Market Insights for the Week Ending December 16, 2016


Mike Hengehold

The big news last week focused almost exclusively on the changing interest rate policy following the low interest rates (monetary stimulus) that have been the driving force behind our economic and market recoveries in the years since the recession bottomed in 2009. With the new administration on its way to Washington, fiscal stimulus (government spending and tax cuts) will be the driving economic force as monetary stimulus begins to fade. The process of removing monetary stimulus took a big step forward last week as the Federal Reserve increased short-term interest rates by 0.25%.

The Fed is not taking the punch bowl away from the party just yet, but they are watering the punch down a bit. That is because these modestly higher rates are less stimulative for the economy.

HCM believes Wednesday's move is the first of many more to come. While last week's increase was just the second in a decade, we believe the Fed will need to raise rates several times a year over the next few years, especially if the new administration is successful in moving forward with both infrastructure projects and tax cuts.

The stock market fell after the rate decision was announced last week as investors fretted over what the future path of rates might be. Rising rates challenge stock prices because the discount models used to value future earnings generate lower "fair values" as interest rates rise.

In time, HCM believes that rising rates will bring on the next market correction. However, with the major pieces of an economic stimulus plan falling into place, we believe the ultimate direction of policy is still likely to mean stronger growth, higher inflation, higher interest rates and improving economic fundamentals that will win the see-saw battle of equity prices for most of the next year, leading to higher stock prices and justifying our current overweight to stocks.

Market Activity

Stocks lost a little steam this week as the Fed's rate increase weighed on the markets, with U.S. stocks (IWV – Russell 3000) losing about 0.28%. Developed foreign markets (EFA) joined the selloff losing about 0.57%. Emerging markets (EEM) with the pressure of a rising dollar lost about 2.43% for the week. Bonds (AGG), continued their slow grind down as they lost about 0.61% for the week. (Note: performance is based on the change in net asset value.)

Last Week's Headlines

- As expected, the Federal Open Market Committee raised the target range for the federal funds rate to 0.50%-0.75%. This is an increase of 0.25% - the first such increase since last December. In its press release, the Committee cited continued strengthening of the labor market and expanding economic activity as reasons for increasing the federal funds rate. The Committee noted that job gains are solid and the unemployment rate has declined. Household spending has been rising moderately, but business fixed investment has remained soft. While inflation has increased since earlier in the year, it remains below the Committee's 2.0% longer-run objective, partly reflecting earlier declines in energy prices and in the prices of non-energy imports. FOMC forecasts project three rate increases in 2017, with the median federal funds rate anticipated to be 1.4% by the end of 2017, 2.1% by the end of 2018, and 2.9% by the end of 2019. Ultimately, as Chair Janet Yellen noted, "In making our policy decisions, we will continue - as always - to assess economic conditions relative to our objectives of maximum employment and 2 percent inflation. As I have noted on previous occasions, policy is not on a pre-set course."

- Pushed by increases in housing and gasoline, the Consumer Price Index rose 0.2% in November over the prior month. Over the last 12 months, the CPI has risen 1.7%. The gasoline index increased 2.7% in November following a 7.0% jump in October. The index for all items less food and energy increased 0.2% in November and has increased 2.1% over the past 12 months. Indexes that rose faster over the last year included motor vehicle insurance (6.7%), medical care (4.0%), and shelter (3.6%).

- Consumer retail purchases slowed in November, despite Black Friday and the stock market surge. Some have suggested that slow sales in the early part of the month were due to cautious consumers who were awaiting the results of the presidential election. Advance estimates of U.S. retail and food services sales for November were $465.5 billion, an increase of 0.1% from the previous month, and 3.8% above November 2015. Retail trade sales were virtually unchanged from October 2016, but are up 3.6% from last year. Nonstore (online) retail sales were up 11.9% from November 2015, while health and personal care store retailers were up 6.2% from last year. Department store sales fell 6.4% from last November, and appliance and electronic store sales dropped 3.8% over the same period. The latest figures also suggest that online retailers are snagging more of the holiday purchases.

- New home construction retreated in November. According to the latest Census Bureau report, housing starts fell 18.7% from October's revised estimates. The number of building permits decreased 4.7%. Compared to November 2015, both housing starts and building permits are down 6.9% and 6.6%, respectively. Privately owned housing completions in November were 15.4% above the revised October estimate, with single-family housing completions up 3.3%.

- The government deficit expanded by over 200% in November from October - although much of the difference relates to the timing of payments and receipts. At $136.651 billion, the November deficit exceeded October's deficit figure by $92.459 billion. Through the first two months of fiscal year 2017, the deficit sits at $180.843 billion. Compared to the first two months of fiscal year 2016, the deficit actually is down about $20 billion. November receipts were $199.875 billion and outlays were $336.526 billion.

- U.S. import prices fell 0.3% in November, the U.S. Bureau of Labor Statistics reported last week, following increases of 0.4% and 0.1% the two previous months. This is the largest monthly decrease in import prices since the index fell 0.5% in February. The drop in November was primarily led by decreasing fuel prices (-4.7%). U.S. export prices also declined in November, edging down 0.1%, after a 0.2% increase the previous month.

- In the week ended December 10, the advance figure for seasonally adjusted initial unemployment insurance claims was 254,000, a decrease of 4,000 from the previous week's unrevised level of 258,000. The advance seasonally adjusted insured unemployment rate increased to 1.5%. The advance number for seasonally adjusted insured unemployment during the week ended December 3 was 2,018,000, an increase of 11,000 from the previous week's revised level.

Eye on the Week Ahead

Following the Fed's decision to raise interest rates for the first time in a year, several key economic reports are out this week that may shed some light on the direction of the economy moving forward. This week includes reports on the gross domestic product, durable goods orders, and consumer personal income and spending.

Key Dates/Data Releases

12/21: Existing home sales
12/22: Durable goods orders, GDP, income and outlays
12/23: New home sales, consumer sentiment

Weekly Focus – Think About It

"A Clear Vision, Backed By Definite Plans, Gives You A Tremendous Feeling Of Confidence And Personal Power."- Brian Tracy

HCM Mission Statement
We work passionately to help our clients and their families enjoy a financially independent life by providing sophisticated wealth planning solutions.

Disclaimer
Please do not send trade requests via email, as they must be made in person or by telephone. Any tax or other advice contained in this document, including any attachments, is not intended and cannot be used for the purpose of avoiding penalties under Internal Revenue Code. No action should be taken on any information contained in this message without first consulting with your tax/legal advisors regarding the tax/legal consequences for your particular circumstances.

Additional Notes:

- The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.
- Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.
- Past performance does not guarantee future results.
- You cannot invest directly in an index.
- Consult your financial professional before making any investment decisions.

• • •