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Momentum has shifted across the major developed economies, both economically and politically.

As shown below, Europe entered 2018 with the strongest composite growth outlook, while the other major economies remained in a solid growth position. Momentum now has shifted to the United States for several reasons. An improved business climate, supported by significant tax cuts, has boosted sentiment. In addition, the euro’s strength through the first quarter is a headwind to European exports. Temporary factors, such as poor weather, also may have hurt Europe. So some momentum may return as the year progresses.

In the meantime, historical political alliances continue to be challenged by both external and internal forces. President Donald Trump’s focus on renegotiating existing trade and political agreements has disrupted the post-World War II order. The continued pressure of populist politics is also leading to new governing alliances in countries like Italy and Germany—challenging the historic support for key tenets of the European Union. In the United States, the mid-term elections have historically heralded a swing in power away from the incumbent party. This year, the swing may be insufficient to alter control of the House of Representatives. But even a change in control of the House would be unlikely to materially change the policy outlook because government would be divided. The result is relative stability in domestic policy within the United States—a redux of our old theme of “Political Volatility, Policy Stability.”

The shifting momentum in growth and more uncertain political picture across Europe and trade could restrain central bankers. Fixed income markets have been buffeted recently by developments in Italy, where the new coalition government has taken a more aggressive stance toward the European Union. We have also heard from several Federal Reserve governors who have noted...
the relative flatness in the yield curve and their lack of desire to risk inverting the yield curve through excessive rate hikes. We don’t expect an inflationary jump to force their hands. The Fed has communicated that it is willing to let inflation run above its 2% target because it was lower for so long. While we are hearing about cost pressures from company managements, our belief is that any inflation that makes its way through to consumer prices will likely be a shorter-term cyclical phenomenon vs. a secular move. In that situation, central bankers are likely to stay accommodative longer than the market believes.

Conclusion

Economic slowing and greater political instability in Europe and the heightening of global trade tensions have prompted us to reduce exposure to foreign equities and to increase exposure to U.S. equities. The outlook for trade is particularly unclear because the United States has thrown up for discussion trade practices with most of the world’s major economies. In addition, the U.S. administration has indicated a preference for bilateral negotiations, which could delay resolution. We think the U.S. economy and markets will keep pace globally in an environment where trade is positively resolved, but also should be a relative safe haven should we have a serious deterioration.

While our risk cases, overall, haven’t changed this month, the context and probabilities have. The risk of a central bank mistake has probably receded a bit, as several Fed governors indicated an aversion to inverting the yield curve through further rate hikes. This is top of mind as the current spread between 10-year and two-year Treasuries is a mere 0.44%. Offsetting a more favorable outlook for U.S. equities, trade tensions have clearly escalated, and the outlook for foreign equities is more uncertain. Our base case scenarios expect the central banks to avoid tightening too quickly, and we expect escalating trade battles to fall short of an all out trade war. We are still positioned for positive stock market returns over the next year, but are more favorably disposed to U.S. equities.
From the Managing Director

Dear Valued Clients,

It is hard to believe that 2018 is more than half over. Weather-wise it seems we went from a cold and wet spring, right into the heat of summer, with some wild variations thrown at us from one day to the next just for good measure.

Although the overall economy still seems to be on sound footing due to most companies continuing to produce solid results, the overall market continues to exhibit a certain level of volatility. Rightly or not, this volatility seems to be heavily influenced by uncertainties around the direction of global trade and tariffs, the direction of long-term rates and the prospects for inflation.

The good news is, we are here to help you navigate these uncertain times. With a long-term view of the markets and our focus on helping you achieve your financial goals, we can assist you to look past the day-to-day movements in the financial markets to stay focused on how best to achieve your long-term goals.

We are finalizing plans for our annual Fall Investment Forum, which will be held on Thursday, November 1st from 5:00 p.m. to 8:00 p.m. at the Andover Country Club. Our keynote presentation will be delivered by Marci Rossell, a highly respected and requested speaker from past Forums. For those of you that have attended in the past, you know it is an evening full of great company, great food and great networking opportunities. I look forward to seeing you there.

Thank you for your continued confidence in Enterprise Wealth Management and I wish you a wonderful rest of the summer. With time marching on as quickly as it does, the Fall Investment Forum will be here before we know it.

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

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