Market Summary – November 13, 2017

For the week ending November 10

This summary is provided by BMT Wealth Management.

Tax Reform in the Spotlight

Tax reform debate is in high gear in Washington. The House Ways and Means Committee passed its version of tax reform last Thursday (Nov. 9), and the legislation will go to the full House for a vote this week.

The Senate Finance Committee will be working on its version of tax reform this week, with a target of late November (post-Thanksgiving) for a full Senate vote.

Information made public about the Senate tax plan reveals stark differences between it and the House version. The following are the main tenets of each:

House Bill
- Four individual tax brackets, with a top rate of 39.6%
- Corporate tax rate reduced to 20% (from 35%), effective in 2018
- State and Local Tax (SALT) deductions eliminated, except that property taxes up to $10,000 may be deducted
- Estate tax exemption doubled to $11 million per person until 2024

Senate Bill
- Seven individual tax brackets, with a top rate of 38.5%
- Corporate tax rate reduced to 20% (from 35%), but delayed until 2019
- State and Local Tax (SALT) deductions eliminated, with no exceptions
- Estate tax exemption doubled to $11 million per person, with no stated end date

Both versions include elimination of the personal exemption and a doubling of the standard deduction. Also, both bills include elimination of the alternative minimum tax and an expansion of the child tax credit.

The final version of the tax bill, if enacted, will likely be different from either version noted above and reflect compromises, probably around corporate taxation.

But, smooth passage of a bill, given slim GOP majorities and discordance within the GOP, is less than certain. There is also a view that Democratic election victories in Virginia and New Jersey last Tuesday (Nov. 7), elevated the urgency by the incumbent party to achieve some legislative successes before the mid-term elections in November 2018.

Domestic Equities: Uneven Performance

We have commented before on the uneven performance of U.S. equities as it relates to market capitalization.

Smaller-capitalization stocks performed well coming out of the November 2016 elections, but with the failure by the GOP to develop viable legislation to replace the Affordable Care Act, small cap stocks (red line in the graph below) and mid-cap stocks (gold line) have notably underperformed large cap issues (blue line) in 2017.

There have been fits and starts, for sure. Smaller-cap stocks underperformed in July and into late

August, as confidence in the passage of tax reform legislation was fading. Conversely, as tax reform became a "front burner" item, smaller-cap issues rallied relative to their larger-cap brethren into early October, before once again giving ground to larger-cap issues.

Relative Performance of
U.S. Large Cap, Mid-Cap, and Small Cap Stocks:
Year to Date

Source: FactSet, Inc.

The importance of corporate tax reform is critical to the sustainability of this long-dated economic expansion, as it relates to improving GDP growth. For smaller-cap issues, which derive a larger share of revenues and profits from domestic sources, the impact of lower corporate taxation is most significant.

What About Earnings?

Third quarter earnings reporting season is winding down, with more than 90% of S&P 500 companies having reported results through Friday (Nov. 10). FactSet, Inc. indicates that the blended year-over-year earnings growth rate is a little north of 6%, which is lower than the 10.43% earnings growth last quarter, but still quite strong.

Even more impressive, however, is that revenue (top line) growth is ahead almost 5.5% this quarter, well above the 25-year average of around 4%.

Looking Ahead

The continued good news on earnings (and revenues) remained supportive of equity prices last week. The S&P 500 registered another new all-time high by mid-week, before giving back some gains in the latter part of the week.

When details of the Senate's version of the tax bill were released early on Thursday (Nov. 9), indicating a delay until 2019 for the proposed reduction of the corporate tax rate to 20%, volatility returned to the equity markets.

The U.S. Treasury yield curve shifted higher last week, leading to negative returns for fixed income. The two-year and 10-year U.S. Treasury notes increased four basis points (0.04%) and seven basis points (0.07%), respectively, and ended the week at 1.67% and 2.40%. Credit spreads widened during the week, as investors favored U.S. government obligations over corporate issuers.

In the current environment, domestic equity indices reflect full valuation based on earnings prospects on a 12-month going-forward basis, which makes the issue of tax reform so imperative. We continue to believe that several offshore equity markets offer attractive opportunities for investors.

We remain overweight in investment-grade credit versus government debt, and we are holding portfolio durations near benchmark levels in our fixed income mandates.

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.

7 Signs America's Economic Growth Will Keep Booming (11/8/2017)
With consumer spending at record highs, Kiplinger asked Ernie Cecilia, Chief Investment Officer at BMT, to interpret the implications for the U.S. economy. Ernie explained that consumers make up a significant portion of our country's GDP and therefore are the engine that keeps our economy moving. *(Scroll to slide 4 of the article for Ernie's comments.)*

What Income Investors Can Expect from Rising Rates (11/8/2017)
U.S. News & World Report turned to Jim Barnes, Senior Vice President and Director of Fixed Income at BMT, in anticipation of an interest rate hike at the Fed's December meeting. Jim offered his take on how investors should reevaluate their exposure to bonds, but underscored the importance of consulting with a fixed income expert before making any drastic changes.

U.S. Stocks Fluctuate as Dollar, Treasuries Rise: Markets Wrap (11/13/2017)
As earnings season winds down, Bloomberg asked Ernie Cecilia, Chief Investment Officer at BMT, what will drive market activity through the end of the year. Ernie explained that the BMT team is keeping a close eye on tax reform on behalf of clients, as regulatory changes usually have a significant impact on the markets.

BMT Wealth Management
Ernest E. Cecilia, CFA | Chief Investment Officer
610.254.2030 | ececilia@bmtc.com
bmtc.com/wealth