

“The truth is at the beginning and its end are alike touching” Yoshida Kenko

Pine Haven Investment Counsel, Inc. – Commentary –1st Quarter 2017

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Spring reminds us of the rhythms of nature and promises of new beginnings. We see similarities with newly elected administrations and business cycles as well. When viewing markets, it’s often said that history doesn’t repeat itself, but rhymes.

The markets have rallied since the latter part of 2016. In the first quarter ending March 31, 2017, the S&P 500 was up 6% and Developed Markets outside the US, measured by the EAFE index, were up 7.39%. Because of the timing, some have attributed the rally to the new administration. The beauty – and some might say curse – of our multi-branch government is that change takes time.

Certainly, there is optimism and speculation that less regulation could promote business growth. If these regulatory changes do occur, changes to the fundamental or intrinsic values of the underlying companies, which make up, “the markets” will take time. However, consumer confidence has grown to a high not seen since 2015. Generally this confidence can lend itself to more business activity supporting a market rally. Consumer consumption contributes nearly 70% of our gross domestic product (GDP).

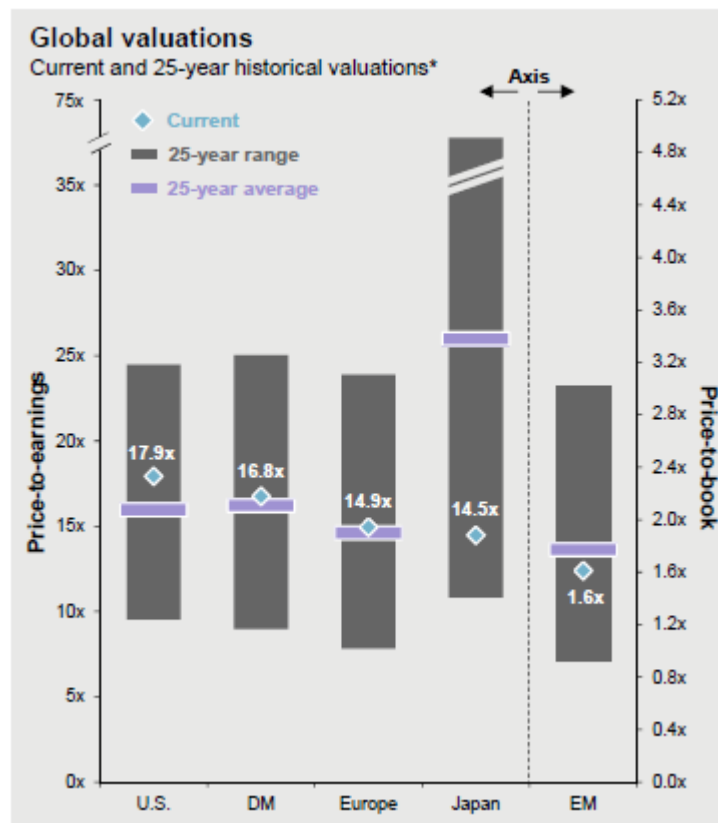
Additionally, the latter part of 2016 saw increasing business activity and improving profits and earnings. In the long-term, a company’s market price is reflective of the earnings and profitability of a company. The improving business climate is evident around the world and is illustrated in the following “heat map” provided by JP Morgan. The heat map colors are based on the Purchasing Managers Index (PMI) which indicates acceleration or deceleration of the sector. Green depicts acceleration; red depicts deceleration.

