ECONOMIC MOMENTUM

Most asset classes kept their positive momentum going in the second quarter, as growth continued and inflation moderated.

The U.S. economic expansion has officially turned eight years old and some question whether the long run is nearly over? Not likely. Helping to extend the good times, fundamentals have continued to impress with global growth stable and/or accelerating in all major economic regions of the world. This constructive growth environment has averted investor attention from the political wranglings in Washington D.C. and the Federal Reserve (which is balancing elevated valuation levels with stubbornly low inflation).
As we shift our attention overseas, we are starting to see the European economy gaining traction. European purchasing manager indexes—providing a real-time read on the state of the economy—remain healthily above the 50 line (the divider between economic expansion and contraction). Meanwhile, European earnings grew by 23% in the first quarter, outpacing expectations by 14%. Japan impressed by even more in the first quarter (28% growth, 16% surprise); while U.S. companies also beat expectations, though to a lesser extent (14% growth, 5% surprise). These first quarter earnings “beats”—mostly announced throughout April and May—have supported equity markets and raised investor expectations for second quarter results. U.S., European and Japanese second quarter earnings are again expected to grow year-over-year at a double-digit pace.

Major central banks are hoping this economic momentum allows them to slowly move out of the spotlight. Both the Federal Reserve (the Fed) and the European Central Bank (ECB) have taken a less-accommodative tone in recent public statements. The Fed is looking to reduce the size of its $4.5 trillion balance sheet soon (possibly as early as September) while the ECB may look to slow its asset purchases from the current €60 billion-per-month rate (possibly in early 2018). Both want higher policy rates as well. The pace at which they raise them will be dictated by the mix of economic growth, inflation and financial market stability. Steady growth and low inflation argues for a gradual approach, but elevated financial asset valuations have some policy makers pushing for policy to be tightened more quickly. We are closely watching for any sign of accelerating inflation and more aggressive action taken by central bankers.
Key Themes

Drama in Washington

D.C. politics have provided a lot of flash but little substance. The healthcare bill now sits in the Senate, where a handful of vulnerable Republican senators up for re-election in 2018 are doing political calculus on whether they should support the bill. Increasingly, investors just want a vote—pass or fail—and a move to tax reform, more important to the markets. Meanwhile, the investigation into Trump administration-Russian ties took an interesting turn when FBI director James Comey was fired by President Trump, introducing new obstruction of justice allegations. Republicans claim all the drama is not distracting from legislative efforts, with House Speaker Paul Ryan promising to “walk and chew gum at the same time.”

Hope for Change in Europe

A new political star is born. Emmanuel Macron, the 39-year-old former investment banker turned politician, went from founder of an entirely new political party to president of France—with majority control in parliament—in just 14 months. Optimism abounds on Macron's chances to reform France’s rigid labor markets and influence broader European Union policies, but it is far from guaranteed. France has resisted reform for decades and opposition parties quickly argued that low voter turnout restricted Macron’s mandate. At the very least, however, France has avoided a worst case outcome by rejecting Marine Le Pen and her populist and anti-euro National Front party, which only won eight seats in parliament.

From the Managing Director

Dear Valued Clients,

I would like to begin by introducing myself to those of you I have not yet had the pleasure of meeting. Though I am new to the role of Managing Director of our Wealth Management Division, I have been with the Bank prior to us opening our doors for business back in 1989, and have served as the Chief Operating Officer for the last eight years. In this role, I have been involved in all aspects of Enterprise’s operations and strategy. In addition to over 40 years of experience in financial services, I am also a Certified Public Accountant, as well as a Certified Financial Planner.
Constructive Economic Fundamentals

The combination of steady economic growth and subdued inflation has provided investors with a “goldilocks” environment (not too hot, not too cold, just right), despite the political drama and geopolitical pressures. In the United States, the “misery index”—a simple summation of the unemployment rate and year-over-year inflation level—has resumed its trend downwards and sits below levels seen prior to the financial crisis. Low unemployment helps consumption while low inflation caps interest rates. The two combined should help to extend the 8-year-old U.S. economic expansion. But this isn’t just a U.S. story. All other major global economies, including Europe, Japan and China, are currently healthy as well.

