Bell Bank Wealth Management

EQUITY & FIXED INCOME OUTLOOK JUNE 2017

Federal Reserve Monetary Policy

Market experts estimate about a 92 percent probability that the Federal Reserve will raise rates when it meets June 14. This suggests the Federal funds rate will increase to the range of 1 to 1.25 percent from its current level of 0.75 to 1 percent. Monetary policy would still be considered accommodative (designed to stimulate growth), because it would be below the inflation rate.

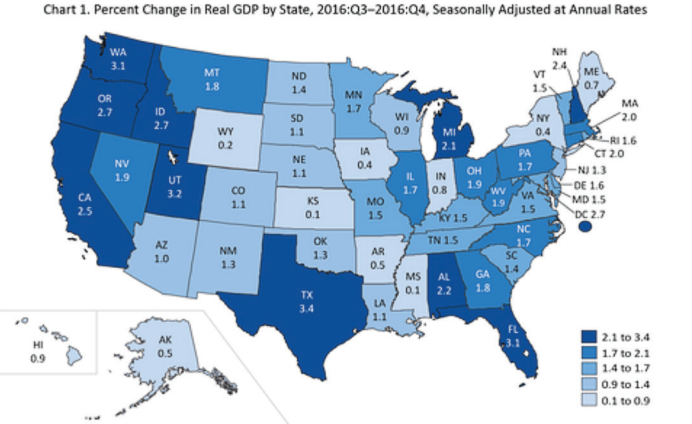
Inflation

The year-over-year inflation rate for April, the latest data available, was 2.2 percent – a drop of 0.2 percent from the previous month. Producer price index increases have been running at a much higher pace over the last 12 months, at 3.9 percent. So far, this trend is not showing up in the consumer price index (CPI). We expect the CPI will remain in the low 2 percent range for the next two months.

Economic Activity

The prospect of reduced taxes and increased fiscal spending coming from Washington, D.C., looks less and less likely before the end of the year. Regular readers know this does not come as a surprise to us. Most of the progress from Washington so far seems to be aimed at reducing regulations. That suggests the economy is moving on its own accord based on underlying fundamentals, which has given corporate spirits and investors a lift. The map below shows fourth-quarter gross domestic product growth by state.

Chart 1. Percent Change in Real GDP by State, 2016:Q3–2016:Q4, Seasonally Adjusted at Annual Rates



U.S. Bureau of Economic Analysis

A record 153 million people are employed in the U.S., meaning 60 percent of the eligible working population has jobs, according to Bureau of Labor Statistics information. Another 7 million people would need jobs to raise employment to 63 percent of the eligible working population – the rate before the financial crisis. We see this as the largest obstacle to raising gross domestic product growth back above 3 percent. Workforce demographics are also changing. The percentage of younger workers in the workforce is declining, and more older workers are remaining in the workforce.

Fixed Income

So far, rising interest rates have been limited to the short end of the yield curve on the heels of Federal Reserve rate increases. The 10-year Treasury bond interest rate is at 2.2 percent, which is right where it was before the Fed began raising the Fed funds rate in December of 2015.

Moving forward, we expect 10-year Treasury bond interest rates to remain below 2.75 percent for the foreseeable future. This goes against the earlier consensus of most economists that 10-year Treasury rates would be above 3 percent by the end of the year.

Stock Market

The S&P 500 is up 8.66 percent this year as of the end of May. The same S&P 500 equally weighted is up 6.77 percent. The S&P Mid Cap index is up 4.30 percent, and the S&P Small Cap index is down 0.21 percent. This suggests a few large companies are having a greater influence on returns so far this year. The breadth of the market may be shallow, which could bring the sustainability of the current market rally into question.

Passive investing has become a popular strategy over the last few years. The idea of passive investing (index investing) is to eliminate the cost of price and value discovery on securities and go along with the market. The only election investors then need to make when investing their portfolios is deciding among an index or group of indexes. The idea of hedge fund investing is to spend a lot of time, effort and money on price and value discovery in an effort to identify investment opportunities that are expected to perform very well.

Somewhere in between is traditional active investment management, in which investors pursue active price and value discovery while being mindful of costs, with the ultimate goal of building a well-rounded portfolio. In the end, different investment approaches serve different needs. Investors' goals help guide which combination works best.

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.