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The stock rally that began after the election continued for a third month propelling benchmark indexes to new record levels. After hitting the 20,000 mark for the first time in January, the Dow Jones Industrial Average reached 21,000 in February. The S&P 500 had a 4.0% gain for the month and is up 5.9% so far this year. The Russell 2000 index lagged large caps but still had a respectable month at 1.9% and 2.3% year-to-date. International stocks in the MSCI EAFE index returned 1.4% in the month and are up 4.4% year-to-date. Emerging markets stocks are mounting a strong recovery up 3.3% for the month and 8.9% so far this year. Ten-year US Treasury yields eased further in February ending the month at 2.36% resulting in a 0.7% gain in the Barclays Aggregate Bond Index for the month.

This rise in stock prices comes at a time when stock valuations already seem pretty rich, leading many to wonder if we've gone too far too fast. Those who would make that argument could make a pretty convincing case. Valuations, while not at historic highs are certainly above average. Momentum can be a powerful force however and often times a rally can go much further than anyone expects. By the same token, putting new money to work at this stage of a rally should be done with caution.

The move higher in stock prices has not been based only on optimism and momentum. There are many factors that make the rally perfectly rational. First and foremost, earnings growth has turned a corner and we are beginning to see a recovery from an earnings slump that continued for 5 quarters. Earnings for the S&P 500 are expected to reach record levels over the next couple of quarters. We are also expecting a gradual increase in the rate of economic growth which has been below average since the recovery began in 2009. Even if interest rates continue to rise gradually as expected, rates will continue to be at historically low levels. A gradual increase from these levels will likely be interpreted as a sign of a healthy economy.

US GDP growth in the 4th quarter came in at 1.9% bringing the growth rate for the full year to just 1.6% for 2016. This was the worst performance since 2011 and continued the trend of lackluster growth since the beginning of the decade. Since the election, analysts have been increasing their projections. Many analysts are projecting growth in 2017 and 2018 to increase relative to recent levels. Wells Capital Management believes we may be four or more years away from the next recession. JPMorgan points out that although this expansion period has been the fourth longest at 89 months, the magnitude of the recovery has not been very strong so there is room for the expansion to continue.

The Federal Reserve has reiterated its plan to continue to raise interest rates gradually in 2017. Analysts expect two to three rate hikes during the year. In recent comments, the Fed seems to be signaling that a rate increase could occur as early as the March meeting. Strategas Research projects that the yield on the 10-year Treasury will end the year at 3.00% which is about a 0.5% increase since 2016. After that, they expect a slower rise with the 10-year Treasury at only 3.10% at the end of 2018. This year may be tough for bonds if rates rise fairly rapidly. But we continue to believe that higher yields will be healthy for income oriented investors when they can derive more income from bonds rather than more volatile sources.

A diversified mix of investment assets has proven beneficial over the past several months as markets have provided ample surprises. Trying to time the market at times like this can prove disappointing or worse. Even though valuations continue to be above average, the economic climate appears to be constructive and we continue to be optimistic for the remainder of the year.

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