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Corporate Federal Credit Union

Andrew Kohl
Chief Investment Officer

Economic Update
January 2017

By Andrew Kohl

Commentary

The markets have been in a holding pattern since year-end, waiting to see what the Donald Trump presidency will bring. They have already placed relatively high expectations that his policies will provide positive momentum for the economy. The stock market has increased by almost 7% since the day before he was elected up until when he was inaugurated. During that timeframe, the stock market has performed better than it has under any of the previous four president elects.

Based on his inauguration speech, it appears that Trump has no intention of backing away from his anti-establishment stance. Some had believed that he would use the speech as an opportunity to reach out to the people that didn't vote for him and attempt to unite the country (he is entering the presidency with one of the lowest approval ratings on record and after losing the popular vote). Instead, his speech largely mirrored his campaign rhetoric.

Therefore, it appears likely that trade protectionism will be the first order of business for the Trump administration. This will put an end to the United States' decades long movement towards freer global trade. Unfortunately, it also means that economic growth will suffer. Free trade allows for the most efficient use of resources, and it benefits the growth rates in both the U.S. and foreign economies. The downside is that the benefits of improved growth are not distributed evenly. Too little was done over the years to help the people that were hurt by globalization. Many of those people cast their votes for the new President in hopes that their situation will be improved.

The president has wide latitude to change trade policy without Congressional approval. The North American Free-Trade Agreement (NAFTA) has been a frequent target of Trump's. He has called it "the worst trade deal maybe ever signed anywhere…" He has the power to leave NAFTA by simply providing six months' notice to Canada and Mexico. It will be an early test to see if Trump is implementing bargaining tactics to get a better deal or if he wants to completely revamp trade relations across the globe.

An early focus on trade deals could place the potentially expansionary policies (tax cuts and fiscal spending) further down the road. We still believe that some form of tax reform and fiscal spending is likely, but don't expect anything to be completed early enough to impact the economy in 2017. Absent any stimulus, we believe that the economy can remain on the 2% real GDP growth trajectory that has been the norm for this recovery. If expansionary policies do get enacted, it is very possible that 2018 economic growth rates can break higher, but we are very doubtful that we will reach the 4% growth target set by the Trump administration.

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Fixed Income Outlook
The Treasury curve is relatively unchanged from year-end. Economic data has been largely at or near expectations to start the year. Headline inflation data has picked up given the increase in oil prices over the last several months. In addition, wage growth for December saw the largest year-over-year increase in over seven years.

The latest Fed projections show a median expectation for three rate hikes in 2017. The market is pricing in two rate hikes. The Fed minutes revealed that “about half” of the participants incorporated an assumption of more expansionary fiscal policy into their forecasts. That would imply equal risk to the Fed’s median rate projection as to whether any fiscal action is taken this year. The Treasury curve seems fairly valued at these levels.

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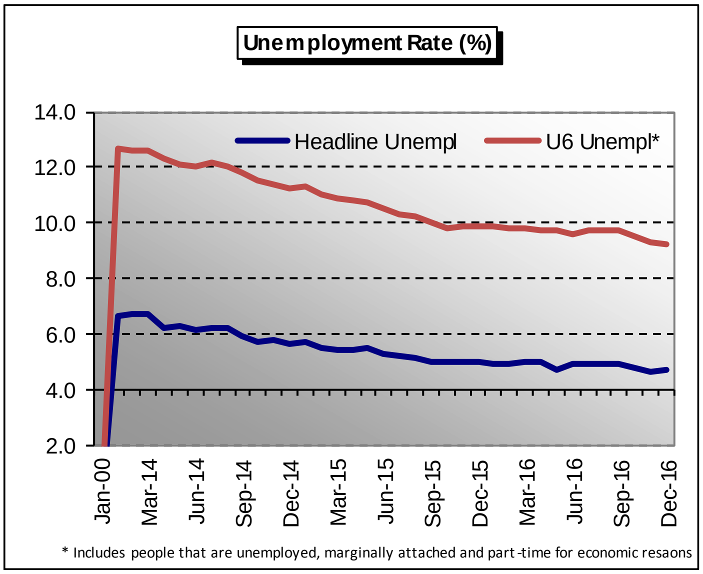
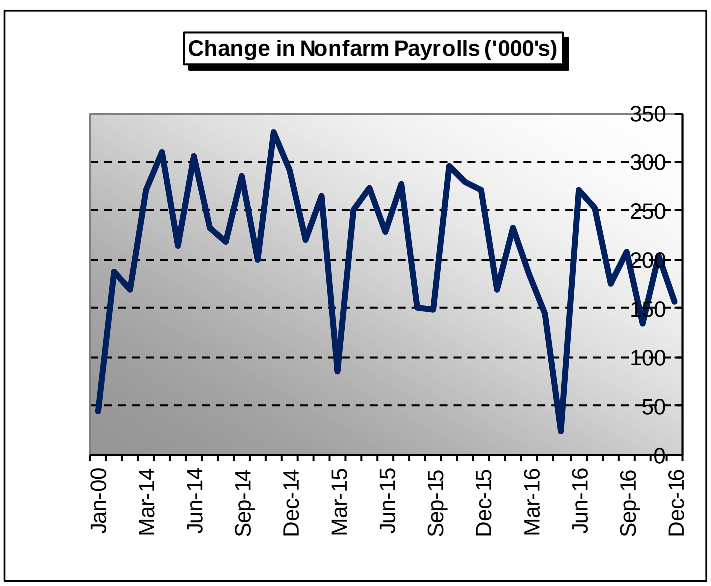
Labor Readings
(Data source: Bloomberg)



