RAYMOND JAMES

Gleanings
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**January 30, 2017**

# Gleanings

**A Monthly Chart Presentation and Discussion Pulling Together the Disciplines of Economics, Fundamentals, Technical Analysis, and Quantitative Analysis**

## "It's a Wonderful Life"

We love the holidays and particularly enjoy watching classic films like "Miracle on 34th Street," "The Wizard of Oz," "Scrooge," and of course "It's a Wonderful Life." "It's a Wonderful Life" is a 1946 Christmas film based on the book *The Greatest Gift.* As you may recall, the film stars James Stewart as George Bailey who has given up his dreams to help others. George's contemplation of suicide on Christmas Eve spurs the intervention of his guardian angel Clarence, who shows George all of the lives he has touched and how life in his community would be totally different without him. Similarly, some kind of "guardian angel" seemed to show up in the January/February timeframe of 2016 to rescue the equity markets from what the Royal Bank of Scotland (and others) were terming a "cataclysmic year" punctuated by a deflationary crisis with crude oil trading to $16 a barrel. RBS's advice was to "sell everything except high quality bonds." That "call" was pretty interesting to Andrew Adams and me because our models had just flipped positive the week before the February bottom, calling for a significant rally. So, what are the models calling for now?


Well, we did not get a Santa Claus rally (SCR) over the holidays. Recall, the SCR is the seasonal tendency for equities to rally during the last five sessions of the year through the first two trading sessions of the new year. Many pundits take the lack of a SCR as an ominous warning for stocks; we do not. Admittedly, we did not get a SCR in 2015 and we got a "trapdoor" decline into the S&P 500's (SPX/2294.69) February 11, 2016 "low" of ~1810. That decline also rendered a negative reading from the January Indicator (so goes the first week of the new year, so goes the month, and so goes the year), and, the first week of 2016 was down as was the month of January. In addition, the January Barometer (if the December closing low is violated any time in the first quarter of the new year, watch out) registered a negative signal when the December 2015 closing low was "taken out" on January 4, 2016. Despite that cacophony of negative signals, our models flipped positive on February 5, 2016, "calling" for a market bottom the next week. From that week's low (1810), the SPX gained ~23.7% into year's end . . . not bad! So, our intermediate-term model called the recent rally, from before the election, no matter who won. We have to admit that

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## Jeffrey Saut

# "It's a Wonderful Life"

*Continued from page 1.*

Trump's win accelerated the envisioned rally. Subsequently, our short-term model called for a trading top the week of December 11, 2016 and was "looking" for a bottom into the last week of December 2016 with a +/-5 session variance. From December 8 to January 24 though, the S&P 500 effectively remained confined, trading back and forth within about a 2% range, before breaking out once more to new highs. This suggests our intermediate-term model's "call," prior to the election, for the equity markets to trade higher into late January/early February is still in force. If the expected pattern still proves correct, the models are looking for some kind of downside attempt beginning soon, which does not get very far. Our long-term model has not varied since March of 2009 in that we are in a secular bull market that has years left to run.

We have played the rally pretty aggressively since the election. However, from a tactical standpoint, we are taking a more cautious stance as February approaches, consistent with our model's original call for a polarity flip around this time. At the January/February 2016 lows, and again at the presidential election lows, investors were fearful, expectations for economic growth were low, the Federal Reserve was still in an accommodative mode, and stocks were cheap based on forward earnings. Currently, that is not the case, at least on a short-term basis. After the over 200-point rally by the S&P 500 from the Trump win overnight lows, bullish sentiment has leaped, bearish sentiment has collapsed, expectations for GDP growth have soared, the Fed has raised interest rates and the expectation is for three more increases in 2017, and based on trailing earnings the SPX is no longer cheap. While we believe the equity markets' earnings growth will allow stocks to grow into better valuations, in the near term there could be a market stumble as we are now entering our late January/early February timing point of vulnerability. As BlackRock's CEO Larry Fink told us several weeks ago over lunch, "This is the biggest election honeymoon of my career, yet it still feels like you should stay long stocks into the January 20th inauguration when reality just might show up." Reality has not shown up yet, of course, but we continue to advise caution until it becomes clearer that this recent breakout is to be believed. Again, this is just a short-term tactical trading call, because, longer-term, we think we remain in a secular bull market that has years left to run.

