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2017 Starts On A Positive Note - Much Better Than 2016!

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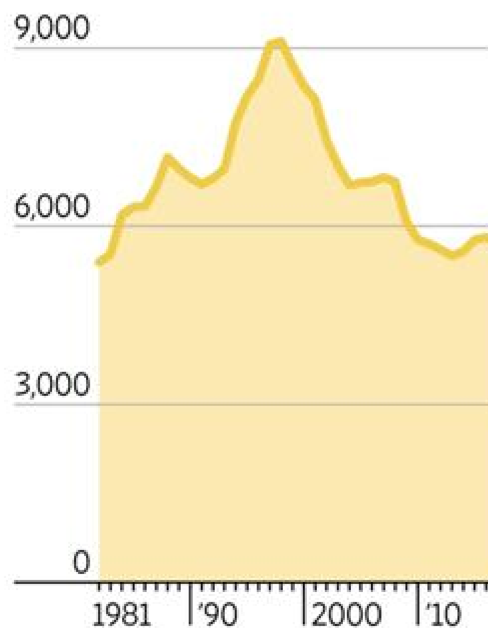
Last year at this time, the S&P 500 fell 6% in the opening week of 2016, the worst opening week ever. This year, the S&P rose 1.7% in the opening week. Last week, the Dow Industrial index rose 1.02%, but 20,000 remains a temporary ceiling. As soon as we break through 20,000, I expect 20,000 will become more of a launching pad for the overall market. Last week, once again, we saw low-quality stocks leading the way, but I believe that earnings season will reward stocks that post strong sales and earnings growth.

Every New Year begins with optimism and 2017 is no exception. A week from Friday, we will have a new President who wants to be a cheerleader for America. This has sparked a new outbreak of "animal spirits," including a stock market rally and an incredible surge in the U.S. dollar. The bad news is that a super-strong dollar could cause analysts to revise their earnings estimates lower for multinational stocks.

I expect 2017 will be a spectacular year! Typically, Americans give every new President 100 days or so to implement his agenda before becoming more critical. This time around, it will be interesting to see how long it takes the Trump administration to implement their agenda before criticism mounts. With control of Congress, it is possible that the Trump administration may have an even longer honeymoon, despite a largely cynical news media. Right now, I expect the stock market will be relatively strong through April, but if Wall Street anticipates accelerating earnings growth from corporate tax reform, the rally could last even longer.

In the upcoming weeks, the S&P 500 is forecasted to post a 3.2% annual earnings growth for the fourth quarter, but the S&P is also expected to post a 1.25% annual sales decline. Later on, however, the overall earnings environment is expected to improve immensely as 2017 unfolds. In April, when the first-quarter sales and earnings are announced, the annual pace of earnings growth is expected to pick up to an 8% annual pace due in part to easier year-over-year comparisons for energy stocks as well as higher natural gas and crude oil prices. If the Trump administration can get Congress to implement corporate tax reform, then the S&P 500's earnings could explode to a 20% annual rate. Mass repatriation of overseas cash is likely to boost corporate stock buy-backs. In other words, the upcoming months could be quite exciting.

One of the reasons I like the chances for the overall stock market in 2017 is the slow disappearance of shares available to investors. Last Thursday, *The Wall Street Journal* featured an excellent article about how the stock market continues to shrink dramatically due to (1) private capital investment, (2) a slump in initial public offerings, and (3) a merger boom. Essentially, the U.S. is becoming "de-equitized." *(Source: The Wall Street Journal, "Investor's Lament: Fewer Public Listings", January 5, 2017).*



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Essentially, U.S. stock markets have shed 3,379 listings since peaking at 9,113 in 1997. As of last June, there were only 5,734 public companies, down 37% in less than 20 years. That doesn't even count the reduction of shares in existing listings through aggressive stock buy-back activity. The fact of the matter is that the overall U.S. stock market is slowly dying and will continue to "melt up" on order imbalances due to persistent inflows from the ETF, mutual fund, and pension industries into a shrinking share base.

The Dollar, at a 15-Year High, Limits the Fed's Options

The U.S. dollar hit a 15-year high on Tuesday. However, the dollar abruptly sold off on Wednesday after the Fed released dovish Federal Open Market Committee (FOMC) minutes of their December 13-14 meeting, which cited "considerable uncertainty" about the impact of the incoming Trump administration. The good news is that the FOMC acknowledged that the prospects for fiscal stimulus, such as infrastructure spending and tax cuts, should boost economic growth in the upcoming years. The bad news is that the FOMC seems to have no idea how market interest rates would react to all the fiscal stimulus, even though market rates have risen considerably since the election on the anticipation of more government spending.

The FOMC also "expressed the need for caution" about the "substantial changes" in financial conditions. This essentially means that the FOMC may not be raising key interest rates further until it gets a better handle on the impact of the Trump Administration's fiscal stimulus. In fact, Fed Chairman Janet Yellen said, "We're operating under a cloud of uncertainty at the moment." The FOMC cited three primary risks: (1) the impact of a strengthening U.S. dollar, (2) financial instability overseas, and (3) the fact that interest rates are close to zero overseas. In other words,

the Fed may be taking its cues from global market rates moving forward. Due to low interest rates overseas, I think the Fed should be increasingly cautious, especially since a strong U.S. dollar could hinder exports and possibly begin to impact overall economic growth.

In the meantime, the Fed will surely see that U.S. job growth remains subpar. The Labor Department reported last Friday that 156,000 payroll jobs were created in December, substantially below economists' consensus estimate of 183,000. Also, the October payroll report was revised down to 135,000 (from 142,000), while the November payroll report was revised up to 204,000 (from 178,000). Average hourly earnings rose a healthy 10 cents an hour to $26 (following a 3-cent decline in November). Earnings per hour are up 2.9% in the past year, so the wage inflation the Fed has been anticipating has finally arrived.

On Tuesday, the Institute of Supply Management (ISM) reported that its purchasing manufacturing index rose to 54.7 in December, up from 53.2 in November. The ISM manufacturing index is now at its highest level in three years despite a strong dollar, but the Fed reported that industrial production rose only 0.1% in November and declined 0.6% in the past year, so there is definitely room for improvement here. Since the Fed is "data dependent," I will be watching the economic statistics very closely in upcoming weeks.

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