Global Purchasing Managers' Index for manufacturing		Apr'15	May'15	Jun'15	Jul'15	Aug'15	Sep'15	Oct'15	Nov'15	Dec'15	Jan'16	Feb'16	Mar'16	Apr'16	May'16	Jun'16	Jul'16	Aug'16	Sep'16	Oct'16	Nov'16	Dec'16	Jan'17	Feb'17	Mar'17
Global		50.8	51.1	50.9	50.8	50.5	50.4	51.0	51.0	50.7	50.9	50.0	50.7	50.2	50.1	50.4	51.0	50.7	51.0	51.9	52.0	52.7	52.7	53.0	53.0
Developed Markets		52.1	52.4	52.1	52.5	52.4	52.1	53.0	52.6	52.0	52.3	50.9	50.9	50.4	50.2	50.9	51.5	51.3	51.6	52.9	53.2	54.0	54.4	54.6	-
Emerging Markets		49.3	49.5	49.2	48.8	48.3	48.3	48.9	49.1	49.2	49.2	48.8	50.0	49.5	49.5	49.3	50.1	49.9	50.0	50.7	50.7	51.3	50.8	51.3	-
U.S.		54.1	54.0	53.6	53.8	53.0	53.1	54.1	52.8	51.2	52.4	51.3	51.5	50.8	50.7	51.3	52.9	52.0	51.5	53.4	54.1	54.3	55.0	54.2	53.3
Canada		49.0	49.8	51.3	50.8	49.4	48.6	48.0	48.6	47.5	49.3	49.4	51.5	52.2	52.1	51.8	51.9	51.1	50.3	51.1	51.5	51.8	53.5	54.7	55.5
UK		52.3	52.2	51.5	52.3	51.8	51.3	54.9	52.5	51.3	52.3	50.9	51.2	49.7	50.7	52.5	48.2	53.5	55.2	54.6	53.5	56.0	55.4	54.5	54.2
Euro Area		52.0	52.2	52.5	52.4	52.3	52.0	52.3	52.8	53.2	52.3	51.2	51.6	51.7	51.5	52.8	52.0	51.7	52.6	53.5	53.7	54.9	55.2	55.4	56.2
Germany		52.1	51.1	51.9	51.8	53.3	52.3	52.1	52.9	53.2	52.3	50.5	50.7	51.8	52.1	54.5	53.8	53.6	54.3	55.0	54.3	55.6	56.4	56.8	58.3
France		48.0	49.4	50.7	49.6	48.3	50.6	50.6	50.6	51.4	50.0	50.2	49.6	48.0	48.4	48.3	48.6	48.3	49.7	51.8	51.7	53.5	53.6	52.2	53.3
Italy		53.8	54.8	54.1	55.3	53.8	52.7	54.1	54.9	55.6	53.2	52.2	53.5	53.9	52.4	53.5	51.2	49.8	51.0	50.9	52.2	53.2	53.0	55.0	55.7
Spain		54.2	55.8	54.5	53.6	53.2	51.7	51.3	53.1	53.0	55.4	54.1	53.4	53.5	51.8	52.2	51.0	51.0	52.3	53.3	54.5	55.3	55.6	54.8	53.9
Greece		46.5	48.0	46.9	30.2	39.1	43.3	47.3	48.1	50.2	50.0	48.4	49.0	49.7	48.4	50.4	48.7	50.4	49.2	48.6	48.3	49.3	46.6	47.7	46.7
Ireland		55.8	57.1	54.6	56.7	53.6	53.8	53.6	53.3	54.2	54.3	52.9	54.9	52.6	51.5	53.0	50.2	51.7	51.3	52.1	53.7	55.7	55.5	53.8	53.6
Australia		48.0	52.3	44.2	50.4	51.7	52.1	50.2	52.5	51.9	51.5	53.5	58.1	53.4	51.0	51.8	56.4	46.9	49.8	50.9	54.2	55.4	51.2	59.3	57.5
Japan		49.9	50.9	50.1	51.2	51.7	51.0	52.4	52.6	52.6	52.3	50.1	49.1	48.2	47.7	48.1	49.3	49.5	50.4	51.4	51.3	52.4	52.7	53.3	52.4
China		48.9	49.2	49.4	47.8	47.3	47.2	48.3	48.6	48.2	48.4	48.0	49.7	49.4	49.2	48.6	50.6	50.0	50.1	51.2	50.9	51.9	51.0	51.7	51.2
Indonesia		46.7	47.1	47.8	47.3	48.4	47.4	47.8	46.9	47.8	48.9	48.7	50.6	50.9	50.6	51.9	48.4	50.4	50.9	48.7	49.7	49.0	50.4	49.3	50.5
Korea		48.8	47.8	46.1	47.6	47.9	49.2	49.1	49.1	50.7	49.5	48.7	49.5	50.0	50.1	50.5	50.1	48.6	47.6	48.0	48.0	49.4	49.0	49.2	48.4
Taiwan		49.2	49.3	46.3	47.1	46.1	46.9	47.8	49.5	51.7	50.6	49.4	51.1	49.7	48.5	50.5	51.0	51.8	52.2	52.7	54.7	56.2	55.6	54.5	-
India		51.3	52.6	51.3	52.7	52.3	51.2	50.7	50.3	49.1	51.1	51.1	52.4	50.5	50.7	51.7	51.8	52.6	52.1	54.4	52.3	49.6	50.4	50.7	52.5
Brazil		46.0	45.9	46.5	47.2	45.8	47.0	44.1	43.8	45.6	47.4	44.5	46.0	42.6	41.6	43.2	46.0	45.7	46.0	46.3	46.2	45.2	44.0	46.9	49.6
Mexico		53.8	53.3	52.0	52.9	52.4	52.1	53.0	53.0	52.4	52.2	53.1	53.2	52.4	53.6	51.1	50.6	50.9	51.9	51.8	51.1	50.2	50.8	50.6	51.5
Russia		48.9	47.6	48.7	48.3	47.9	49.1	50.2	50.1	48.7	49.8	49.3	48.3	48.0	49.6	51.5	49.5	50.8	51.1	52.4	53.6	53.7	54.7	52.5	52.4

Source: Markit, J.P. Morgan Asset Management.
Heatmap colors are based on PMI relative to the 50 level, which indicates acceleration or deceleration of the sector, for the time period shown.
Guide to the Markets – U.S. Data are as of March 31, 2017.

While consumer confidence is high, there could be gathering clouds on the horizon. One of those clouds could be a rise in inflation. Unemployment remains at a low of 4.7% but wage growth has been stuck sideways at 2.5% versus a 50-year average of 4.2%. This alone could contribute to inflation, should wages start improving. And, if some of the programs or ideas floated during the campaign become enacted, such as infrastructure spending or trade wars, we could also see inflation rise. Stagnant or declining wage growth could also dampen confidence.

Consumer confidence also is reflected in confidence in the stock markets. Currently the S&P 500 appears to be over-valued (or overly optimistic?) in relation to historical norms. The following graph illustrates global valuations comparing 25 year historical price to earnings and price to book range, average and current. (Price to earnings, or P/E and price to book are two metrics used to determine valuation.)



Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
 *Valuations refer to NTMA P/E for Europe, U.S., Japan and Developed Markets and P/B for emerging markets. Valuation and earnings charts use MSCI indices for all regions/countries, except for the U.S., which is the S&P 500. All indices use IBES aggregate earnings estimates, which may differ from earnings estimates used elsewhere in the book.
 Guide to the Markets – U.S. Data are as of March 31, 2017.

We remain committed to diversification and the belief that we will never be able to predict where the short-term winds of the market will blow. Long-term, quality companies, regardless of country origin, will create value for their shareholders. Well-run companies will manage their businesses with high business ethics and high regard for their resources whether they be the environment or people. Quality businesses will retain their core culture and values regardless of fleeting political or consumer sentiment.

Spring may bring winds of change and storm, but the rhythms of the seasons and business cycles give us confidence in believing in the rhymes in history.