JULY 2018 COMMENTARY

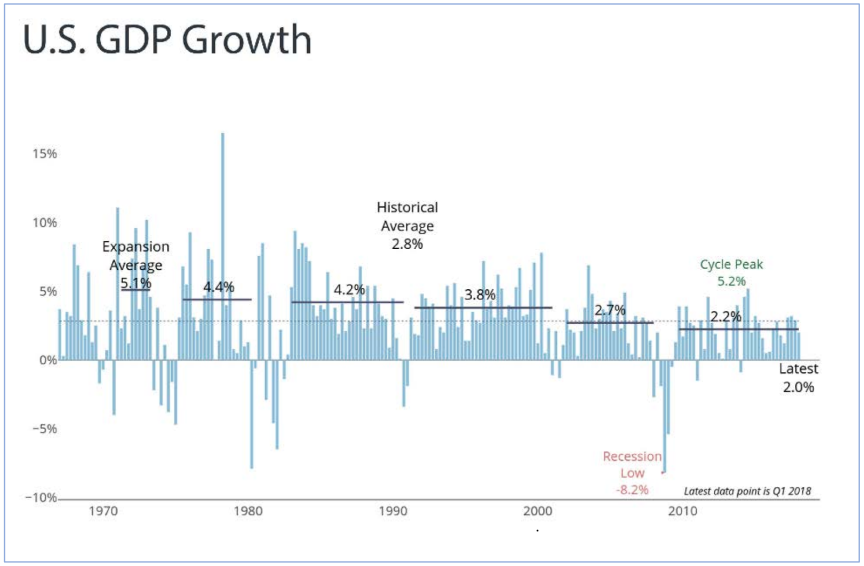
Despite short-term concerns around trade wars, markets are driven in the long run by economic trends. Historically, healthy economic growth supports stock returns while economic downturns result in market pullbacks. Thus, understanding where we are in the business cycle matters much more than day-to-day market movements.

Fortunately, the U.S. economy continues to look healthy. Last week's jobs report showed that 213,000 jobs were created in June, with wage growth that accelerated to 2.7%. GDP grew by 2% in the first quarter and is estimated to have grown 3.5-4% in the second. The Fed continues to raise rates slowly and steadily in response to solid growth. All in all, this is still a good time to be invested, especially with a balanced portfolio tailored to long-term financial goals.

While the economy has come a long way over the past nine years, not everything is rosy. In terms of the sheer pace of growth, this is still the slowest recovery on record. The yield curve, which often functions as an early warning sign of the late stages of an economic cycle, is extremely flat with long-term interest rates still stubbornly low. Still, these dynamics have been enough to generate exceptional corporate earnings growth. This in turn has supported strong stock market returns for those investors who stayed balanced after 2008.

Thus, in general, a healthy economy supports investment returns. While it's clear we're in the later stages of this business cycle, this is yet another reason for many investors to maintain a balanced portfolio and focus on long-term planning. Two charts illustrate where we are in the business cycle:

1. The economy is still healthy



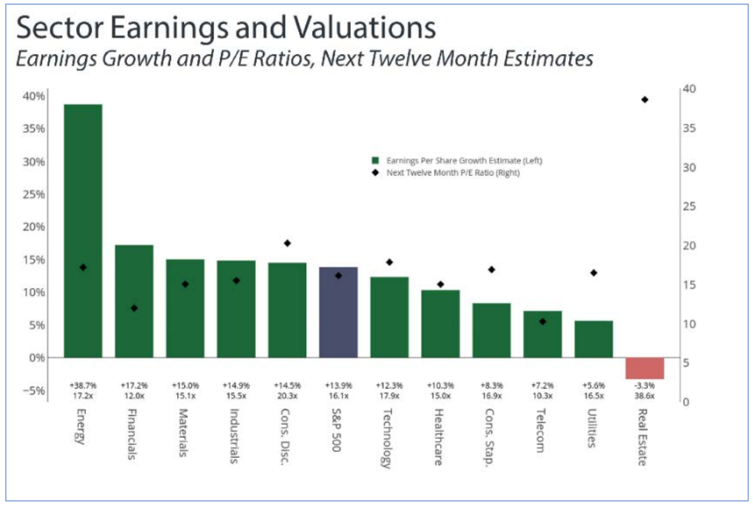
Source: U.S. BEA, NBER   © 2018 Clearnomics, Inc.

The good news is that, despite being in the tenth year of the economic expansion, the economy is still healthy. GDP growth in the first quarter measured 2%, a healthy pace that is around the cycle average, and is expected to accelerate in the second quarter. This is also the second longest economic expansion on record - only the 1990's was longer.

The bad news is that the average pace of economic growth has slowed over time. The chart above clearly shows that the rate of economic growth over the past 50 years has declined with each cycle. This is due to a variety of factors, including an aging demographic and falling productivity growth.

Ultimately, it's not just about the pace of growth - the fact that growth has been steady has been enough to push unemployment to historically low levels and generate strong corporate profits, pushing stocks to record highs.

2. Earnings continue to grow



Source: Thomson Reuters, Standard & Poor's ©2018 Clearnomics, Inc.

While we've emphasized the importance of economic growth, this only matters to investors if it translates into growth in corporate profits. After all, investors take advantage of the long- run growth in the economy by buying shares of major corporations. Even if stocks move randomly in the short run, they tend to follow earnings in the long run.

Expectations for corporate earnings have actually accelerated even as market volatility has increased. This disconnect, which represents more attractive market valuations, could help to support long-run stock market returns. Over the next twelve months, earnings for the S&P 500 are expected to grow by nearly 15%. Many sectors may grow even more quickly, creating opportunities for diversified investors.

The key takeaway for investors? While this may be a volatile market in the short-run, long-term economic growth is still healthy. This should continue to support returns for well-diversified investors.

Sincerely,

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