Positive Market Growth Despite Negative Headlines

The last several months have been delightfully dull for long-term focused investors. Stocks and bonds slowly rose in value as the economy continued to grow and corporate earnings moved higher. At the same time, market volatility remained low. In fact, as of June 30, 2017, there have been only 4 days in which U.S. stocks gained or lost more than 1%. In contrast, over the same period last year, U.S. stocks closed up or down by more than 1% on 37 days.

This stability in stock returns is in stark contrast to the daily news flow we have seen regarding debate and controversy in Washington, elections in Europe, and sadly, terrorist acts. For the most part, it appears markets have ignored these headlines and have instead remained focused on improving global growth and higher corporate earnings. For instance, the news of the recent Federal Reserve interest rate hike in June may have caused a stir in the past, but now it is seen as a positive reflection of U.S. economic growth.

Summary

- Global stock markets moved higher, driven by accelerating corporate earnings and improving economic conditions.
- We have been closely watching labor markets for changes in wages and inflation, which could weigh on corporate earnings should they rise.
- Market corrections are unpredictable, but normal. That is why we maintain a long-term focus, to help you achieve your financial goals.
We believe this market focus on growth and earnings can benefit our clients. That’s because we believe there is a strong connection between the pace of economic growth and the direction of stocks and bonds. In fact, we believe the backdrop for stocks remains positive given the slowly growing economy. We also strongly believe that staying calm amid negative headlines is good policy. However, when stock and bond volatility is low, like it has been, we believe it is important to sharpen our focus and pay close attention to near-term changes. Two areas we have been closely watching are labor markets and new pro-growth policies.

**Labor, Wages, and Pro-Growth Policies**

Regarding labor, job openings are plentiful and weekly unemployment claims are near 45 year lows. Healthy labor markets and low unemployment rates have historically spurred faster wage growth and higher inflation. These pressures can weigh on corporate earnings as rising inflation and employee costs shrink profits. So far in 2017, wages have been slow to rise and inflation is stable. Yet, should wages rise at a faster pace, we would anticipate a more challenging environment for stocks.

Shifting to new pro-growth policies, the possibility of tax reform and deregulation occurring in 2017 has fallen significantly. This does not mean they won’t occur at all. Rather it is likely that the pace of any new pro-growth policies will be slower than originally anticipated by markets following the U.S. election. This could change should more constructive policy debate resume in Washington.

**International Stocks and European Elections**

Looking overseas, stocks have also moved higher. Driven by accelerating corporate earnings and improving economic conditions international stocks have outpaced U.S. stocks in 2017 and over the last year. Although, six months ago this story was less clear as several European elections had become referendums on nationalism. Today, the election results in France and the Netherlands, and to a lesser extent in the U.K., suggest a slower rise of nationalism. These results also helped the European growth story advance. In fact, manufacturing remains strong, unemployment rates continue to fall, and exceptionally low interest rates aimed at boosting borrowing and spending remain in place. With this backdrop, the outlook for international stocks seems to be bright with corporate earnings for international stocks expected to grow at a faster pace than U.S. stocks for the remainder of 2017.

**Market Corrections are Normal**

While economic growth and market returns have been positive, helping lift the value of client accounts, it is hard to ignore the fact that it’s been nearly 18 months since we have experienced a market correction. If this is on your mind, just remember that corrections, defined as a drop of 10% or more, are quite normal. They happen about once a year and they are very unpredictable.

The next correction could be driven by certain events such as a geopolitical event, terrorist act, or perhaps the uncertainty regarding the U.K exit from the Eurozone, which will likely take years to conclude. This is why we stay focused on the long-term and follow a disciplined investment process, including where we are in the business cycle. This means that as events occur in the future we will seek to deeply understand the implications they may or may not have on economic conditions, corporate earnings, and valuations. The goal is to make adjustments to your account as appropriate and form sound investment insights to help you achieve your financial goals. That is our commitment to you and remains our number one priority.
Questions?
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