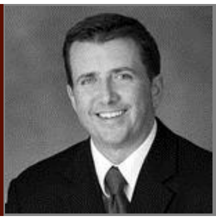
Aviance Capital Partners
Investing for Generations

INVESTMENT COMMENTARY

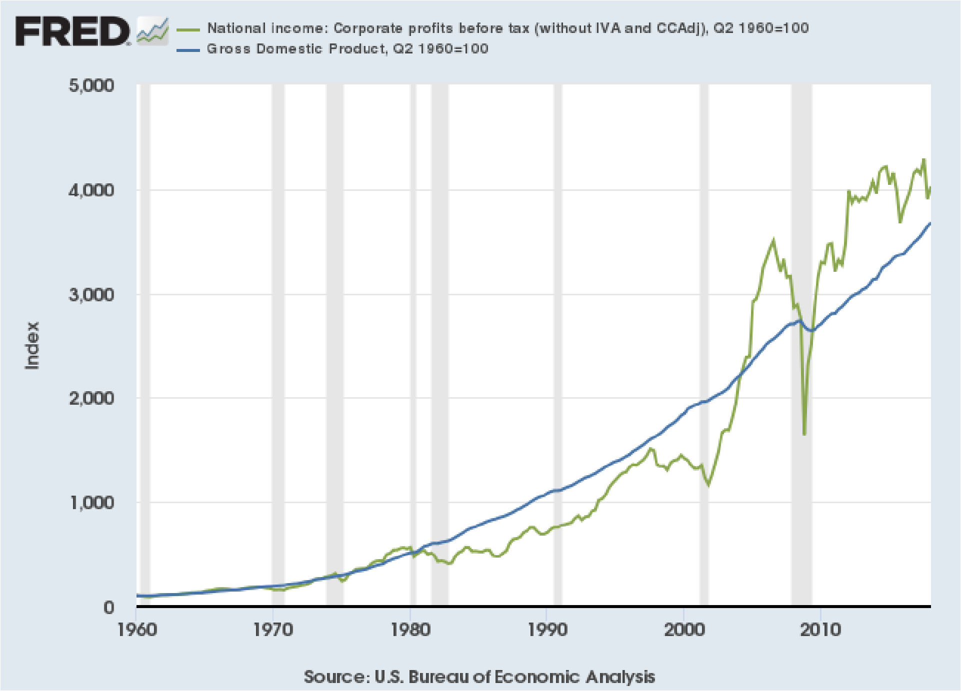
JULY 2018



JACK BROWN, CFA

Despite the hand-wringing and volatility, the stock market, as measured by the S&P 500, has returned an admirable +6.0% year-to-date and +16.4% over the past 12-months (as of 07/18/2018). Stocks have been buoyed in part by earnings which have also grown considerably over the previous year; +20% quarter-over-quarter for constituents of the S&P 500 as of March. In essence, share prices have grown as a result of business profit growth.

