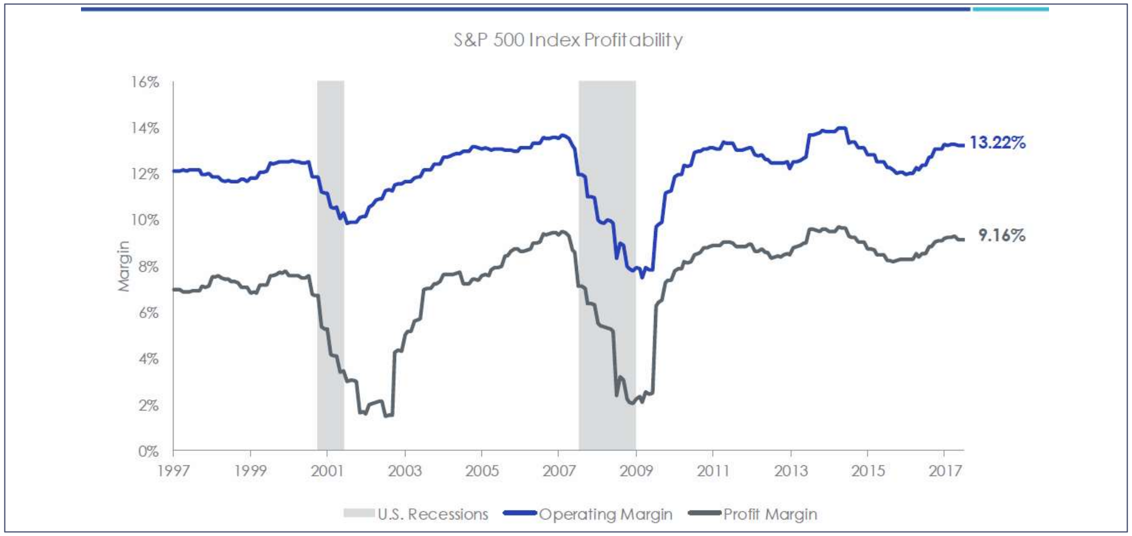
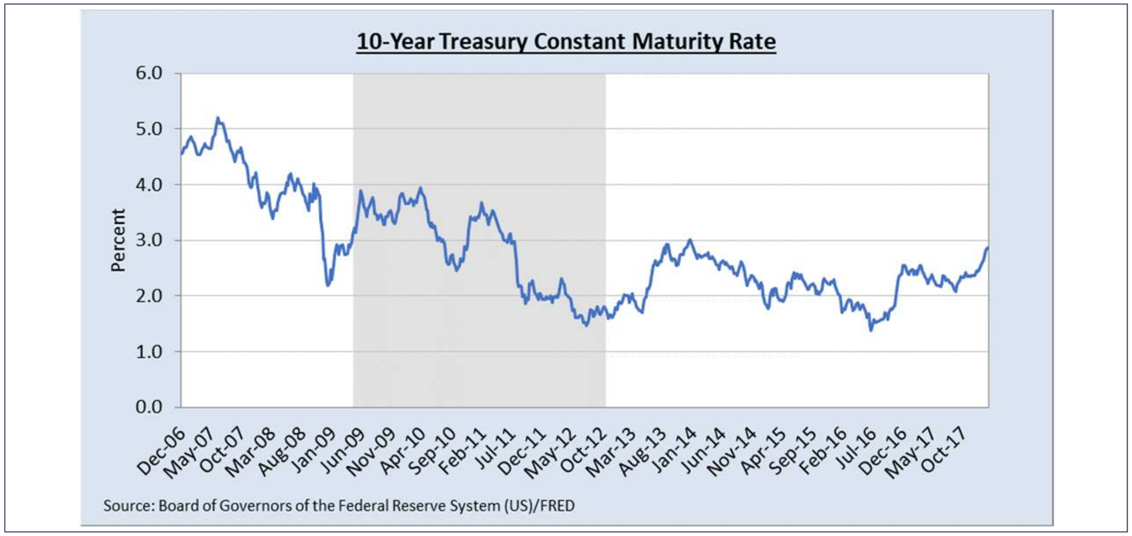
Market Recap

Have Corporate Profit Margins Peaked?



Source: WisdomTree

Rising Treasury Yields Pose Risk to Equity Markets



Source: Federal Reserve

After tax corporate profit margins currently stand at roughly 9%, well above their 6.5% historical average dating back to World War II. Profit margins tend to oscillate through different phases of a business cycle. Profitability typically increases as the economy heats up and demand rises, eventually peaking and moderating as wage pressures and rising costs of capital pressure margins in the latter stages of an economic expansion. As such, falling profit margins have often been a precursor to past recessions. Today, with profit margins near all-time highs and well above historical averages, some investors are understandably concerned that profits are bound to get squeezed this late into a nine-year expansion. While wages have shown signs of life, potentially pressuring margins, a continuation of the solid growth in corporate revenues we have seen over the past year would help cushion any negative impacts to aggregate profits.

