DELTA
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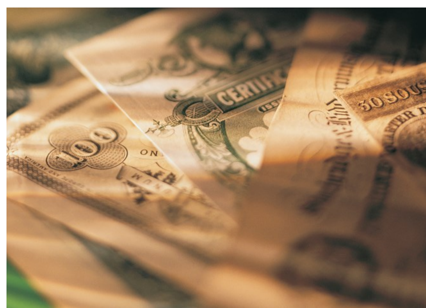
Economic Comments

The winter of 2018 saw the close of Janet Yellen's 4 year tenure as head of the Federal Reserve with her successor, Jerome Powell, assuming the role in February. Under Chair Yellen, the U.S. central bank sought to navigate between two conflicting signals, falling unemployment and stubbornly low inflation. Ms. Yellen's solution was to raise rates gradually—just three times last year. Her intent was to allow historically low unemployment to nudge inflation up to the Fed's 2% goal without sending price pressures out of control. However, the latest fiscal policy changes by the Trump Administration have delivered a curveball to this strategy by providing additional fuel to the American economy. Leading up to the FOMC's March meeting, the first to be led by the new chairman, Mr. Powell promised continuity with the strategy of only gradually raising interest rates. Consistent with expectations, the March FOMC meeting saw an increase of overnight interest rates by 0.25 percentage points to a range of 1.50% - 1.75%. At the same time, the forecast of only two additional rate increases for the remainder of 2018 remains unchanged.

The multi-trillion dollar question moving forward though is the pace and size of rate increases for 2019 and 2020. The close of the Yellen regime saw expectations for only two rate increases in each of these years. Already though, the surge of fiscal stimulus resulting from the newly approved 2018 budget, combined with steady economic growth and historically low unemployment, has raised the question as to how long the Fed can maintain its current accommodative monetary policy. The new Fed leadership has already indicated that three rate increases for 2019 are most likely. In his first public comments since becoming Fed Reserve Chair, Powell expressed the belief that the U.S. economy is running so strongly that it is close to maximum employment, i.e. the lowest unemployment rate that does not spur rapid inflation. Having therefore met its mandate for full employment, Fed attention is shifting to its other mandate of price stability, i.e. an appropriate rate of inflation. As a quick refresher, the Fed's targeted inflation rate is 2%. The challenge has been that inflation, both too low (which the country has suffered for the last 9 years) and too high, causes substantial harm to the economy.

Looking at current economic data, the Labor Department's most recent unemployment report showed an economy firing on all cylinders. For March, unemployment remained at 4.1%, the same level it has now been for 6 months, and the lowest level since the year 2000. For the year's first quarter more than 202,000 jobs/month were created. March also saw the 90th consecutive month of job growth – by far the longest streak on record. Meanwhile, initial claims for unemployment compensation fell to 215,000, the lowest level seen since 1973. Even the labor force participation rate, which has remained at historically depressed levels since the Great Recession, has shown recent improvement as this reading rose a healthy 0.30 percentage points to 63 percent. That being said, the employed share of the population 25 to 54 years old, the age range economists generally consider a person's prime working years, is still almost a full percentage point below where it was on the eve of the Great Recession, and more than two percentage points below where it was before the 2001 recession.



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Economic Comments continued from cover

American consumers, confronting a tightening labor market, rising home prices and December's tax cuts, have become more optimistic recently. As a result, a March reading of consumer sentiment unexpectedly jumped to a 14 year high after the recent tax cuts boosted disposable incomes. However, a potential trade war with China has raised inflation expectations and dimmed the future outlook according to a recent University of Michigan survey. On balance though, the U.S.'s economic engine remains strong with the final reading of 4th quarter's gross domestic product rising at an adjusted 2.9% annual rate. This unexpectedly strong performance exceeded expectations and was up from the prior estimate of 2.5% growth, and only a little slower than the year's second and third quarters. The growth forecast for 2018's first quarter though is anticipated to be on the softer side. Forecasting firm Macroeconomic Advisers currently projects a more tepid 1.8% growth rate for the period. However, forecasts for another strong year in 2018 remain in place, aided by tax cuts, government spending, rising incomes, low unemployment and healthy growth overseas.

The only cloud on the economic horizon has been weak wage growth which has been lower than most analysts had expected given the historically low unemployment rate. Economists have proposed many potential explanations for this low growth of wages including globalization all the way to weak productivity growth. No matter, expectations are that in the near future, businesses will be forced to raise wages more rapidly to attract and retain workers. Meanwhile personal consumption expenditures, the Fed's preferred gauge for inflation, increased at a seasonally adjusted 0.20% in February. Excluding volatile food and energy costs, prices rose 0.20% in February. The latest reading suggests inflation is creeping closer to the Fed's 2% annual target and offers policy makers some comfort in their ongoing struggle against persistently low rates of inflation.

With the current economic expansion now 9+ years old, the question on everyone's mind is what event will eventually derail the current economy? There are a number of potential suspects although the one that has received the most attention recently is the war of words by the Trump Administration about our trade with China. Even Fed Chair Powell has shared concerns regarding this quickly escalating dispute.

In picking a fight with China, President Trump is only following up on one of his many campaign promises. However, we are concerned about the potentially far reaching consequences of his recent gamesmanship with America's largest trading partner.

