Equities End Week Narrowly Mixed

December 19, 2016 - U.S. stocks slipped on Friday on concerns regarding China's navy seizing a U.S. underwater drone in international waters in the South China Sea. Equities ended the week narrowly mixed with the Dow Industrials climbing within 0.5% of 20,000, and for the week, outpaced the broader S&P 500 and NASDAQ Composite, which fell fractionally. Financials edged lower for a third day last week, losing just over 1% over the past five sessions. Even so, strong gains in banks have led the broader financials group up more than 17% since Election Day, outpacing a comparable 14.3% gain on the Russell 2000, a measure of small cap performance.

On Wednesday, the Federal Reserve announced a unanimous decision to raise its key federal funds rate by 0.25% to a range of 0.50% to 0.75%. While market expectations had fully priced in the rate hike during the month leading up to the meeting, the policy statement contained the Fed's outlook for three 2017 rate increases instead of the two that policymakers had forecast at their September and November meetings. Fed Chair Janet Yellen said the central bank's new outlook includes some expectation for fiscal stimulus from the upcoming Trump Administration, yet the scope and impact of fiscal expansion remains unknown. Overall, Wall Street accepted the decision to raise rates as a vote of confidence in the strength of the U.S. economy and set the stage for a slightly faster pace of rate increases in 2017.

For the week, the S&P 500 slipped 0.03%, the Dow Industrials increased by 86points (+0.43%), and the NASDAQ Composite fell by 0.11%. The Dow Industrials extended gains for a sixth straight week, its longest rally in a year and has returned 8.6% since Donald Trump won the presidential election. That's the largest "pre-oath" gain associated with any new president since 1900. On Thursday, the US Dollar Index reached 103.02, its highest level since January 2003, and strengthened by 1.34% during the week. Crude oil prices jumped 2% on Friday, ending at $51.90/barrel for a net 0.8% gain during the week. Treasuries continued to trend lower, pushing the yield on benchmark 10-year Treasury notes up another 13 basis points to 2.593%.

What We're Reading

China Pledges to Return Captured Drone ↗

Rare Trend with Dollar/Commodities ↗

Market Jitters Over Yellen's Speech ↗

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Week's Economic Calendar

Monday, December 19: PMI Flash Services Activity Index;

Tuesday, December 20: No major releases;

Wednesday, December 21: MBA Mortgage Applications, Existing Home Sales;

Thursday, December 22: Jobless Claims, Durable Goods Orders, 3Q Final GDP, Chicago Fed Natl Activity, Corporate Profits, Personal Income & Outlays, Leading Indicators ;

Friday, December 23: New Home Sales, University of Michigan's Consumer Sentiment.

Market Watch

Stocks	1-Week	MTD	3-Month	YTD	1-Year	3-Year
Dow Jones Industrial Avg.	0.43%	3.76%	9.48%	13.87%	11.77%	7.70%
S&P 500	-0.03%	2.78%	6.11%	12.84%	11.32%	10.43%
NASDAQ Composite	-0.11%	2.17%	3.99%	9.93%	8.56%	11.84%
Russell 3000	-0.28%	2.71%	6.60%	13.58%	12.15%	9.99%
MSCI EAFE	-0.55%	2.41%	0.72%	0.01%	1.41%	-0.42%
MSCI Emerging Markets	-2.43%	-0.72%	-3.08%	10.15%	10.89%	-2.44%
Bonds						
Barclays Agg Bond	-0.61%	-0.96%	-3.49%	1.52%	1.64%	2.58%
Barclays Municipal	-0.60%	0.30%	-4.28%	-0.62%	-0.24%	3.78%
Barclays US Corp High Yield	-0.06%	1.25%	2.39%	16.44%	16.74%	4.57%

Chart of the Week:
Fed Policymakers Accelerate 2017 Rate Outlook

FOMC December 2016 Forecasts*

Percent

	2016	2017	2018	2019	Long Run
Change in real GDP, Q4 to Q4	**1.9**	**2.1**	2.0	1.9	**1.8**
September Forecast	1.8	2.0	2.0	1.8	1.8
Unemployment Rate, Q4	**4.7**	**4.5**	4.5	**4.5**	4.8
September Forecast	4.8	4.6	4.5	4.6	4.8
PCE Inflation, Q4 to Q4	**1.5**	1.9	2.0	2.0	2.0
September Forecast	1.3	1.9	2.0	2.0	2.0
Federal Funds Rate, end of year	0.6	**1.4**	**2.1**	**2.9**	**3.0**
September Forecast	0.6	1.1	1.9	2.6	2.9

Source: Federal Reserve, J.P. Morgan Asset Management. Data as of December 14, 2016.