Unemployment Rate Ticks Up to 4.7%
The unemployment rate in December rose to 4.7% from 4.6% the prior month. The rise was due to an increase in the labor force and was in line with expectations. The biggest surprise in the labor report was the large increase in average hourly earnings. The year-over-year increase for December was 2.9%. This is the largest year-over-year increase since June 2009.



Job Gains Come in Near Expectations
Payroll growth in December came in slightly below estimates. Payrolls increased by 156,000 jobs versus an expected gain of 175,000 jobs. Offsetting this slight miss was an upward revision of 19,000 jobs for the prior two months. Payroll growth averaged 180,000/month in 2016 versus 229,000/month in 2015. Most economists believe that approximately 100,000/month is needed to offset the growth in the labor market. Therefore, anything above that number indicates that the labor market is tightening.

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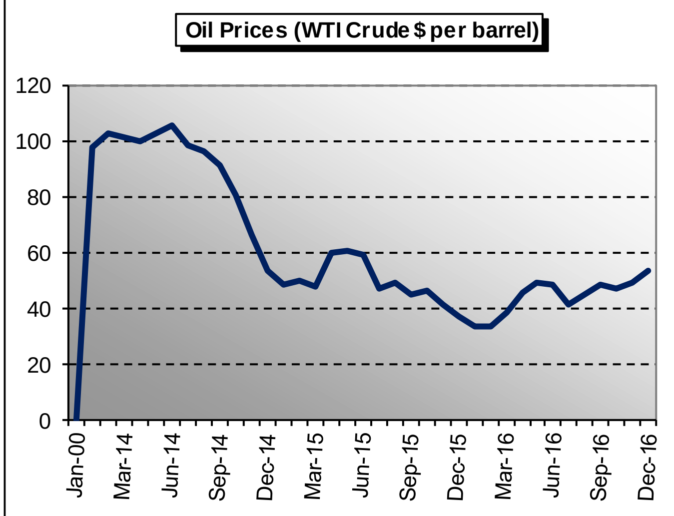
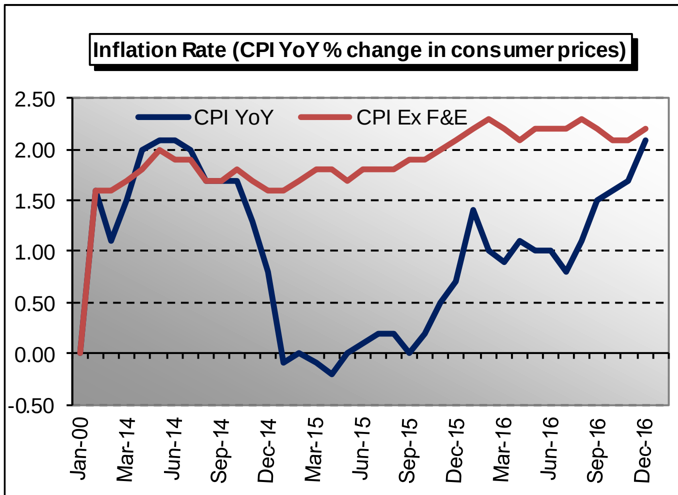
Inflation Readings
(Data source: Bloomberg)



Oil Prices Move Higher
Oil prices have continued to climb after OPEC announced cuts a few months ago, and due to renewed economic optimism. Prices now stand near an 18-month high. Oil prices increased by 45% in 2016 after falling 46% in 2014 and 30% in 2015.



