Bell Bank
Wealth Management

EQUITY & FIXED INCOME OUTLOOK FEBRUARY 2017

Federal Reserve Monetary Policy

When the Federal Reserve announced there would be no change in rates after their February 1 meeting, the market's response was so muted it was hardly noticeable. That suggests the news was very close to what the market expected. Right now, there is a less-than-50-percent probability of a rate increase before June. It is too early to tell how that will shape up, but assuming it is the first rate increase this year, it reduces the chances of two more occurring before the year ends. Perhaps there will only be two rate hikes in 2017 instead of the three or four projected at the beginning of the year.

Inflation

Inflation year-over-year released in January was 2.1 percent, which was a bit higher than we anticipated. We expect to see another increase when the February 15 release is announced, but we also expect it to start leveling out and perhaps even decline midway through the second quarter.

Economic Activity

The first announcement of fourth-quarter gross domestic product (GDP) growth was only 1.9 percent on an annualized basis. Full-year 2016 real inflation-adjusted GDP growth was 1.6 percent. We have a long way to go to bring this number back in the range of 3 to 4 percent, where it more often hovered prior to about nine years ago. The market may be in for disappointment if progress does not materialize as quickly as expected.

When it comes to prospects for economic advancement, GDP growth numbers may be taking a back seat to economic drivers like higher employment and the possibility of increasing wages. Consumers are carrying record levels of personal debt, which suggests interest rates need to remain low to support additional consumer spending. If interest rates rise too much, consumers could redirect any new earnings toward paying down debt.

We continue to look at the progress in jobs, personal income, consumption, personal debt levels, productivity and demographics to get a feel for the U.S. economy's growth prospects. Right now we see a higher probability of 2 to 2.5 percent economic growth in 2017 than we do the 3 to 4 percent the market is hoping to see. Maybe the higher growth level will develop in future years, but it doesn't look likely in 2017.

Fixed Income

The 10-year U.S. Treasury bond has been hovering around 2.5 percent, plus or minus a bit, for the last two months. The 10-year Treasury yield was 1.8 percent going into the election but moved up to 2.38 percent by the end of November. The market appears to be in a holding pattern waiting for more developments. The 10-year bond yield was projected to be above 3 percent by the end of the year. The way we look at it, there's a good chance it will not get that high, but could finish the year around 2.75 percent.

Fixed income positioning is challenging in a market that could break out in either direction. Our focus is to capture as much income as reasonable, while maintaining an investment grade rating without extending duration or bond maturities.

Stock Market

It is hard to sink or swim if you're not in the water. There has been a lot of media attention around the Dow hitting 20,000, which masks the fact that the Dow is only up 0.5 percent this year. The big run over the last three months happened in the final two months of 2016. Market timing rarely (okay, never) works as an ongoing successful investment strategy. Fear and greed have a way of making investors zig and zag at the wrong time.

By most measures we use, the stock market looks fully priced. Predicting where the markets might go is entertaining, but not meaningful for someone with a long-term investment horizon. In many cases, highs and lows in the market today will be hard to find 20 years from now. A fully priced stock market is useful as an indicator for rebalancing portfolios if stock holdings have grown beyond a portfolio's target allocation.

Greg Sweeney, CFA,
Chief Investment Officer

Tenure: 9/92

Years of Investment Experience: 31 years

Education: Greg holds a bachelor's degree in business from the University of North Dakota and is a CFA charter holder.

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