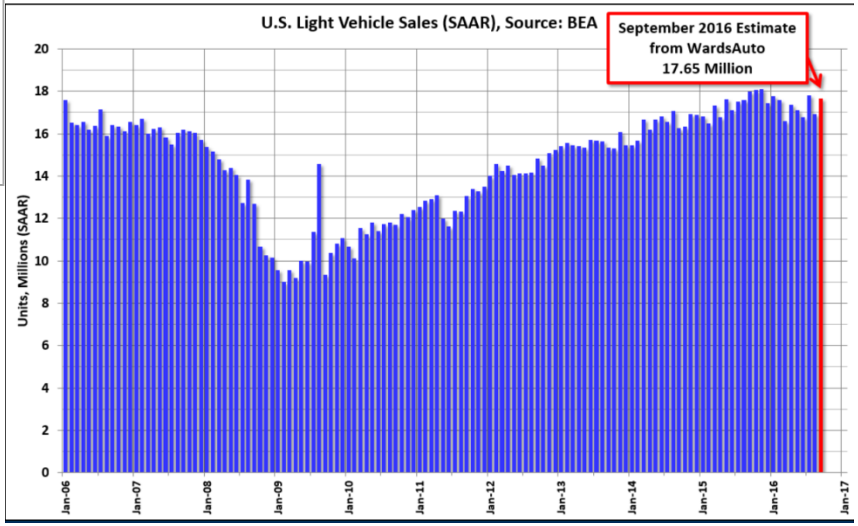
Led by declining unemployment and steady, although unimpressive, increases in disposable income, the American household appears to be in good shape.



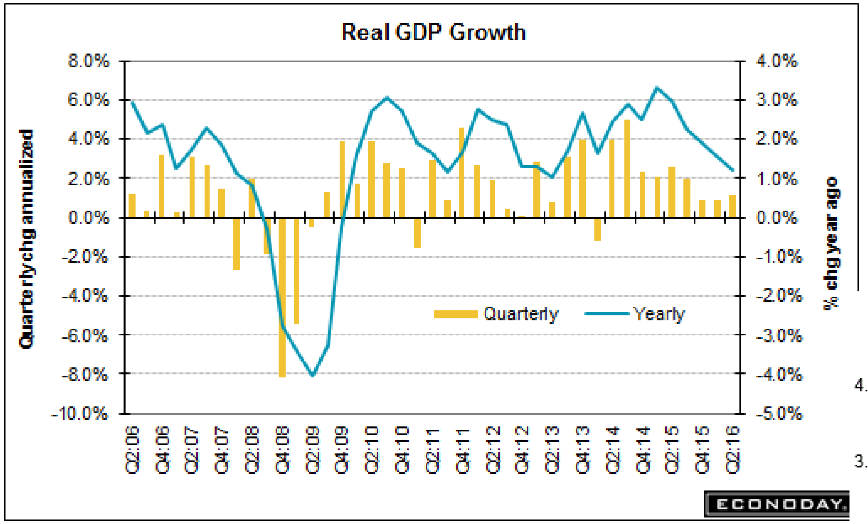


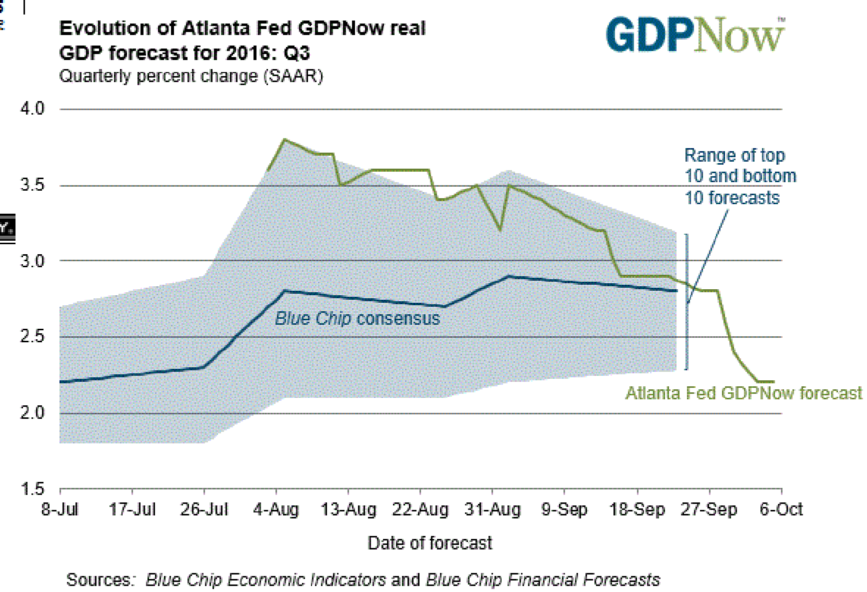
In fact, U.S. consumers have been confident enough to buy new houses and new vehicles, although both measures may have begun leveling off somewhat.





