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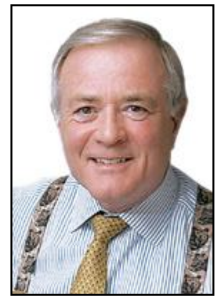

William Rutherford

In the face of adversity, the market powers on

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Despite numerous negative events – hurricanes, shootings and nuclear threats – the market powers on as if there are no worries. But worries abound, and that is a good thing, because they discourage “irrational exuberance.”

Analysts expect earnings to be up about 3 percent in this earnings season starting in October; that is positive, but down from the 7-plus percent we have been experiencing. However, it is likely that earnings will be somewhat higher than 3 percent – perhaps in the neighborhood of 6 percent. Earnings are unlikely to exceed what was achieved in the preceding two quarters, which would mean the pace of growth is decelerating.

Forecasts for GDP growth remain stubbornly under 3 percent, in spite of the enthusiasm for less regulation and the tax reform on Trump’s agenda. Revised second-quarter GDP came in barely higher, at 3.1 percent. The Commerce Department said that the increase was mainly the result of farmers decreasing their stockpiles less than expected previously.

On the policy front, the tax reform agenda still provides hope for the market, but failure to pass significant legislation to date casts doubt on the prospects for such reform. Time is running out and if tax reform fails to pass, the Trump agenda and, indeed, presidency may fail. At this writing, Trump has announced that he has a new tax plan, although it is Congress that will actually write the bill.

Trump’s proposal could be viewed as a plan to make a plan. By using a large font and narrowing the margins on the paper, he has expanded his tax reform proposal to nine pages. The nine pages are short on detail, which of course is where we know the devil lurks. For instance, how is it paid for? This plan looks about as deftly crafted as the health care repeal and probably has about the same chances of passage. Still, the market saw the “plan” as progress and found new traction.

Two devastating hurricanes have taken their toll on the economy. The payback will come later when the rebuilding gets fully under way. A severe construction labor shortage in the region affected is reversing slowly.

Worker productivity has increased, which is good. Low jobless claims mean more people are finding work. The labor market is tight, so wages should rise. Yet consumer confidence for

September decreased to 119.8 from 120.4 for August. The consensus estimate for the period was 118.9. Meanwhile, new home sales for August decreased to 588,000.

In spite of a weak dollar, exports are declining. This should keep inflation low. The Fed will have to be careful not to overstep with its projected rate increase.

What all of this suggests is that the Federal Open Market Committee (FOMC) may rethink its position going forward. Many market participants are eyeing a December hike to a 1.25-1.5 percent rate. This represents the low end of the range of estimates following the surprise election of President Trump more than 10 months ago. But in the wake of Fed Chairwoman Janet Yellen's recent statements, even this rate hike looks less likely. Clearly, the Fed would like to see more economic and inflation growth before tightening the screws on interest rates. Interestingly, only four of the 16 highest Fed officials have suggested waiting until 2018 in order to increase interest rates. The CME Fed Watch predicted a 76 percent probability of a rate hike in December.

While addressing the National Association for Business Economics meeting in Cleveland recently, Yellen cautioned against raising the interest rate gradually. She said that it would be "imprudent to wait until after the inflation levels reach 2 percent and then increase the interest rates gradually, as this might lead to the labor market becoming overheated. Consequently, such a scenario would lead to inflation problems for the economy and hence financial instability."

Dysfunction in Washington is creating uncertainty, which is causing business and people to slow investment decisions. Furthermore, there is always the possibility of a policy accident, either political or monetary. The erratic behavior in Washington raises the chances of such an accident.

The outlook is decidedly mixed. The global economy is growing. Continue to be fully invested in a diversified portfolio.

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