Investment Management of Virginia

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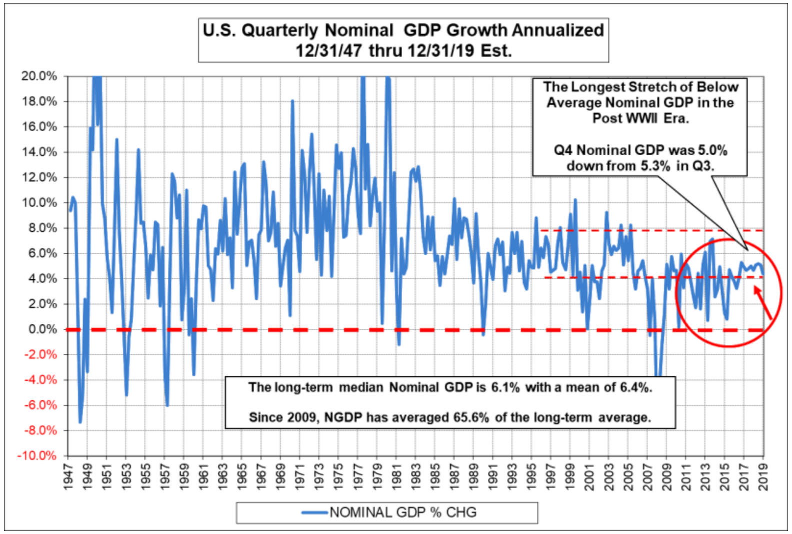
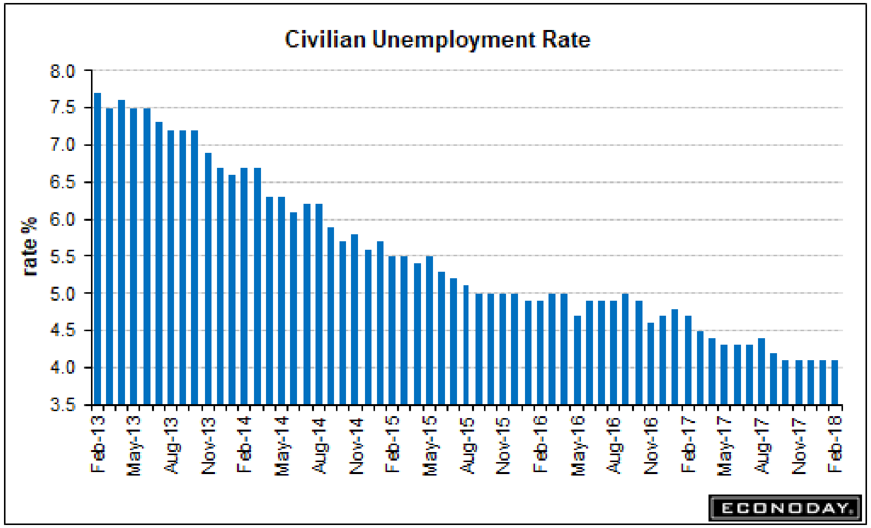
Interesting Charts and Commentary

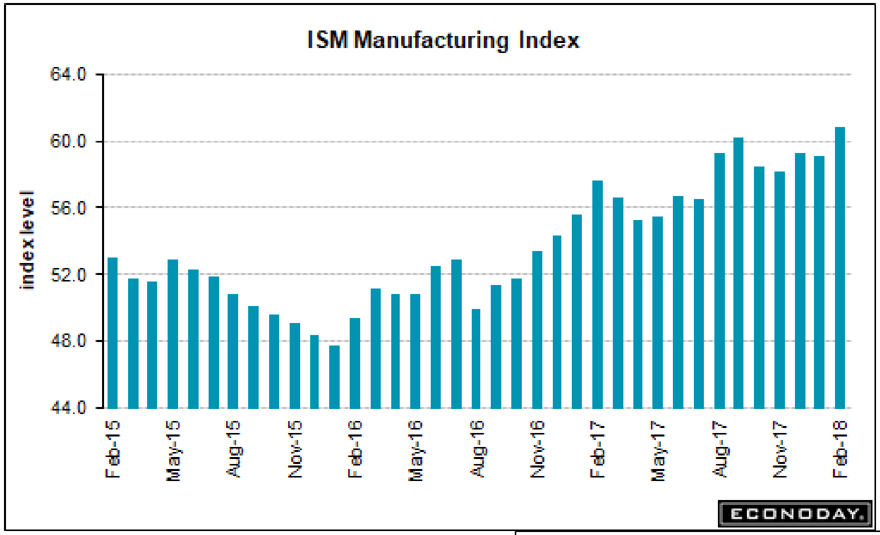
The U.S. economy is expected to continue growing between 2% and 3% for the foreseeable future. The unemployment rate has remained around 4%, the lowest rate in 15 years.

