



THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – MARCH

US Markets and Economy:

The Trump Rally powered US markets to new all-time highs in the first quarter, with the Dow-Jones Average breaching 21,000, the S+P 500 touching 2400, and the NASDAQ breaking 5900. Although March was generally flat-to-down, quarterly gains for the Dow and S+P were still around 5%, with the NASDAQ up almost 10%. The key factor that propelled stocks higher in January and February was the promise of a business-friendly Trump administration removing the shackles of government regulation, easing the heavy burden of taxation, repairing the nation's infrastructure, and replacing the controversial Obamacare healthcare system. In March, however, the failure to repeal and replace Obamacare cast a brief shadow over the administration's other initiatives, since a divided Republican party, combined with oppositional Democrats, could potentially torpedo any or all of them. Yet recent surveys of institutional investors and individual investors alike show that market participants are very optimistic about stock prices for the next twelve months, with Wall Street estimating that corporate profits in the first quarter of this year will be up a strong 10% over last year's first quarter. Combined with consumer and business optimism, the stage is set for a continuation of the bull market.

The economy itself is still stuck in slow-growth mode, with 2016's GDP up only about 2% in real terms, and guesstimates for 2017's first quarter (January-March) even slower at 1-2%. This slow growth has nonetheless been accompanied by continued strength in the labor market, with strong monthly job gains and an unemployment rate below 5%. It may well be that GDP growth will accelerate in the rest of 2017, following a pattern of recent years, and providing the economic strength to push corporate profits, and stocks, higher for the rest of the year.

Fuel for the rally will probably not come from the Federal Reserve, which did raise short interest rates by an expected ¼% in March. FOMC officials have suggested that the economy can easily withstand two more ¼-point increases this year. This will still leave the real Fed Funds rate at a negative level at the end of the year, since inflation is approaching the Fed's target of 2%. Since the economy is close to what economists define as "potential" output, the FOMC will gradually and preemptively raise rates to make sure the economy does not "overshoot" potential, which could drive inflation above 2%. Since 10-year Treasury rates have stabilized around 2.4%, bond traders clearly believe the Fed will be successful in its effort to achieve its dual mandate of

employment growth and low inflation. So Fed policy will still be “easy” money, but not as easy as the zero-interest-rate policy of 2008-2015.

The prospect of higher short-term rates in the United States, combined with continued zero (or even negative) rates in the EU and Japan, has kept the international (trade-weighted) value of the dollar strong. A mild setback for the greenback in March still left it near a 15-year high. This strength is a double-edged sword: it keeps inflation down, since imports get cheaper, but it acts as a drag on exports, since our goods look more expensive to buyers in countries with weak currencies. The Fed is well aware of this effect, and the strong dollar will make it easier for the Fed to keep inflation at or below its target, and may also allow the Fed to limit its interest rate increases.

World Markets and Economy:

Europe must now deal with the two years of uncertainty surrounding Britain’s exit from the European Union (EU). The EU is likely to insist on harsh terms for the divorce, which would hurt the British economy more than Europe. Stock prices in March mirrored this possibility, with the EUROSTOXX 50 Index up nicely for the month, and up over 6% for the year. The FTSE 100, on the other hand, fell in March, and is up only 2.5% this year. The EU must also contend with the upcoming French election, where one leading candidate (Le Pen) wants to take France out of the EU, and with the continuing saga of Greek tragedy and default. Yet both French stocks and Greek stocks managed gains for March and for the first quarter.

Japanese stocks lost some ground in the first quarter, with a weak March pulling down the Nikkei. This weakness is a bit surprising, since the Japanese economy continues to show signs of growth, aided by very easy money, a weak yen, and strong exports.

In the Americas, the Mexican stock market continued its strong rebound since its selloff after the American election. The Mexican peso has also strengthened against the dollar, giving foreign investors in the Mexican market a double benefit. The rally is likely driven by receding fears of a wall and/or an abrogation of NAFTA.

OUTLOOK: The US bull market logged a strong first quarter even with a pause to catch its breath in March. With corporate profits growing strongly again, and investors of all stripes optimistic, the outlook for the rest of the year is positive. Short-run gyrations, like the one-day selloff in March, are a reminder that the course of bull markets is never smooth, but the financial race is always won by those with a long-term perspective.