Analyst Corner

With the media and entertainment business undergoing rapid change, content producers have been conducting a desperate struggle with content deliverers. One company that we believe will weather these storms well is Discovery Communications (*NDQ– DISCA*). Discovery, a global media producer, is taking vital steps towards defending its franchise. Just weeks ago, the company took the aggressive step of buying a larger company, Scripps Networks Interactive. Upon the deal's completion, Discovery substantially broadened its content offerings while also appreciably increasing the firm's debt load. On balance though, we believe that this acquisition has positioned DISCA well for the quickly evolving market place. However, given the size of the transaction and the debt associated with the purchase, investing in Discovery is not a low risk proposition. That being said, for the appropriate client, some shares of DISCA should prove to be worthwhile.

Market Comments

Our current bull market is just five months away from becoming the longest market upswing ever. Unfortunately, and after largely being absent in 2017, market volatility came roaring back in the year's first quarter on the shoulders of Federal budget battles and a brewing trade war with China. While fights over the Federal budget drove an initial spike in market fear, attention shifted to a looming trade war with China as the quarter closed. Although stocks initially surged ahead almost 7% as the year commenced, the quarter closed with the market showing a modest loss, largely on the back of concerns over a threatened trade war with China. Interestingly, the first quarter marked the first time in two and half years where both the S&P 500 and the Dow posted a loss.

Assessing the underlying performance of the various market segments, the IT sector continued to shine with this group advancing more than 3.5% for the quarter as investors sought higher growth businesses. The market laggard was the telecom sector, continuing its poor performance of last year as the sector declined almost 7.5% in the year's first quarter. In addition to concerns over proposed corporate acquisitions, telecom investors remain alarmed by the segment's poor earnings growth. On the fixed income front, bond yields modestly increased with 10-year U.S Treasury obligations paying an extra 0.30 percentage points by the end of March. Recently though, the gap between 2-year and 10-year Treasury yields has shrunk to its narrowest differential since 2007; this reduced yield spread differential suggests that investors are betting that the Fed will raise interest rates at least two more times this year. Critically, this shrinking interest rate gap can also be seen as a sign of weakening sentiment about economic growth.

Meanwhile, December's tax legislation, which slashed the corporate tax rate to 21% from 35%, has muddled many corporate earnings reports as most large public companies have had a number of one-time modifications to their financials. Additionally, the corporate tax code changes created an incentive for some firms to shift earnings and expenses between late 2017 and early 2018. Several quarters will have to lapse before the tax-related noise fades from profits reports. In general though, excluding these one-time tax related items, America's corporate earnings have been solid. Providing additional optimism has been the strong economic growth globally which should continue to provide support for Wall Street for some time to come.

However, the path upward is not likely to be smooth. In the first quarter alone, the S&P 500 has already suffered 11 days of declines of 1% or more. The market's fear gauge, the CBOE Volatility Index, jumped almost 100% in the first quarter and has remained at these more elevated levels. With the S&P 500 closing the quarter down 8% from its last record close in late January, a more jaundiced view could yield a more negative thought on Wall Street's prospects.

Modest but improving economic growth and a gradual rise in interest rates may indeed continue to characterize the year's financial markets but, signs of higher inflation, rising U.S. interest rates and threats of a global trade war have clearly shaken investor confidence. At the same time, large, positive surprises on global growth have started to fade, according to the global chief investment strategist at BlackRock, the world's largest money manager.

What does all of this suggest for investors? At a minimum that they should not be stretching to assume risk at this stage of both the economic and market cycles. Rather today's investors should be focused on assuming only the risk level that will both let them sleep soundly at night and achieve their longer term financial goals. To do otherwise would be fool hardy.

Performance as of 3/31/18

	Close	Month	YTD	1 Year
DJIA	24,103.11	-3.59%	-1.96%	19.39%
S & P 500	2640.87	-2.54%	-0.76%	13.99%
NASDAQ Comp.	7063.45	-2.88%	2.32%	19.48%

	Quarter end yield	Prior Year end yield	Yield 1 year ago
10 yr. U.S. Treasury	2.74%	2.40%	2.40%

Planning Thoughts

Created more than 20 years ago, 529 plans were designed to help pay for higher education costs with tax free assets. Once cash is deposited into a 529 account, funds may be removed fully tax-free so long as they are used for qualified expenses. What is lesser known is that the 2017 tax reform act allowed for the plans to cover up to $10,000 a year per individual of qualified K-12 expenses. The wrinkle, at least for some states including LA, is that 529 plans cannot be used for K-12 expenses until the state legislature amends current state law. Given the current budget issues for Louisiana's state government, it is not certain that the needed legislation will be passed in the Sportsman's Paradise anytime soon.

However, even in the absence of the new K-12 benefit, 529 plans strengths are highly compelling. In LA, the local Start Savings plan has very low costs, a partial matching of plan contributions and State tax credits awarded for plan contributions. If you have not yet availed yourself of this attractive tax vehicle, and want to help someone with their educational costs, we urge you to consider a 529 plan. As always, give us a call if you would like to discuss this opportunity further.

Partners

Gerard A. Plauché, CFA

Clifford F. Favrot, CFA CFP™

Ainsley D. Bishop

Frank A. M. Williams, Emeritus

Operations Manager

John T. Egnatchik

Office Manager

Angelle M. Verbois

Contact Us Toll Free:
1-888-522-9019

228 St. Charles Avenue, Suite 1100, New Orleans, LA 70130
504-522-9019 PHONE • 504-522-9676 FAX

www.deltafinad.com