John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday June 7, 2017

"Some have posited that the key long-term market driver is monetary policy. Others believe the current rally is built on the promise of fiscal policy. From our perspective, the stock market is reinvigorated by the great earnings season" (*Argus Update* June 2017 issue)

As of May 2, with more than 70% of companies having reported, S&P 500 earnings from continuing operations for the opening quarter of this year are up15.4%. Towards the end of last year,

the consensus forecast among analysts was for a 9% gain in the first quarter. This time, and for the first time in a couple of years, analysts were far too cautious. The opening quarter even beat the Argus optimistic forecast. Argus chief Investment Strategist Peter Canelo predicted a 13% gain in S&P 500 first quarter earnings. At the time he published his calculations, he looked too optimistic compared with his fellow analysts. Now he is praised for being one of the more accurate forecasters.

The last time S&P 500 earnings grew at a double-digit rate was in the second quarter of 2014, when they gained 11%. The third quarter came close to double digits, but after that earnings suffered. For the rest of 2014, and all of 2015 and 2016, earnings limped along with single digit losses interspersed with a few single digit gains. That nine -quarter period is now labeled an earnings recession. To the shock of pessimists, stocks did not succumb to the earnings recession. There was no stock market plunge. There were bouts of volatility, but on balance stocks performed better than in past earnings recessions.

The earnings recession was finally over when fourth quarter 2016 earnings were reported. But they were up only 5% in last year's final quarter - not enough to silence the pessimistic stock market bashers. This year's burst of earnings growth has changed that for the better. Pessimists' forecasting ability has suffered a blow.

The oil price collapse was a major part of the earnings recession. Energy companies suffered losses dragging down overall S&P results. Now that the oil price has stabilized, energy company earnings are growing again, providing a boost to S&P overall results. However, a very bright spot in this year's opening quarter is S&P earnings excluding energy. They gained 11.5% in the first quarter - a clear signal that the earnings recession is over, and that we have begun a new earnings growth cycle.

Another confirmation that a new growth cycle has begun is that positive earnings surprises far outnumbered unforeseen negative results. With 75% of companies having reported, only 18% missed expectations and 7% met analysts' expectations. The rest, or 50% of companies, beat analysts' expectations. That is a very healthy result.

Besides energy companies, where results are astronomical because they are going from losses to profits, the best sectors for first quarter earnings growth were Information Technology and Materials. Healthcare and Financial companies also did well, reporting double digit earnings growth.

Earnings growth was supported by growth in revenues. Year-over-year revenue growth was 7.6% in this year's opening quarter.

What’s next? Argus researchers see earnings growth continuing this year and next. “We forecast three more quarters of double digit growth across the remaining quarters of 2017. We will adjust on the fly, but for now forecast high-single-digit EPS growth across the four quarters of 2018.

Fiscal policy in the form of tax reform and infrastructure spending could influence 2018 earnings, likely to the upside. Our forecast builds in no tangible progress on either of those initiatives and reflects the solid work by top-tier companies to build sustainable profit-growth models.”

First quarter earnings growth provides a solid foundation for stocks at current valuations. For the rest of this year stock prices will likely follow earnings to higher ground.

During his campaign, and for weeks after the election, President Trump frightened economists and investors with scary talk about trade with China. He is still talking tough about trade deficits, most recently bad mouthing Germany. However, recent trade agreements between the U.S. and China are very positive. President Trump’s tough talk may be positioning before negotiations.

“The 100 day-trade plan between the U.S. and China reached its first result this month, with the release of a 10-point trade deal. It promises to boost market access between the two nations in agricultural products, energy, financial services and investment. The trade talks, which began last month with a meeting between U.S. President Donald Trump and Chinese President Xi Jinping, are seen as a big turnaround from Trump’s election rhetoric which almost slammed China’s trade practices for harming U.S. employment.

While the terms of the new deal could spell good news for some U.S. companies, whether they can substantially narrow down the nation's overall trade deficit with China (which touched $347 billion last year) is something that's too soon to predict. Also, as we know, the stages between promises and implementation often take time to unfold.

Bottom Line for Investors

Compared to murmurs of trade war possibilities not too long ago, the new U.S.-China trade deal is a glimmer of hope for American companies in industries covered in the deal. However, for opportunities to progress into tangible gains, much depends on the *final* stages of regulatory approvals-which do not manifest overnight. Plus, there are capacity issues to resolve and competition to strategize before U.S. players can invest towards their expansion in Chinese markets.

The new deal may not be a major needle-mover for U.S. trade balance with China in the near-term, but over time it could help in bolstering U.S. exports to China, *unless* there's a marked departure of regulatory verdicts from the deal's potential." *Zacks Investment Research*

The media is focused on anything and everything negative about President Trump. That is their privilege. Positive economic developments are being ignored by the media. Fortunately, that is not the case when it comes to economists and the markets. The positives including robust earnings growth and a new trade deal with China are real. And fundamentals will continue to drive financial markets, including stocks.

I will have the next market review and update for you one week from today on Wednesday, June 14, 2017.

All the best,

John Dessauer

© June 2017