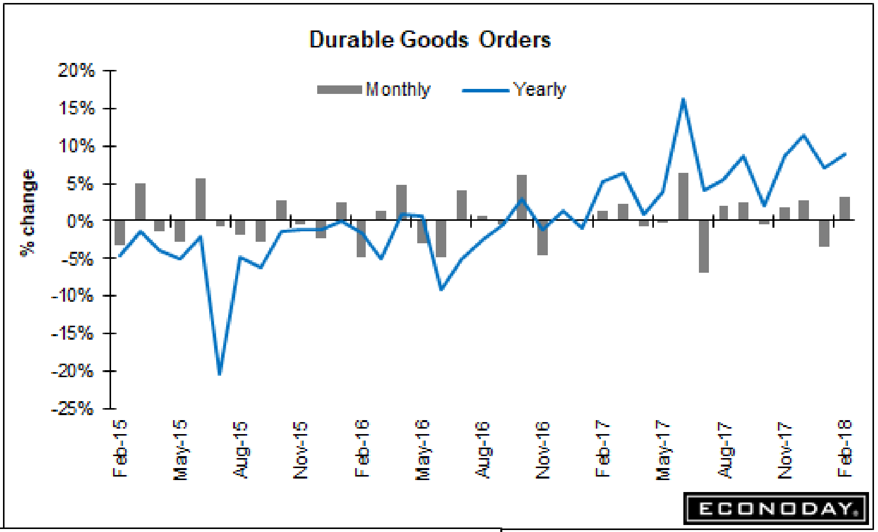


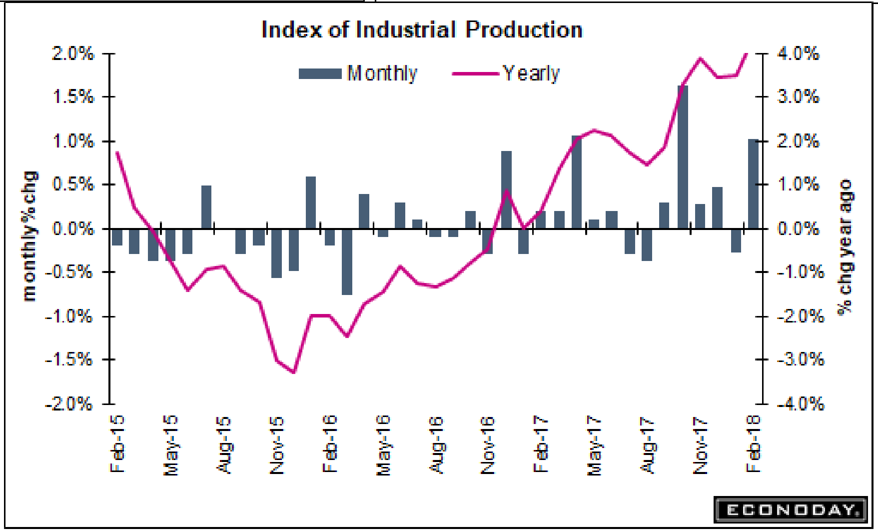


Source: Bloomberg, LP, Wells Fargo Economics, EconoDay and IMVA

Steady economic growth has been led by manufacturing, which has continued to surprise with stronger than expected readings. The Institute for Supply Management Index (ISM) recently hit a new 10-year high, with industrial production expanding over 4% year-over-year and durable goods orders remaining strong.