Inflation Rate Continues to Ascend
The rate of inflation rose for the fifth consecutive month due to rising fuel and housing expenses. It now stands at its highest level since June 2014. The large gap between headline and core inflation has now been closed. The Fed's preferred measure of inflation (core PCE) remains below their 2% target, but has also increased during 2016.

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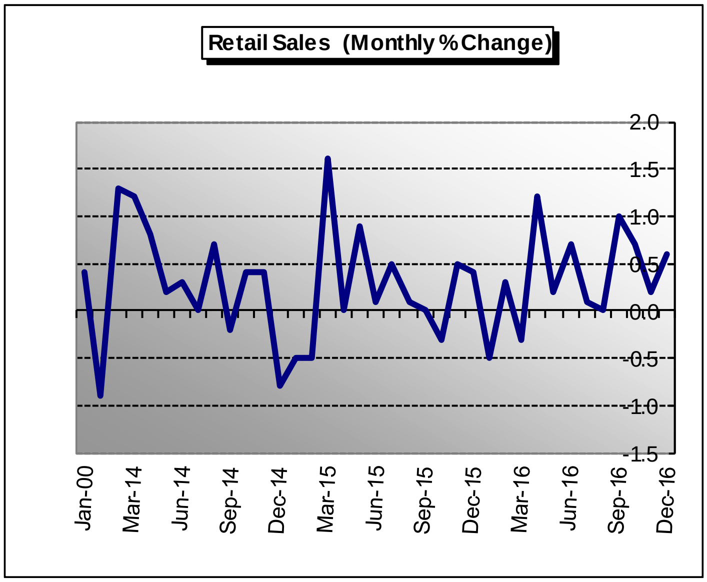
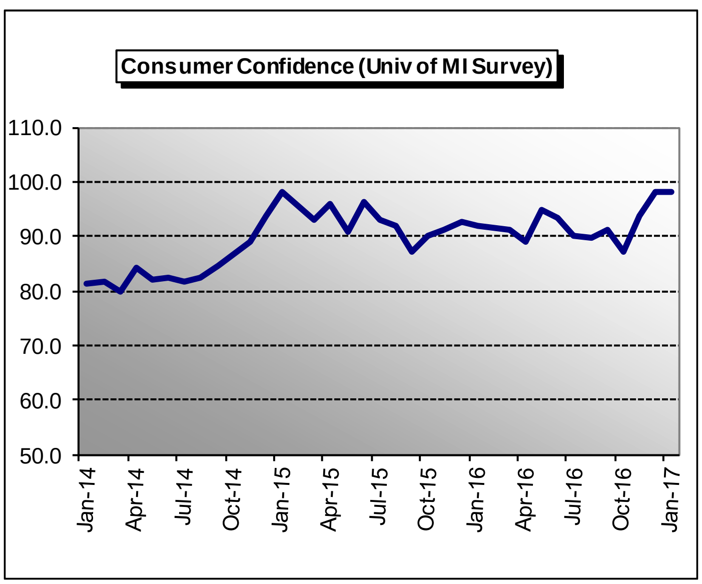
Consumer Readings
(Data source: Bloomberg)



Retail Sales Fail to Meet Expectations
Retail sales in December were weaker than expected. Sales advanced by .6% on a month-over-month basis versus a forecast for .7% growth. Much of the gain came from auto sales and gasoline station sales (due to higher gas prices). Confirming anecdotal reports, internet sales did far better than department store sales.



Consumer Confidence Remains High
Consumer confidence came in slightly below expectations in January, but remains near a twelve-year high. Economic expectations remain high following the Trump victory. Inflation expectations also ticked up from last month.