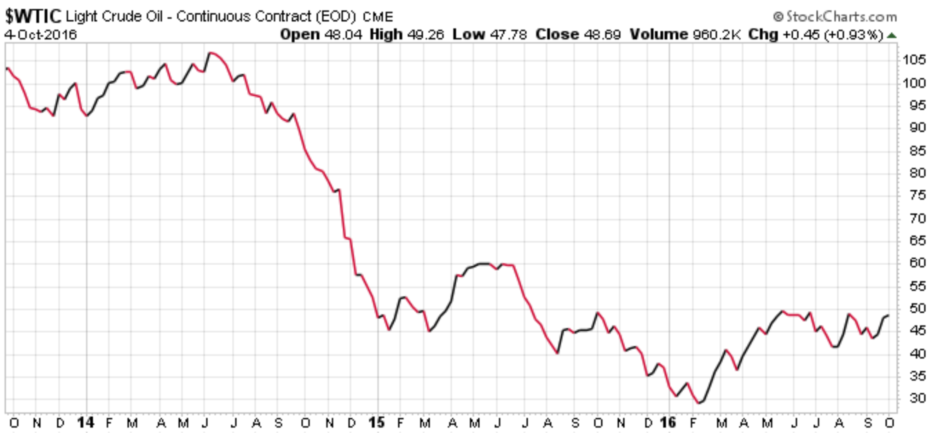
Despite consumer strength, this recovery has been underwhelming. Since the current recovery began in 2009, nominal U.S. GDP growth has averaged only 3.3%, compared to 5.3% during the last expansion. Current estimates for Q3 GDP growth appear mixed but higher than that for Q2.

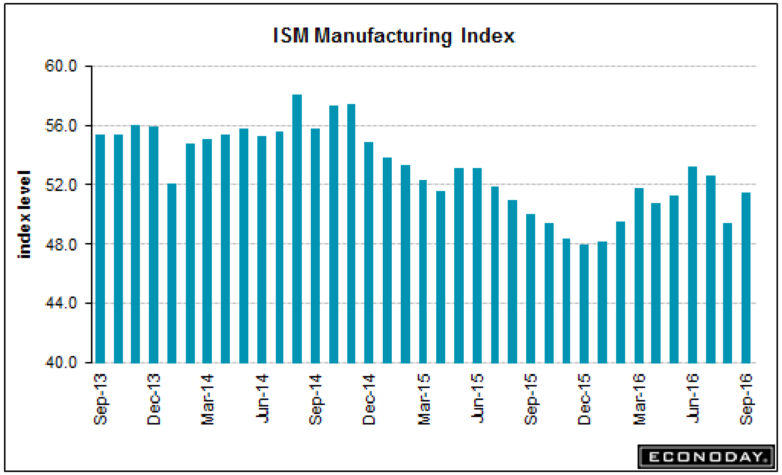




Source: Bloomberg LP, Econoday.com and Atlanta Fed

Beginning in 2014, declines in oil prices and the resulting declines in domestic energy infrastructure investment slowed the economy. Oil prices have firmed considerably since February of 2016. The most recent ISM Manufacturing Index data rose as well, indicating U.S. economic expansion.





