



WEEKLY MARKET UPDATE

December 12, 2016



The Rally Continues. Profit-Taking Imminent?

The month-long rally since the US presidential election rolled along last week, helping to bring many popular market benchmarks to a series of record highs. **The uptrend continued to favor small-caps over large-caps and lower P/E (price to earnings) value stocks over higher P/E growth companies.** As evidence, consider the strong move in the small-cap Russell 2000 Index, which ended the week as the performance leader for the year-to-date.

As mentioned in this space last week, optimism about the incoming administration's plans for reduced taxes and increased infrastructure spending, along with deregulation, seemed to continue to drive positive sentiment.

Also noted were technical factors that might have been in play, as investors who had taken short positions in the S&P 500 Index were forced to cover their positions as the benchmark crossed an important threshold (2,225) at midweek. (Recall that short positions involve selling borrowed shares to profit from a decline in a stock's price. Covering short positions involves buying the borrowed shares back, spurring additional buying demand that can extend a rally.)

The week's economic data were generally supportive of sentiment, with positive readings on service sector activity, factory orders, and mortgage applications. The number of job openings fell a bit in October, but this backward look at the labor market was offset somewhat by a drop in the number of jobless claims during the previous week. The number of people seeking unemployment benefits remained at lows not seen since the early 1970s, when the overall labor force was much smaller.

Meanwhile, Eurozone stocks ended the week on a strong note, with some indexes reaching their highest levels since October on Wednesday. European bank shares rallied, following a report that the Italian government is taking steps to rescue its troubled banking sector. Bank shares extended the rally after the European Central Bank (ECB) said it would continue to buy government bonds within the Eurozone. The export-heavy German Dax 30 climbed to its highest level in 2016 on Thursday, powered by a weaker euro following the ECB's decision.

In the week's major political news, Italy

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voted to reject the constitutional reform plan.

The “no” vote was followed by Prime Minister Matteo Renzi’s tendering his resignation and raised the possibility of new elections. The developments drove the yield on the 10-year Italian government note again above 2%. Despite the finality of the vote, political uncertainty remains. Uncertainties remain about a separate set of changes in the electoral law, and a general election will occur by the first

half of 2018, if not before. **Most importantly, further progress is required to recapitalize the Italian banking system,** a potential landmine that we will follow closely into the new year.

Just under two weeks until Christmas Day! We hope you are taking time to enjoy this holiday season.

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