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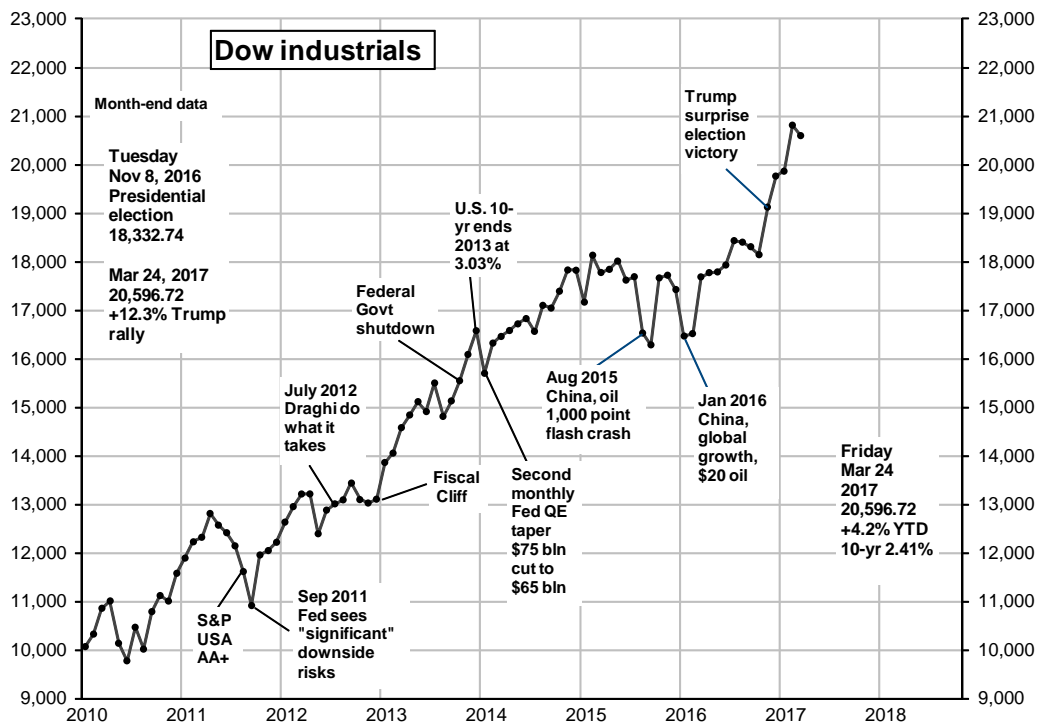
24 MARCH 2017

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STOCK MARKET SINKS TRUMP RALLY THIS WEEK WITH 3% LOSS

Another exaggeration. Stock market losses. False facts on our part. Though we remain impartial and will not take sides when it comes to the debate over the political economy as we used to call it. More political now perhaps than economy.

A lot was made of Tuesday's stock market loss. It was the biggest one-day drop in the Dow industrials (237 point sell-off) since Trump was elected president.



