My Thoughts: Review and Outlook 2017-2018
By Andrew Schultz

For most investment categories, 2017 was a very good year for returns. Will it be the same for 2018? I do not predict the future. But what I can do is look at some of the reasons why so much did so well this past year and see if the same fundamentals are still in place for next year. We can look at some of the visible potential risks and we can also look at what fundamentals I think might be different going forward and what may cause that.

For the most part, earnings have been good. The global economy has grown, albeit slowly. Inflation is still low, and interest rates in most of the world are still low. Most Americans are working (very low unemployment) and American, Asian, and European consumers are spending. Most businesses have far less fear of more regulation or taxes than they may have in years past. These have been some of the ingredients that may have helped drive the stock market to new highs this year.

It appears that these fundamental drivers may still be in place today and may be for the foreseeable future. In addition, if we get some form of tax relief and more deregulation out of the federal government that may add more fuel to the fire that may push markets even higher next year.

What could derail this? Well a lot of things. I just want to touch on a few main potential catalysts with the mindset that it usually is something that we are not looking at or do not take seriously enough that causes the derail. If the economy continues on the same trajectory, then in theory unemployment can continue to drop. Since we are almost fully employed already this may lead to wage inflation. If that is the case then the Federal Reserve could be pressured to raise short term interest rates at a pace faster than already planned. This could have the potential to create more volatile markets than we have gotten used to recently. If other central banks around the world begin to raise rates as well and unwind their respective balance sheets this will potentially put more pressure upwards on interest rates and may push bond prices downward. Mind you this may all happen because the global economy is improving, not because of bad things. Therefore it may not crash the stock market but it may make it more volatile with the risk of corrections. A side note; central banks have never had this many trillion dollars of bonds on their balance sheet and an unwinding of this size has never happened before. If the unwind is not timed correctly and if inflation all of a sudden rears its ugly head and therefore forces a speeding of the unwind; that alone may cause issues which could then effect stocks to the negative.

Risks that could slow an economy are many as well. But certainly none have manifested themselves (and may not) or occurred to an extent that they are horribly effecting the global economy and therefore causing market selloffs. Let’s review a few. I am concerned with effects on commercial real estate and the loans made on them due to the continued transitions in retail from bricks and mortar to cyber. Many traditional retailers run the risk of failure. This can create a lot of empty real estate and therefore cause serious downward pressure on commercial real estate prices. This could then negatively ripple across all markets. I am also concerned with subprime auto loans. There are many non performing auto loans on the books of many banks. If we get a mild economic slowdown or we get an increase in the transition towards electric vehicles, auto loan and lease defaults run the risk of increasing even more than they are now and could cause issues in markets. Then there is the “unknown unknown,” which may be the biggest risk.

In conclusion, I am very happy with the state of the current economy and markets. Although not seen on the horizon currently, inflation is that which I fear most. Not that I think it is imminently coming. My
fear is that most people do not think it is coming at all. Therefore, if it all of a sudden does, I do not think the central banks or most investors are prepared for it. As stated earlier, unwinding multi-trillion dollar balance sheets by central banks has never been done before. A lot can go wrong.

As I have stated in the past “continue to ride this market wave, but have your portfolio prepared to handle getting knocked off your surf board as there are sharks in the water and you better be able to swim with them.”

Please feel free to forward this article to anyone who might benefit from reading it.

Thank you,
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About the author: Andrew Schultz has been a Financial Advisor at Morgan Stanley and its predecessor firms for over 25 years. He is a Private Wealth Advisor, a group within Morgan Stanley Wealth Management who focus on Ultra High Net Worth individuals, families and foundations. Andrew has recently been recognized by Barron’s as one of the Top 1200, by Forbes as one of the Top 200, and by the Financial Times as one of the top 400 Financial Advisors in the country.

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