

Eagle Eye

October 2017 | www.EagleStrategies.com

Market & Economic Outlook

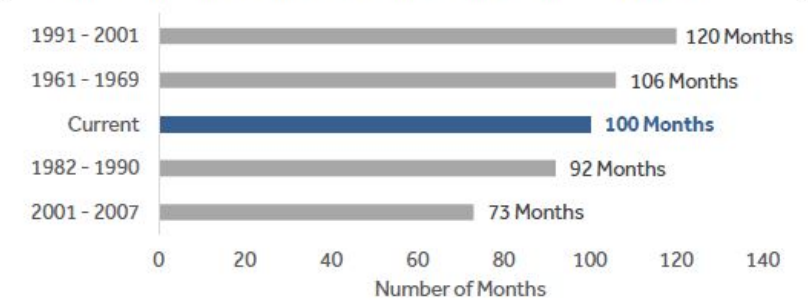
Eagle Strategies is pleased to present economic and market insights from the Portfolio Managers in the MainStay Investments Strategic Asset Allocation and Solutions Division.

“As long as the music is playing, you have to dance. We’re still dancing.” — former Citi CEO Chuck Prince

The long climb endures. The U.S. economic expansion is now into its ninth year making it the third longest in U.S. history. Expansions aren’t limited by time, but the sheer longevity of the current cycle does demand that we be mindful of an eventual turning point. More disconcerting are some indications that a turning point may be approaching:

- 1) Unemployment readings have fallen to very low levels with many business owners reporting difficulty filling open positions.
- 2) The Federal Reserve Bank continues a series of rate hikes that look increasingly well entrenched, even as they begin to mop up excess liquidity in the financial system via balance sheet runoff.
- 3) There are some signs of excess in the credit markets: underwriting standards are relatively lax, use of leverage is heavy outside of the financial sector, and delinquencies are rising in some areas, such as credit card debt and auto loans.

Current Economic Expansion is Third Longest in U.S. History



Sources: Strategic Asset Allocation and Solutions Group (SAS), NBER, 9/30/2017.

On the radar screen

1. We are keeping a close eye on wage gains as an indicator that we have moved beyond full employment; that core inflation may be percolating; and that tighter monetary policy lies on the horizon.
2. Rising wages ultimately threaten corporate profitability. As we move through the upcoming earnings season, we will be monitoring profit margins for the possible compression from their current elevated levels.
3. We hear anecdotal reports of lax underwriting standards—or “covenant-lite” issues—and mounting use of leverage [leveraged buyout (LBO) debt exceeded earnings before interest, taxes, depreciation, and amortization (EBITDA) by seven times, which is above regulatory guidelines.] Deteriorating credit conditions are not yet a source of immediate concern, but the trend is worrisome.
4. With monetary policy shifting into reverse, a boost from fiscal policy would be welcome. Tax reform could do much to engender faster economic growth, but we are skeptical that a meaningful piece of legislation can be passed in the current political environment. Negotiations through the fall will be telling.

Without ignoring these cautionary omens, a broader reading of incoming data suggests growth of economic output is likely to continue for a while longer. Even though the Fed is in the process of gradually removing monetary accommodation, current conditions are nevertheless extremely benign. Rates remain low in both absolute and real terms, credit spreads are tight, lending standards are not stringent, and equity pricing is generous. Elevated confidence readings and ready access to inexpensive debt have combined to drive both household spending and business capital expenditures.

Demographic changes, technological developments, and globalization help to constrain inflation—allowing the Fed to move slowly in normalizing policy and thereby extending the life expectancy of the current cycle.

Anticipating that the expansion still has room to run, we are not yet defensive in our portfolio positioning, nor are we aggressive in our risk posture. Our reluctance to lean into risk assets is our belief that valuations are rich across most assets in the U.S. We also harbor some concern that wage inflation, oddly absent thus far, will begin to rise soon—eating into corporate profitability as it does. All this being so, we’ve set our overall equity exposure close to benchmark weight, reallocated holdings within the fixed income portion of our portfolios to favor higher quality and shorter duration instruments, on average, and redeployed equity assets away from the U.S. toward stocks in developed and developing foreign markets where we believe growth opportunities are more attractive.

“ A tax loophole is something that benefits the other guy. If it benefits you, it is tax reform.” – Russell B. Long.