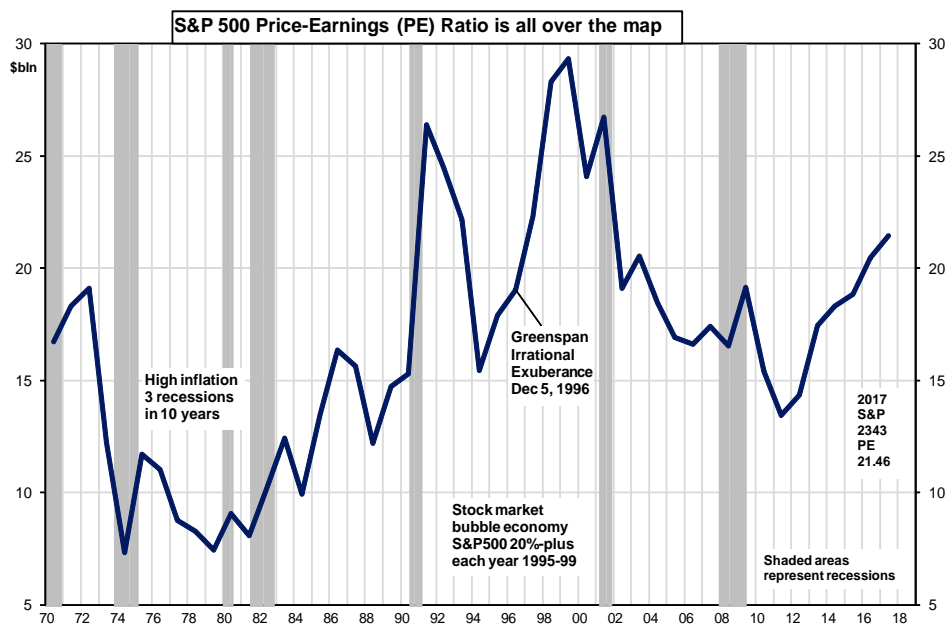
And as the losses, that looked technically based at the opening at least, gained steam on Tuesday the reasons behind it centered more and more on the Trump administration's inability to advance its new healthcare bill through Congress. The afternoon headlines trumpeting that even if it passed the House it would not pass the Senate. The worry on Tuesday then is if they cannot roll back Obamacare how will they get their corporate and individual tax cuts through, etc. Indeed, the week and year's stock market low was made on Friday after Trump and House Speaker Ryan pulled the Obamacare repeal and replace legislation. Ryan said the failure to pass the health care legislation will make tax reform more difficult: "This is a setback no two ways about it." They need the \$1 trillion of healthcare spending cuts over the next ten years to fund the corporate and individual tax cuts. Fund the corporate and individual tax cuts and keep them all deficit neutral otherwise they can only pass tax cuts by getting 60 (unlikely) votes in the Senate.

How bad it is? Well the stock market loss this week was really peanuts historically speaking. Dow industrials are down all of 3.0% from the record 21,169 high made on March 1 the day after Trump's State of the Union address. Not enough to cause Fed Chair Yellen to pause the Committee's gradual pace of rate hikes. (Actually gradual pace is Bernanke's four rate hikes per year and the current Federal Open Market Committee has a "cautious and gradual" pace seeing just three rates this year.)

We can remember at least two Fed votes for rate hikes that were scuttled by stock market volatility. We guess it stands to reason

if it is true as Bernanke famously said once that monetary policy seeks to "improve financial conditions." The stock market is the key indicator of whether financial conditions are improving or not. Yellen did not liftoff in September 2015 after the August 1,000 point flash crash in the Dow industrials even though 8 out of 12 Fed presidents wanted to hike rates. The Dow industrials fell 11.9% on a Friday close basis back in May-September 2015. Yellen did not follow-up the December 2015 liftoff with a second rate hike in March 2016 due to stocks with the Dow industrials falling 10.8% from November 2015 to February 2016 with many market concerns like China, "\$20 oil," and world growth. There has not been much selling since. Brexit was just two days. The loss ahead of the November 8 election never reached the 5% significance threshold.

Dow industrials market sell-offs						
Week ending Fridays						
Chg %	Points	High	Low	High	Low	Reason
-15.1	-1909.7	7-22-11	9-23-11	12681.2	10771.5	S&P USA AA+, Fed sees "significant" downside risks
-8.4	-1109.7	4-27-12	6-1-12	13228.3	12118.6	European sovereign debt crisis pre-Draghi do whatever
-7.5	-1021.8	10-5-12	11-16-12	13610.2	12588.3	Fiscal cliff
-5.4	-848.05	8-2-13	8-30-13	15658.4	14810.3	Bond yields taper tantrum, Syria
-5.2	-899.33	9-19-14	10-17-14	17279.7	16380.4	Ebola, IMF cuts world growth forecast
-11.9	-2170.2	5-15-15	9-4-15	18272.6	16102.4	China, oil, 1,000 point flash crash Monday, Aug 24
-10.8	-1936.5	11-6-15	2-12-16	17910.3	15973.8	Fed liftoff, China, \$20 oil, world growth, Japan negative rates
-5.3	-947.99	June 2015		18011.1	17063.1	Brexit: Two days June 23 close to Monday, June 27 low