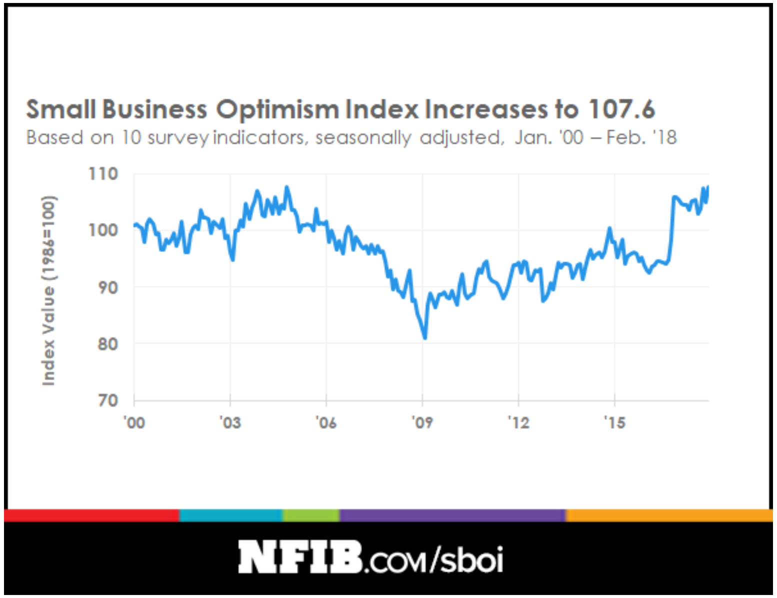
Source: Bloomberg, LP, EconoDay

The strong economy has led to increased optimism among small businesses. According to the National Federation of Independent Business's (NFIB's) Chief Economist, Bill Dunkelberg, the "historically high readings indicate that policy changes – lower taxes and fewer regulations – are transformative for small businesses. After years of standing on the sidelines and not benefiting from the so-called recovery, Main Street is on fire again. Small business owners are telling us loud and clear that they're optimistic, ready to hire, and prepared to raise wages – it's one of the strongest readings I've seen in the 45-year history of the Index."

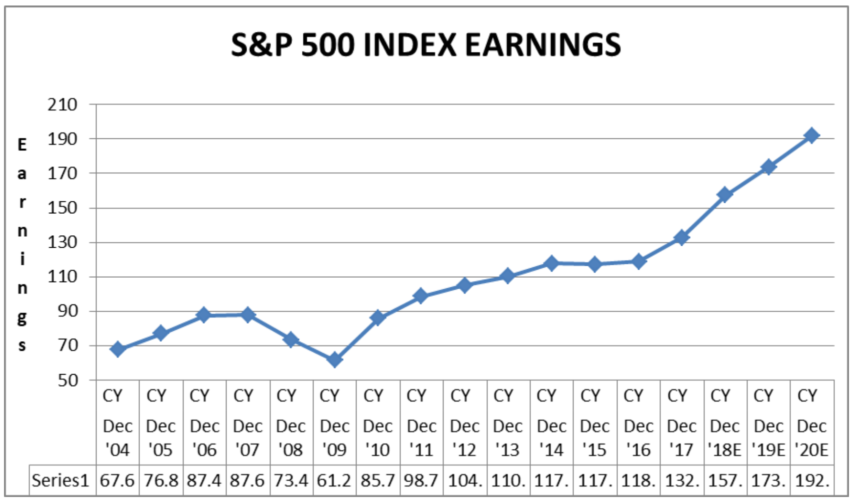
Small Business Optimism
Increases in February

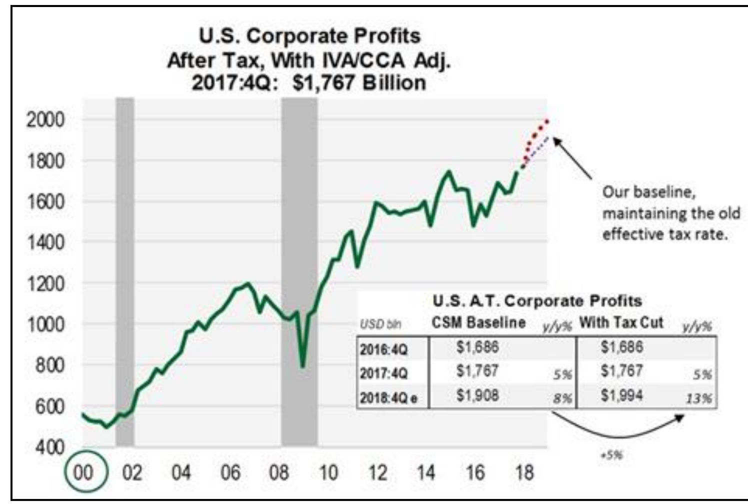
Index Component	Net %	Change From Last month
Plans to Increase Employment	18%	▼ -2
Plans to Make Capital Outlays	29%	▬ 0
Plans to Increase Inventories	4%	▲ 1
Expect Economy to Improve	43%	▲ 2
Expect Real Sales Higher	28%	▲ 3
Current Inventory	-3%	▲ 2
Current Job Openings	34%	▲ 0
Expected Credit Conditions	-3%	▲ 1
Now a Good Time to Expand	32%	▬ 0
Earnings Trends	-3%	▲ 1

