"The State of the Union"

By Tommy Williams, CFP®

Markets are off to a much better start in early 2017 than they were in 2016. You may recall that a year ago, markets faced a number of significant challenges. Numerous market indicators were signaling a high probability of recession. The so-called earnings recession was at an all-time low. Oil was plummeting, fueling worries about the health of the banking system and the high-yield bond market; and the market and the Federal Reserve (Fed) had very different expectations for the path of monetary policy.

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Today, many of these and other challenges during 2016 have been resolved. Most reliable indicators suggest a low probability of recession in the U.S. over the next year. Policy risk has subsided after markets coped with last year's Brexit vote in June and the U.S. presidential election in November. The earnings recession has ended and global corporate profits are poised for an upswing. China's economy and markets have stabilized, and oil prices have rebounded. Thankfully, markets and the Fed are much better aligned with regard to the path of monetary policy over the next few years, which has helped alleviate many of the global imbalances that impacted the market in early 2016.

Still, some issues have not been resolved, and new challenges have emerged. While we may be aware of our new President's political views, and what the new Congress looks like, the impact that these changes will have on U.S. trade policy, healthcare reform and tax reform is still unclear. Important elements of these policies need to be determined and addressing these issues will be instrumental in shaping 2017 for markets:

- Will President Trump use the threat of tariffs, or actual tariffs, to get better trade deals with our key trading partners?
- Will the approximately 20 million people that receive health insurance through the Affordable Care Act remain insured after the law is overhauled?
- Will tax reform include a border adjustment tax to stimulate exports and limit imports?
- Will bank regulation be eased despite the political backlash against the big Wall Street firms during the election?

Despite ongoing political and policy uncertainty, the stock market finished 2016 on a high note, with a 3.8% return for the S&P 500 in the fourth quarter, bringing the 2016 return to an impressive 12%. Markets have gotten a lift from improving economic expectations, partly due to optimism surrounding potential pro-growth policies under a Trump presidency. Third quarter gross domestic product (GDP), reported on December 23, 2016, accelerated. Purchasing manager surveys have indicated manufacturing was on the rise in late 2016 after a nearly two year slump, and consumer spending has remained firm, supported by strong consumer sentiment readings. Fundamentally, the U.S. economy and markets remained on solid footing as the New Year began.

All in all, this year began much smoother than 2016 did, but we are mindful that risks remain. A policy mistake by a government or central bank, issues with the Trump transition, Brexit, China's bad debt problem, and above-average stock valuations may present challenges to the relatively smooth ride we've seen for financial markets so far in 2017. No matter what emotions the election results and the beginning of a new Presidential administration might have stirred up, it still remains a fact that those who stick to a plan (you must have one first), focus on long term goals, and seek the assistance of a trusted advisor tend to experience superior results.

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