



THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – JANUARY

US Markets and Economy:

The Trump Rally continued in January, with stock indexes setting new all-time highs. The Dow Jones broke through the psychologically important 20,000 barrier, while the broader S+P 500 and NASDAQ Indexes also set records.

Stocks are still rallying based on predictions that Trump will ease restrictions on businesses in all sectors of the economy (as long as they don't offshore jobs), while cutting corporate tax rates across the board. A large new dose of infrastructure spending on roads, bridges, airports, ports, water distribution, and the internet could fuel faster economic growth in the short run and raise productivity growth (and thus economic growth) in the long run, further boosting corporate profits. Infrastructure spending also has the advantage of bipartisan support, and is thus quite likely to be enacted in some form. Markets are also positively inclined toward the Trump Supreme Court pick; Judge Gorsuch will likely be confirmed and will provide a reliable pro-business 5th vote on the court which will also be good for business profits.

The economy itself is still growing, although the sluggish pace, which has persisted for most of the recovery since 2009, has not altered. Real GDP grew less than 2% in 2016, and this rate may not accelerate much in 2017. Trump policies, even if enacted soon, will take a number of months to show an impact. Even if a speedup in growth does take place, the Federal Reserve's Open Market Committee (FOMC) may feel obliged to tap on the monetary brakes frequently in 2017 to make sure that inflation does not exceed their target of 2% in 2017. Since wages are beginning to rise faster than prices, while unemployment hovers between 4.5% and 5% (considered by many to be "full" employment), and monthly employment gains continue in the 150,000-200,000 range, the economy could be approaching its productive capacity limit. The FOMC may decide that exceeding this limit could spark a bit of inflation, and they are likely to decide to raise rates sooner rather than later, since monetary policy acts on the economy with a substantial lag. With monetary policy not providing the forward thrust it maintained during the 2008-2016 period, the stock market will have to rely more on the expectation of higher profits. At the same time, bond holders may have to contend with an upward creep in short and long-term interest rates in 2017. Bonds have been on the defensive during the entire post-election Trump rally, and this pattern could persist in 2017 if the economy does pick up steam.

Rising interest rates also strengthen the international exchange value of the dollar, which in January touched its highest level since 2002. A rising dollar can put a crimp in overseas profits of US multinationals, and also lead to increased imports, which will appear cheaper as other currencies fall against the dollar. If this pattern persists in 2017, it may encourage the Trump administration to “level the playing field” by increasing barriers against imports in an attempt to eliminate a rising trade deficit. Erecting a tariff wall could stimulate American manufacturing in the short run, but most economists argue that the longer-term consequences could be disruption of world supply chains and retaliation by our trading partners.

World Markets and Economy:

European stocks had a weak January, with the EUROSTOXX 50, a blue-chip index, declining for the month. British stocks also fell. The specter of Brexit looms over both Britain and the continent, and Europeans and the British must face the possibility of a “hard” Brexit, a full break from the EU. Although economic growth is still positive in England and the EU, a disruption of trade relations could impose significant economic costs on all parties. Europe is also facing the possibility of a further tilt toward nationalist parties in elections in 2017. Although Marine Le Pen, the Donald Trump of France, is not favored to win the second (May) round of the French election, she could pull the same upset achieved by Donald Trump in the US. Her stated platform is to take France out of the EU, which could spell the end of the EU, and create financial shockwaves which would reach US shores. Even if she loses, Europe must still face the prospect of another default by the Greek government. The IMF has argued that the Greeks must reach an agreement with creditors by late February, and even then, must receive a further bailout. Greek stocks fell during January as the economic storm clouds thickened.

The mood was better in Japan, with stocks eking out a small gain in January. The Japanese economy has been growing slowly for three quarters, and forecasters suggest slow growth should continue in the first half of 2017. This is indeed an improvement over the numerous recessions the economy has suffered since 2009. Aggressive monetary and fiscal policy, and now a weak yen, could power both the economy and stock market in 2017.

OUTLOOK:

The US bull market began 2017 on a strong note, with new all-time highs achieved in January in most stock indices. Wall Street may continue to bid up stocks in anticipation of Trump policies which will increase corporate profits. Optimism could be tempered by regular interest rate increases by the FOMC, or by fears that the Trump administration will attempt to stem the flow of US imports with tariffs, or by political and economic instability in Europe. Any of these factors could cause the US market to “correct,” although every correction since March of 2009 has been followed by a further upsurge in prices.