We are often asked as an economist what we think of the stock market, basically meaning do we think it is going to crash. There is not a lot that economics has to say on stock market valuations. The stock market has predicted 9 of the last 5 recessions as Nobel laureate Paul Samuelson once said. Stock market plunges are based on the market's worst fears and don't always reflect current economic data or conditions. We always remembered what Treasury Secretary Rubin said in a different time when investors continued to fear a repeat of the -22.6% Black Monday, October 19, 1987 crash. It was ten years later that he came out on the steps of the Treasury Building to calm the markets and nervously read a short statement. It seemed to work. It was the Dow's 554 point drop (7.2%) on Monday, October 27, 1997 that brought him out with this simple statement: "It is important

to remember that the fundamentals of the United States economy are strong and have been for the past several years, and the prospects for continued growth, with low inflation and low unemployment, are strong." Maybe this will be a ploy that current Treasury Secretary Mnuchin can use though hopefully he won't need it.

There may not be a lot that economics has to say on stock market valuations but that did not stop Greenspan from talking about stocks. His most famous quote on irrational exuberance was in a long dinner speech on December 5, 1996 which was also long on the history of central banking and light on the stock market. "But how do we know when irrational exuberance has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan the past decade?" At the moment the S&P 500 PE ratio does not look too out of line historically at 21.46 on Friday, March 24, 2017.

Review and Summary: We have more of a fixed income focus where relative value is easier to assess than the broader stock market indices because 10-yr Treasury yields can be measured against the Fed funds rate and inflation. Valuation in the stock market, the broader indexes, is less precise. There are earnings and interest rates and animal spirits. Investors want to know the unknowable—can the market hold at these levels with just “animal spirits” even as some of Trump’s economic reforms look endangered. Stay tuned. Story developing.

FEDERAL RESERVE POLICY

The Fed meets ~~June 13-14~~ strike that we mean May 2-3 to consider its monetary policy. The May 3 decision date is most unlikely given it is a non-press conference meeting. If they are only going three times a year then there is little point to telling markets every meeting is a “Live” one where action could take place. They don’t sound like the need to raise rates is all that urgent.

They firmed up the odds of three rate hikes this year at least. In March fourteen out of seventeen members said at least three rate hikes in 2017. In December eleven out of seventeen said three rate hikes in 2017. We

will keep our forecast for four rate hikes this year: March, June, September, and December. We assume unemployment will fall more than they think and that 1.7% core PCE inflation will increase more than they think. July Fed funds futures are a few months out and closed at 1.02% on Friday, which is 11 bps or 44% of the way towards discounting a June meeting 25 bps Fed hike to 1.25%. A couple of Fed naysayers spoke out against additional Fed rate hikes this week: St. Louis Fed President Bullard and Minneapolis Fed President Kashkari. We find their arguments totally without merit. Their reasons against would have some merit if Fed rate hikes from this low level were actually “tightening.” But even the ever cautious Yellen just reminded us last week that Fed policy still has its foot on the gas as long as rates are below 3% normal, neutral levels.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	22-Mar	15-Mar	8-Mar	1-Mar	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2463.974	2463.812	2463.650	2463.488	479.782
Federal agency debt securities	13.329	13.329	13.329	13.329	0.000
Mortgage-backed securities	1777.645	1771.184	1763.191	1763.186	0.000
Primary credit (Discount Window)	0.001	0.010	0.013	0.001	23.455
Term auction credit (TAF auctions)	0.000	0.000	0.000	0.000	150.000
Asset-backed TALF	0.000	0.000	0.000	0.000	
Maiden Lane (Bear)	1.707	1.707	1.704	1.705	29.287
Maiden Lane II (AIG)	0.000	0.000	0.000	0.000	0.000
Maiden Lane III (AIG)	0.000	0.000	0.000	0.000	0.000
<u>Central bank liquidity swaps</u>	1.019	0.917	0.491	1.132	62.000
Federal Reserve Assets	4524.5	4515.9	4506.0	4504.3	961.7
3-month Libor %	1.16	1.15	1.11	1.09	2.82
Factors draining reserves					
Currency in circulation	1533.834	1531.006	1528.995	1521.561	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	251.013	226.510	212.124	156.010	0.000
Reserve Balances (Net Liquidity)	2313.962	2368.120	2351.131	2307.954	24.964
Treasuries within 15 days	13.559	0.000	0.000	0.000	14.955
Treasuries 16 to 90 days	46.910	60.469	60.468	48.558	31.549
Treasuries 91 days to 1 year	183.363	183.357	183.351	195.256	69.272
Treasuries over 1-yr to 5 years	1216.867	1216.841	1216.815	1216.789	170.807
Treasuries over 5-yrs to 10 years	376.203	376.170	376.137	376.104	91.863
Treasuries over 10-years	627.071	626.975	626.878	626.781	101.337

