



THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – JULY

US Markets and Economy:

US stocks rallied again to new all-time highs in July, led by the Dow Jones Average, which gained almost 500 points for the month, and approached another milestone at 22,000. (It closed above this level in early August.) The S+P 500 Index gained almost 2%, and approached its own milestone of 2,500. The NASDAQ Index, driven by soaring tech stocks, recovered from a weak June and rallied almost 4%, briefly breaking through 6,400 near the end of the month. The bull market which began in March 2009, is now in its ninth year, and is the second longest in US history.

The economic news was good. The first report on US GDP growth for the second quarter (April-June) did in fact show a pickup to 2.6% growth from a weak 1.2% growth rate in the first quarter. Although this was a bit of a disappointment, since forecasters had been expecting 3% or more, the rest of the year should show this kind of slow but steady growth which has helped support stocks in recent years. The US labor market continues to show strong growth, with unemployment in July back down to 4.3%, and employment rising by over 200,000, which is a faster pace than in recent months. Wage gains have now risen to 2.5% at an annual rate, which is ahead of inflation of 1.5%. (July employment statistics were reported by the Department of Labor in early August.)

With inflation remaining low, Wall Street is now forecasting no more than one more ¼-point increase in the Federal Funds rate this year, with another smidgen of tightening in September as the Fed finally begins the process of shrinking its balance sheet. The process of Quantitative Easing (QE), which the Fed put in place to boost the economy after the Great Recession, dramatically increased the Fed's holdings of long-term Treasury and mortgage bonds. When QE finally stopped, the Fed was holding an unprecedented *\$4.5 trillion* of securities. The current plan is to very gradually reduce these holdings to more normal levels. The Fed will start the process by no longer reinvesting in new securities ("rolling over" all of the proceeds from its long-term holdings which mature every month). Although the details are not definitive yet, it is likely that, starting in September, the Fed will allow about \$10 billion a month in newly maturing long-term securities to "run off," that is, not be replaced with new securities. This process will very slowly reduce its overall securities holdings, and could exert some very slight upward pressure on long-term interest rates. In July, long-term rates did not show any net change,

staying around 2.3% on the US 10-year note, which suggests that the bond markets are facing the “run off” with equanimity.

In July, the broad trade-weighted US dollar index continued its 2017 decline. The dollar has now retraced all of its gains since the November 2016 election and is actually at its lowest level in the last 15 months. This is good news for American exporters, who should be able to boost international sales, which will boost US GDP growth. . It is not such good news for American consumers, who could face higher prices for imports. But, as we have noted above, there is no sign as yet that inflation is picking up as a result of this decline of the dollar.

World Markets and Economy:

European blue-chip stocks marked time in July, ending almost flat, as measured by the EUROSTOXX 50 Index. This index is up over 20% for the last year, however, as the European economy continues a slow recovery from its economic funk. Much of the gains have been driven by the European Central Bank’s (ECB) policy of easy money and negative nominal interest rates. The latest good news for Europe is that the Greek government, “the sick man of Europe”, was actually able to sell new bonds to investors in June, at an interest rate of less than 5%. Although Greek stocks were flat in July, they have gained over 50% in the past year. In addition, Spain, which has also suffered mightily since 2009, is also showing more signs of sustained economic growth. Although Spain’s IBEX Index was also flat in July, it has gained over 30% in the last 12 months. On the other hand, Germany, the powerhouse of the European economy, saw its stocks fall in July, mostly because the flip side of the weaker dollar this year has been a stronger euro. German export growth is crucial for German economic growth and corporate profits, and a more expensive euro could eventually slow the German export machine.

Tokyo stocks were flat for the month, although the Nikkei Index has gained 27% over the last 12 months. Signs of growth in the Japanese economy have been offset by fears of political instability in Japan and on the Korean peninsula. Prime Minister Abe is now embroiled in several scandals involving his government, and his popularity ratings have plummeted. At the same time, continued testing of ballistic missiles by North Korea have raised regional tensions sharply.

OUTLOOK:

The US bull market continues to move forward, driven by rising corporate earnings, low interest rates, low inflation, and economic recoveries in Europe and Japan. The economic outlook has been brightening, which could be enough to drive the stock market higher for another year, which would then make the bull market the longest in US history.