FFTW Weekly Commentary
FOR PROFESSIONAL INVESTORS

The First 100 Days...

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Key takeaways

- In President Trump's first 100 days, what can we expect from markets…?
- Amidst the uncertainty, market forecasts have become increasingly polarized.
- The risk of a policy error from protectionist policies has risen….

Full commentary

The dramatic shift in investor sentiment over the last few months begs the question: *what can we expect from markets in the coming weeks?* Historically, the first 100 days of a new presidential administration are the most formative, though there is some evidence that the level of productivity has decreased in the modern era as the legislative process has become more complex and partisan. In recent years, new presidents have relied more heavily on executive orders rather than the messy legislative process to make their initial mark. While the bulk of President Trump's agenda requires congressional approval, the near term risks may be the result of executive orders.

Amidst the uncertainty, market forecasts have become increasingly polarized. The more optimistic folks are calling for smooth implementation of the campaign platform with little resistance from the Republican-led legislature. Personal and corporate tax cuts, deficit fueled infrastructure spending and reduced regulation, are expected to drive growth well above trend. Interest rates would rise as growth fuels inflationary pressures. The dramatic change in markets appears to support this view.

On the other extreme, naysayers see numerous obstacles to the Trump legislative agenda. Challenges from Democrats and right-leaning Republicans are expected to limit the new administration's ability to push through unfunded tax cuts and spending measures. The mercurial President Trump would respond by flexing his executive muscle to recast trade policy through executive order further muddying the economic landscape. This camp sees interest rates as having already peaked and expects equity markets to correct retracing the post-election euphoria.

At FFTW, we expect markets to follow a path that falls between the two extremes. Tax reform and infrastructure spending programs are unlikely to be fast-tracked through the legislature given both the level of complexity and a lack of consensus in congress. A success starved Trump may refocus near-term efforts on the protectionist agenda through renegotiation of bi-lateral trade deals and implementation of import tariffs. While the Trump administrations aspirations of creating a manufacturing renaissance are noble, the plan is misguided as the rules of business do not always translate well into the global macroeconomic framework.

At first glance, an increase in tariffs or a border tax would increase the prices of imported goods relative to domestic substitutes resulting in a decline in imports relative to exports and a narrowing of the current account deficit. In practice, a decline in imports would reduce the supply of off-shore U.S. dollars (USD) resulting in a corresponding increase in the trade-weighted USD. A stronger USD would negatively impact demand for U.S. exports leaving the trade deficit largely unchanged. Trade flows are likely to revert slowly back to pre-tariff levels after the foreign exchange adjustment. At best, the impact of protectionist trade policy may have no lasting impact on the trade deficit as tariffs/border taxes are quickly offset by currency adjustments. At worst, tariffs result in a disproportionate impact on U.S. exports relative to imports as trade partners retaliate.

Trade deals have often been blamed for domestic industry contractions, job losses, and trade deficits. This view runs contrary to basic economic theory which suggests that current account deficits are simply a function of low domestic savings relative to investment where the shortfall (excess investment) is funded by foreign trade partners. Ceteris paribus, the trade imbalance would be expected to normalize as the currency of trade surplus countries appreciates relative to those with trade deficits. This identity does not hold well for reserve currencies such as the USD with significant offshore demand. Most foreign trade partners retain a large percentage of their trade dollars in reserve rather than converting to their domestic currency. This excess demand keeps the dollar strong while creating incentives for the U.S. to consume foreign goods in excess of exports leading to persistent trade deficits. In the absence of an adjustment to the savings/investment imbalance, any change in net trade levels would be offset by a corresponding adjustment in USD foreign exchange valuations. This paradox, formally known as the Triffin Dilemma, dates back to the 1960's when Robert Triffin first presented this concept to congress.

