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MARKETCOMMENTARY
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Global and National Economies Look Good

Trump's Plan Offers More Questions & Variables

Market surge continues to be driven by hopes and expectations

As Trump settles into his new role as president, he continues to surprise and entertain, providing the media seemingly endless fodder. Amidst the noise, his anti-regulation, pro-business stance has spurred a record setting run on Wall-Street. Since Trump's November 8 election, the S&P 500 has surged more than 10 percent, posting 17 record closes, and in late February, the popular Dow Jones Industrial Average recorded its longest run of consecutive record-high closing prices in 30 years.

Yet, as mentioned in previous newsletters, the market surge is driven by hopes and expectations rather than results because President Trump has not been in office long enough to affect significant change. Historically, such high expectations have been difficult for new presidents to satisfy, and it seems likely that we will see a market correction at some point as investors grow impatient with the inevitable grinding nature of change in Washington. Reactions to his first major address on February 28th may provide an early indication of the market's short-term direction and investors' continued patience.

Adding to potential downward pressure, stock valuations have gotten a bit expensive with the S&P 500 trading at nearly 18 times forward earnings estimates versus the long-term average of 15 times, according to Thomson Reuters data. While market valuations can and do remain above average for extended time periods, if President Trump's plans appear too difficult to execute or lack specificity, markets could quickly curb their enthusiasm and higher valuations could add to downward pressure, resulting in a correction of five percent or more.

By Daniel Wildermuth

> *'... Dow Jones Industrial Average recorded its longest run of consecutive record-high closing prices in 30 years.'*

While perceptions of President Trump's plans and progress could trigger a stock pullback, when asked to identify the biggest risk to the economy in their economic forecasts, 75 percent of economists identified a trade war or trade restrictions that could damage the U.S. economy. If bad trade policy becomes the focus of investors rather than tax and regulatory policy improvements, markets will likely suffer.

Looking beyond investor expectations to more fundamental issues that drive market valuations, economists project around a 20 percent probability of recession over the next year. While this sounds high, any projection below 30 percent is historically quite low. More meaningfully, money managers around the world remain extremely willing to buy high-yield bonds, and their seemingly insatiable appetite has driven Bloomberg's USD High Yield Corporate Bond Index up 20 percent over the past year. Simply, global investment managers believe that there is essentially no chance of recession in the next year.

A couple key sectors bear further evidence of strength. Despite adding 227,000 jobs in January, marking the strongest month for jobs gain since last September, the U.S. unemployment rate rose in January as more workers returned

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Housing and Labor Markets Remain Optimistic

to the labor force – a very positive sign for continued productivity gains. Wages are increasing, but modestly, and both the Trump Administration and the Fed see this as evidence that the economy has more room for expansion without overheating.

Amazingly, the largest share of Americans in decades, 35 percent, believes the labor market still has room to grow according to University of Michigan. This is the largest percentage expecting an increase since March of 1984, but back then, unemployment was over three percent higher than today. This perception will likely pull more Americans back into the workforce, further expanding the economy's ability to expand without overheating.

Housing also remains strong. A shortage of inventory is reducing new contracts to buy homes down, according to the National Association of Realtors. Buyers easily outnumber sellers in multiple parts of the country, particularly metro areas and the west. A strong housing market not only lifts the value of a key asset for many Americans, it also portends to a stronger future economy as people can more easily relocate reaping personal and economic benefits.

A solid economy and many notably positive trends is also positively shaping small business sentiment. According to the National Federation of Independent Businesses' monthly survey, business optimism rose to its highest level in more than a decade in January. Given how much hiring and spending this sector of the economy influences, this upturn also signals likely future strengthening of additional sectors.

"... emerging markets appear poised for continued recovery, Europe is finally showing signs of significant strength."

Overall, it seems likely that the market will gyrate due to conjecture and speculation, with much of the movement driven by guesses surrounding the new administration and its success. But fundamentally, the base of the economy should remain strong, and risk of a large or extended market correction remains low.

Beyond the U.S., macro-optimism is surging, and confidence has risen to its highest level since 2011, with over 75 percent of investors expecting higher than average growth and 23 percent expecting an outright "boom," according to a survey released in mid-February by Bank of America Merrill Lynch.

The enthusiasm appears to have a solid base. While China is moving forward more predictably, and emerging markets appear poised for continued recovery, Europe is finally showing signs of significant strength. Real GDP in the Eurozone has grown for 15 consecutive quarters with the help of monetary policy stimulus, the winding down of fiscal austerity policies, and a healthier financial sector that has helped spur lending. The steady growth has been more muted than in the U.S., but the continued recovery, albeit averaging only 1.6 percent annually, has lent confidence to international markets that Europe will continue to grow rather than slip back into recession. Confidence is also growing in that Europe will be able to successfully navigate inevitable challenges surrounding Greece, Brexit, and political instability.

More recently, growth and beginning of the year surveys positively surprised many forecasters and economists. The flash purchasing managers' indices for France, Germany and the Eurozone released on Feb 21 revealed that eight of the nine indices registered growth, and six showed growth higher than any economist polled by Reuters had predicted. The European Commission monthly sentiment survey showed the index well above the long-term average, and a separate business confidence indicator, rose well above market expectations to it highest level since June 2011.

Various factors ranging from a strengthening global economy to a solid U.S. economy with a potential champion in a new president suggest the market trend should continue up. However, higher equity market valuations combined with very likely delays and false starts with President Trump's new policies will potentially result in upward U.S. market progress becoming increasingly uneven, and corrections should not be a surprise.

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