# THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – FEBRUARY

**US Markets and Economy**:

The Trump Rally gained steam in February, with new records being set for all major indexes. (The Dow breached the psychologically important 21,000 mark on the first trading day of March, and the S+P 500 reached 2,400 on the same day.) Stocks are now up almost 15% since the election, one of the sharpest post-election run-ups in modern history.

The main basis for the rally is no secret: a pro-business President and Congress are preparing to roll back regulations on a variety of industries, which should drive corporate profits higher. Higher spending on the military (perhaps an extra $54 billion next year) will drive revenues up for defense contractors and all their suppliers, while infrastructure spending (perhaps $1 trillion) will drive up profits in construction and related industries. If Dodd-Frank regulations are indeed rolled back or eliminated, the banking and financial sectors will profit handsomely. For-profit colleges and universities will benefit with Secretary DeVos in charge of the Department of Education. Firms in the fossil fuel industry, which were harassed by an aggressive EPA, will benefit with Scott Pruitt, a close ally of the industry, taking over the EPA.

A secondary basis for the rally is the hope that a combination of business and personal tax cuts will drive up after-tax profits for corporations, unleash a flood of innovation, and speed up the US's anemic rate of economic growth (less than 2% in real terms in 2016.) While some of this fiscal stimulus could be offset by deep cuts in the federal budget elsewhere, such as in foreign aid, the net effect could still be quite expansionary. What could temper this expansionary impulse is a gradual tightening of monetary policy by the Federal Open Market Committee (FOMC). Both Federal Reserve Board Governors, and Federal Reserve District Bank Presidents (all members of the FOMC) have been publicly suggesting that the Fed's key short-term interest rate benchmark, the Federal Funds rate, will be increased in March, as part of a set of three likely increases in this rate in 2017. The stock market has shrugged off the prospect of higher rates, in part because, with inflation at 1.7%, an increase in the Fed Funds rate to 1.25% at the end of the year will still mean that the real short-term interest rate will be negative. Thus monetary policy will be still be expansionary, just less so than in past years.

The prospect of rising interest rates keeps the international value of the dollar high, as foreigners demand dollars to purchase US assets (such as US Government bonds) which yield more than the equivalent European or Japanese assets. In February the broad "trade-weighted" value of the US dollar remained at a high level not seen since 2002. A strong dollar, which does keep inflation down (imports appear cheaper) does impose a burden on exporters, which have more difficulty competing with foreign suppliers whose prices in local currency look cheaper than the US dollar price. Overall, however, consumers, businesses, and stock market traders are mostly optimistic about US economic prospects, and this optimism can drive US stock prices still higher.

**World Markets and Economy**:

In the Americas, Mexican stocks were flat as worries about NAFTA, the wall, and changes in immigration policy sidetracked the recovery from a broad selloff after the US election. The Mexican peso, which also fell sharply after the US election, managed to recover some lost ground in February, and is now trading at about 20 pesos to the US dollar. A weak peso should help strengthen Mexican exports to the US, and partially offset a potential surge in US protectionism. Canadian stocks were flat for the month, but remain at multi-year highs. Canadian growth rates often follow the US, and the prospects of faster growth in the US have encouraged stock traders north of the border.

European stocks followed the US market higher in February, with the EUROSTOXX 50, a blue-chip index, up nearly 3% for the month. British stocks gained a smaller amount, as worries about Brexit continued to dog the markets. But France, facing a major election in May, and Greece, facing once again the specter of default, managed solid stock rallies for the month.

Japanese stocks were flat in February, but the Nikkei 225 remains very close to its 10-year high near 20,000. The Japanese economy continues to limp forward, propelled by continuing bouts of expansionary monetary policy, negative short-term interest rates, and a weak yen. Whether this trio of tools will finally get the Japanese economy on the path to sustainable growth remains to be seen.

**OUTLOOK:**

The US bull market has been on a tear in 2017, and there is no sign that the Trump Rally is ending. Stocks never go straight up, however, and bull market "corrections" can appear at any time. Investors should remember that the courage to ride out the inevitable corrections will be amply rewarded in the long run.