August 2017

Economic & Market

Forecast

A monthly report issued by the advisors at KPP Financial

ECONOMY

Economic figures continued to decelerate in July and some hit outright contraction. Construction spending was down 1.3% month over month in June, but remains up 1.6% year over year; however the trend looks to have peaked in March. Real personal income remains sluggish and vehicle sales have clearly peaked for the cycle and are likely to continue lower for the next couple years on the back of record oversupply in the used and new inventory market. One main positive is that consumers continue to spend at a modest clip with real core personal consumption expenditures still positive, albeit very modestly. Also, the weaker dollar has given new life to the manufacturing industry along with a more favorable regulatory environment in Washington. Financial conditions also remain very loose with risk spreads on credit as low as they have been in years. Commercial and industrial loan growth remains flat from the beginning of the year which is a worry since loan growth is crucial to the Fed's economic plan. Credit card and auto loans in particular have started to contract. Overall, GDP growth remains subdued and absent major policy approval in Washington, it is hard to see a catalyst to break us out of this funk.

U.S. EQUITIES

July was a positive month for domestic equities, except for the Russell 2000, which represents small cap companies, which was flat. Most sectors were up, but the most interesting sector that sustained losses was transportation, which was down 4% on the month. This is a trend that must be watched and weighted heavily. Semiconductors also failed to reach new highs after a tough June which is always the most important technology sector to study for the broader economy. Most other risk centric sectors did well however which gives the current market a mixed technical perspective. Earnings have come in ok, but we have not had any earnings growth from 2013 which makes valuations stretched. Many of the FANG stocks rallied on high volume mid-month, but sold off into the end of the month. They look tired and ready for a major correction in the near term. Look for volatility to pick up during the month of August.

FOREIGN EQUITIES

The weakness in the dollar along with a more upbeat economic environment fueled a strong month for equities abroad. Valuations remain attractive compared to those in the US, but geopolitical risks out of North Korea and Syria remain top of mind. The political environment in Europe has calmed for now due to the economic recovery fueled my massive ECB bond buying. China has fared well so far under the Trump Administration despite the rhetoric during the campaign that threatened our relationship with the second largest economy in the world. Meanwhile in South America there is a budding civil war brewing in Venezuela which could have an impact on the oil markets and emerging market bond spreads as well. The German DAX had a rough month, down 6.5% from mid-June, which is curious considering the ongoing strength in Europe. This must be watched.

FIXED INCOME

The Fed announced no change to their policy, but indicated that they will likely announce a slowing of bond repurchases during their next meeting in September that will likely commence in October. The market reaction was muted and risk spreads did not seem to mind the threat to reduce liquidity in the system. All in all rates and credit flow remain strong in the bond market. Oil price strength has lightened worries about the sector, but retail risk remains somewhat elevated. Problems in the auto market are also picking up as sales declines and weak used car values are hurting many names in the sector. Expect many bankruptcies from this area of the market over the next couple of years.

COMMODITIES

Gold and silver had a very strong month and look poised to break out sooner rather than later. Agriculture commodities had a choppy month, but also look strong after a powerful reversal in June. Oil back above $50 a barrel due to geopolitical problems in Venezuela and threats from OPEC that they may extend production cuts beyond March of 2018. Either way those situations break we continue to expect oil prices to remain range bound as domestic shale producers will pump to sustain their large debt loads. Do not be surprised if we see oil with a 3-handle at some point by year end due to a continually oversupplies market.

Recommended Portfolio Weightings

As of July 31, 2017

Equity Sectors

Overweight	Neutral	Underweight
Telecom	Consumer Staples	Technology
Utilities	Materials	Consumer Discretionary
		Health Care
		Industrials
		Financials
		Energy

Asset Classes

Overweight	Neutral	Underweight
Precious Metal Commodities	REITs	U.S. Mid-Cap Stocks
Short-Term Investment Grade Bonds	Emerging Market Stocks	U.S. Large Cap Stocks
Agriculture Commodities	Long-Term Investment Grade Bonds	High Yield Bonds
Cash Alternatives	International Developed Fixed Income	U.S, Small-Cap Stocks
Resource Commodities		International Developed Stocks
Intermediate-Term Investment Grade Bonds		International Emerging Market Fixed Income

Fixed Income

Overweight	Neutral	Underweight
TIPS	Municipal Bonds	Bank Loans
	Agency Securities	Mortgage-backed Securities
	U.S. Treasuries	Preferred Securities
	Corporate Bonds	

Economic & Market Forecast

Data Point	Current	Year-end Projection
S&P 500	2,470	2100-2125
NYSE	11,967	10,000 -10,300
10-Year	2.29%	2.4-2.6%
Crude Oil	$50.17	$40-45
Gold	1,273	1,475-1,525
Dollar Index	92.86	90-95
Effective Fed Funds Rate	1.16%	1.16 %

Disclaimers

There is no assurance that any of the target prices or other forward-looking statements mentioned will be attained. Any market prices are only indications of market values and are subject to change. Past performance is no guarantee of future results.

The prices of small and mid-company stocks are generally more volatile than large company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.

Technology and Internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

There are special risks associated with investing in preferred securities. Preferred securities generally offer no voting rights with respect to the issuer. Preferred securities are generally subordinated to bonds or other debt instruments in an issuer's capital structure, subjecting them to a greater risk of non-payment than more senior securities. In addition, the issue may be callable which may negatively impact the return of the security. Preferred dividends are not guaranteed and are subject to deferral or elimination.

Income from municipal securities is generally free from federal taxes and state taxes for residents of the issuing state. While the interest income is tax-free, capital gains, if any, will be subject to taxes. Income for some investors may be subject to the federal Alternative Minimum Tax (AMT).

Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline of the value of your investment. Investing in fixed income securities involves certain risks such as market risk if sold prior to maturity and credit risk especially if investing in high yield bonds, which have lower ratings and are subject to greater volatility.

All fixed income investments may be worth less than original cost upon redemption or maturity.

Although Treasury Inflation-Protected Securities (TIPS) are considered free from credit risk, they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate, and deflation risk, which may cause the principal to decline and the securities to underperform traditional Treasury securities. TIPS have special tax consequences, generating phantom income on the "inflation compensation" component of the principal. A holder of TIPS may be required to report this income annually although no income related to "inflation compensation" is received until maturity.

The yield, average life and the expected maturity of mortgage-backed securities are based on prepayment assumptions that may or may not be met. Changes in prepayments may significantly affect yield, average life and expected maturity.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. These risks are heightened in emerging markets.

Investments in the energy sector are subject to the adverse economic events within that industry. A downturn in the energy sector of the economy, adverse political, legislative or regulatory developments or other events could have a large impact on a portfolio's investments in this sector.

Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks.

Real Estate investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions.

Additional information available upon request.

Past performance is not a guide to future performance.

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