NFIB.com/sboi



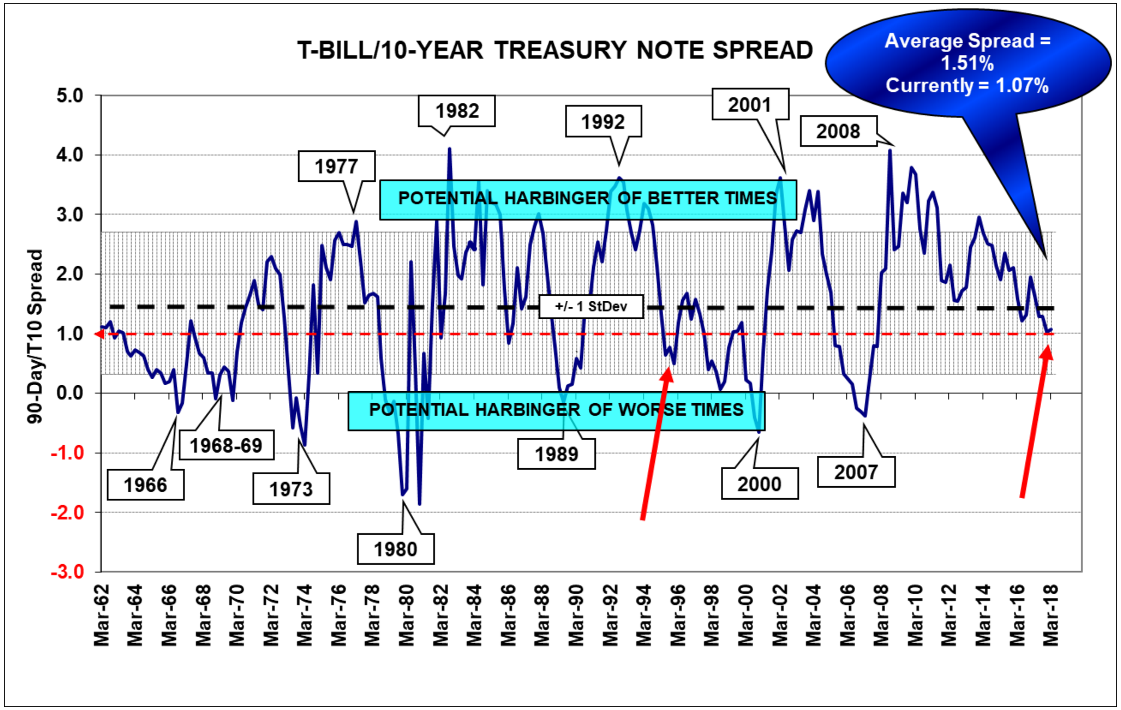
This optimism, strong economic data, and the potential effects of recent policy changes (e.g., corporate tax rate revisions) are reflected in rising earnings estimates for U.S. corporations. S&P 500 Index company earnings are now expected to jump from $132 per share in 2017 to $157 per share in 2018. Corporate profit margins and overall profits are expected to reach record highs this year. Recently enacted tariffs could dampen this forecast.





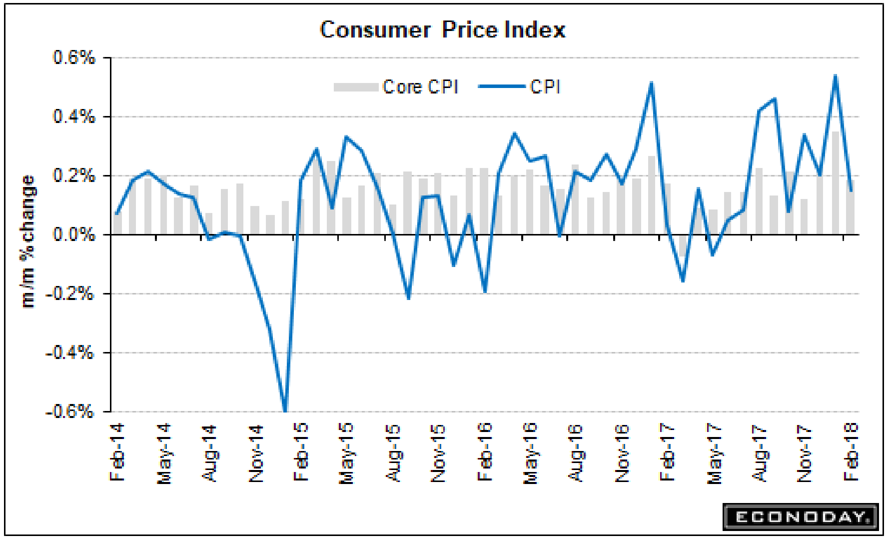
Source: Bloomberg, LP, FactSet and Cornerstone Macro

