FFTW Weekly Commentary

FOR PROFESSIONAL INVESTORS

America… Not Quite the Patriots, But Still Making a Comeback

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Key takeaways

- Increasing optimism among U.S. corporate management teams, signaling higher capital spending to come.
- President Trump signed executive orders aimed at reducing financial regulations.
- The U.S. economy has started 2017 on solid footing, with healthy labor conditions and rising inflation.

Full commentary

Economic data released the past week shed a positive light on the U.S. economy, and with the fourth quarter earnings season in full swing, management commentaries also are indicating renewed optimism for U.S. economic growth in 2017. Amidst uncertainties about the new administration's policies, corporations are focused on the outcome of lighter regulation, corporate tax reform and overall, an expectation for a more business friendly environment under a new regime. While overall fixed investment remains soft, business confidence is improving. Anecdotes from the earnings conference calls point to a higher level of capital expenditures if corporations get clarity on tax reform, and the commodity sectors have already budgeted increased spending for 2017. Of course, the devil is in the details. The Republicans are not united on reform proposals and the administration's plans are still vague, causing markets to discount them somewhat. The market is much more focused on regulatory reform and the Trump reflation story.

The pen is proving to be mightier than the sword. The financial sector reacted favorably on Friday after President Trump signed two orders aimed at reducing restrictions put in place after the financial crisis. The President has ordered a review of the Dodd-Frank Act, signaling that the rules, in their current form, are overly restrictive on bank lending and have forced banks to hoard more capital rather than lending to businesses. The fiduciary rules, which are scheduled to go into effect in April, will also be reviewed.

With over 50% of the Standard & Poor's 500 (S&P 500) having reported, fourth quarter results are showing roughly 4% revenue growth and 6% earnings growth. Management teams are optimistic that a pro-business agenda under the current administration will bode well for corporations. However, there is a growing divergence in earnings revisions, with domestic companies offering more upside revisions, while the trends for global companies have deteriorated. The outlook for cyclicals and financials is bullish, and we are seeing increased optimism from companies set to potentially benefit from lighter regulation and corporate tax reform. Elimination of interest rate deductibility and tax relief on repatriation of cash currently held overseas could have a significant impact on credit markets, while the impact from border taxes will be mixed in the short-run. A border tax will negatively impact sectors relying on imports, such as retail, apparel, and parts of manufacturing relying on imported raw materials or semi-finished goods. The longer-term impact of a border adjustment tax, however, is uncertain and will depend on the response from other governments. Credit fundamentals have weakened over the past few years, but expectations for better earnings should mitigate the deterioration. Financials' credit trends are set to improve and non-financials are seeing signs of stabilization. Additionally, the stress in commodities is easing.

Despite the pickup in economic momentum this year, the Federal Reserve held rates steady, as expected, given uncertainty and the lack of clarity from the planned fiscal stimulus under the new administration. Among the economic data released this past week, the jobs reports showed a continuing tightening of the labor market and reflected generally healthy conditions. Job creation was solid, labor costs did not appear to be accelerating and participation edged higher. January's 227k payroll increase exceeded the 180k consensus estimates and represented a solid improvement from the fourth quarter average of 148k. It was the strongest gain since September 2016. The surge in January reflected broad-based private sector strength. During the fourth quarter, productivity increased 1.3%, marking an improvement over the past two quarters, but still remains weak. Wage growth was a bit disappointing, and unemployment ticked higher to 4.8% on an increase in labor force participation. In addition to the improving employment picture, the U.S. consumer could also benefit from individual tax reform, but if border tax adjustment passes, higher prices on imported goods will ultimately dampen these positives.