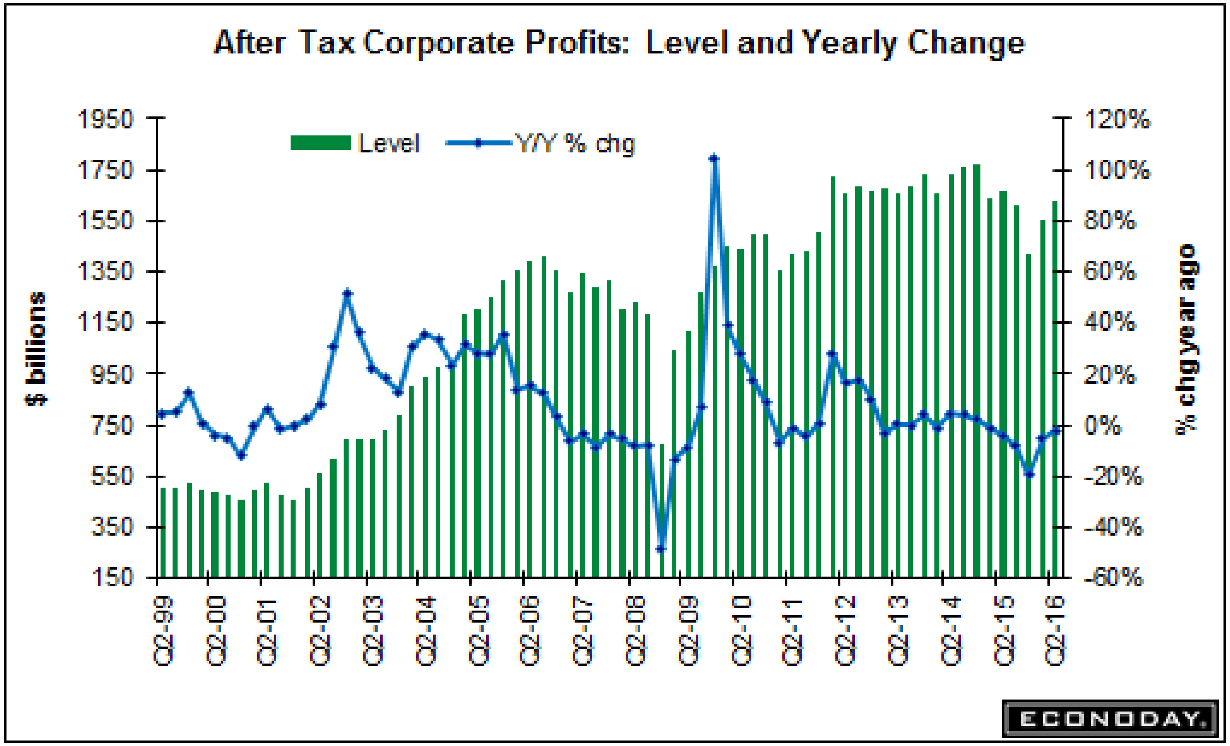
Source: Bloomberg LP, Econoday.com, and Stockcharts.com

Additionally, data just released by the Commerce Department show an increase in goods exports during August, perhaps signaling that a weak global economy is improving. Other conditions such as Brexit, terrorist attacks around the world, divergent central bank policies, and the upcoming U.S. presidential election are sustaining elevated levels of uncertainty, as is reflected in low GDP forecasts for mature economies.

GDP Growth Rates (Percent Change)					
	Actual	Forecast	Forecast	Projected	Trend
	2015	2016	2017	2016-2020	2021-2025
United States	2.6	1.4	1.8	2.0	1.6
Europe*	2.0	1.6	1.4	2.1	1.7
of which: Euro Area	*1.7*	*1.4*	*1.3*	*1.9*	*1.5*
Japan	0.6	0.5	0.1	1.4	1.6
Other mature**	1.9	2.0	2.3	3.2	2.7
Mature Economies	**2.0**	**1.5**	**1.5**	**2.1**	**1.8**

Source: WorldBank

The combination of slow economic growth, high uncertainty, and deflationary influences have put downward pressure on corporate earnings over the past eighteen months. However, year-over-year trends appear to have improved recently.

