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February Market Watch

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It's still early in the year, but a lot has been happening both in markets and the economy. The American stock market isn't just sitting at record highs; it's enjoying an unusually long period of tranquility. The last time the S&P 500 closed down at least 1% was 88 trading days ago on October 11th – over a month before President Trump was elected. That's the longest stretch without a downward daily market move of 1% or more since 2006 according to Bespoke Investment Group. Before that, the last time there was such a long period of calm was 1995.

The obvious question: How long can this last?

The stock market has gotten off to a positive start in 2017, the S&P 500 followed up 2016 strong return with a 1.9% gain in January. The Dow's first close ever above the 20,000 level drew a lot of attention to the granddaddy of the three major indexes, but the real winner so far in early 2017 has been baby of the three, the Nasdaq, which, as of February 15, made new all-time highs on seven consecutive days for the first time since December 1999, and finished 4.9% higher in January.

Looking at some of the key drivers of recent index performance, I remain optimistic but am closely monitoring a variety of data and important events that could impact our portfolios. Starting with fourth quarter earnings season, which is quickly winding down, I am encouraged that S&P 500 earnings estimates are now tracking to an 8.4% year-over-year increase, about 2.3% above initial estimates on January 1. Technology and financials earnings have contributed to the strong performance in the fourth quarter; energy earnings have had a recent bounce as well.

I am also encouraged by recent U.S. economic data that are pointing to improving growth. In fact, two-thirds of economic reports received in January 2017, which mostly reflect economic activity from December 2016 and early January 2017, met or exceeded consensus expectations. Looking deeper, sentiment reports on the services and manufacturing sectors, new orders for durable goods, vehicle sales, and employment were all notably better than expected.

One noteworthy data point that failed to meet expectations was the initial estimate of 2016 fourth quarter gross domestic product growth (GDP), which was released in late January. It showed the economy grew 1.9% over the quarter, slower than the solid 3.5% growth rate in the third quarter. However, GDP is backward looking and economic activity has picked up more recently.

Turning to the Federal Reserve (Fed), its first policy meeting of 2017 took place on January 31- February 1, 2017. As expected, the Fed made no change to its interest rate policy but struck a positive tone in its assessment of the economy. The Fed continues to indicate that any future rate hikes would be data dependent and gradual. We continue to expect the Fed to raise rates two to three times in 2017.

With all of the momentum in equity markets and the improving economic data, I am still mindful of policy risks that remain. A policy mistake by a government or central bank, uncertainty associated with the new presidential administration, Brexit, China's debt problems, and above-average stock valuations may present challenges to the relatively smooth ride we've seen so far in 2017. We certainly expect volatility to increase over the course of the year. That said, the obvious question: How long can this last?

As always if you have any questions, I encourage you to contact me.

Sincerely,

Preston

J. Preston Byers CPA CFP®
President

pbyers@clearbridgewealth.com

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7000 Central Parkway Suite 1760 I Atlanta, GA 30328 I 770-350-9605