*Forecasts of 17 FOMC participants, median estimate.

Since the Federal Reserve's November policy meeting, President-elect Trump's rhetoric promising fiscal expansion and tax reform have spurred reflation in the U.S. economy. This is reflected in the FOMC's December upward revisions to near-term growth and inflation forecasts, and some downward revision to the unemployment rate. Higher median projections for the federal funds rate in each year after 2016 suggest that the move is a "hawkish" trending hike. According to strategists at J.P. Morgan, these longer-term projections are more likely to be realized if economic growth is stoked by fiscal expansion, because expansionary fiscal policy lessens the need for accommodative monetary policy.

With so much uncertainty around future fiscal policy, Wall Street is left to assess risks both to the upside and downside of the Federal Reserve's median scenario. First, if the bullish scenario of stronger growth and inflation falls short of expectations, it could cause a hiccup in financial markets and deter the projected increases. The second scenario is that more expansionary fiscal policy combined with a tight labor market could cause inflation to pop faster than anticipated, leading to more aggressive monetary policy tightening and an ever-strengthening dollar.

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Glossary

*The **Barclays U.S. Aggregate Bond Index** is an unmanaged index composed of Barclays Credit government bond index, mortgage backed securities index, and asset backed securities index and is generally representative of the US Bond market.*

*The **Barclays U.S. Corporate High Yield Index** measures the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below, excluding emerging market debt.*

*The **Barclays U.S. Municipal Bond Index** is an unmanaged, market-value-weighted index of investment-grade municipal bonds with maturities of one year or more.*

*The **Bloomberg Commodity Index** is a broadly diversified index that allows investors to track commodity futures through a single, simple measure. It is composed of futures contracts on physical commodities and is designed to minimize concentration in any one commodity or sector. It currently includes 19 commodity futures in five groups. No one commodity can comprise less than 2% or more than 15% of the index, and no group can represent more than 33% of the index (as of the annual reweightings of the components).*

*The **CBOE Volatility Index® (VIX®)** is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. Since its introduction in 1993, VIX has been considered by many to be the world's premier barometer of investor sentiment and market volatility.*

*The **CRB Index** is a pricing index that measures changes in the price of 22 commodities that are believed to be among the first to react to changes in economic conditions.*

*The **Dow Jones Industrial Average** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ.*

*The **Hang Seng Index** is a market capitalization weighted index of the stocks of the 33 largest companies in the Hong Kong market. The Hang Seng Index is a price weighted/share price index which measures movements in the prices of shares, but not of their dividends.*

*The **MSCI EAFE Index** (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada.*

***MSCI Emerging Markets** is designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index.*

*The **NASDAQ 100 Index** is a modified capitalization-weighted index of the 100 largest and most active non-financial domestic and international issues listed on the NASDAQ. No individual listing can have more than a 24% weighting. Launched on February 1, 1985, the index carried a base value of 125.*

*The **NASDAQ Composite Index** includes all domestic and international based common type stocks listed on The NASDAQ Stock Market. The NASDAQ Composite Index is a broad based index.*

*The **Producer Price Index** is a family of indexes that measures the average change over time in the selling prices received by domestic producers of goods and services. PPIs measure price change from the perspective of the seller. This contrasts with other measures, such as the Consumer Price Index (CPI), that measure price change from the purchaser's perspective.*

*The **Russell 3000 Index** measures the performance of the largest 3,000 U.S. companies representing approximately 98% of the investable U.S. equity market.*

*The **S&P 500** is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.*

*The **S&P GSCI Gold Index**, a sub-index of the S&P GSCI, provides investors with a reliable and publicly available benchmark tracking the COMEX gold future.*

*The **S&P GSCI Crude Oil** Index is a sub-index of the S&P GSCI and provides investors with a publicly available benchmark for investment performance in the crude oil market.*

*The **Shanghai Composite Index** is a stock market index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange.*

*The **STOXX Europe 600 Index** is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalization companies across 18 countries of the European region: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.*