**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08

MARKETS OUTLOOK

	30-Dec 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019
30-Yr Bond	3.07	3.10	3.10	3.20	3.40	3.60	3.70	3.80	4.00	4.10	4.10	4.20	4.30
10-Yr Note	2.45	2.40	2.50	2.70	3.00	3.20	3.40	3.50	3.70	3.80	3.90	4.00	4.10
5-Yr Note	1.93	2.00	2.10	2.40	2.70	3.00	3.20	3.30	3.50	3.60	3.70	3.80	4.00
2-Yr Note	1.19	1.60	1.80	2.00	2.20	2.50	2.75	2.85	3.10	3.30	3.50	3.50	3.70
3-month Libor	1.00	1.25	1.50	1.70	1.95	2.20	2.45	2.70	2.95	3.20	3.45	3.45	3.70
Federal Fund Rate	0.75	1.00	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50
2s/10s spread	126	80	70	70	80	70	65	65	60	50	40	50	40
Libor/funds spread	25	25	25	20	20	20	20	20	20	20	20	20	20

We will change the interest rate forecast next week. We will keep with four rate hikes this year. The 3% 10-yr forecast at the end of 2017 still depends on more Fed action. It may depend upon the name of the next Fed Chair as well. Yellen's term in office finishes February 3, 2018. We are surprised the short-end has not responded more to the new 1% Fed funds rate this quarter. Three month Libor was only 15 bps higher than the 1% Fed funds rate on Friday, March 24, and especially the 1.26% 2-yr note yield closing on Friday is just 26 bps above the Fed funds rate which is way too tight historically speaking... unless the market thinks Fed rate hikes could stop at a moment's notice and will never reach the 1.5% Fed funds rate policymakers have penciled in for December 2017.

Bonds rallied this week with yields falling to 2.41% at Friday's close from 2.50% a week earlier. Yields fell with stocks falling 237 points on Tuesday with the news seemingly running against Team Trump. 10-yr yields kept falling with stocks on Wednesday before reaching the week's 2.37% yield low around 10am EDT. We are not expecting more Trump fiscal news for a while as any tax legislation will take time to develop.

