DELTA
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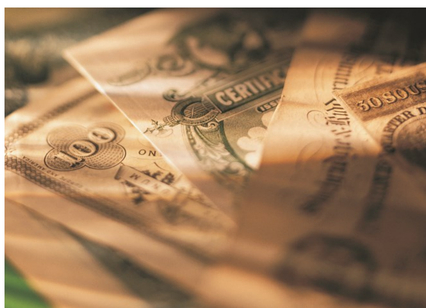
Economic Comments

Surprising no one, the Federal Reserve's Open Market Committee (the FOMC) raised overnight interest rates by 0.25 percentage points at its most recent March meeting. Additionally, the central bank reiterated its expectation that overnight interest rates would be raised by at least an additional 0.50 percentage points during 2017. Importantly, the Fed also announced its intention to start reducing, within the next year, its $4.5 trillion investment portfolio – which was the end result of the bank's giant monetary expansion in the aftermath of the financial crisis. The meeting's minutes emphasized that the central bank's economic forecast has held steady in recent months. While bank officials have not seen evidence of an improvement in economic data since the presidential election, growth has remained sufficiently strong to move forward with some long anticipated, and by some dreaded, interest rate increases.

The Fed had a near unanimous consensus that the economy is "at or near maximum employment" with the February rate at 4.7%, a level consistent with the normal churn of hiring and firing. Looking at other hard data, personal income rose as expected by 0.4% in February while personal spending was softer than projected at 0.1%, rather than the 0.2% consensus. Meanwhile, the Fed's preferred inflation measure, the personal consumption price index, rose by 2.1% from the year earlier. With this jump, the economy reached an important milestone as February's inflation reading finally exceeded the central bank's 2% target after undershooting this goal for nearly five years.

Crucially, firmer inflation gives Fed officials leeway to follow through with their plans to continue raising overnight rates and reducing the bank's vast bond holdings. Inflation's rise is a signal that slack in the economy in the form of excess industrial capacity, high unemployment and empty buildings has diminished, removing the forces that have weighed on consumer prices for the last several years. Additionally, inflation's move above 2% confirms that the sharp drop in oil prices that began in mid-2014 was only a temporary shock, not a sign of fundamental weakness in the global economy.



More recently, business spending has been tepid with retail sales slowing in February. After a banner 2016, auto sales have appreciably slowed as the year started. Economic activity for 2016 finished modestly with GDP growth of 2.1% annualized in the year's final quarter. Consensus expectations for 1st quarter GDP growth remain muted with estimates of only 1.6% - lower than the average throughout the current economic recovery.

One important wild card is the actual behavior of U.S. consumers. Inflation-adjusted household spending declined 0.1% in February after falling 0.2% in January, according to the Commerce Department. The decline was the largest two-month drop since the recession ended, albeit partially a reflection of

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unseasonably warm weather depressing spending on utilities. A slowdown in consumer spending, which accounts for about two-thirds of U.S. economic activity, would prove to be a new headwind to growth and could potentially derail the Fed's plans.

Interestingly, the "soft" data paints a far more optimistic situation with the late March reading of consumer confidence by the Conference Board soaring to 16-year highs. Other surveys of both small business owners and chief executives of large corporations recently reflected the highest level of optimism in more than 7 years. While people are feeling more optimistic, the hard economic data is speaking to a different, more tepid, narrative. In short, "soft" sentiment data has surged since November while the hard economic metrics remain stuck in low gear, as they have for most of the recovery from the Great Recession. Our belief is that either confidence will start to wane or these positive spirits will provide fuel for a more substantial uptick in economic activity. Either way, the current dichotomy is unlikely to remain.

