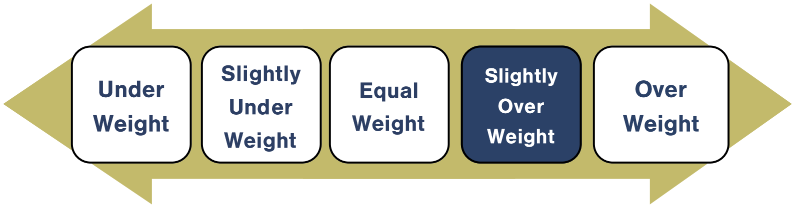
SFMG WEALTH ADVISORS
AN INDEPENDENT WEALTH MANAGEMENT FIRM

ECONOMIC AND MARKET UPDATE - JUNE 2017

SFMG MARKET RISK SIGNAL—STOCK ALLOCATION



CURRENT ASSET CLASS ALLOCATIONS

The U.S. equity markets remain in a long-term uptrend. We have maintained our equity exposure and are **Slightly Over Weight** to stocks. The allocation mix of bonds vs. equities depends on our risk signals that shift our weightings accordingly.

ECONOMIC NEWS

- The Federal Reserve raised rates in June by 0.25%, bringing the Fed funds rate to a range of 1.00–1.25%. Strength in employment, business investment, and household spending were cited as their reasoning.
- Optimism among U.S. small businesses remains high and has been an important factor in the aforementioned business spending as a part of economic growth.
- Retail sales fell 0.3% in May, the biggest decline in 16 months. While this single data point didn't change the Fed's decision to raise rates, it's ultimate impact on Q2 GDP growth could influence the pace of future hikes.

MARKET NEWS

- Oil prices hit a 7 month low, down just over 20% in the past year. This puts crude into a bear market, i.e. greater than 20% decline, and has also weighed on energy stock prices.
- Despite the recent pullback, the tech sector has been a major contributor to market growth this year compared to more interest rate sensitive sectors such as financials.
- European equities have one more worry in the rear-view for the moment with the Italian government agreeing to bail out two of the country's failing banks. The bailout is stirring controversy however, as the terms have taxpayers footing the bill as opposed to the bank's investors.

EUROPEAN ECONOMY AND EARNINGS DATA

Source: IBES, Thomson Reuters, Citi, as of May 19, 2017.

Earnings revisions from analysts for Eurozone companies (blue line) shows sustained strength, i.e. more earnings upgrades than downgrades. Economic data has also been surprising to the upside (green bar). Company profitability estimates however are still only around 50% of their pre-financial crisis peaks, which supports the more reasonable valuations investors are finding in the region.

AIRLINE STOCKS PUSH HIGHER

Past performance does not guarantee future results. **Source:** Bloomberg, U.S. Global Investors

Airline stocks are just surpassing their peaks from before the 9/11 terrorist attack in 2001. Although airlines are a notoriously cyclical industry, consolidation among smaller carriers has helped the now fewer larger airlines better control costs. That said, they are still affected by fuel costs and the current prices should provide a tailwind to airlines and other transportation-related industries as well.

CURRENT THOUGHTS

U.S. inflation still hasn't accelerated in a meaningful way, which has been a bit of a surprise to the markets and the Fed. This along with some moderation in economic growth is increasing the probability of fewer rate hikes for the rest of this year. Likewise, the European Central Bank (ECB) also expects a pickup in inflation and consequentially the ability to gradually reduce monetary stimulus. If the U.S. Fed's monetary stimulus impact on inflation is any indication, it's not likely inflation will take-off in Europe, especially with the added pressure of low oil prices. While expansions in the U.S. and Europe can continue without higher inflation, the level of interest rates is a key consideration. Without higher inflation, rates should remain relatively low, which is unfavorable for certain sectors. Banks around the world for example have been squeezed by low rates for years. While banks in Italy being bailed out relieves some immediate concerns, banks in Europe are still being closely watched by investors. U.S. banks have also been under the microscope with the Fed completing a "stress test" to measure banks' ability to operate efficiently during a recessionary period. The results were positive overall and the Trump administration will likely use that as justification for some form of bank deregulation. That said, bank deregulation and tax reform are still uncertainties, given the difficulty in attempting to pass a healthcare bill. More central bankers are sounding more restrictive in their forecasts for monetary policy, which could be making investors nervous, leading to some of the recent weakness in the markets. But after a prolonged period without a meaningful pullback, a correction could be the catalyst needed for a continuation of the bull market.

Contact one of our Wealth Management professionals today at **972.960.6460** or visit us online at **www.SFMG.com**

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