The Fed Presses Forward

Softening inflation did not stop the Fed from raising interest rates to a range of 1-1.25% in its June meeting. Fed Chair Janet Yellen asserted that raising rates gradually now would save the Fed from more aggressive monetary policy later. The Fed also announced its plan for reducing the size of its $4.5 trillion balance sheet. Thus far, the Fed has been reinvesting all maturing assets. It continues to do so, but sometime soon (likely later this year) it will, at first, allow $6 billion in Treasury—and $4 billion in mortgage-backed security—maturities to roll off each month, reinvesting any amount above that. For perspective, the chart shows monthly Treasury maturities over the past year; there will still be a lot of reinvestment going on.

I can’t thank you enough for the trust you have placed with our Bank, our advisors, and with Enterprise Wealth Management. We pride ourselves on the relationships we establish with our clients, helping guide you through some of the most important financial aspects of your lives. We will never take your trust in us for granted.

We are finalizing our plans for our Fall Investment Forum. For those of you that have had the opportunity to attend in the past, you know it is an evening that is fun as well enlightening. Please save the date for the Fall Investment Forum which will be held the evening of Wednesday, October 25th at the Andover Country Club from 5:00pm-8:00pm. Our guest presenter for the evening is Nina Easton. More details will follow.

If I can ever be of assistance in any way, please do not hesitate to reach out to me directly. I look forward to meeting you personally at some time in the near future.

Sincerely,

Stephen J. Irish, CFP®, CPA
Managing Director, Enterprise Wealth Management
Chief Operating Officer, Enterprise Bank
Financial Market Review

Interest Rates

The U.S. yield curve moved little from point-to-point over the quarter, masking underlying interest rate volatility. The 10-year UST reached as low as 2.12% in the quarter as inflation rolled over and the “Trump bump” was put on hold. However, the last week of the quarter brought a nearly 0.2% jump in the 10-year as the Fed signaled its intent to remain committed to accommodation unwind despite “transitory” softness in recent inflation data. As important, ECB President Mario Draghi struck a more optimistic tone on the ECB’s ability to remove ultra-accommodative policies; the 10-year German bund jumped to 0.47% from 0.24% in response. Japanese rates remain concentrated around 0% across the yield curve.

Credit Markets

Credit spreads drifted lower during the quarter; investment grade spreads were tighter by 9 basis points (bps) to 1.03% while high yield spreads were tighter by 19 bps to 3.64%. Quarterly returns equalled 1.4% and 2.2%, respectively, pushing year-to-date returns further into positive territory. Market liquidity remains healthy and investor demand remains high, combining with the constructive fundamental backdrop. High yield credit spreads jumped a bit in mid-June, responding to oil price weakness, but moved lower towards quarter-end. While both high yield and investment grade yields remain near all-time lows, credit spreads are still wider than the levels reached pre-financial crisis.
Equities

The post-election jump in U.S. stocks has continued to broaden into a global equity rally. Second quarter returns from developed ex-U.S. equities (6.1%) and emerging market equities (5.9%) were roughly double that of U.S. equities (3.0%). For the year, global equities are up 11.8%, led by emerging markets—up an impressive 18.3%. The emerging market story is a good lesson in not getting too caught up in political rhetoric. Instead, investors should focus on actual government policy and its impact on fundamentals. Immediately after the U.S. election, emerging market equities were down as much as 7% over political concerns that have not come to fruition. Since that sell-off, emerging market equities have rallied over 22%.

Real Assets

Global listed infrastructure was the best-performing real asset in the quarter, gaining 6.0% (14.4% year-to-date). As we have noted in the past, the companies within the index merely maintain infrastructure, but don’t directly benefit from its build-out. As such, the returns of these cash flow assets are more driven by falling interest rates than falling odds on infrastructure spending. Natural resources fell (-2.0%) after a strong 12-month run (+23.6%). Despite healthy demand and OPEC mostly sticking to agreed-upon production quotas, oil inventories remain stubbornly high as unconventional (fracking) production growth continues. Global real estate mostly tracked global equities for the quarter, up 3.7% (7.2% year-to-date).