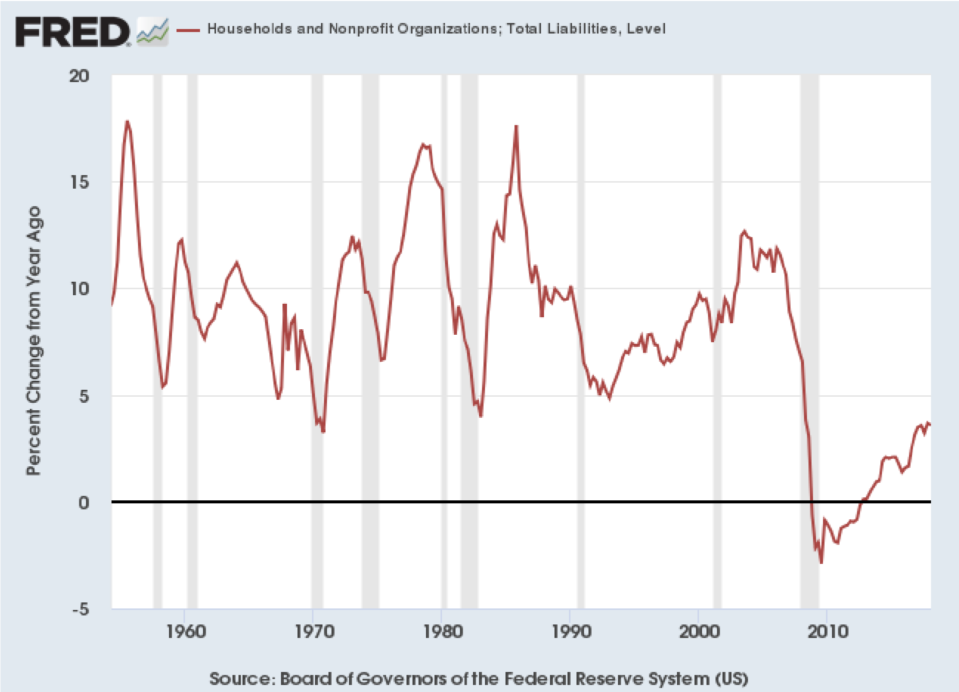
As indicated in the graph below, business profit growth is tied to economic growth, and the economy has been doing well. Another observation below is that nominal economic *growth* as indicated by the blue line is the norm, and recessions look rather mild compared to the volatility in corporate profits. This relationship between economic growth and profit growth is not only logical but holds as we go back even further in time.



Given this tie between business growth and economic growth, it is also logical that the stock market would see its most significant pullbacks (i.e. deeper than 10% and longer than 6-months) in and around recessions. Notice the market declines near the gray recession bars in the chart below:

The good news for the stock market is economic growth appears to be on sound footing. For example, consumers are doing very well based on a broad swath of employment statistics. The unemployment rate currently stands at a low level of 4% while job openings are at high levels.

Further, households are still reasonably cautious in terms of how much debt they are adding. For example, household liability growth stands at low levels. In our view, this indicates the borrowing-and-lending cycle has plenty of room to run before it peaks. As the following chart seems to indicate, recessions (gray bars) tend to follow peaks in household liability growth rate.



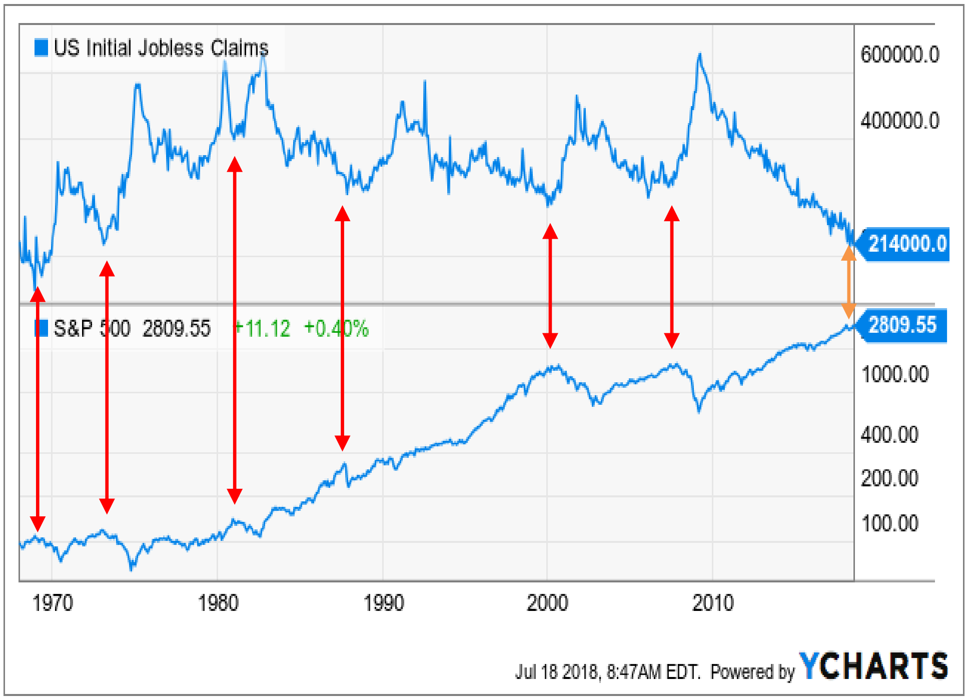
In balancing out our view of the economy, we do remain cautious in at least two areas.

