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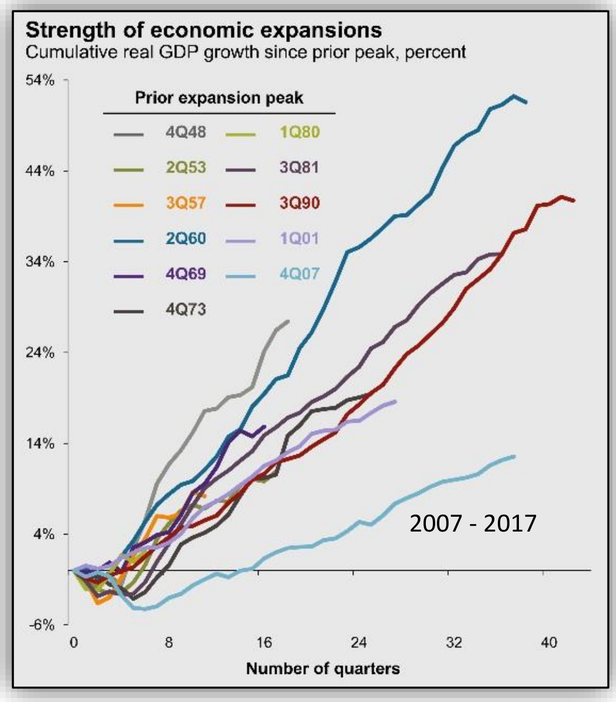
Our Economic & Market Outlook is "Cautiously Optimistic" – Alex Petrovic III, CFP®

Wow, half of 2017 is already behind us and, so far, it has been a good 6 months for the U.S. and global economy. Although there are always risks, at this point in time, we do not see a U.S. recession around the corner over the next 6 – 12 months. Barring some shock, the U.S. economy for now doesn't look at risk of imminent recession, though we continue to believe we are in the later stages of our economic growth cycle. Let's hit the economic highlights shall we!

U.S. Economic Growth: U.S. Federal Reserve officials continue to expect U.S economic (Gross Domestic Product, or GDP) growth of about 2.2% for 2017.

As you can see from the chart, this is the slowest economic expansion in the post-WWII era. This cycle of U.S. growth has averaged a little over 2% a year. Economists say there are multiple reasons for this, but slower labor force growth is one of the key factors. Unfortunately, economists have increasingly come to accept the view that slower U.S. labor force growth will limit our future domestic growth rate. Financial markets may have yet to fully embrace this "new normal." The silver lining though could be that this economic expansion ends up being one of the U.S.'s longest on record.

Regarding Trump's economic plan of reducing corporate and personal taxes and a large infrastructure plan, little progress has been made so far. We believe these will be difficult to achieve at the levels Trump and the financial markets had initially hoped. However, with or without these plans, U.S. economic fundamentals appear to remain sound.



Source: BEA, NBER, J.P. Morgan Asset Management.

U.S. Jobs: According to the U.S. Bureau of Labor Statistics, the unemployment rate was 4.4% in June, below what the U.S. Federal Reserve (or the Fed) considers to be a long-term equilibrium rate. "Wage inflation has been moderate, but officials fear a sharp pickup in inflation if the unemployment rate were to decline further," according to Raymond James Chief Economist Scott Brown. This is one of the key reasons why the Fed is raising interest rates, even though U.S. inflation remains below the Fed's target of 2%.

U.S. Interest Rates: The U.S. Federal Reserve has raised interest rates 4 times since December 2015, and the Federal Funds rate currently sits at 1%. The Fed is targeting 3% by the end of 2019, and the only way it will achieve rates close to 3% is if the economy and jobs outlook remains positive the next couple of years. Most market prognosticators don't believe the Fed will be able to increase rates continuously through 2019 given how soft growth and inflation have been.

The Fed also plans to begin reducing the Fed's enormous $4.3 trillion balance sheet later this year. The effect of both of these moves is to gradually reduce the stimulus that has been applied to the U.S. economy since 2007. Both the interest rate increases and the planned balance sheet reduction may (eventually) have a substantial impact on our economy and financial markets. Investors are anxiously hoping the Fed can successfully navigate 'taking away the punch bowl' from the economic party.

Global Growth: The Economist Intelligence Unit increased its forecast for global growth in 2017 to 2.7%, from 2.6% previously. The driver of the increase was an upward revision to its forecast for the euro zone, to 1.8%, from 1.6% previously, owing to a strong first quarter. The U.S., Europe and the broader global economy are currently all growing concurrently. This may not last for long, but it is most welcome. European and global stocks have performed very well this year as a result.

Chinese Risks: The health of the Chinese economy is probably the biggest risk to the global economy. China represents roughly 15% of global GDP, but it makes up approximately 25% of global GDP growth. In 2016 it grew by 6.7%, but this was achieved at the cost of a further increase in indebtedness. This credit expansion has continued largely unabated since 2008, and as a result, China's total debt-to-GDP ratio has ballooned from 162% in 2007 to 258% currently. The build-up in debt, particularly in the corporate sector, is unsustainable, and we think that once the president, Xi Jinping, has consolidated his power at a party conference in late 2017, he will sanction policies to rein in credit growth. As a result of these necessary policies, The Economist Intelligence Unit forecasts growth will slow sharply in 2018, to 4.6%, from 6.6% in 2017.

This kind of shift is unprecedented in modern China and will come at a time when the global economy is still weak and central banks have very limited scope to react. At a minimum, we think the world's second largest economy will keep slowing; at a maximum, it will suffer a crisis that impacts the globe given increasing trade and financial links.

In Closing: We are cautiously optimistic about the U.S. and global economy. In the U.S., Europe and China, these economies are trying to slowly reduce the stimulus that has been applied uninterrupted for almost 10 years. Thankfully, slow global growth continues, and could continue for years to come, but navigating high debt levels and rising interest rates will most likely be a bit bumpy in the coming years.