This week's market developments

Monday, January 23
- Eurozone Consumer Confidence (advanced estimate) increased to -4.9 for January

Tuesday, January 24
- Markit Eurozone Manufacturing PMI (prelim estimate) increased to 55.1 for January
- Markit Eurozone Services PMI (prelim estimate) decreased to 53.6 for January
- Markit US Manufacturing PMI (prelim estimate) increased to 55.1 for January
- US Existing Home Sales decreased to 5.49 million for December

Wednesday, January 25
- German IFO Business Climate decreased to 109.8 for January

Thursday, January 26
- UK 4th Quarter GDP (advance estimate) remained at 0.6% q.o.q.
- US Wholesale Inventories growth (prelim estimate) remained at 1.0% m.o.m. for December
- Markit US Services PMI (prelim estimate) increased to 55.1 for January
- US New Home Sales decreased to 536,000 for December
- Japan National CPI growth decreased to 0.3% y.o.y. for December

Friday, January 27
- US 4th Quarter Annualized GDP growth (advance estimate) decreased to 1.9% q.o.q.r

Source: Bloomberg, as of January 30, 2017

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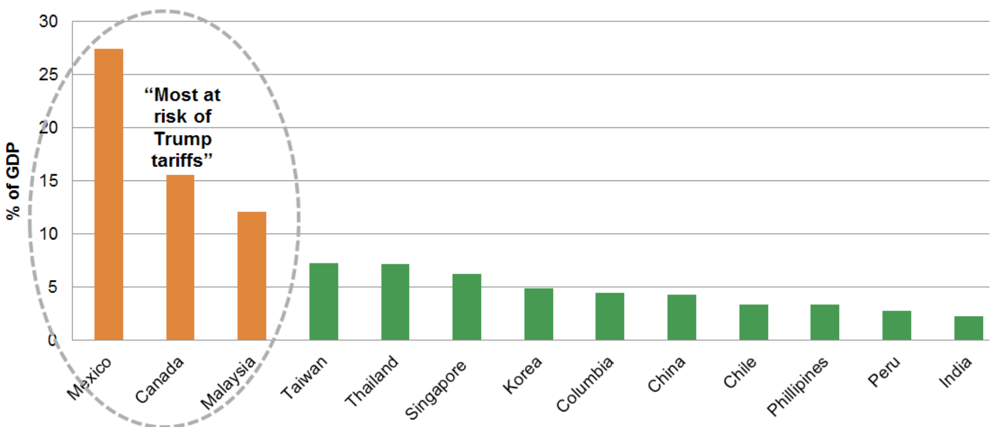
On Friday, January 27th we learned that fourth quarter U.S. gross domestic product (GDP) declined to 1.9% quarter-on-quarter (QoQ) largely due to a surge in imports relative to exports, some of which can be attributed to recent dollar strength. Clearly, the risk of a policy error from protectionist policies has risen, we may be just one tweet away…

Chart of the Week

Non-Energy Exports to US (% of GDP)



Sources: Bloomberg, as of September 30, 2016

Central Bank Watch

	Last move	Date of move	Current policy rate	Implied 3-Month Rate on March 2017 Interest Rate Futures Contract	Next meeting
Fed	+25 basis points	December 14, 2016	0.50% - 0.75%	0.69%	February 1, 2017
ECB	-5 basis points	March 10, 2016	0.00 %	-0.18%	March 9, 2017
BoJ	-20 basis points	February 16, 2016	-0.10 % - 0.00%	0.06%	January 31, 2017
BoE	-25 basis points	August 4, 2016	0.25%	0.37%	February 2, 2017

Sources: Bloomberg, as of January 30, 2017

Next week's market developments

Monday, January 30

- US Personal Income growth is expected to increase to 0.4% m.o.m. (s.a.) for December
- US Personal Spending growth is expected to increase to 0.5% m.o.m. (s.a.) for December
- Japan Industrial Production growth (prelim estimate) is expected to decrease to 0.3% m.o.m. (s.a.) for December

Tuesday, January 31

- Eurozone 4th Quarter GDP growth (advance estimate) is expected to increase to 0.5% q.o.q. (s.a.)

Wednesday, February 1

- Markit UK Manufacturing PMI is expected to decrease to 55.9 for January
- US ADP Employment Change is expected to increase to 167,000 for January
- US ISM Manufacturing is expected to increase to 55.0 for January
- US Construction Spending growth is expected to decrease to 0.2% m.o.m. (s.a.) for December

Thursday, February 2

- Markit/CIPS UK Construction PMI is expected to decrease to 53.8 for January

Friday, February 3

- Markit/CIPS UK Services PMI is expected to remain at 53.6 for January
- US Change in Nonfarm Payroll is expected to increase to 175,000 for January
- US Unemployment Rate is expected to remain at 4.7% for January
- US Factory Orders growth is expected to increase to 0.8% m.o.m. (s.a.) for December

Source: Bloomberg, as of January 30, 2017