Midyear Market Update

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At the beginning of the year, markets were concerned about an impending recession. We experienced our second correction in about six months in January and market participants feared the downward cycle would continue. However, after first-quarter earnings came in, it became apparent that this wouldn't be the case and markets were on the road to recovery.

As we round out the first half of the year, it appears the equity markets are continuing to rebound from the earlier corrections and the stock market is dotting along an upward trend.

Pending second-quarter earnings news, our focus for the second half of 2016 is no longer on a looming recession. Instead, we're keeping an eye on three themes: energy, interest rates and the U.S. dollar.

Energy

When you take a look at earnings over the last four years, it appears we haven't made much progress. However, there is a valid reason for this and the market is well aware of it. Stagnant market earnings over recent years can almost entirely be attributed to the energy sector. Not only is the sector failing to contribute earnings, they are generating losses.

The good news, however, is that while energy companies' bottom lines are hurting due to low oil prices, those prices should somewhat recover and move higher, and consumers in the meantime are able to pocket the extra savings from the pump. As results from the second quarter unfold, we are keen to see where consumers are spending their energy savings and will be keeping an especially close eye on the consumer discretionary sector, which we expect to benefit the most from low energy prices.

Interest Rates

Current inflation data does not support a significant hike in interest rates. While there was a lot of talk about the Fed moving rates higher leading up to the FOMC meeting in mid-June, a weak jobs report suppressed any drastic measures. That said, we do expect minimal rate increases within the next year, and our economy appears stable enough to absorb these moves without major market fluctuations.

However, inflation could eventually be impacted by aftereffects of the Troubled Asset Relief Program (TARP) and quantitative easing. These programs have created the kindling for inflation growth. The Fed is closely monitoring this and, as it relates to interest rates, will likely try to stay ahead of inflation levels.

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U.S. Dollar
The U.S. dollar has come off of its highs from earlier in the year, but relative to long-term trends, we feel it is still overvalued. Fundamentally, there is a large supply of dollars, which has and should continue to drive the value lower, though we're not seeing as much of a decline as we'd expect.

We believe this is largely because investors realize they can make more money in the U.S. than in Europe because of the latter region's economic issues. As the situation in Europe starts to improve, we expect the larger dollar supply to begin impacting its value. This is something we'll be monitoring for in the second half of the year.

Overall, as we look at the economy from a big-picture perspective, we are optimistic about the second half of the year. Even though there have been some bumps along the way – and there will continue to be – we believe households are much healthier than they have been and that equity markets are priced appropriately.

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