Namely:

1. The unpredictable nature of a trade war could lower growth expectations in investment;

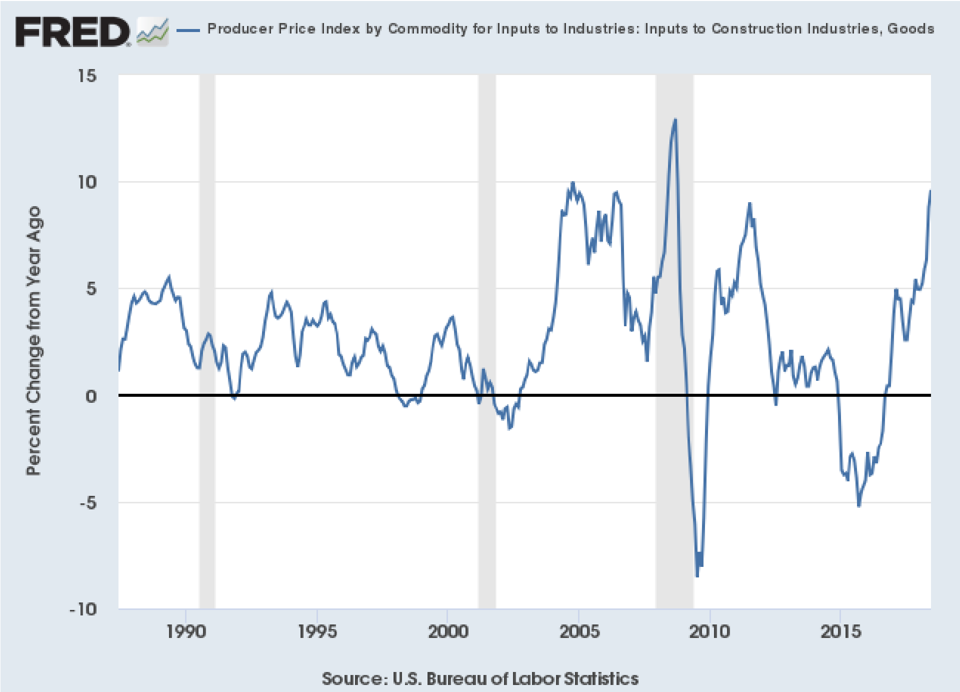
2. When the economic growth rate peaks so might the stock market. We see this in some statistics like Initial Jobless Claims as illustrated on our next chart.

Initial Jobless Claim lows tend to be tied to market peaks



Despite these areas of caution in our outlook for the economy, our base case is for continued growth over the next year with normal stock market returns. While we touched on only a few positives for the economy, the overwhelming body of evidence points to continued economic growth. Further, as we believe the market is overvalued, we are not concerned in the short-term about a related correction. The valuation concern will be addressed over time as earnings growth outpaces stock price increases or as a market pullback occurs due to a recession or other reasons.

Our view of fixed income markets also hinges on our economic view. We believe economic growth will continue for some time and potentially lead to a pick-up in inflation expectations. Additionally, there are signs that a pickup in inflation has begun, for example, in the construction industry where input prices have risen by approximately 10% over the past year.



This potential for high-than-expected inflation is somewhat complicated by aggressive central bank policies around the globe. By in large, central banks have bought their own sovereign debt (like the U.S.) and lowered overnight lending rates. When these policies eventually reverse, the bond market could see an excess supply of global debt as central banks unwind their positions; lowering bond prices. As a result of this potential inflation and unwinding of sovereign debt by central banks, we are somewhat cautious on the bond market.

From an asset allocation perspective, the environment modestly favors stocks over bonds in our opinion. New assets need to be carefully evaluated before being put to work. Regardless, long-term investors should not stray far from their personalized strategic asset allocations based on individual goals and the willingness-and-ability to withstand risk.

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