

Steady Growth Pushes Markets Ever Higher

An uptick in U.S. economic growth, along with continued economic momentum in international economies, led to a broad-based extension of the global stock market advance in the second quarter of 2017. The U.S. markets rose +3.0% for the quarter and are now up +8.9% through June 30, 2017. Overseas, both developed and Emerging Market stocks outpaced domestic stocks again and have now risen +13.8% and +18.4%, respectively, since the beginning of the year.

These positive market developments are the result of numerous indications of healthy economic growth, both here and abroad. As the chart at the bottom of this page shows, Global Purchasing Managers' Indi-

ces, an important group of survey-based leading economic indicators, remain solidly in growth mode around the world (readings above 50 indicate expectations of expansion). Domestically, the labor market remains strong, consumer spending continues to rise, and financial conditions remain loose and accommodative for companies looking to expand. We are seeing very few signs of excess building in the U.S. economy, despite an expansion that is entering its ninth year. Absent an exogenous shock, there appear to be few reasons why this economic cycle cannot continue into 2018 and beyond.

In the Eurozone, the lagged impacts of a weaker currency and lower rates pushed growth above expectations in the second quarter of 2017. While potential changes to U.S. trade policy remain a wildcard, emerging market economies are also benefitting

Global Purchasing Managers' Index for manufacturing		Jul'15	Aug'15	Sep'15	Oct'15	Nov'15	Dec'15	Jan'16	Feb'16	Mar'16	Apr'16	May'16	Jun'16	Jul'16	Aug'16	Sep'16	Oct'16	Nov'16	Dec'16	Jan'17	Feb'17	Mar'17	Apr'17	May'17	Jun'17
Global		50.8	50.5	50.4	51.0	51.0	50.7	50.9	50.0	50.6	50.2	50.1	50.4	51.0	50.8	51.1	52.0	52.1	52.7	52.8	53.0	53.0	52.7	52.6	52.6
Developed Markets		52.5	52.4	52.1	53.0	52.6	52.0	52.3	50.9	50.9	50.4	50.2	50.9	51.5	51.3	51.6	52.8	53.2	54.0	54.4	54.4	53.9	54.0	54.6	53.9
Emerging Markets		48.8	48.3	48.3	48.9	49.1	49.2	49.2	48.8	50.0	49.5	49.5	49.3	50.1	49.9	50.0	50.7	50.7	51.3	50.8	51.2	51.4	50.8	50.6	50.8
U.S.		53.8	53.0	53.1	54.1	52.8	51.2	52.4	51.3	51.5	50.8	50.7	51.3	52.9	52.0	51.5	53.4	54.1	54.3	55.0	54.2	53.3	52.8	52.7	52.0
Canada		50.8	49.4	48.6	48.0	48.6	47.5	49.3	49.4	51.5	52.2	52.1	51.8	51.9	51.1	50.3	51.1	51.5	51.8	53.5	54.7	55.5	55.9	55.1	54.7
UK		52.3	51.8	51.5	54.5	52.5	51.2	52.5	50.9	51.1	49.5	50.4	53.1	48.3	53.5	55.3	54.2	53.5	55.9	55.6	54.6	54.0	57.0	56.3	54.3
Euro Area		52.4	52.3	52.0	52.3	52.8	53.2	52.3	51.2	51.6	51.7	51.5	52.8	52.0	51.7	52.6	53.5	53.7	54.9	55.2	55.4	56.2	56.7	57.0	57.4
Germany		51.8	53.3	52.3	52.1	52.9	53.2	52.3	50.5	50.7	51.8	52.1	54.5	53.8	53.6	54.3	55.0	54.3	55.6	56.4	56.8	58.3	58.2	59.5	59.6
France		49.6	48.3	50.6	50.6	50.6	51.4	50.0	50.2	49.6	48.0	48.4	48.3	48.6	48.3	49.7	51.8	51.7	53.5	53.6	52.2	53.3	55.1	53.8	54.8
Italy		55.3	53.8	52.7	54.1	54.9	55.6	53.2	52.2	53.5	53.9	52.4	53.5	51.2	49.8	51.0	50.9	52.2	53.2	53.0	55.0	55.7	56.2	55.1	55.2
Spain		53.6	53.2	51.7	51.3	53.1	53.0	55.4	54.1	53.4	53.5	51.8	52.2	51.0	51.0	52.3	53.3	54.5	55.3	55.6	54.8	53.9	54.5	55.4	54.7
Greece		30.2	39.1	43.3	47.3	48.1	50.2	50.0	48.4	49.0	49.7	48.4	50.4	48.7	50.4	49.2	48.6	48.3	49.3	46.6	47.7	46.7	48.2	49.6	50.5
Ireland		56.7	53.6	53.8	53.6	53.3	54.2	54.3	52.9	54.9	52.6	51.5	53.0	50.2	51.7	51.3	52.1	53.7	55.7	55.5	53.8	53.6	55.0	55.9	56.0
Australia		50.4	51.7	52.1	50.2	52.5	51.9	51.5	53.5	58.1	53.4	51.0	51.8	56.4	46.9	49.8	50.9	54.2	55.4	51.2	59.3	57.5	59.2	54.8	55.0
Japan		51.2	51.7	51.0	52.4	52.6	52.3	50.1	49.1	48.2	47.7	48.1	49.3	49.5	50.4	51.4	51.3	52.4	52.7	53.3	52.4	52.7	53.1	52.4	
China		47.8	47.3	47.2	48.3	48.6	48.2	48.4	48.0	49.7	49.4	49.2	48.6	50.6	50.0	50.1	51.2	50.9	51.9	51.0	51.7	51.2	50.3	49.6	50.4
Indonesia		47.3	48.4	47.4	47.8	46.9	47.8	48.9	48.7	50.6	50.9	50.6	51.9	48.4	50.4	50.9	48.7	49.7	49.0	50.4	49.3	50.5	51.2	50.6	49.5
Korea		47.6	47.9	49.2	49.1	49.1	50.7	49.5	48.7	49.5	50.0	50.1	50.5	50.1	48.6	47.6	48.0	48.0	49.4	49.0	49.2	48.4	49.4	49.2	50.1
Taiwan		47.1	46.1	46.9	47.8	49.5	51.7	50.6	49.4	51.1	49.7	48.5	50.5	51.0	51.8	52.2	52.7	54.7	56.2	55.6	54.5	56.2	54.4	53.1	53.3
India		52.7	52.3	51.2	50.7	50.3	49.1	51.1	51.1	52.4	50.5	50.7	51.7	51.8	52.6	52.1	54.4	52.3	49.6	50.4	50.7	52.5	52.5	51.6	50.9
Brazil		47.2	45.8	47.0	44.1	43.8	45.6	47.4	44.5	46.0	42.6	41.6	43.2	46.0	45.7	46.0	46.3	46.2	45.2	44.0	46.9	49.6	50.1	52.0	50.5
Mexico		52.9	52.4	52.1	53.0	53.0	52.4	52.2	53.1	53.2	52.4	53.6	51.1	50.6	50.9	51.9	51.8	51.1	50.2	50.8	50.6	51.5	50.7	51.2	52.3
Russia		48.3	47.9	49.1	50.2	50.1	48.7	49.8	49.3	48.3	48.0	49.6	51.5	49.5	50.8	51.1	52.4	53.6	53.7	54.7	52.5	52.4	50.8	52.4	50.3

