Global Economic Review

Eagle Eye

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Market & Economic Outlook

Eagle Strategies is pleased to present economic and market insights from the Portfolio Managers in the MainStay Investments Strategic Asset Allocation and Solutions Division.

Delivering what's possible. Some things in this world are timeless, among them is the practice of politicians making campaign promises they have no hope or intention of keeping. On the road to defeating Clinton, Trump pledged to lower taxes (corporate and individual) and raise spending (mostly on infrastructure and defense) while simultaneously lowering the deficit. You don't need a graduate degree in physics to see that the arithmetic doesn't work. Something has to give; it's just a question of what.

There are elements of Trump's campaign platform that are unequivocally positive for growth, and the probability of their passage is significantly enhanced as a result of the Republicans now controlling both Houses as well as the Oval Office. Corporate tax reform (not tax cuts) that includes a significant rate reduction on repatriated foreign earnings can be expected to provide a material boost to activity and add further support to stock prices through enlarged share buyback programs. Fiscal thrust, funded in large measure by taxes on the newly repatriated earnings, is also within reach.

And, deregulation of the financial, energy, and healthcare sectors can boost growth without straining the budget, although the argument can be made they come at a cost of less economic stability, a dirtier environment, and fewer consumer protections. All in, there is clearly the potential for policy to stimulate an economy that is already seeing a more rapid pace of growth.

"The first lesson of economics is scarcity: There is never enough of anything to satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics." — Thomas Sowell

But there are reasons for skepticism too. To the extent that the new administration does impose tariffs or impose other barriers to trade that are likely to elicit retaliation, the effect will be to retard growth and lift inflation. Likewise, restrictions on highly skilled foreign workers, resulting from visa reform and deportation of undocumented workers depleting the pool of unskilled workers, stand to slow growth and add to inflationary pressure. So market response notwithstanding, Trump's victory is a mixed blessing.

On the radar screen

1. Investors will be closely monitoring the evolving plans of Trump's staff and Congressional colleagues as he prepares to take office. Policy initiatives undertaken in 2017 could have a profound impact on the economy and financial markets.

2. Recent focus has been on government policy, but there has also been activity in the private sector. Watch durable goods orders and non-residential construction for indications that business investment is further accelerating.

3. A strong job market, rising equity prices, and an optimistic assessment of the pro-cyclical elements of Trump's campaign platform are producing higher confidence readings. And, an upside breakout for equity prices is possible.

4. With employment costs growing and energy/materials prices now higher on a year over year basis, inflationary pressures were building. Deficit spending, trade barriers, and visa restrictions may amplify that effect as we move through 2017.

5. A constitutional referendum in Italy and a Presidential election in Austria, both occurring in the first weekend of December, have the potential to reintroduce political instability and rattle European markets.

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"Experience teaches only the teachable."
— Aldous Huxley

We like to believe that we are teachable. With both Brexit and Trump, reality turned our expectations on their head. And, we similarly miscalculated the market response in both instances (this was one of those fortunate times when two wrongs make a right). The lesson we take from these experiences is that we have allowed politics to command a larger influence on our thinking than it deserves. Refocusing on the underlying fundamentals, we see a sound economy that is picking up modestly as we move through year end. People are finding work, they're being increasingly well paid for that work, and they are spending the income they bring home. With earnings having turned the corner and demand steady, corporate management is in the early stages of a reinvestment cycle. Confidence is riding high. The economy may not be booming, but it is doing well enough. And while stocks aren't cheap, they are not particularly expensive. So, our outlook is shifting, and we're inclined to back away from the defensive posture we've maintained since June. We don't wish to be left behind if the fabled "Santa Claus rally" makes an appearance this year.

As we write, the Organization of the Petroleum Exporting Countries (OPEC) is locked in deliberations over a possible agreement to cut production. The outcome will have some near- term impact on oil prices, but OPEC as a cartel has lost its ability to control pricing on a global market. Technological innovation has thoroughly disrupted the energy sector. Efforts by the gulf state producers to drive shale drillers out of the market have failed unquestioningly. U.S. domestic production did retreat to a limited degree in the face of sub $50/bbl prices, but drillers are adapting to the new low price environment and are finding ways of turning a profit even at these levels.

"History suggests a good recipe for dooming an organization, regime or even a country is to take a pie, shrink it dramatically, and divide the pieces very unevenly."
— Bloomberg columnist Liam Denning.

Production is hooking back up as evidenced by the 50% increase in the number of rotary rigs in operation over the past six months. The U.S. is well on its way to becoming not only the largest energy producer in the world but also one of its most efficient. The revolution lives on, and we're invested in it.

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