To reiterate, as we enter 2017 we expect the current economic rebound to continue, suggesting GDP growth will likely move towards the 3% level by the end of the year based on less monetary stimulus, more fiscal stimulus, a reduction in the corporate tax rate, and deregulation. Our S&P 500 price target for the year is 2450, but believe the S&P 500 may actually exceed that level as earnings growth ramps. We think the post "Trump Trades" will continue to have legs. Our team favors small-capitalization names over large caps and value over growth. We also urge investors to overweight Financials and Technology and underweight bonds, bond proxies, Consumer Staples, and Utilities. In our opinion, interest rates have bottomed, deflationary trades are wrong-footed, inflation is rising, "real assets" names should be bought, the U.S. dollar probably trades a little higher, the labor market continues to tighten, wages rise, and business investment improves.

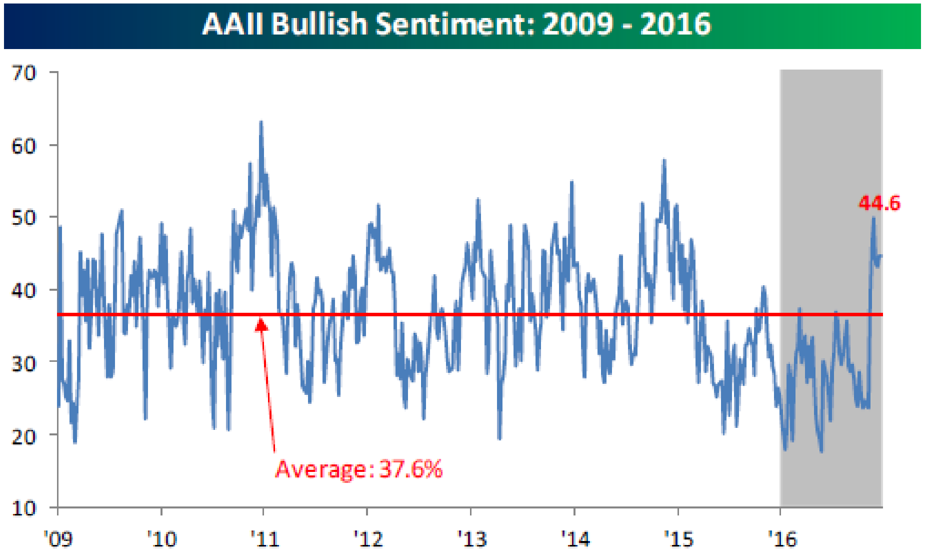
## Jeffrey Saut

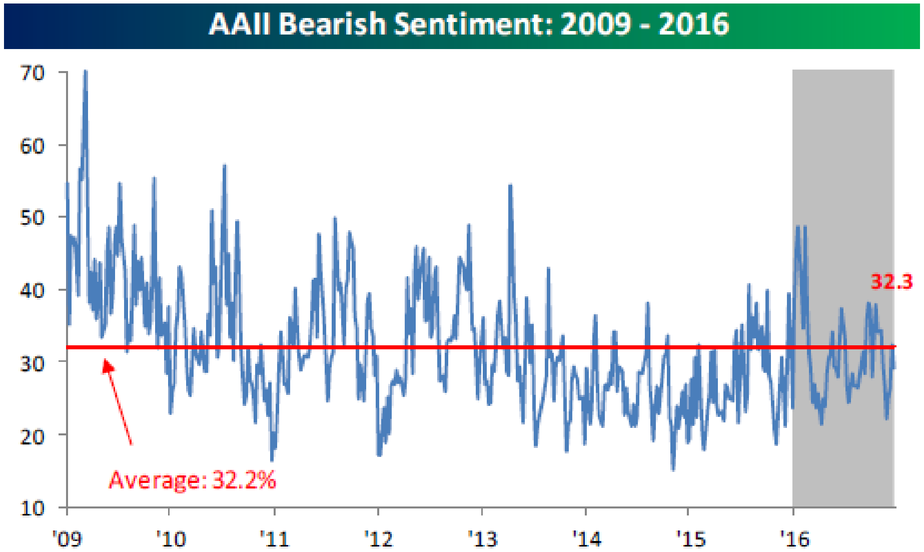
# Royal Bank of Scotland, and Others, Said “Sell Everything Except High Quality Bonds”


