Maybe Government Gridlock Ain't so Bad…

by Bob Deitrick

The good news as we conclude the month, July, historically the best month of the year for more than 50 years, was once again a great month for the market. Here are the returns for July 2017:

- ***Nasdaq - July Return: 3.38%***
- ***S&P 500 - July Return: 1.93%***
- ***DOW - July Return: 2.54%***
- ***Russell 2000 Small Caps - July Return: 0.69%***

These numbers are impressive given the back drop of the drama in Washington since May 9th.

Last week was a challenging one to watch the state-of-affairs in Washington. The Republican Party's seven-year quest to scrap Obamacare ended Friday morning with a 51-49 defeat on the Senate floor at 1:15 a.m. John McCain's deciding vote was likely a result of the 2015 insult by Donald Trump.

Then candidate Trump told conservatives gathered in Iowa in July of 2015 that "John McCain was a war hero because he was captured. I like people who weren't captured…" Trump said. This insult was beyond the pale then, and it came back to roost on Friday morning. If Trump had never made that incendiary remark, the repeal would likely have taken place. So, again, as I have said repeatedly for decades, what goes around, comes around…

The rout of Obamacare repeal was a major set-back for the GOP. After seven years of promising simultaneous repeal and replacement of the ACA with something better for the American people, the GOP controlled House and Senate could not do it... Our concern today is can Congress and this White House accomplish anything promised? Can they get tax reform and repatriation done, can they get a needed infrastructure bill signed, can they roll-back Dodd-Frank partially or entirely? These are beginning to look suspect given the drama in Washington since May.

Having said that, what is driving the equity markets today are two things: a very solid credit market and better than expected corporate earnings. Here is what is propelling this market forward:

- ***Strong earnings and a weaker dollar are driving U.S. markets to all-time highs.***
- ***Overseas growth is one of the drivers of strong profits for the S&P 500.***
- ***PFP's S&P 500 price target goes to 2,600+ for this year.***

The bottom-line is that equity bull markets don't die of old age. They die from the ill-effects of poor credit markets or a policy mistake made by the FED. So far, neither has or is likely to take place this year. The credit markets, relative to 2007, are very strong today and the FED is acting responsibly not being overzealous in its approach to raising rates. Inflation is in check and that is key to this market moving forward.

Earlier this year, optimism surrounding Trump's presidency was the catalyst driving U.S. markets; however, that is not the case as we enter August. Strong earnings and global

growth are the driving forces to this stock market. S&P 500 companies with greater foreign sales exposure are carrying equities higher.

In the first half of 2017, ironically, the equity markets and the economy were driven by a weak dollar and falling bond yields rather than a strong dollar and higher bond yields that were assumed when Trump was inaugurated. PFP reports that more than 68 percent of companies our firm tracks have reported earnings better than expected. Financials, health care, industrials and technology are the leaders so far this year.

Will the Trump trade turn into the Trump fade? *Investors are beginning to back away from some key sectors that would have benefited from President Trump's aggressive pro-business agenda. Flows to ETF's now show market players looking for more dependable growth sectors rather than the reflation areas dominated earlier this year.*

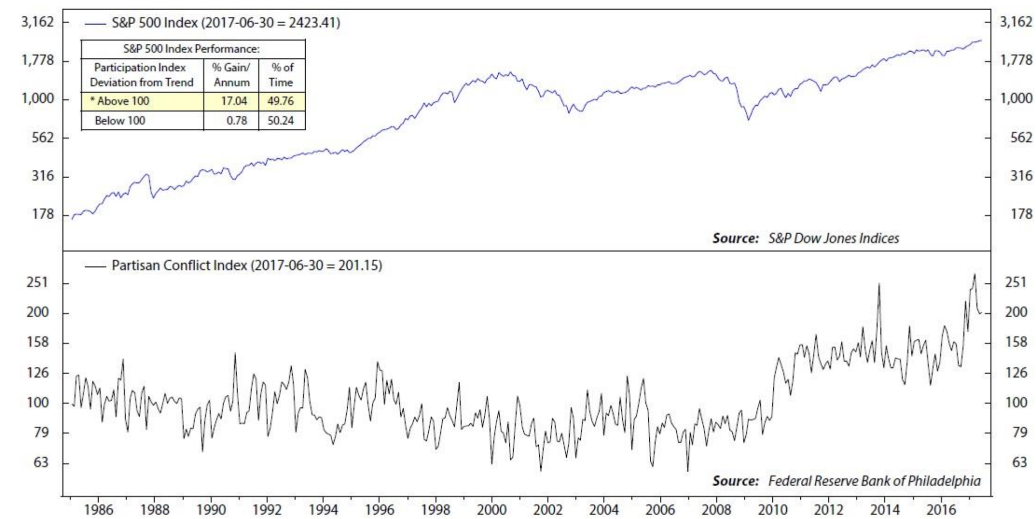
After the election, PFP was all-in on the Trump trade. Essentially what has happened over the last 90 days, with more background noise coming in daily, the Trump agenda that was put forth in the campaign trail started to stall like a subway train stuck between stations.

Since May, money is moving from technology, energy, and industrials over to health care, consumer staples and financials. From November 8th to early May, the opposite had been the case, with tech, energy and industrials seeing substantial inflows. Health care and biotech did well in both periods. The trend against industrials and materials reflects pessimism that tax reform and an infrastructure rebuild may not come to fruition. We remain optimistic on financials because Trump stands the best chance at scoring victories in cutting the post-financial crisis regulatory load on banks. However, time will tell.

In January, we shared our view that 2017 would be a year characterized by reflation globally, an end to FED easing, and a US economy inspired by the new administration's agenda to increase fiscal spending and get tax reform done. In March, we noted that if this administration wanted to see any success, they needed to govern, and not campaign. We have remained fully invested because we remained optimistic that global growth and strong earnings from Wall Street were going to be the drivers in 2017, and they have been.

As 2017 commenced, we believed potential policy changes would add a tailwind to certain sectors of the market. However, we are coming to the realization that those policy changes are going to be difficult for this administration given its temperament. Having said that, we remain cautious but optimistic. Here is why:

- ***Stocks continue to rally despite bad press for the White House.***
- ***While Congress could not pass Health Care, stocks have curiously continued to climb.***
- ***So, what else is driving the equity markets? When the Philly Fed's Partisan Conflict Index rises above 100, The S&P 500 tends to gain and climb significantly as it has since 2009... I know this sounds counter-intuitive but it is accurate. Apparently, stocks like government gridlock as much as tax reform…***
- ***Philadelphia Fed's Partisan Conflict Index, which is a measure of political disagreement in the United States, when it rises above 100, the S&P 500 has risen at an 11.7 percent annual rate. In contrast, the S&P rises just 5.8 percent when the index is below 100!***



- ***The market surged post-election on the hopes of pro-growth policies such as Tax Reform, deregulation, infrastructure spending et al.***
- ***The essential point is this: <u>Strong equity markets climb walls of worry.</u>***

We are watching these events in Washington and Wall Street for you and will keep you apprised of any changes we see taking place. For now, relax and enjoy this amazing summer.

Finally, our <u>Night Out at The Ballpark</u> Client Appreciation Event will be held on:

- ***Sunday afternoon/evening at Huntington Park on September the 3rd in the Tansky Suite. Game Time this year is: 4:05 p.m. Door prizes and a raffle will be held. We hope to see you there! Please RSVP to Steven or Dominic at 614.901.3400.***