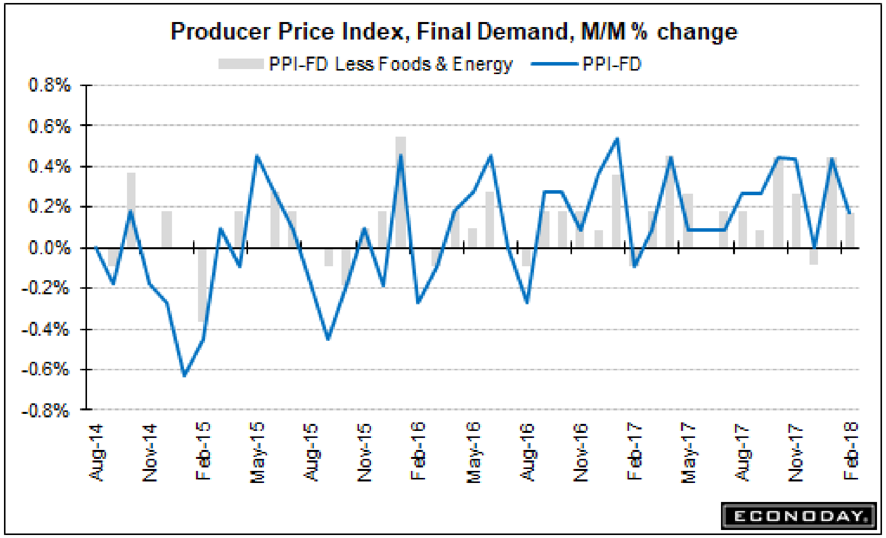
With economic data generally improving, the U.S. Federal Reserve raised rates four times last year, and it is expected to increase rates at least three times this year. The Fed's activity and signaling have produced a "flattening" in the yield curve; that is to say, the spread between short and long rates has declined (short rates are up, long rates are up less). One of the biggest risks the equity market faces is that the Fed raises rates too quickly or unexpectedly, killing confidence and the recovery just as they are gaining some momentum.



Source: Bloomberg, LP and IMVA

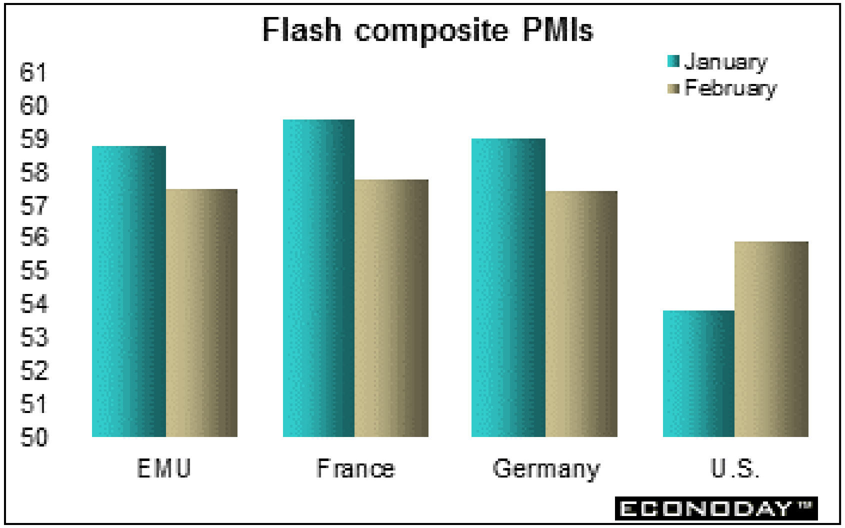
Ostensibly, and in addition to wanting to "normalize" rates to more traditional levels, the Federal Reserve is raising interest rates now to prevent the economy from overheating in the future – and producing unwanted levels of inflation. Although the Consumer Price Index (CPI) and Producer Price Index (PPI) are still registering below 2.5% inflation, the Fed sees anecdotal evidence of rising prices in the manufacturing sector. According to the Dallas, Richmond, and Empire State Beige Books "capacity utilization is up, delivery times continue to slow, and prices look like they may be overheating."





