DELTA
FINANCIAL ADVISORS
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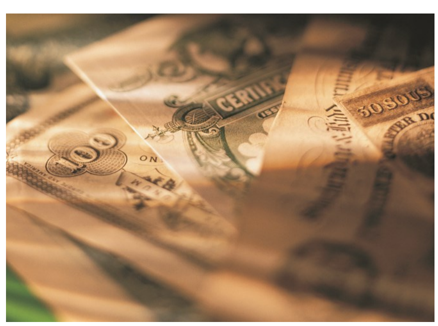
IN THIS ISSUE

Economic Comments

At its mid-June meeting, the Federal Reserve's Open Market Committee (the FOMC) did as expected and raised the targeted overnight interest rate to a range of 1.75% - 2.0%. Providing strong justification to June's rate hike was the expected 4% economic growth for the second quarter coupled with high consumer and business sentiment. Additionally, the U.S. central bankers forecasted their expectation of four interest rate hikes occurring in 2018 rather than the prior expectation for only three. What did come as a surprise though was the newly raised concern regarding the potential for the economy to overheat.

This change in stance came on the heels of the most recent reading of the Fed's preferred inflation gauge, the core personal consumption expenditures price index, which rose 2.3%. Since the recent inflation reading was above the Fed's target of 2%, officials indicated they would tolerate a slight overshooting of price increases to bolster inflation expectations after years of inflation running under the desired target. With inflation now at a six-year high, the Fed's goal is to raise interest rates just enough to keep prices from rising faster, but not so much as to smother growth. As a result, a number of central bankers indicated that the focus should shift to a neutral monetary policy, i.e. one that neither helps nor hinders economic growth. Raising rates to achieve a "just right" interest rate, where inflation runs neither too high or too low, is an exceedingly difficult task; policy makers have never managed to find this level without unintentionally tipping the American economy into recession. A consensus has formed among the bankers that the near-term monetary strategy should be to raise interest rates on a more regular and consistent basis.

On the American labor front, unemployment dipped as low as 3.8% in May, matching the lows last seen in the late 1960s, before climbing back to 4.0% to close the quarter. June's jobless rate climbed from May's low as an additional 601,000 Americans entered the labor force - not all of whom immediately found jobs. These are impressive figures in what is now the nation's ninth year of economic expansion. The U.S.' current "boring" economy has now produced an unprecedented record of 93 straight months of job growth. The slight month-over-month rise in unemployment was healthy as the increase reflected an uptick in the labor participation rate from 62.7% to 62.9%. This is a clear sign that that the historically low unemployment has prompted some who had given up on finding jobs to leave the sidelines and start new job searches.



(Continued on page 2)

Economic Comments continued from cover

The unstated mystery behind the recent employment milestone is why wage growth has not been more robust. With April's hourly earnings up 2.6% year over year, wages are increasing only marginally faster than inflation. While providing some relief that modest wage gains will allow the Federal Reserve to be more moderate in its raising of interest rates, today's 4% unemployment rate is appreciably different from that of prior years. Now the question arises as to whether joblessness might fall so much that the central bank should accelerate its pace of rate increases to prevent the economy from overheating. On balance though, with a smaller share of people now participating in the labor force as compared to prior decades, we believe this particular risk to be minimal.

Looking back at the recent quarter, the single biggest economic headline has been the rapidly escalating trade war brought on by the White House. Starting this past winter, the Trump Administration has been increasingly vocal in its desire to achieve a more level playing field for U.S. goods with its trade partners. The president has demanded action from both the U.S.' closest allies as well as its ideological enemies.

After initially imposing new tariffs on solar panels and washing machines in January, early June saw the Administration levying new tariffs on steel and aluminum imports from the EU, Canada and Mexico. Most recently, an additional $34 billion in import tariffs were to be levied on Chinese products in the first week of July. The challenge though is that each round of new U.S. tariffs have been responded to in like fashion by the targeted countries. We are unclear as to what the Administration's end game is but can only surmise that the president believes that the current economy is strong enough to withstand the current upheaval while achieving a structural improvement in the U.S.' overall global trading position.

With the current economic expansion now officially the second-longest in the post-WWII era, we believe that the U.S. has entered a late stage of the business cycle. Nonetheless, we do not believe that a recession is on the imminent horizon. This belief, however, is contingent upon a quick resolution, or at least a de-escalation, of the heated trade war.

Analyst Corner

Due to the consistent and growing global demand for both computer chips and display screens, Applied Materials Inc. (NDQ: AMAT) is sitting in the cat bird's seat. One of the globe's leading producers of equipment used to make both microchips and display screens, AMAT is well positioned to excel for many years to come. Given its extremely broad product line, the company has developed deep relationships with all major chipmakers. Furthermore, with an installed base of more than 30,000 devices, and engineers stationed in nearly every global chip factory, AMAT boasts substantial advantages over most competitors. Additionally, the firm's solid finances allow it to weather the industry's sharp cyclicality better than most. As a result, we believe that AMAT is well positioned to excel in the future. Although not an appropriate addition to all accounts, Applied Materials could be a strong addition to a number of clients' portfolios.

