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After a long time of having watched economic and investment market behavior, I don't remember seeing so many indicators as relaxed as they seem to be now. Perhaps the removal of some suppressive regulations of the past decade has been helpful. Certainly helpful were the cuts in corporate and personal income taxes. Although opinions vary about the extent of that economic stimulation, there is little doubt that the combined effect will be substantial and across the board.

Consider the breadth of developments beyond tax relief: tariff increases to reduce the $550 billion US trade deficit and bolster domestic production; a new trade agreement with China to reduce that $350 billion portion of the deficit; widespread construction projects to restore roads, bridges and other projects encompassed by the term "infrastructure"; and restoration of US military equipment including ships, tanks and weaponry. On top of that, some American factories abroad presumably will be returning to the US or expanding to prepare for the inflow of business.

When a portion of those plans start to be felt late this year and in the two years following, the measures of the current domestic prosperity will be elevated.

Employment, for example, now at about 63 million persons, should move to record levels of around 65 million, wages which had been rising by 2.6% annually should advance beyond 3% even without a boost in the minimum wage, and GDP growth seems likely to reach rates above 4% compared to 2.5 to 3% recently. Actual labor shortage is being reported in the Midwest which would add to the tendency to raise wages.

Other background factors also are conducive to expansion such as the political focus on trade by the President, himself a businessman, along with union workers who look forward to positive changes in international trade. Also, there is a growing awareness that restrictive trade rules imposed by Europe and China might be relieved through skillful negotiation which is a noteworthy part of the Presidential skill set.

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These expansionary trends are taking place at a time of a benign financial condition which is capable of accommodating the advancing wave of prosperity. Interest rates are low (but will be moving up), and stocks appear to be reasonably priced at about 17 times estimated 2018 earnings.

A limiting factor to every expansion is the rate of inflation as expressed by labor and materials costs and product price trends. Inflation was suppressed in recent years by sluggish growth rates but if we are correct in the expectation of accelerating growth, a gradual rise in inflation should develop. Under such conditions, long term bonds would decline in price (that is why we have excluded them from your investments) and stocks and real estate values would tend to rise, both because of the inflationary price effect on corporate assets and the increased flow of investment money out of long bonds and into stocks and real estate.

Recent events which have been roiling the market lately include the presidential criticism of Amazon and Facebook, the former for benefitting too much from low Post Office delivery costs and the latter for questionable ethics in the use of personal data of FB users. It is possible, also, that the tariff impositions could have negative effects on some companies.

Another factor may be the increased flow of illegal immigrants from South of the border, most of whom, presumably, hope to participate in the American prosperity, either by working or by welfare. Finally, the President's tendency to target companies or countries with offhand criticism might contribute to the skittishness in the stock market.

Sincerely,

John May

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