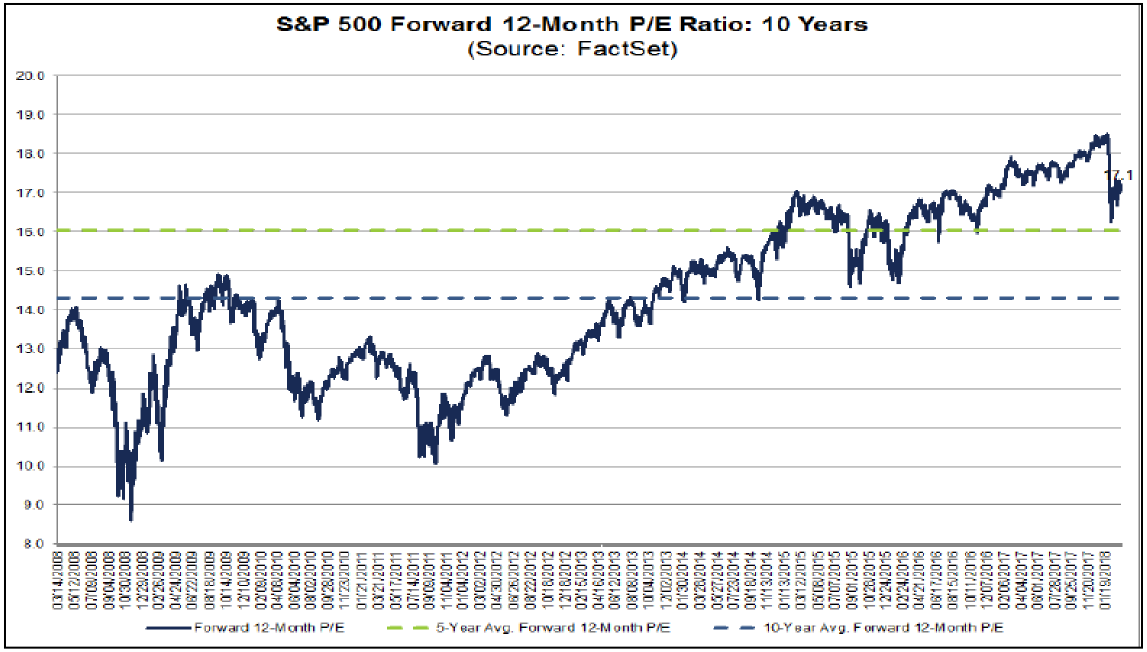
Source: EconoDay, Federal Reserve

Besides rising inflation, the other risk the equity market faces is a slowing global economy. While the U.S. economy continues to expand, the global expansion that began in 2012 is showing signs of decelerating. The Composite Purchasing Managers Index (PMI) of the world economies (aside from the United States) are in fact leveling off – but still at levels over 50; any readings over 50 indicate growth and expansion. China's slowing growth is somewhat concerning since that country has driven the progress in European manufacturing and industrial production over the past five years.



Source: EconoDay and Cornerstone Macro

The recent market correction has returned valuations to more reasonable levels, as measured by price-to earnings (P/E). As long as the economy remains in expansion mode and earnings continue to increase, the market appears much closer to fairly valued today than it was at the beginning of the year.



Commentary

- The U.S. economy is expected to continue growing between 2% and 3% for the foreseeable future. The unemployment rate has remained around 4%, the lowest rate in 15 years.

- Manufacturing has continued to expand in the United States thus far in 2018. The Institute for Supply Management Index (ISM) recently hit a new 10-year high.

- Strong economic data, along with the prospective impacts of lower taxes and fewer regulations, are leading to high optimism among small businesses, many of whom, per NFIB, had been “standing on the sidelines and not benefiting from the so-called recovery.”

- On the heels of good economic data and such optimism, S&P 500 Index company earnings are expected to jump from $132 per share in 2017 to $157 per share in 2018. Corporate profit margins and overall profits are expected to reach record highs this year. Concerns over tariffs could moderate this optimism.

- The Federal Reserve raised rates four times last year, and it is expected to increase rates at least three times this year. The yield curve has flattened somewhat but not alarmingly (short rates up, long rates less so). One of the biggest risks the equity market faces is that the Fed raises rates too quickly or unexpectedly, killing confidence and economic momentum.

- The other risk the equity market faces is a slowing global economy. While the U.S. economy continues to expand, the synchronized global expansion that began in 2012 is now leveling off somewhat.

- The recent U.S. equity market correction has returned valuations (P/Es) to more reasonable levels. Continued economic expansion, accompanied by advances in earnings, would help confirm this trend.

Disclosure:

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