Market Update
February 2017
By Scott D. Ehrig, CIMA®, CFP® and Peter J. LaBella, CFP®

Market Update – February, 2016

The Trump Rally continued in earnest in February, lifting equity markets to previously unseen heights on a surge of optimism. Signs of economic expansion around the globe are spreading, and investors responded by selling bonds and pushing equity indexes to record levels. The bull market in stocks just marked its eighth year of gains. Even the Federal Reserve has weighed in, with a clear pivot toward monetary tightening discernable in the rhetoric of its leaders. It's all very exciting… to which we say:

"Take a deep breath"

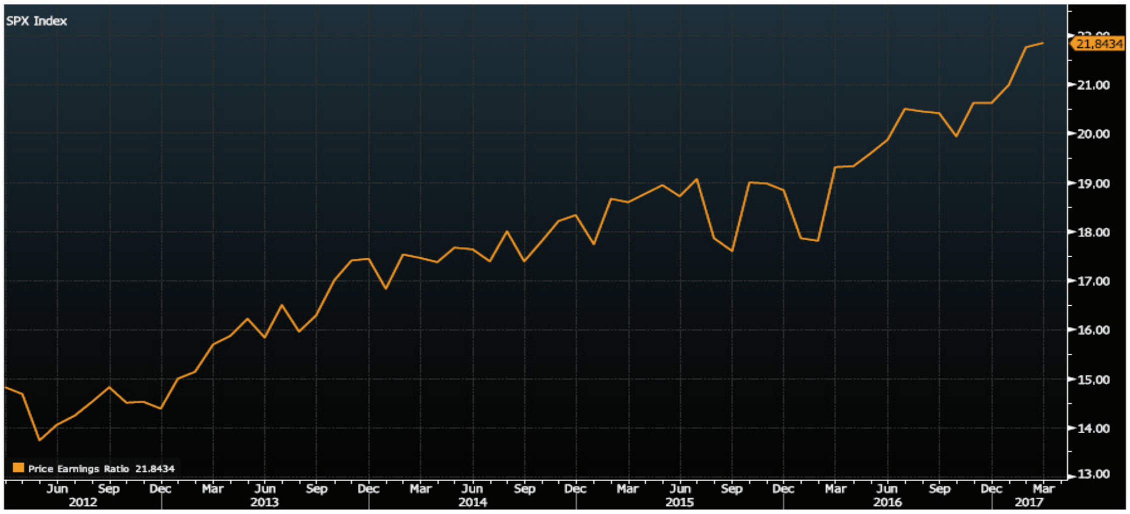
As your advisor, it is paramount that we separate fact from fiction, euphoria from legitimate strength, and despair from true value. And what we see right now is a market that has ascribed too much faith and credit to the new President's fiscal policies and plans. As we have pointed out previously, the gap between the stock market's assumptions regarding future growth and the economic reality on the ground is difficult to square. The higher stocks run, the more difficult the reconciliation becomes.

True, there are encouraging signs of growth from different regions around the globe. And yes, business owner confidence is higher than it has been in more than a decade. Those are decidedly positive indicators. Stocks have charged to dizzying heights on expectations for stronger corporate earnings and accelerating growth (Gross Domestic Product – GDP), pricing in the benefits of tax reform, less regulation, and increased spending on infrastructure projects and the military.

But what happens if some (or all) of those policy changes are not achieved? Tax reform, for example, is notoriously difficult to accomplish. Most readers will remember 1986, the last time Congress came together to revise the Code in a meaningful way. What many may not recall is that entrenched special interests nearly killed the proposed changes which eventually became law. It required a tremendous amount of heavy lifting by several true leaders at the time: James Baker, Bill Bradley, Bob Packwood and Dan Rostenkowski. Does anyone see such leadership on Capitol Hill today, with a sense of shared purpose and a willingness to "trade horses" in the spirit of compromise? We certainly do not. Indeed, we take a very dim view of the prospects for real statesmanship and bipartisan cooperation, which will almost certainly be needed if meaningful change is to occur. Similarly daunting obstacles stand between rhetoric and reality with respect to infrastructure spending, as well, which leads to our cautious outlook. The equity markets are priced to near-perfection and ripe for disappointment when actual policies and subsequent corporate earnings fall short.

February 2017

Market Update



Source: Bloomberg

The accompanying chart illustrates how expensive stocks are. The Price to Earnings (or P/E) ratio shows how much investors are willing to pay for a dollar's worth of earnings. As that figure climbs, it illustrates how richly valued equities have become.

Interest rates are likely to climb. Strong employment data in the jobs report last Friday has cleared the path for the Federal Reserve to raise short term interest rates, which will be their third such move since the financial crisis. Firming inflation and accelerating wage growth are exactly what Fed officials were hoping to see, and the unemployment rate ticked down to 4.7%. The economy continues to grow at a moderate pace, and the reasons the Fed had previously articulated for keeping rates low have all been rendered moot.

What does all this mean for the management of your investments? We continue to stress quality in our equity selection process, favoring companies with strong balance sheets and healthy dividends. Those attributes tend to put a firmer base under their respective stock prices, so we expect them to be less volatile in periods of market stress. We also continue to rebalance portfolios to trim equity positions which have swelled toward the upper range of their allocation targets. In so doing, we are paring back on equities and deploying those funds in shorter duration fixed income investments. We are also comfortable building modest cash cushions to enable us to be a bit more defensive in the present and opportunistic when markets retreat, as they inevitably will.

Thank you, as always, for the confidence you have placed in us as your advisor. We welcome your thoughts and appreciate any feedback or information that may help us to be even more effective on your behalf.

With warmest regards.

Peter J. LaBella, CFP® is the President of FMA Advisory Inc., headquartered in Harrisburg, Pennsylvania. He can be reached at plabella@fma-advisory.com

Scott D. Ehrig, CIMA®, CFP® is Co-Chief Investment Officer for FMA Advisory, Inc., headquartered in Harrisburg, Pa. He can be reached at sehrig@fma-advisory.com

FMA ADVISORY INC
Compounding the future of You.™