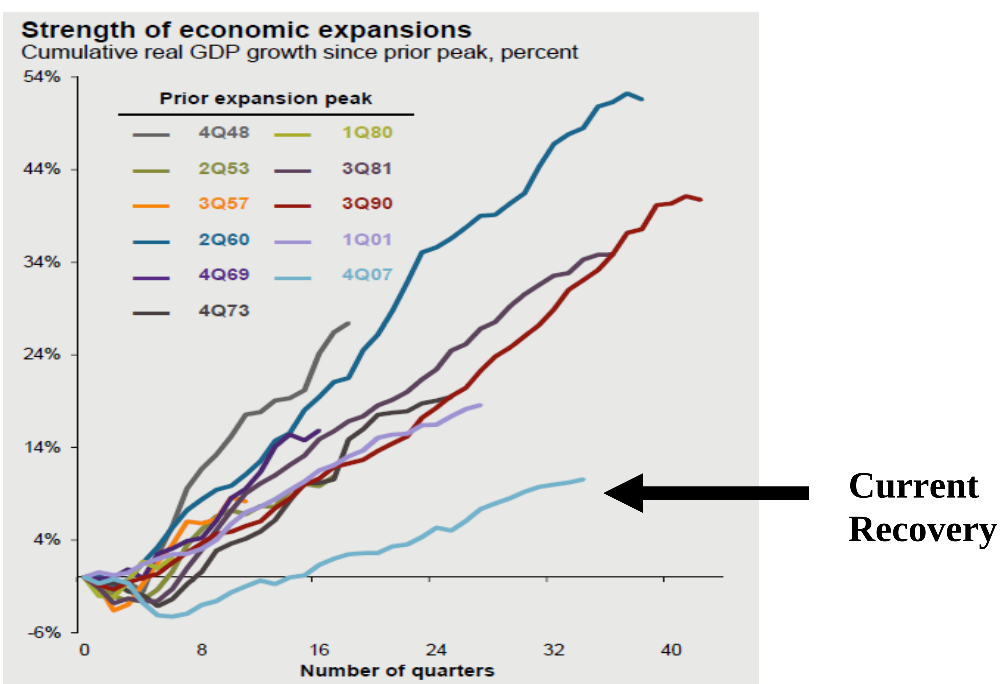
October 2016
Market Comments

Tying it all together

In each quarterly letter we provide our views on global economic and market trends to help our clients better understand the investment landscape. To meet your investment goals, in addition to investment climate you need to consider the current and future events in your life. Like the economy, our lives take twists and turns as we are strive to meet our personal objectives. We need to tie together our own financial situation with the overall markets to help us achieve the best outcomes. For each presidential election there could be a child's college tuition to be paid; for each FED interest rate move a potential mortgage refinance; for each Euro-crisis we might be experiencing a birth, marriage, or death in our family.

Most of us work for decades building wealth so we can support our families, give to important causes and spend our retirement years engaged in activities we enjoy. We call that "winning the game". We work with our clients on a strategy so that they can be comfortable in knowing they have sufficient financial resources to live life as they planned.

The US economy and stock market both are on are on a slow and steady growth trend and we expect they will remain on this path for the near term. The economic recovery from our last recession in 2008 has been the slowest in the post-war era and we see no signs that it will change soon.



Source: JPMorgan Guide to markets 9/30/16

As you can see in the preceding chart, after 35 months of recovery, we are far behind the GDP growth of any of the past 10 recoveries dating back to 1948. Each month we trudge ahead adding jobs and posting GDP growth indicating that the economy is still moving forward. This unremarkable history has produced more than 13 million jobs over the past 6 years (1) and had our GDP grow from $14.3 trillion in 1q 2009 to a $18.5 trillion in 2q 2016 (2) and drove the DJIA to more than double from 8,776 at year end 2008 to 18,312 today(3). By almost all measures we should be thrilled with these results, but the raw figures don't tell the entire story.. It certainly does not feel good to be part of an economy posting a sub 2% annual GDP growth rate. It sure does not feel like the fast growth years that we experienced growing up in the 70's or 80's, but slow is still growth and far better than a contracting economy.

Our view is that this could be our new normal as described by economist Mohamed El-Erian: a prolonged period of low growth, low inflation and low interest rates. Demographics are also pointing to continued slow growth in our country as the baby boom generation is beginning to retire and exit the workforce.

In this slow growth environment, the FED is doing all it can with monetary policy to keep the wheels of the economy moving. Near zero short term interest rates since 2008 have made it cheaper for both consumers and businesses to borrow money. More borrowing leads to more spending and growth. Consumers seem to be satisfied with the situation since Michigan's Consumer Sentiment Index is over 90 climbing steadily from a low of 65 in 2009(4). Remembering that consumer spending makes up nearly 70% of GDP, a happy consumer is good for the economy! It seems that not all new consumer spending is directly translating to business growth since we have seen weak business investment (6). We can understand why businesses are cautious to invest in our slow growing economy. Instead of building new plants and buying new equipment, many businesses are using excess cash to buy back stock in their own companies. This practice does not expand GDP but it rewards investors.

Our view of the future is that we will see much of the same: slow GDP growth, low interest rates, low inflation, and rising stock market. The FED at some point will raise rates but we are not convinced it will have more than a short term impact on the stock market. The immediate news of a rate increase will put negative pressure on stocks but they will ultimately recover because the reason for the rate increase is an improved economy.

Another near term factor is the election cycle which will also cause some market volatility, but over the medium term, we don't believe either candidate will have a material impact on our economy. The fiery campaign rhetoric is unlikely to translate into material changes in the laws of our country. Once the new president takes the Oval Office, they will be faced with the fact that they need to get their policies through a Congress that has been the least productive in 30 years (5). There are a wide range of views on what it will take to get our country moving again but we are pleased to see that both candidates see a need for rebuilding our country's infrastructure. This is important for two reasons. Short term it provides a measure of fiscal stimulus and longer-term it enhances national productivity by making domestic activities more efficient. We are in dire need of upgrades to airports, rail, roads, bridges and energy infrastructure.

In our own lives, we need to consider how our personal landscape is changing over time. At each stage of our lives we have different financial requirements and challenges. TO get the best results, setting your portfolio strategy should take into account BOTH the economic/market expectations and your personal situation. With a backdrop of our economy and markets moving forward on a slow steady path, how does this tie in to your life events that will impact your financial future? We are happy to meet with you in person or by phone to discuss how the various aspects of your financial lives so that we can together set a path for you to meet your personal goals.

Sources:

1. US Bureau of Labor Statistics data table, Employment, Hours, and Earnings from the Current Employment Statistics survey (National)
2. US Bureau of Economic Analysis data table1.1.5 Gross Domestic Product
3. Reuters
4. University of Michigan Index of Consumer Sentiment
5. Based on numbers of laws enacted by the 114th Congress, www.govtrack.us/congress/bills/statistics
6. Wall Street Journal 6/15/16 “Weak business investment weighs on policy makers”

The Galleria • 2 Bridge Avenue, Suite 633B. • Red Bank, NJ 07701
P (800) 878-3310 • (732) 758-1004 • F (732) 741-3270 • www.lucascapital.com
Registered Investment Advisor