Market Summary – February 13, 2017

For the week ending February 10

This summary is provided by BMT Wealth Management.

A Quiet Week of Economic Data Releases

Last week was relatively quiet on the economic front. The University of Michigan's preliminary report on Consumer Confidence for February, which was released on Friday (Feb. 10), came in at 95.7, down from the decade peak of 98.5, which had been recorded in January. The decline was centered on the "expectations" component of the Index. The reading is still very high, with only five readings higher in the last decade.

Oil prices, as measured by West Texas Intermediate (WTI), declined on Tuesday (Feb. 7) to an interim low of $51.35 in the futures market. Oil traders anticipated an inventory build with Wednesday's (Feb. 8) report from the Energy Information Agency. The report met expectations, as crude oil inventories jumped up by an outsized 13.8 million barrels in the week ending Feb. 3, before prices regained their footing last week and moved more than $2.00/barrel higher based on global demand and production data.

Equity Markets: Tax Cuts and Earnings

Domestic equity markets traded in a narrow range through the first half of last week. On Thursday (Feb. 9), President Trump said there would be a "phenomenal" tax announcement within the next three weeks. Equity markets embraced the news, sending the S&P 500 Index upward to a new intraday high. The Index hit another intraday high on Friday (Feb. 10).

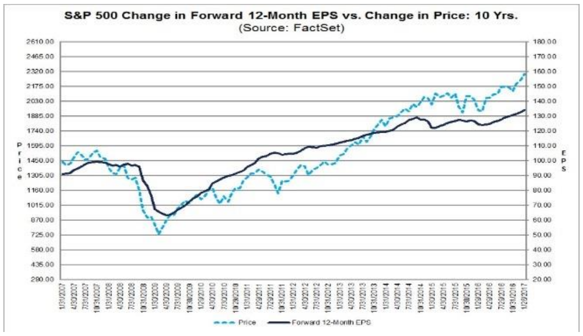
International developed and emerging nations' equity markets took their cue from the U.S. equity markets, also rising in price last week.

The late-week move higher in the equities markets was coincident with a rise in interest rates, based on the market's perception that tax cuts were very much a "front burner" item. Financial Services stocks rallied on the news.

On the earnings front, more than 70% of S&P 500 companies have reported fourth quarter 2016 earnings through Friday. According to FactSet, Inc., those companies are reporting a blended earnings growth rate on a quarter-over-quarter basis of 4.93%. On an economic sub-sector basis, Financial Services and Information Technology are leading to the upside in results. This quarter would represent the first back-to-back quarter of positive sequential growth since the fourth quarter of 2014 and the first quarter of 2015.

Corporate earnings are the key to current and prospective equity valuations. The following graph demonstrates the correlation between share price growth (blue dotted line) and earnings growth on a forward basis (solid black line).

**S&P 500 Change in
Forward 12-Month Earnings per Share
vs. Change in Price
1/2007 – 1/2017**



Source: FactSet, Inc.

The graph shows that recently, the change in share prices has accelerated faster than the forecast for forward earnings growth, thus opening more of a “spread.” The spread began to widen demonstrably beginning in early 2016, and then accelerated again in the post-election period.

Based on FactSet’s 12-month forward earnings per share estimate of $133.54 for the S&P 500, the broad market is trading at 17.2 times forward earnings estimates, which is about 5% above the 20-year historical range of 16.4 times.

Fixed Income

The short end of the U.S. Treasury yield curve was little changed last week. According to market assumptions, there is only a 28% chance that the Federal Open Market Committee (FOMC) will elevate short-term rates at its next meeting, on March 14-15. However, the probability rises to 69% for action at its June 13-14 meeting.

We also find it interesting that the market is assuming a greater than 50% likelihood that there will be two rate hikes executed before the FOMC’s meeting of Oct. 31 – Nov. 1, which would lift overnight rates to the 1.00% - 1.25% range.

At the longer end of the yield curve, 10-year U.S. Treasury bond yields traded in a narrow range the first three days of last week. They then rose on Thursday (Feb. 9), after Trump’s comment about a coming tax announcement. The modest market shift to higher yields assumes that tax cuts and, perhaps, other fiscal reform measures, remain critical items for the new administration and Congress. Since Nov. 30 of last year, both short- and longer-term rates have traded in a very narrow range.

Our View

We are encouraged by the uptick in corporate profits mentioned above, which had stagnated for quite some time.

However, it is important that the specifics of fiscal policy, tax reform, and regulatory legislation take shape quickly, as we see the effectiveness of monetary policy waning with time and its direction having a less supportive impact on economic growth.

In the interim, we would expect bouts of both equity and bond market volatility due to the uncertainty.

BMT in the Press

Bryn Mawr Trust professionals are regularly sought after by the media for their insights on financial matters. The following are some recent highlights.

Energy Shares Lead Wall Street Lower (2/6/2017)
Reuters sought expert insight from Ernie Cecilia, Chief Investment Officer at BMT, about what's driving market behavior most recently. Ernie explained that the markets are awaiting specifics on the substance and timing of policy changes by the Trump administration and the new Congress.

Stocks Drift Lower as Trump Policy Concerns Remain; Energy Off 1% (2/6/2017)
Ernie Cecilia spoke with CNBC.com to share his market outlook. Ernie explained that he and the BMT investment team are keeping a close watch on the timing and shape of tax cuts and regulatory changes coming from the new administration. In particular, BMT's focus is on the timing and extent of corporate tax cuts.

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