



## THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – NOVEMBER

### **US Markets and Economy:**

Donald Trump surprised the pundits, forecasters, and about half the American electorate, with a narrow win over Hillary Clinton on Election Day. The stock market surprised the pundits and forecasters by rallying sharply for the rest of the month of November. The Dow Jones rose more than 1,000 points to a new all-time high above 19,000; the S+P 500 rallied sharply and pierced 2,200 for the first time, and the NASDAQ Composite Index cracked the 5,400 level, a new all-time high. So far stocks are concentrating on the positive elements of a Trump administration combined with Republican control of Congress: more government spending (especially on the military and infrastructure), lower taxes, and less government regulation of businesses of all types. Tax cuts and spending increases should stimulate real economic growth, which has been slow even after seven years of recovery. Reduced regulation should directly lead to higher corporate profits. This scenario accounts for the especially sharp rise in big bank stocks. The large banks will gain from the possible repeal of Dodd-Frank, which has limited their leverage and profitability, and by the hobbling or elimination of the Consumer Financial Protection Bureau, which has limited their lending options. This faster-growth scenario also accounts for the sharp selloff in the bond market after the election: more rapid growth will encourage the Fed to increase short-term interest rates (a ¼-point increase in December is almost a certainty), and a spurt of rapid growth could also lead to a pickup in inflation (the bugaboo of bondholders), which was already slowly approaching the Fed's target of 2%.

The Fed is likely to continue raising rates in 2017, since the economy was already picking up steam in the third quarter, with a revised real GDP growth rate of 3.2%. November unemployment (reported on December 2nd) showed a drop to 4.6%, while employment rose by a solid 177,000 net new jobs. Consumer optimism rose sharply in November, which often presages more spending by households, which accounts for 70% of GDP in the US. The new President will also be able to exert some influence over the Federal Open Market Committee, since there are two vacancies right now on the Board of Governors, and the terms of Janet Yellen (chair) and Stanley Fischer (vice-chair) expire in 2018, and they will certainly be replaced. There are caution signals here, however: a more conservative Fed ruled by inflation "hawks" is more likely to raise interest rates faster, and the deficit "hawks" in Congress may impede the spend more-tax less scenario.

US stocks have a full head of steam entering the strongest two-month period for stock returns. The first part of an old Wall Street adage, “The bears get Thanksgiving, the bulls get Christmas,” has not held up, as the bears fumbled the ball, the bulls picked it up and ran it in for a November touchdown. The bulls could continue to run up the score in December and January. The bears (not unlike the Chicago variety) appear dazed and confused.

### **World Markets and Economy:**

South of the border, Mexican stocks and the Mexican peso fell sharply after the US election. A wall and mass deportations could wreak havoc in the Mexican economy. Many in the US think these Trump promises will not be kept, but those in Mexico are rightly worried. As Porfirio Diaz said of his country’s economic predicament, “Poor Mexico, so far from God and so close to the United States.”

European markets were not enthusiastic about the surprise Trump victory. The EUROSTOXX 50, a pan-European index of larger companies, was held to no gain in November. Europeans worry about the possibility of trade wars, stresses on NATO, and geopolitical uncertainty. British stocks actually fell for the month, as measured by the FTSE 100, perhaps in response to further confusion about the timing and nature of British exit from the EU. Across the Channel, French stocks managed a small gain, while German stocks fell. Both countries face elections in 2017, and the rising tide of populist nationalism has added another layer of concern. Marine Le Pen has pledged to take France out of the Euro and the EU, which would no doubt destroy both. In the meantime, Europe’s economy continues to struggle with anemic growth, in spite of massive stimulus from the European Central Bank (ECB). The ECB will keep interest low or negative, and economic strength in the US may further weaken the Euro, which could stimulate European exports. The ECB must also contend with a weak Italian economy and banking sector, with an Italian referendum looming on December 4th. If Prime Minister Renzi loses the referendum, he will likely resign and a new election will follow, which could put the populist 5-star party in power. Italian stocks lost ground in November in advance of the referendum.

Japanese stocks did rally along with the US, at first falling sharply after the US election, but then rallying close to a yearly high. The good news in Japan in November was that the economy actually grew for the third consecutive quarter (although deflation is still present), while the Bank of Japan (BOJ) announced a program to buy 1-5 year government bonds in an “unlimited” amount. Stocks love easy money, and the BOJ continues to provide it.

**OUTLOOK:** The US bull market has continued to gain ground, entering the strongest seasonal months of the year. Although rising interest rates may temper bullish enthusiasm, the path of least resistance for the US seems to be upward. Economic weakness and political uncertainty in Europe may mean these markets lag the US, as they did in November.