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Capital Market Outlook

2/19/2020

QUICK VIEW

- At this time, we categorize the coronavirus outbreak as a temporary deflator of global supply and demand, and we expect strong fundamentals to support a rebound as control of virus spreading improves
- Target federal funds rate level (1.50%-1.75%)[1] has kept inflation within the 2%-3% expectation set forth by the US Fed
- In this continued pattern of market growth, we maintain a preference for equities over fixed income across all core portfolio models
- Planning for your financial future can be challenging. Contact one of our financial advisors today for a wealth management consultation

GROWTH FROM DEBT

Who says that personal debt is such a bad thing?

Over the past 7 years, we have seen that consumer spending has continually propelled the economy through periods of weakness into historically high territory. One uncommonly explored factor of this mechanism is just how households are generating the funds needed to keep such a fervent pace of purchasing.

Since mid-2005, US household debt has risen significantly, gaining 22.59%[2] as of December 2019. Likewise, residential mortgage liabilities have followed a similar trajectory over the time period, and they continue to increase as home prices grow across the country.

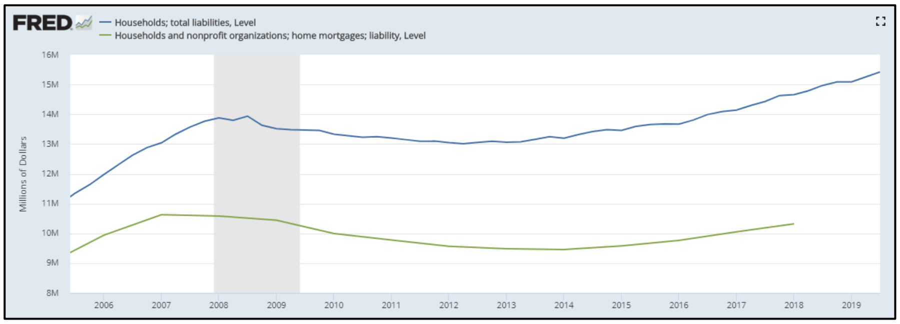

Fig. 1 - Total Household Liabilities & Residential Mortgage Liabilities[2]

At face value, this seems to tell us that people are borrowing more in order to spend more, especially on big-ticket items. The missing factor here, however, is the corresponding level of real personal income. Since 2005, personal income, after adjustments for tax expense and inflation, has risen by an amazing 39.65%[3]. Sustained jobs, unemployment and payroll growth support this improvement in household utility, an intended consequence of the expansionary fiscal policy enacted by the Federal Open Market Committee.

Fig. 2 – Real Disposable Personal Income[3]

Economists actually have a simple way to monitor this balance, the *Financial Obligations Ratio,* which compares household debt servicing payments, including consumer debt (i.e. auto loan payments, credit card debt, personal debt) and mortgage debt, to total disposable income in the United States. Basically, it allows analysts to assess whether consumers can afford the debt they amass over time.

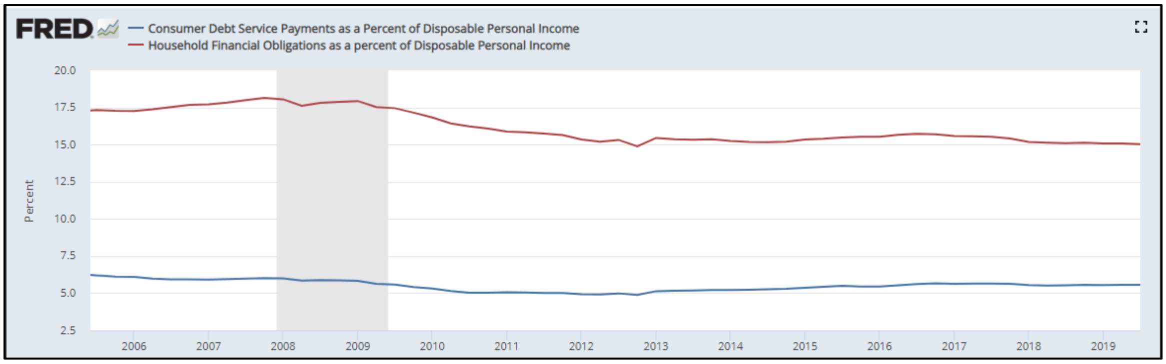

Fig. 3 - FOR/Consumer Debt Service Payments to Disposable Personal Income[4]

In Figure 3, we see that, since 2005, the U.S. financial obligation ratio decreased by 2.49%[4]. Here, the increased level of personal financing that has coincided with the growing total consumption behind this historic bull run has been offset by household wage growth, marginally improving the ability for consumers pay off their debt obligations.

As a personal investor, this insight should leave you with a useful takeaway - debt can serve as a great catalyst for the economy as long as households maintain their ability to pay their obligations. If consumers can continue to maintain a realistic level of purchasing without allowing greed to stretch material expectations and budgets, both the economy and households may be better off for it in the long run.

MARKET INDEX PERFORMANCE

As of 02/18/2020

	Total Return %		
INDEX	WTD	MTD	YTD
Dow Jones Industrial Average	-0.15	3.45	2.43
S&P 500 Index	0.37	4.50	3.94
NASDAQ	1.01	6.38	7.74
MSCI EAFE	-1.18	1.82	-1.87
MSCI Emerging Markets	0.10	4.25	-3.67

Source: http://finance.yahoo.com

INDEX DEFINITIONS

Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Indexes are all based in dollars.

S&P 500 Index is a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy. Although the index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market.

The Dow Jones Industrial Average (DJIA) is a price-weighted index of 30 actively traded blue-chip stocks.

GLOSSARY

Benchmark Rates are globally-accepted reference rates used to determine the values of various classes of financial instruments traded worldwide. A famous example is LIBOR (the London InterBank Offered Rate) which is the agreed cost at which major global banks can borrow funds from one another.

Monetary Policy consists of management of money supply and interest rates, aimed at achieving macroeconomic objectives such as controlling inflation, consumption, growth, and liquidity.

Fiscal Policy is the means by which a government adjusts its spending levels and tax rates to regulate a nation's economy.

Money Market is the market for securities with short-term maturities. Times to maturity range from overnight to a maximum of one year. Anything with a longer time to maturity is considered part of the capital markets.

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[1] https://www.federalreserve.gov/monetarypolicy/openmarket.htm
[2] https://fred.stlouisfed.org/series/BOGZ1FL194190005Q#0
[3] https://fred.stlouisfed.org/series/DSPIC96
[4] https://fred.stlouisfed.org/graph/?id=CDSP,FODSP,