This week's market developments

Monday, January 30

- US Personal Income growth increased to 0.3% m.o.m. (s.a.) for December
- US Personal Spending growth increased to 0.5% m.o.m. (s.a.) for December
- Japan Industrial Production growth (prelim estimate) decreased to 0.5% m.o.m. (s.a.) for December

Tuesday, January 31

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

Wednesday, February 1

- Markit UK Manufacturing PMI decreased to 55.9 for January
- US ADP Employment Change increased to 246,000 for January
- US ISM Manufacturing increase to 56.0 for January
- US Construction Spending growth decreased to -0.2% m.o.m. (s.a.) for December

Thursday, February 2

- Markit/CIPS UK Construction PMI decreased to 52.2 for January

Friday, February 3

- Markit/CIPS UK Services PMI decreased to 54.5 for January
- US Change in Nonfarm Payroll increased to 227,000 for January
- US Unemployment Rate increased to 4.8% for January
- US Factory Orders growth increased to

Source: Bloomberg, as of Feburary 6, 2017

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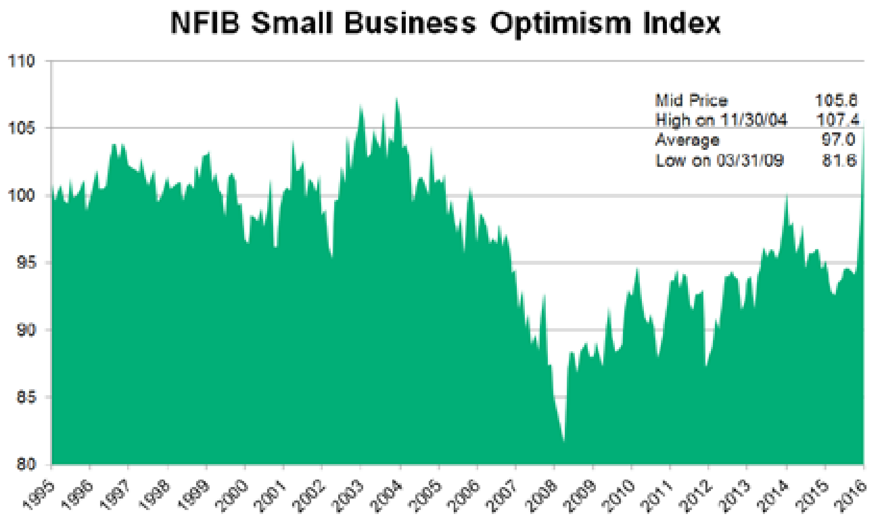
The Trump phenomenon could have big picture implications for U.S. corporations. It has also become apparent over the past few months that we have shifted from a deflationary theme in 2016 to one of reflation, with inflation expectations moving higher. Corporate management teams are signaling increased optimism fueled by expectations for reduced regulation and more business friendly policies under the new administration. In addition to business confidence improving, the labor market continues to tighten, which should be beneficial for the U.S. consumer.

Chart of the Week

National Federation of Independent Business (NFIB) Index of Small Business Optimism



Sources: Bloomberg, as of February 6, 2017

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%	0.68%	March 15, 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%	March 16, 2017
BoE	-25 basis points	August 4, 2016	0.25%	0.36%	March 16, 2017

Sources: Bloomberg, as of February 6, 2017

Next week's market developments

Monday, February 6

- Germany Factory Orders is expected to increase to 0.7% m.o.m. for December

Tuesday, February 7

- Germany Industrial Production is expected to decrease to 0.3% m.o.m. (s.a.) for December
- UK Halifax Housing Prices index is expected to decrease to 0.00% m.o.m. (s.a.) for January

Wednesday, February 8

- Japan Machine Orders growth is expected to increase to 3.00% m.o.m. (s.a.) for December

Thursday, February 9

- US Initial Jobless Claims are expected to increase to 249,000 (s.a.) for the week ending February 4th
- US Wholesale Inventories growth is expected to remain at 1% m.o.m. for December
- Japan PPI is expected to increase to 0.00% y.o.y. for January

Friday, February 10

- UK Industrial Production growth is expected to decrease to 0.2% m.o.m. for December
- US Import Price Index is expected to decrease to 0.2% m.o.m. for January
- US University of Michigan Sentiment is expected to decrease to 97.8 for February (prelim)

Source: Bloomberg, as of Feburary 6, 2017

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