While the new administration has expressed its strong desire for tax reform, little attention has been given to the nation's growing national debt burden. Based on a recent Congressional Budget Office analysis, the national debt is now anticipated to grow by almost 100% over the next 3 decades. Federal debt, having doubled since 2008 to 77% of gross national product, is projected to hit 150% of GNP by 2047, barring any unanticipated fiscal reform. Of particular concern, this projection is meaningfully worse than even the CBO's recent January 2017 projection. Critical drivers to the explosion in the debt burden are higher costs for Social Security and health-care programs, both the result of an aging population, along with higher interest payment on the federal government's debts. Interest costs alone, barring an unexpected policy change, are anticipated to rise from 7% of federal spending to more than 21% by 2047.

We are deeply concerned that the administration has not identified the structural escalation of the country's debt burden as a key issue. Barring structural changes in the existing entitlement programs, non-discretionary budgetary outlays will escalate sharply in coming years. It is vital that the Trump administration take action now rather than waiting for this recently dormant volcano to explode.

Analyst Corner

Nothing quite says hello like a nice smile. Quite likely, that smile came from the Patterson Companies (*NDQ: PDCO*). The firm is a major wholesaler to the very fragmented dental and animal health markets. While PDCO has faced some increased competition of late, we believe the scale and distribution network advantages for the company remain intact. Strong competitive advantage will be maintained moving forward as the firm continues to find leverage from its significant scale, supplier pricing advantages, and broad customer base. In our view, a new competitor would find it quite challenging to displace Patterson from its strong and entrenched market position. When considering PDCO's growing revenue base and consistent cash flows, not to mention its above average dividend, the company is likely to put at least a grin on many investors' faces.

Market Comments

Stocks rallied appreciably during the first quarter on the back of enthusiasm for the pro-business/anti-regulation promises of the new Trump administration. As the quarter closed, Wall Street backed off of its recent highs as hopes diminished for a rapid implementation of tax reform and infrastructure spending following the administration's healthcare delay. Nonetheless, the quarter end found the broader market more than 6.5% higher than at year-end. The IT sector led the charge with gains of almost 12.6% while the energy sector played the laggard with a decline of more than 6.6% in the face of the recent fading of oil prices as the winter progressed.

While U.S. Treasury yields remained largely unchanged during the quarter, some areas of concern have recently risen. As the quarter closed out, junk bond investors were demanding a risk premium relative to the U.S. Treasury that was 15% higher than that required in early March. The larger differential indicates that bond investors see these companies to be riskier than they were a few short weeks ago – an attention grabbing shift as the junk-bond market is a widely watched barometer for those seeking clues about the U.S. economy.

Returning to fundamental factors for a moment, current expectations are that the S&P 500 companies will report first quarter earnings increases of 9.1% - their best performance since 2011 and the 3rd consecutive quarter of growth. According to Ned Davis Research, the median expectation for the earnings growth of S&P 500 companies is 7.8%. While these numbers are good but not great, they show that analysts have not become overly optimistic about the current corporate earnings recovery.

When looking at the overall health of Wall Street, all is not necessarily good as the CBOE Volatility Index, better known as the market's fear gauge, remains abnormally calm with current readings lower than all but 3% of historical readings. The first quarter's average reading was 11.7, the second lowest quarterly reading since the index's inception almost 30 years ago. During the quarter, the S&P 500 only had one decline in excess of 1%. On average, extremely low readings have historically coincided with subpar returns. That being said, low VIX readings have also been followed by perfectly respectable market performance in subsequent months and even years. Markets love to climb a wall of worry. Our concern, however, is that there is very little anxiety to be found in today's markets.

Many investors continue to hope for a market correction as they believe such a retrenchment would tamp down on recent speculation, deflate pockets of froth in popular investments and provide buying opportunities for those still on the sidelines. The guiding conviction, and which we largely share, is these periodic declines serve an important function in a healthy market cycle. By contrast, long periods without corrections can lead to unruly trading and end in larger, more disruptive declines. While much of last year's rally reflects a more positive evolution in the global economic outlook now appearing healthier than it has in several years, some analysts fear that stocks' surge since the election has left corporate profit growth behind.