In punting the debt ceiling and government funding issues to December, President Trump was trying to clear space on the calendar for Congressional Republicans to tackle tax reform. While certain to garner headlines throughout the fall, we are doubtful that a substantive piece of legislation can be passed. We wish we could say otherwise, for a more efficient tax system promises significant long term structural benefits at no cost, but we simply can’t see meaningful reform in the current political environment. At its core, tax reform requires lots of compromise and will bring with it winners and losers. Given the extreme partisanship that exists today and rampant internal warfare within Republican ranks, it strikes us as improbable that such compromise can be secured. A more likely outcome is that a modest tax cut with little actual reform is passed offering only a small fiscal boost to the economy and adding to the nation’s ever-mounting debt burden.

The GOP Tax Bill Looks to Significantly Reform the Tax Code

Corporate	
Corporate Tax Rate	20%
Expensing	Businesses will be able to expense equipment for five years
Repatriation	Two rates—cash vs. hard assets
Business Tax Credits	R&D and low-income housing credit preserved, most others eliminated
Personal	
Individual Tax Rates	Three individual rates: 12%, 25%, 35%
Itemized Deductions	Charitable giving and mortgage interest deductions preserved, most others eliminated
Standard Deduction	Nearly doubled: \$24,000 for a couple and \$12,000 for single filers
Personal Exemption	Repealed
Estate Tax	Repealed
Alternative Minimum Tax (AMT)	Repealed

Source: Comerstone Macro Research, "Unified Framework for Fixing our Broken Tax Code," Trump congressional tax plan outline, 9/27/17.

“You cannot surprise an individual more than twice with the same marvel.” - Mark Twain. Two months ago, North Korea set markets on edge with the launch of an intercontinental ballistic missile that was met with “fire and fury” hyperbole from our own President. Several missiles and one underground nuclear detonation later, and such antics barely merit comment from market pundits. The novelty has worn off.

Given the catastrophic implications of actual military conflict, the likelihood of such has struck us as being extremely remote from the outset. Nevertheless, the crisis can be a clear and present threat to capital markets. Allowing the Kim regime to obtain the expertise needed to deliver a nuclear warhead to the continental U.S. is simply not a state of affairs the Trump administration is willing to accept. Pressure is being brought to bear on other nations believed to have influence over North Korea, most specifically China. Our worry is that this pressure has the potential to spill over into a very damaging trade war. “Rocket man” could inflict great harm on Western economies simply in pursuing the bomb, regardless as to whether he is successful in obtaining it. It’s our relationships with our trading partners that are vulnerable, not Guam.

Past performance is no guarantee of future results.

Eagle Strategies LLC (Eagle) is an indirect wholly owned subsidiary of New York Life Insurance Company and an SEC-registered investment adviser. Registration with the SEC does not imply a certain level of skill or training. Eagle investment adviser representatives (IARs) act solely in their capacity as insurance agents of New York Life, its affiliates, or other unaffiliated insurance carriers when recommending insurance products and as registered representatives when recommending securities through NYLIFE Securities LLC (member FINRA/SIPC), an affiliated registered broker-dealer and licensed insurance agency. Investment products are not guaranteed and may lose value. No tax or legal advice is provided by Eagle, its IARs or its affiliates.

About Risk: All investments are subject to market risk, including possible loss of principal. **Stocks and bonds** can decline due to adverse issuer, market, regulatory, or economic developments. **Foreign securities** can be subject to greater risks than U.S. investments, including currency fluctuations, less liquid trading markets, greater price volatility, political and economic instability, less publicly available information, and changes in tax or currency laws or monetary policy. These risks are likely to be greater for emerging markets than in developed markets. **A bond’s prices** are inversely affected by interest rates. The price will go up when interest rates fall and go down as interest rates rise. **Bonds** are subject to credit risk and interest rate risk. **Diversification** cannot assure a profit or protect against loss in a declining market. **Active investing** is an investment strategy involving ongoing buying and selling actions by the investor. Active investors purchase investments and continuously monitor their activity in order to exploit profitable conditions. Active management typically charges higher fees. **Passive investing** is an investment strategy that aims to maximize returns over the long run by keeping buying and selling to a minimum. The idea is to avoid fees and the drag on performance that frequent trading can potentially cause.

Eagle Strategies

51 Madison Ave

New York, NY 10010

www.eaglestrategies.com

ES.EagleEye_APR 2017

The information and opinions contained herein are for general information use only. MainStay Investments does not guarantee their accuracy or completeness, nor does MainStay Investments assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are as of the date of this report, are subject to change without notice, and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. There can be no guarantee that any projection, forecast, or opinion in this material will be realized.

SMRU #1751891
Exp. 9/29/2019

MainStay Investments® is a registered service mark and name under which New York Life Investment Management LLC does business. MainStay Investments, an indirect subsidiary of New York Life Insurance Company, New York, NY 10010, provides investment advisory products and services.