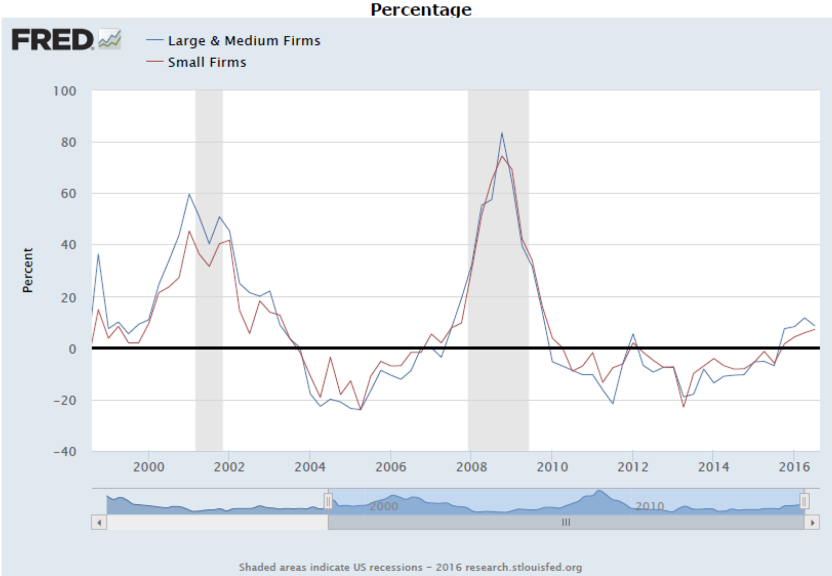


Source: Bloomberg LP

Some measures of bank lending and commercial credit reflect healthy growth in loans; other data point to recent tightening in lending standards.

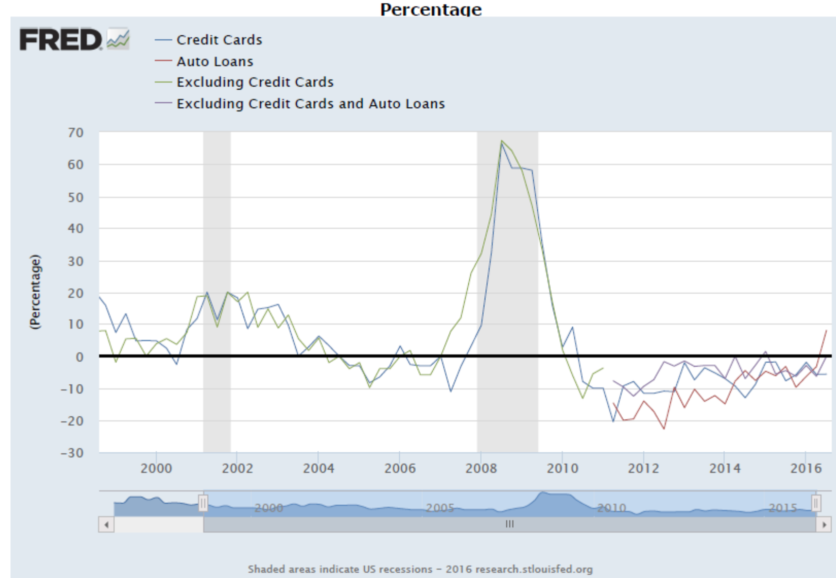
Net Percentage of Domestic Banks Tightening Standards for Commercial and Industrial Loans

Percentage



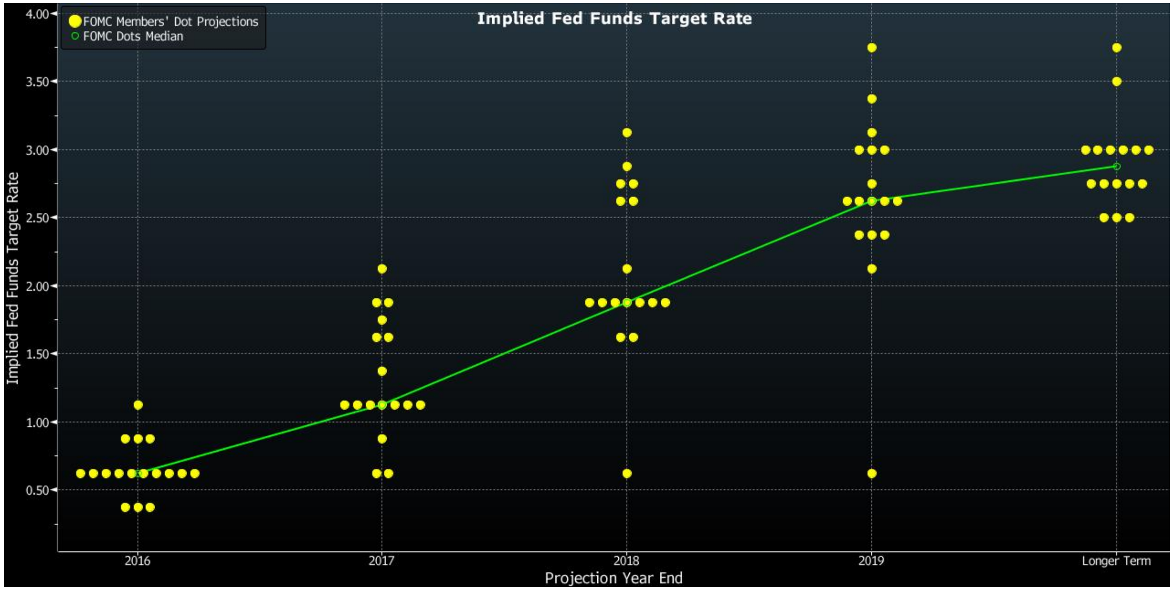
Net Percentage of Domestic Banks Tightening Standards for Consumer Loans

