ViewPoint

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The Dow Hits ~~20,000~~ 21,000 - The Story Behind the Headlines

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After two years of volatility and directionless equity markets, the strong performance of stocks of late has certainly been welcome to investors. On January 25, 2017, the Dow Jones Industrial Average passed the 20,000 mark for the first time in history. Thirty-five days later (on March 1st), it passed the 21,000 mark. The Dow has now more than tripled its value in less than eight years.

Though Dow ~~20,000~~ 21,000 is an attention-grabbing mark, it doesn't carry much importance for the way we assess markets, nor does it matter much to the outlook going forward. Big round numbers are easy to remember, and they make interesting topics of conversation, but their usefulness stops there.

What is Responsible for the Equity Rally: Trump or the Economy?

We are encouraged by the broad participation ("breadth") in equity markets across styles and geographies in recent months. In our opinion, the so-called "Trump Rally" has had more to do with the broad and synchronized pick-up in economic activity, here and abroad, than with President Trump himself.

Fundamental economic improvements since the summer of 2016 have been very noticeable. All of the economic models we follow have been improving steadily month after month and leading indicators signal that the trend is likely to persist over the remainder of the year. Faster economic activity leads to improving corporate earnings and earnings trends are important drivers of equity performance. The primary catalysts for more robust economic activity have been a pick-up in Chinese growth, a rebound in commodity prices and the end of a protracted inventory destocking cycle.

Rising Interest Rates

Unfortunately, more often than not, a by-product of faster and sustained activity at the later stage of an economic cycle is higher and accelerating inflation. Although still low by long-term historical standards, inflation signals have started to appear in the United States as the domestic economy operates closer to its full potential. Excess capacity has largely been absorbed, and the U.S. economy is approaching full employment. As a result, wage growth is now accelerating. Many of Trump's policy proposals (fiscal or protectionist) are inflationary, which could also add to the prospect for higher inflation (and interest rates) in the years to come. From June 30, 2016 to February 28, 2017 alone, the 10-year U.S. Treasury yield rose from 1.47% to 2.39%.

Portfolio Positioning

At a time when most investors have started to become more concerned about rising yields and their negative impact on bond values, Trust Point's clients have prospered. We continue to position clients' portfolios for slowly rising inflation and interest rates. In fixed income, we are most bullish on senior bank loans, inflation-linked bonds, and credit. We are most bearish on domestic and international government debt. Also, we have maintained a lower-than-benchmark duration in modeled clients' portfolios (meaning that the downside price sensitivity of our bond holdings to changes in interest rates is less than the benchmark).

From the end of June 2016 to the end of February 2017, the Barclays U.S. Aggregate Bond Index is down 1.7%, while the Barclays Global Aggregate Bond Index (USD Hedged) is down 1.3%. In the meantime, the fixed-income portion of our modeled clients' portfolios is up 1.7%, a significant outperformance in an otherwise difficult environment for fixed income. We also remain overweight global equities and underweight fixed income in portfolios—a tactical move that has added to our clients' performance.

Active vs. Passive

The debate between active management (most mutual funds) and passive management (most index funds and exchange-traded funds) continues to rage. At Trust Point, our research on the topic led us to conclude that a hybrid strategy that combines the two provides the best risk/return trade-offs for clients. As far as we are concerned, the debate is not so much about active vs. passive as about reducing the cost of investing for our clients. We are doing that by using a complete open-architecture structure combining low-cost passive investment vehicles with low-cost institutional-share-class mutual funds with active managers. The lower the costs, the greater your share of an investment's return; compounded over many years, this can have a significant impact on your total wealth. In 2016 we increased exposure to passive investments while also revisiting the key characteristics that we think make an active manager successful. Many of the fund families we use in modeled clients' portfolios were top-ranked in 2016 in a recent study published by Barron's, a respected financial newspaper from Dow Jones & Co.

Portfolio Performance

At times, 2016 brought surprises that required portfolio adjustments. We didn't hesitate to make those adjustments. "Leaving investments on cruise control, no matter what" is not a philosophy we adhere to. We continually apply the principles of discipline, logic, and reason to our multi-layer investment analysis and our entire investment decision-making process.

We are committed to achieving competitive returns for every client we serve, consistent with that client's level of risk tolerance. The last 12 months proved to be a very rewarding time for our modeled clients' portfolios, as both absolute and relative returns were very strong. Over the next three to five years, as we highlighted in our "Market Point" publication last quarter, we continue to expect positive but modest returns (relative to recent history) from asset markets.

As an investor, it can be challenging at times to remain patient and not get caught up in headlines that can sway investment behavior. While our disciplined investment philosophy has guided us to recent success, the true success of Trust Point's strategy can be seen in the growth of our assets under management. Over the past five years, Trust Point has added significant new business and has more than doubled its assets under management to over $3.5 billion. We greatly appreciate the trust and confidence you continue to have in us.

Our goal is to help as many individuals and businesses as we can to grow and flourish. We appreciate it when you share your Trust Point experience with others. If you have friends or family members who can benefit from Trust Point's services, we would welcome the opportunity to share our story with them.

Your Success is Our Success

View Point is a timely investment publication designed to provide you with insightful views into the discussions and debates of our investment professionals on themes or events affecting global financial markets.

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