Preparation, Peaks, and Patience

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Have you ever climbed a mountain or ran a marathon? At the beginning of the adventure you have a clear head, lots of adrenaline, and you've researched and packed your provisions and trained appropriately. With energy and drive, the first part of the adventure progresses well and maybe even comfortably. It's the summit or the last few miles where you have to dig deep. You've done the hard work, but little things can help get you to the top or across the finish line.

This economic expansion is in its 9th year (!)— you might say, near its summit. It has been a long recovery, yet shallow. US equities, on the whole, are fully-valued and the major indices are breaking new records. The corporate landscape and the US economy are healthy according to many measures.

The US gross domestic product (GDP), a primary measurement of an economy, has been averaging growth of 2.2% since the recession and is growing slower than the 50-year average of 2.8%. The last reading had GDP increasing at a rate of 2.3%. Roughly 69% of GDP is dependent upon consumption, both from corporations and consumers.

Earnings per share of the S & P 500, another barometer of the US economy, is at a record high. Corporate profitability is robust and corporate cash, as a percentage of assets, is near an all-time high. Corporate debt has also climbed to a high, rivaling the beginning of the last recession. Yet thanks to the accumulated cash and low interest rates, the debt is comfortably managed. In addition to accumulating cash, companies have decreased capital expenditures and have been using cash to pay investors through dividends, or buying back shares.

Over the past 10 years, consumers have been reducing their overall debt and partially reducing spending. Consumers' debt ratio is now at the lowest it's been ever recorded and 2/3 of the debt is attributed to mortgages (considered by many as "good" debt). Household net worth is also at a new high, thanks to the recovering stock and housing markets. The unemployment rate is rivaling lows seen in the late '60's at 4.1% as of December 2017. The 50-year average is 6.2%. For the worker, however, wage growth is still anemic at 2.3% compared to a 50-year average of 4.2%

There are a lot of positives in the market and economy, so similar to climbing the mountain or running a marathon, we are nearing the peak or the finish line and there is not much more room to influence an already successful excursion. Tax reform may provide a slight boost in several areas, but because of our already strong economy, the economic boost may be short-lived and modest.

Consumer spending may increase slightly, especially during 2018. Upper income households will see the biggest reduction in taxation, yet this group has a lower propensity to consume and given the strength of the consumer balance sheet and net worth, they may already be spending at their pace. Unless we see an uptick in wage growth, lower income households may not experience much change in discretionary income to increase their consumption.

Tax reform could possibly encourage more corporate spending with lower tax rates and more favorable tax treatment of capital expenses and this may in turn boost the economy. Additionally, companies with overseas profits may repatriate those earnings and possibly increase their spending with these funds.

If spending does pick up and our economy (GDP) does grow even incrementally, we will probably see wage growth pressure. This coupled with unemployment, which continues to tick downwards, could hamper any significant growth. Further, baby boomers continue to retire and restricted immigration, helpful to corporate productivity, conspire to temper growth as well.

In the next couple of years, we may see incremental growth helping the stock markets continue their ascent, yet, in the long term, the recent tax cuts will contribute to growing the deficit. In essence, the tax reform has been an attempt to spur the near-term growth at the possible expense of long-term growth.

The 24 hour twitter tirades and news cycle may undermine confidence in the Executive Branch and Congress, yet the economy has many influences which are not all dependent upon political winds. With our numerous checks and balances and an ever increasing global community — public and private — forces may exert themselves to continue our slow, but strong economic expansion.

We'll reach the summit or finish line, take our pictures, and hopefully with knowledge and remaining strength, continue our adventures with perhaps more maturity. Investing, as you know, is not a quick walk around the block or a 100 yard dash, but an exercise of endurance, patience and steadfast focus on a long-term goal.

Good things come slow – especially in distance running
- Bill Dellinger, University of Oregon coach