Percentage



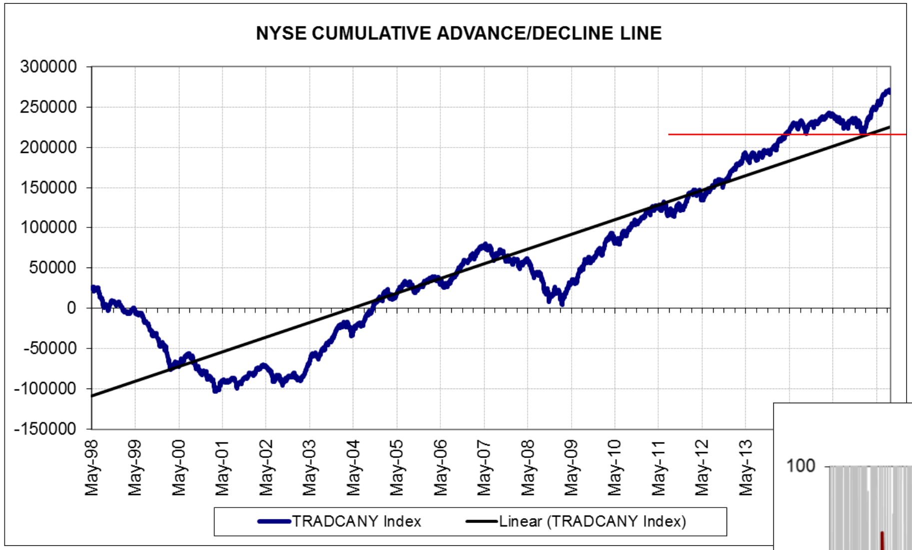
Source: Saint Louis Federal Reserve Bank

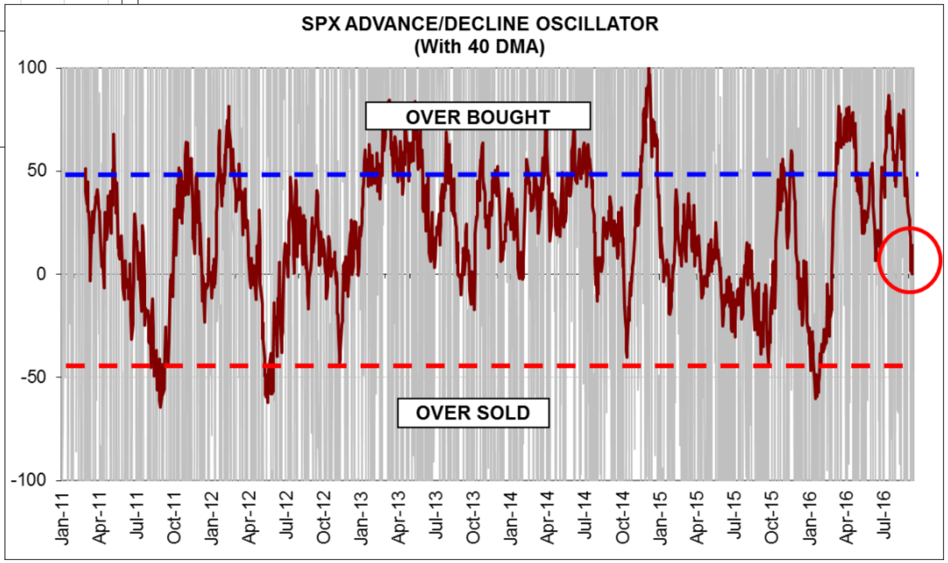
Although the Federal Reserve repeatedly has expressed a desire to "normalize" interest rate policy (raise rates), the Fed decided to sit tight in September but noted that the economy appeared to be "now expanding more strongly." Presently, the FOMC Members' projections reflect an average of three rate hikes in 2017 to bring the Fed Funds Rate to 1.00%.



