The U.S. stock market's recovery from the early 2018 sell-off continued in August. The Standard & Poor's 500 Index is now more than 11% above the February low of 2581, and has, in fact, risen back above the January high of 2872.

Bulls will argue that the market should be well above the January highs, since earnings expectations for the S&P 500 are (by some estimates) 16% above where they were seven months ago. In their view, the market is about 12% undervalued. But the bulls fail to account for the fact that the S&P's forward Price/Earnings multiple had risen to 20x in January, while the 10-year Treasury yield was approaching 3% for the first time since 2014, setting the stage for the January-February correction. Notably, when the 10-year Treasury breached 3% in 2014 for the first time since the Great Recession, the S&P's forward P/E was only 15.5x.

In our view, rising earnings expectations are probably fairly discounted in current stock prices, and will eventually become a drag on the market as expectations inevitably reach unattainable levels. As earnings begin to peak late in the cycle, investors are well advised to maintain a skeptical view of analysts' earnings forecasts.

Now in its 110th month, the current economic expansion is the second longest on record, and will almost surely eclipse the 1991-2001 expansion next year. Even though the current recovery is, in the minds of many, well past its expiration date, there are factors which could continue to fuel economic growth well into next year and beyond, even if that growth remains less robust than in similar stages of past expansions. Capital investment, which had collapsed in the 2008-2009 recession, is just now recovering as the economy has reached full employment. Some improvement in productivity is necessary to maintain our growth potential in light of the slowing of our working age population. The positive effects of lower corporate tax rates and deregulatory efforts will likely last into 2019, though they will likely be at least partially offset in the short term by more restrictive immigration and trade policies, and in the long term by a ramping up of fiscal deficits.

Of course, all of the above factors affect the supply side of the economic equation; the demand side, apart from housing, remains healthy, with household spending strong and wages rising at a rate that is not likely to spook the Fed into accelerating its pace of rate hikes.

On balance, it would appear, solely on the basis of fundamentals and valuations, that the near term market view remains mostly positive. The main risks to this view are political – specifically, the potential for upheaval from the November mid-terms, and our ongoing skirmishes with our global trading partners.

The mid-terms, whatever the results, are more likely to be a short term market event than a long term economic event. But with respect to trade, about which we have written repeatedly in recent *Outlooks,* it seems that there is more news and noise than usual at the moment. An agreement appears to have been reached between the U.S. and Mexico to update some NAFTA rules, but Canada, our largest trading partner, has not yet agreed. At the same time, the President has announced the imposition of tariffs on an additional $200-billion of imports from China, although the details have not yet been announced.

It would be best not to over-interpret every twist and turn in the trade war saga, and the stock market, at least in the U.S., appears to be currently undisturbed by such events. To be fair, the President, for all of his protectionist instincts, has never signaled his intention to unwind the global trading system. But even if recent moves represent nothing more than posturing, and if the impact on the markets and the economy is minimal, protectionism increases the potential to roil the financial and currency markets in unpredictable ways. Prices of commodities such as steel and soybeans, currencies such as the Mexican peso, and shares of auto companies have all been buffeted by trade news in recent weeks. And protectionism is likely to remain a force in the markets for the foreseeable future.

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