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Dear Valued Investor:

The hottest part of the summer has arrived across the U.S., with many feeling the effects of heat and humidity with temperatures well into the 90s in many places. At the same time, the stock market has put together a pretty impressive hot streak of its own, achieving a series of record highs and avoiding a 5% pullback for over a year. Although this pullback "drought" is not unprecedented, it is rare, and provides a reminder that while it may be summer vacation time, we cannot become complacent.

So have stocks overheated given this long stretch of calm? Here are several reasons to suggest conditions for investing may still be comfortable:

- **Earnings are on the upswing.** Second quarter earnings season is underway and consensus estimates are calling for a second straight quarter of double-digit earnings growth for the S&P 500 Index. Corporate tax reform, still a realistic possibility in early 2018 despite the failed healthcare reform effort to date, provides upside to already solid earnings growth expectations in 2018.

- **The Federal Reserve (Fed) remains careful.** The Fed will likely hike interest rates very gradually, minimizing the chances of a major market disruption or abrupt recession. The Fed may only hike rates once more this year, while the bond market is currently pricing in just one hike in all of 2018. During the economic expansion of the 1990s, the U.S. economy grew for seven years after the first rate hike of that cycle (the first hike of the current cycle came in December 2015).

- **The U.S. economy isn't overheating.** Consumers and businesses are not exhibiting the same type of overspending, overborrowing, or overconfidence seen at other major market peaks. While we are likely past the cycle's midpoint, we are not at the end of this economic expansion and bull market.

- **Sentiment is balanced.*** Balanced sentiment suggests investor optimism has not become excessive, reducing the odds of a selling wave pressuring the market in the near term and suggesting buyers still could potentially be lured off the sidelines and support stocks.

- **Valuations, in context, still look reasonable.** Stock valuations have historically been higher when interest rates and inflation have been low. Given low interest rates and benign and falling inflation readings, the stock market should not be viewed as meaningfully overvalued.

These factors help give us comfort that the stock market is not overheating. However, some clear risks could cool this market down, such as a difficult path ahead for tax reform and a tough 2018 budget battle looming on Capitol Hill this fall. Future developments will continue to be closely monitored.

So as you head out to the beach this summer, use sunscreen and drink plenty of water so, like the markets and the U.S. economy, you don't get overheated. Watch out for the riptides and jellyfish, but don't let fear keep you out of the water.

As always, please contact your financial advisor with questions.

Sincerely,

Burt White
Chief Investment Officer
Managing Director, LPL Research

*Sentiment survey results are from the American Association of Individual Investors (AAII), an independent, nonprofit corporation.

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Economic forecasts set forth may not develop as predicted.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond and bond mutual fund values and yields will decline as interest rates rise and bonds are subject to availability and change in price.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The AAII Investor Sentiment Survey is published in financial publications including Barron's and Bloomberg providing a measure of the mood of individual investors.