Source: Markit, J.P. Morgan Asset Management.
Heatmap colors are based on PMI relative to the 50 level, which indicates acceleration or deceleration of the sector, for the time period shown.
Guide to the Markets – U.S. Data are as of June 30, 2017.

from this broad developed market strength.

Bond markets continue to show resiliency as well, with the Barclay's Aggregate up +1.5% for the second quarter, and now up a respectable +2.3% for the year. The U.S. 10-year Treasury bond yield fell slightly, from 2.39% to 2.27%, despite another increase in the Federal Reserve's benchmark overnight rate to a range of 1.0% - 1.25% at the June meeting. The Fed has raised rates three times since December 2016 and now seems to have settled into a rate normalization path that is being well accepted by the fixed income markets. While rates remain low enough to provide inexpensive capital for corporate and consumer lending, the recent increases are beginning to put the Federal Reserve in a position where they can either act to stem harmful inflation that may emerge (by raising rates further) or stimulate a slowing economy (by lowering rates again) as dictated by conditions later in the cycle. This flexibility will be important as the end of the current economic expansion approaches.

In the meantime, Americans who rely heavily on the income from savings may want to start reacquainting themselves with an old, long-absent friend: interest income. While current interest rates on CDs, money markets and other deposit accounts remain quite low, history suggests that they will not stay that way if the Federal Reserve continues to tighten. The last time the Fed Funds rate was at 1.25% in a rate-raising cy-

cle was in the summer of 2004. By the time that cycle was over three years later, national average CD rates had risen to approximately 4%. The return of similar rates of return on safe, short-term investments during this cycle would definitely be a welcome development for savers.

Despite these broadly positive trends, we are growing increasingly concerned that elevated market and business sentiment is leading to an unhealthy level of complacency in the markets. The CBOE VIX, a widely used "fear gauge" measure of implied market volatility, is at its lowest levels since 2007. As a result, we remain mostly neutral in our stock exposure for clients.

Additionally, we are generally underweight fixed income investments in our client portfolios. While today's bond prices can be justified given the general lack of inflation in the U.S. markets, we do not believe the current yields are adequately compensating investors for the risks of stronger growth and the potential for tighter monetary policy. Instead, we prefer the optionality of cash in this environment and are holding slightly elevated levels in anticipation of a return of volatility and, perhaps, new opportunities in the markets in the second half of the year. We also continue to search diligently for alternative investments that can provide truly differentiated sources of return.

Total Return (%), Ending 6/30/2017	Annualized					
	Qtr	YTD	1 Year	3 Years	5 Years	10 Years
MSCI All Country World Index	4.27	11.48	18.70	4.79	10.50	3.70
Russell 3000 Stock Index	3.02	8.93	18.43	9.06	14.53	7.23
S&P 500 Stock Index	3.09	9.34	17.82	9.56	14.57	7.15
Russell 2000 (Small Cap Stocks)	2.46	4.99	24.50	7.32	13.65	6.89
MSCI EAFE (International Stocks)	6.12	13.81	20.18	1.14	8.66	1.02
MSCI EMF (Emerging Markets)	6.27	18.43	23.64	1.07	3.94	1.91
Barclays US Aggregate Index	1.45	2.27	-0.31	2.47	2.20	4.46
FTSE NAREIT All Equity REITs	2.27	4.88	0.22	8.82	9.91	6.19
CPI (through February 2017)	0.47	1.46	1.63	0.92	1.35	1.76

There is no assurance that expectations expressed in this article will prove to be correct. Past performance is not indicative of future results. Investment in securities, including mutual funds and ETFs, may result in loss of income and/or principal. Nothing in this article is intended to be or should be construed as individualized investment advice. Investors should consult their Cobblestone advisors for tailored advice. Any references to third-party data or opinions are listed for informational purposes only and have not been verified for accuracy by the Advisor.