Martone Capital Management: Weekly Investment Commentary (8/2/2017)

Last week was eventful. Second quarter gross domestic product growth was announced and the Federal Reserve held a regularly-scheduled policy meeting. Investors also saw a flurry of corporate earnings releases, with 191 of the S&P 500 companies reporting results last week. And, of course, the Senate failed to pass a health care bill while White House turmoil continued. Despite all of these events, equity prices were little changed for the week.

A key financial markets theme developing in recent months has been the weakening U.S. dollar. Although the U.S. economy remains in good shape, investors are concerned about an ugly and uncertain political environment and have been shedding dollar-based portfolio positions. In our view, the weaker dollar primarily reflects fading optimism around prospects for pro-growth legislation and points to fears around political instability in the United States.

If the value of the dollar continues to sink, it could act as a drag on both equity and bond markets. But, for now, investors have largely shrugged off negative implications of a weaker currency. The weaker dollar is also magnifying the effect of higher oil prices, which have been helped by a drawdown in inventories. We think this is a temporary development, and expect supply and demand dynamics will help exert downward pressure on oil prices.

Looking ahead, we believe the falling dollar brings more positives than negatives. The weaker dollar is providing a headwind for corporate earnings, especially for companies with significant overseas businesses. It's also allowing the Federal Reserve to be more circumspect in its rate-hiking campaign. We expect the Fed and other central banks to continue moving away from the era of low emergency interest rates, but rate increases are unlikely to be quick or dramatic (especially since inflation remains low).

As such, the macroeconomic backdrop is likely to remain unchanged for some time: We expect the environment of slow growth, low inflation, still-accommodative monetary policy and rising corporate earnings will persist. This environment has been friendly for equity markets and we do not expect that to change soon.

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