The new administration has indicated its strong support for pro-business/anti-regulation measures along with substantial tax reform; all are tools which could further spur on economic growth and the financial markets. Notwithstanding this potential positive narrative, the current market upswing started more than 8 years ago. We cannot readily predict when the current bull will be laid to rest, only that it will happen as a normal part of the market cycle. sooner rather than later. As a result, we encourage investors to be clear on both their long-term needs and financial goals. With this knowledge in hand, a risk appropriate strategy, and portfolio, can be successfully crafted.

Performance as of 3/31/17

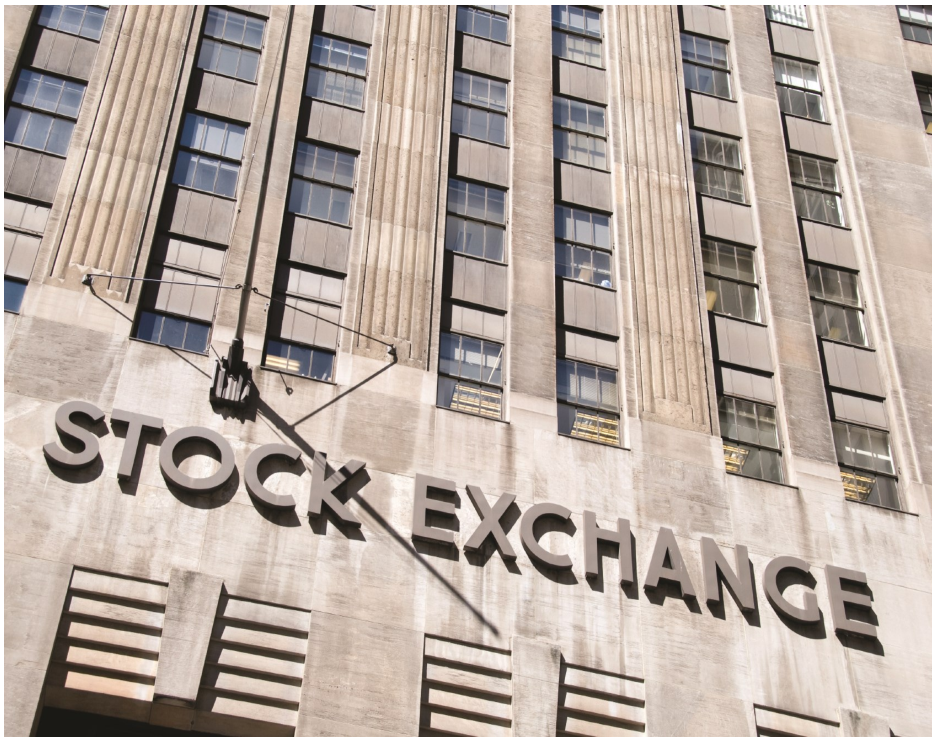
	Close	Month	YTD	1 Year
DJIA	20,663.22	-0.60%	5.19%	19.91%
S & P 500	2362.72	0.12%	6.07%	17.18%
NASDAQ Comp.	5911.74	1.48%	9.82%	21.89%

	Quarter end yield	Prior Year end yield	Yield 1 year ago
10 yr. U.S. Treasury	2.40%	2.48%	1.79%

Planning Thoughts

Like an early death, few want to consider the likelihood of a pre-mature disability. Unfortunately, the probability of long-term disability is several-fold higher than that of an early death. The most valuable tool to reduce the financial risk of early disability is long-term disability insurance (LTD). In purchasing LTD, care should be taken to pay premiums with post-tax dollars as this results in benefits being tax-free. For those who work in a specialized profession, an "own occupation" rider should be considered de rigueur.

In the event of disability, there can be substantial financial repercussions –even factoring in existing LTD. Often an individual's tax situation will change as tax deductions for medical and mortgage expenses may no longer be useful since the insurance's benefits are tax free. Current spending goals will often need to be modified while retirement plans often must be re-set based on the changed cash flow situation. While ill health is daunting to consider, we strongly encourage you to take action now to reduce the risk to your long-term financial health!



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