The 10-year U.S. Treasury note is the one of the most frequently cited market benchmarks in finance. The prevailing yield on the 10-year acts as both a reference point for current borrowing costs (e.g., mortgage rates) and as an indicator of recent trends in interest rates (i.e., up, down, or stable). The current level of the 10-year is approximately 2.90%, effectively doubling since July 2016, but still well below historical levels. As borrowing costs rise, economic growth tends to moderate. Given increased deficit spending via the recent tax cut, issuance of U.S. Treasury debt (i.e., supply) is projected to increase. Additionally, demand for U.S. Treasury debt is projected to decline as the Federal Reserve gradually reduces its quantitative easing program. Increased supply and weaker demand implies lower prices, which translates into higher yields. Given current cycle dynamics, this is a key variable for 2018 and beyond.

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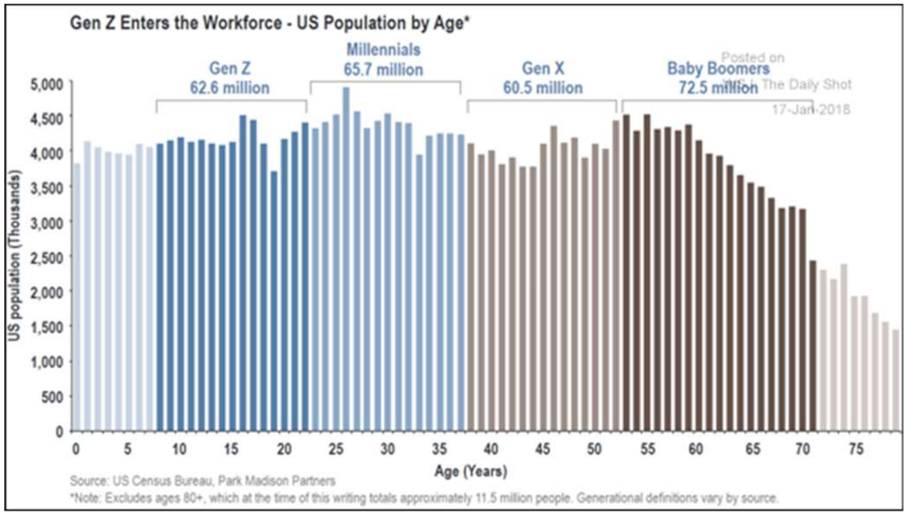
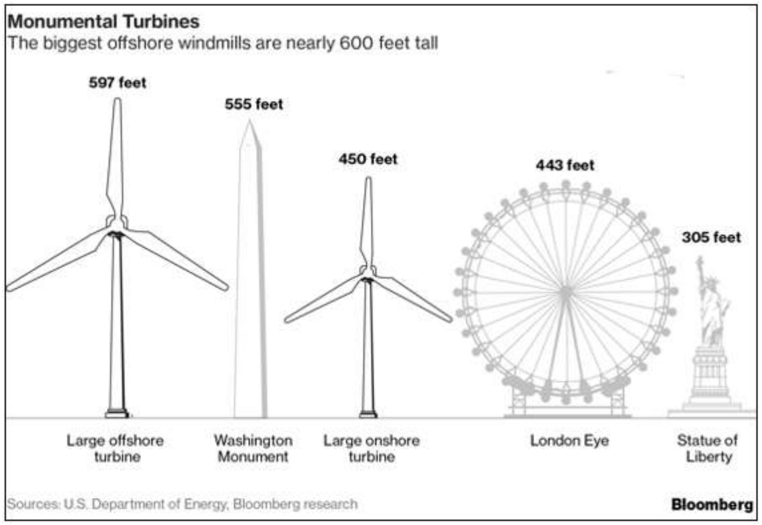
Shifting Demographics Within the U.S. Labor Force



Source: Wall Street Journal

Demographics refers to the statistical data of a segment (i.e., a generation) within an overall population. The differences among various generations can be subtle or profound, with important cultural and economic implications. Changing preferences among generations can affect everything from lifestyle choices to asset class returns to government policies. Currently, workplace dynamics are undergoing large shifts, with an estimated 10,000 “Baby Boomers” retiring daily. “Generation X” and “Millennials” are assuming a greater role in leadership, while “Generation Z” begins its foray into the workforce. Given the relative size of the Baby Boomer cohort, their exit from the workforce is expected to have material implications for both the composition of the workforce (e.g., more temporary and/or contract workers) and for the policies within a workplace (e.g., unlimited vacation).

Wind Turbines Keep on Growing



Source: Bloomberg

As demand for renewable energy increases alongside rapid technological advances in the space, the size of off-shore wind turbines has increased dramatically in recent years, almost doubling since 2007. Indeed, Benj Sykes, the UK boss for Dong Energy’s wind power business, has projected that the wind turbines they produce will again double in size from today through 2024. Larger rotors can extract greater quantities of energy from an equivalent level of wind, and it comes as no surprise that the height of wind turbines is increasing to support larger energy outputs. The increase in height and rotor size of wind power harvesting devices also has the added benefit of decreasing the cost per unit of energy, making the product more attractive to governments looking for a sustainable way to power their jurisdictions.

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