Source: Bloomberg LP

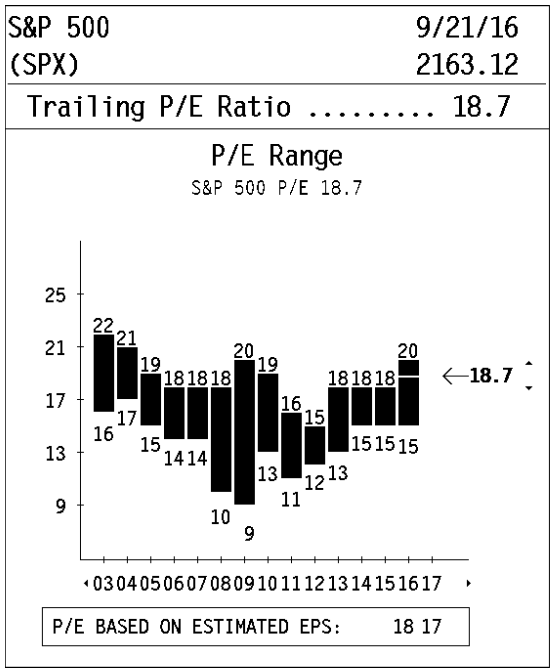
From a technical perspective, most stocks appear to remain in uptrends, with the majority working off overbought conditions through sector rotation.

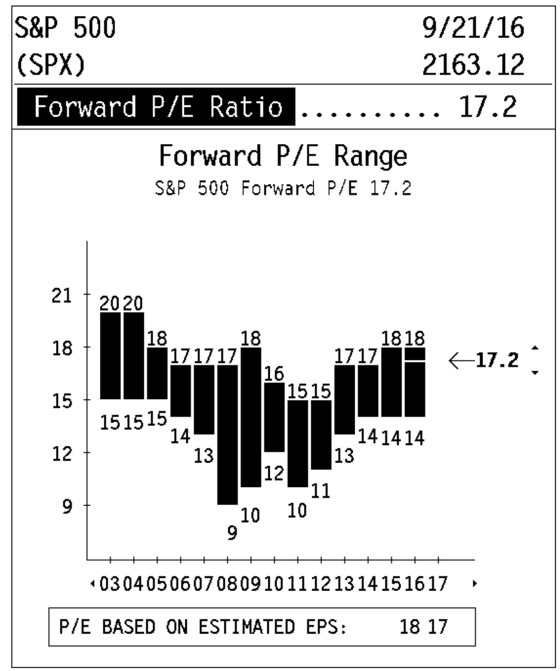




Source: Bloomberg LP

Valuations for the vast majority of stocks remain at the top end of the historical range.





Compared to many alternatives, like negative yielding bonds in Europe and Japan, stocks with steady earnings and good dividend yields appear less pricey. The S&P 500's 2.1% dividend yield is 128% of the yield on the 10-year U.S. Treasury.

Source: Bloomberg LP

- The third quarter started out with upbeat reports on the strength of the housing and auto markets, continued strong job growth with higher wages, and improved consumer confidence. In late August and early September, however, the market paused on hawkish commentary by the Federal Reserve.
- After the Fed left rates untouched and the dust settled on the quarter, the S&P 500 Index had advanced, on a total return basis, 3.85% for the three-month period and 7.84% year-to-date.
- Equity valuations remain at the top end of the historical range, but dividend yields appear supportive in what we expect to remain a low-yield/low-return environment.
- Looking ahead, many concerns remain: Brexit, rising macroeconomic and geopolitical tensions, full valuations for equities and fixed income, negative sovereign interest rates, divergent central bank policies, widespread populism, and the divisive political climate in the U.S. and in other countries with upcoming elections. If (as famous investor Ken Fisher, citing John Templeton, reminds us in a recent *MarketWatch* interview) bull markets usually collapse amid euphoria, we are not seeing any!
- Some recently released data, notably that of the ISM Manufacturing Index, do appear encouraging.

Disclosure:

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