THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – JUNE

US Markets and Economy:

US stocks rose to new highs in June, led by the Dow Jones Average, which rose nearly 400 points (1.62%) in June. The S+P 500 logged a more modest gain of 0.48%, while the Nasdaq actually lost about 0.94% for the month. All three indexes are up sharply for the first half of the year.

The bull market is now the second longest in history, at 100 months, exceeded only by the 1990-2000 bull market which lasted 113 months. Fueling the rally have been corporate profits, which are growing again after a "profits recession" which lasted five quarters. The consensus outlook for the rest of the year is for profits to continue to grow at a 10% annual rate. Built into this forecast is an assumption that the Trump administration will achieve its goals in terms of health care reform, tax reform, and deregulation, all of which should drive corporate earnings higher, and thus provide still more fuel for a stock rally.

More fuel: monetary policy remains accommodative. Even though the FOMC did raise its nominal overnight benchmark Fed Funds rate by ¼% in June, to a current range of 1% to 1¼%, this rate is still below the current rate of inflation of 1.6%. This means that the real (nominal minus inflation) Fed Funds rate is still below zero. The Fed has also hinted that this sensitive short-term rate may not exceed 1½% by the end of the year, meaning that the real Fed Funds rate will stay negative all year. In addition, the US 10-year Treasury yield ended June at 2.3%. This decline not only drives bond prices higher, but makes stocks, which yield about 2%, and which compete with bonds for investors' money, even more attractive. These low rates also stimulate economic growth (and thus corporate profits) by keeping the cost of borrowing low for consumers and businesses. The outlook on US interest rates may be even more favorable than the consensus forecast, since several FOMC members have suggested in public statements that the Fed might consider not raising rates again this year. Their reasoning may be that, with inflation still below the Fed's target, and the economy growing slowly, the Fed can continue to push the economy forward with very low rates. Indeed, the revised first-quarter real GDP growth for the US was very slow at 1.2%. This growth is expected to pick up in the rest of the year, however, with the Wall Street forecast for the second quarter of about 3% growth. What has clearly surprised many FOMC members, and many economists, is that wage and price inflation has remained low even though the US unemployment rate has dropped to 4.3-4.4%, near its lowest level in 16 years. Under normal textbook conditions, this rate is low enough to force businesses to raise wages to attract workers, and then pass those higher wage bills on to consumers in the form of higher prices. The FOMC's "doves," who are more concerned with employment growth than inflation, may thus win the day in 2017, which will make the monetary environment even more favorable for US stocks. The US dollar weakened further in June, which is welcome news to US exporters, who will thus face a bit less of a currency handicap when competing with the rest of the world's exporters.

World Markets and Economy:

Monetary conditions are certainly favorable for stocks in most of Europe and Japan, too, where short-term nominal interest rates remain negative, a development that most economists used to think was well-nigh impossible. But it is not just short rates. At the end of June, the German government 5-year bond was yielding -0.4%, and the Japanese government 5-year bond was yielding -0.1%. As one would predict, this extraordinary monetary ease has driven the German stock market up 33% in the last 12 months, and the Japanese market up 37% over that time.

The power of easy money, driven in part by Quantitative Easing in both Europe and Japan, and further supported by very stimulative fiscal policy in Japan, may finally be sufficient to end stagnant growth in Europe and Japan. Historically low levels for the euro and yen (the counterpart to historical strength in the US dollar) have also stimulated exports from these regions.

Chinese stocks rose almost 5% in June, in part because they will be part of the MSCI World Index for the first time, and in part because the Chinese government is likely to keep monetary conditions easy before the major Party Congress in the fall of 2017, when there will be significant leadership changes.

OUTLOOK:

Monetary policy will remain expansionary in the US, Europe, Japan, and probably China, which should help support stock prices around the world. With growth slated to pick up speed in the US and perhaps even Europe and Japan, and inflation nowhere in sight, the outlook for world equities is positive.