Market Comments

With the year half over, Wall Street has only been able to sustain a modest advance with the S&P 500 ending June up only 2.7% since January. Despite the year's tepid gains, 2018 actually opened on a surging tide of economic growth and strengthening corporate earnings. Investors, in short, were giddy. The recently enacted tax cut added to the exuberance with the market advancing smartly in the first several weeks of January. The high spirits didn't last though as inflation concerns quickly knocked the market down almost 12%. Since then, Wall Street has bounced up and down, struggling to find a clear direction. Year-to-date the market's leaders have been the technology and consumer discretionary sectors with gains of more than 11% each; the laggard has been the little loved consumer staples sector whose earnings have suffered in the face of changing consumer demand.

Looking to the debt markets, ten-year US Treasury rates briefly spiked above 3.1% in May over trade concerns. Since then, bond yields have drifted lower as investors appear to have increasingly discounted the broader risks of the Administration's ongoing tariff battle. What is particularly concerning bond investors in recent weeks has been the narrowing of the interest rate differential between short-term and longer term bonds, also known as a flattening of the yield curve. Generally speaking, two-year yields typically climb along with investor expectations for tighter Fed interest rate policy as we are currently experiencing. Meanwhile, longer-term yields are more responsive to sentiment about the outlook for growth and inflation. With the gap between the interest rates on 10-year and 2-year Treasuries having diminished from more than 1 percentage point to 0.3 percentage points over the last year, the yield curve is now its shallowest in more than a decade.

As many believe the fixed income market to be a barometer of both current and future economic health, this bond market shift has attracted much attention. The recent flattening has occurred as U.S. economic growth appears steady. This situation has left many split on what the recent signaling says. Although the yield spread tends to shrink whenever the Fed begins lifting interest rates, the recent narrowing has happened very swiftly – strongly suggesting a change in the market's animal spirits. All that being said, most analysts remain sanguine about the recent curve flattening.

2017's tax reform bill lowered corporate America's tax rate from 35 percent to 21 percent and also provided incentive to repatriate international profits. As a result, many firms have recently stepped up their repatriation of monies from overseas. While the tax reform also provided for tax breaks for companies investing in capital, most of the newly available corporate cash is being returned to shareholders by either increasing stock dividends or stepping up stock buybacks.

As for earnings, the first quarter's profits were solid as more than 80% of firms beat analyst forecasts. In addition to the market support provided by strong earnings, Wall Street has been further bolstered as share buybacks of $180 billion set a record in the year's second quarter. Furthermore, shareholders received almost an 8% increase in dividends in the second quarter, a record $111.6 billion. Finally, corporate mergers and acquisition activity has spiked with activity more than doubling over 2017 levels. Simply put, corporate America has been providing solid support to the market in 2018. However, these actions run up against the concern that these actions are being taken only because corporate executives cannot find more attractive investments within their own firms. The increasing trade uncertainty has only worsened the current market psychology.

Caught between the tailwinds of strong economic and solid earnings growth, the headwinds of an uncertain trade situation, and increasingly tight monetary conditions, a clear near-term direction for the market is hard to discern. Throw in the historical volatility around a midyear election, and it looks like investors would do well to keep their seatbelts fastened tight. Investment discipline is warranted. Although further market advances are possible, investors should also be prepared for more volatility.

Performance as of 6/30/18

	Close	Month	YTD	1 Year
DJIA	24,271.41	-0.49%	-0.73%	16.31%
S & P 500	2718.37	0.62%	2.65%	14.37%
NASDAQ Comp.	7510.30	0.92%	8.79%	22.31%

	Quarter end yield	Prior Year end yield	Yield 1 year ago
10 yr. U.S. Treasury	2.85%	2.40%	2.30%

Planning Thoughts

In several past newsletters, we have highlighted the benefits of Roth Individual Retirement Accounts (Roths or Roth IRAs). However, previously we may not have sufficiently highlighted the benefits of funding Roth IRAs by family members on behalf of their teenagers and/or young adults. As a quick reminder, and similar to traditional IRAs, Roths may only be funded from earned wages. However, if a family member chooses to fund a Roth IRA for a young family member(s), there can and will be at least two good outcomes: 1) The young wage-earner will start building retirement funds at an even earlier age, thereby allowing the wonders of compounded interest to be realized over an even longer period; and 2) the fund matching can often increase the youngster's desire to work and/or interest in the financial markets. Either outcome would serve the young investor well.

Our perspective is that there are few downsides to commencing Roth funding at an early age and numerous upsides. We strongly urge all of our clients to consider the appropriateness of Roth IRAs - if not for themselves, possibly for their children. Of course, if you avail your children of this option, please make sure to consult with your tax professional. As always, we are available to discuss this investment option in greater detail.

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