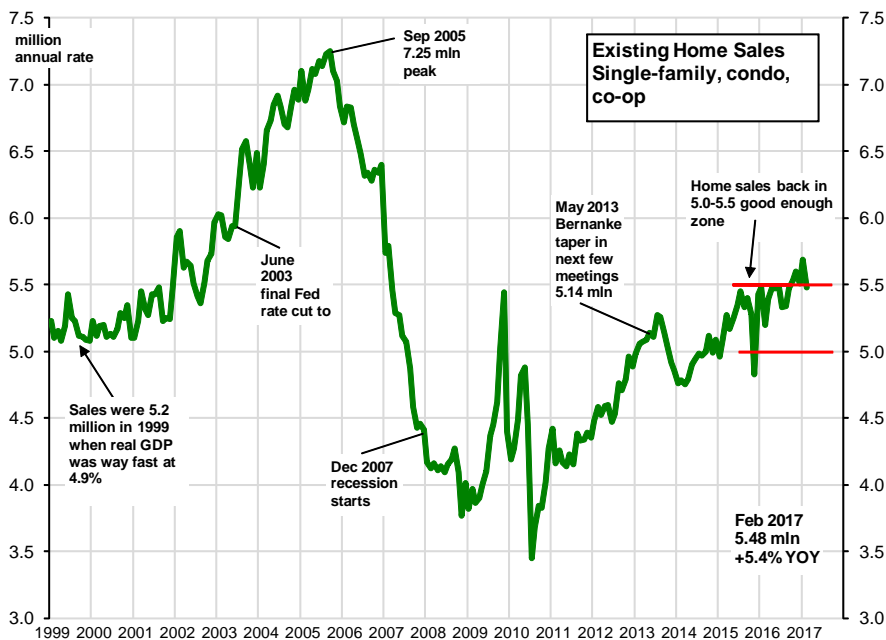


Other News This Week

Home sales turnover the slowest yet since Trump's win

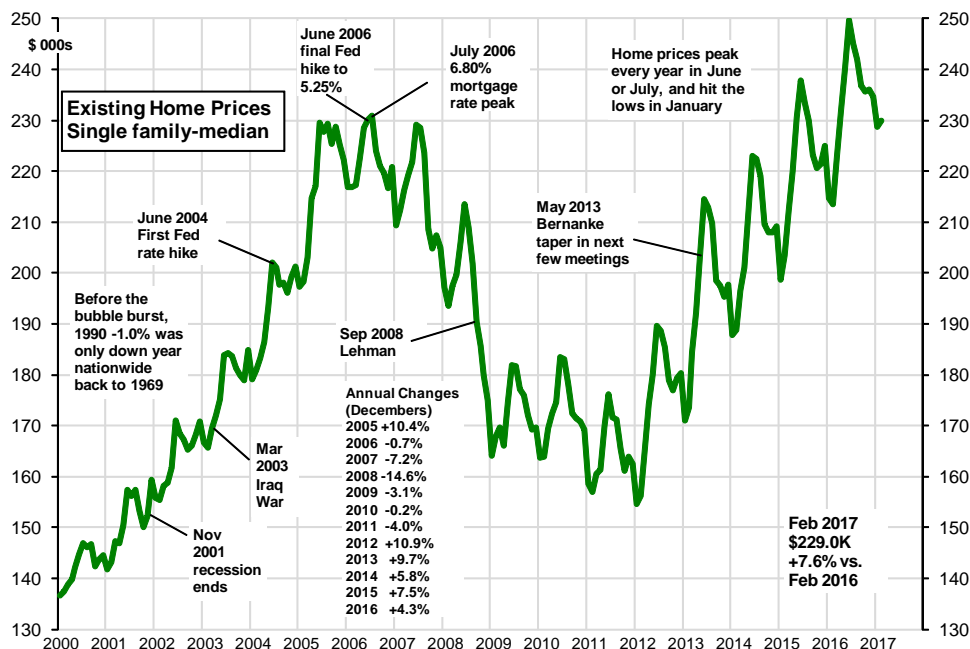
Breaking economy news on Wednesday. Not for the market which is more concerned about yesterday's stock market sell-off, the biggest one-day loss since Trump's surprise victory with the Dow industrials falling 237 points Tuesday. Dow industrials were down another 73 points this morning when the existing home sales data were released at 10am EDT.

Existing home sales fell 3.7% to a 5.48 million annual rate in February which is now the lowest rate of turnover since Trump was elected. Not by a lot of course. Oct 5.53, Nov 5.6, Dec 5.51, Jan 5.69, and Feb today at 5.48 million. Before you tweet that we are exaggerating and spreading false news, we would point out that it would not be surprising in the months ahead to see homebuyers pull back from making the biggest purchase of their lives with all the economic uncertainty over individual tax rates and importantly, whether itemized deductions will be allowable especially for mortgage interest. Not likely, but you never know. We aren't sure why the new administration wants to tinker with the tax codes. It can't be to create more jobs can it? Nonfarm payroll employment up a cool 2.35 million the last year to 145.798 million. American workers are already great again. Or at least there are a lot more of them.



Looks like housing still a good investment over time

We thought existing home sales would move higher on the warmer than seasonal temperatures, but sales in the Northeast fell from 0.80 to 0.69 million (-13.7%), Midwest fell from 1.29 to 1.20 million (-7.0%), and fell in the West from 1.29 to 1.25 million (-3.1%). These reduced sales were offset modestly by sales in the South, the biggest housing market in the nation, rising from 2.31 to 2.34 million (+1.3%).



Net, net existing home sales were the lowest yet since Trump's surprise election victory in November last year. There is a lot of uncertainty out there over taxes and the path of interest rates that may be giving would-be homeowners pause. Don't forget higher home prices either for taking



the shine off of sales. If homebuyers are looking for clarity on the outlook however they could have a long wait as any new tax legislation may not be signed by the President until 2018 given the complexity of the changes being talked about. For February, home buyers have not gone on strike exactly, but they aren't rushing out to make a new purchase either.

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