Source: Stockcharts.com.

**Jeffrey Saut**

## Bullish Sentiment Has Soared While Bearish Sentiment Has Collapsed

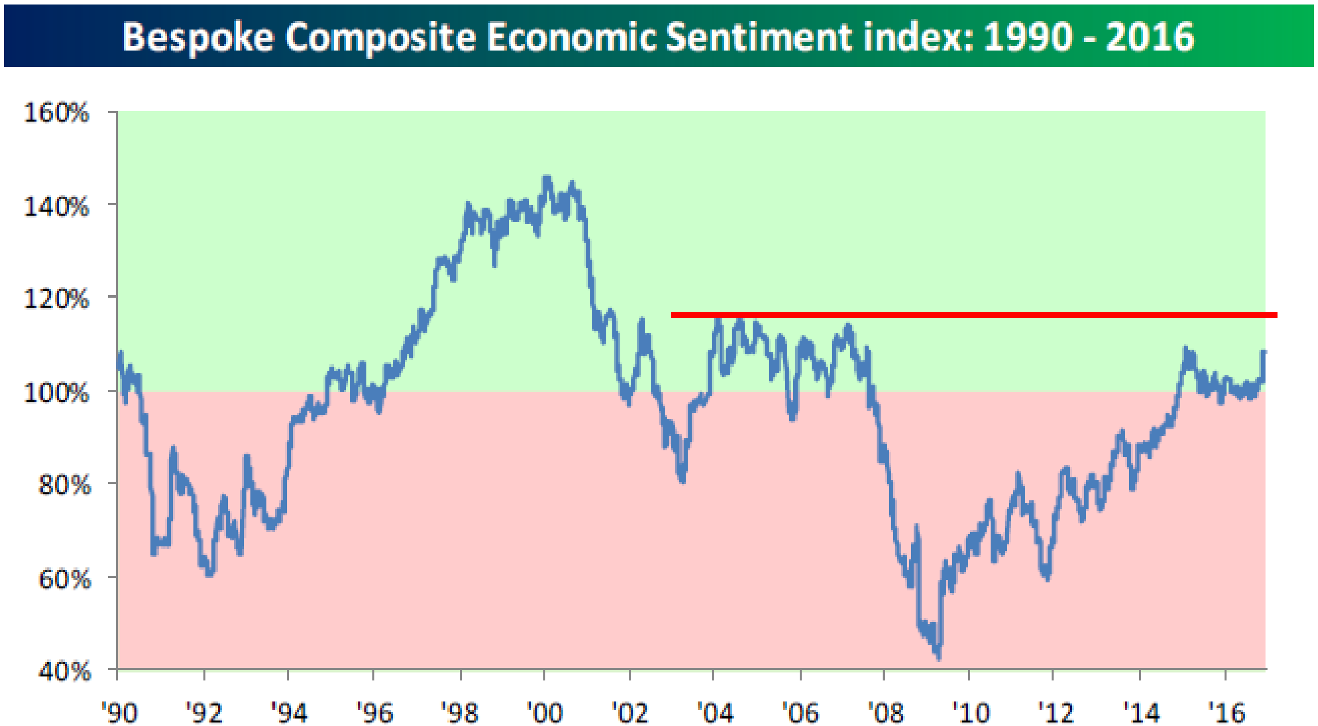



Source: Bespoke Investment Group.

**Jeffrey Saut**

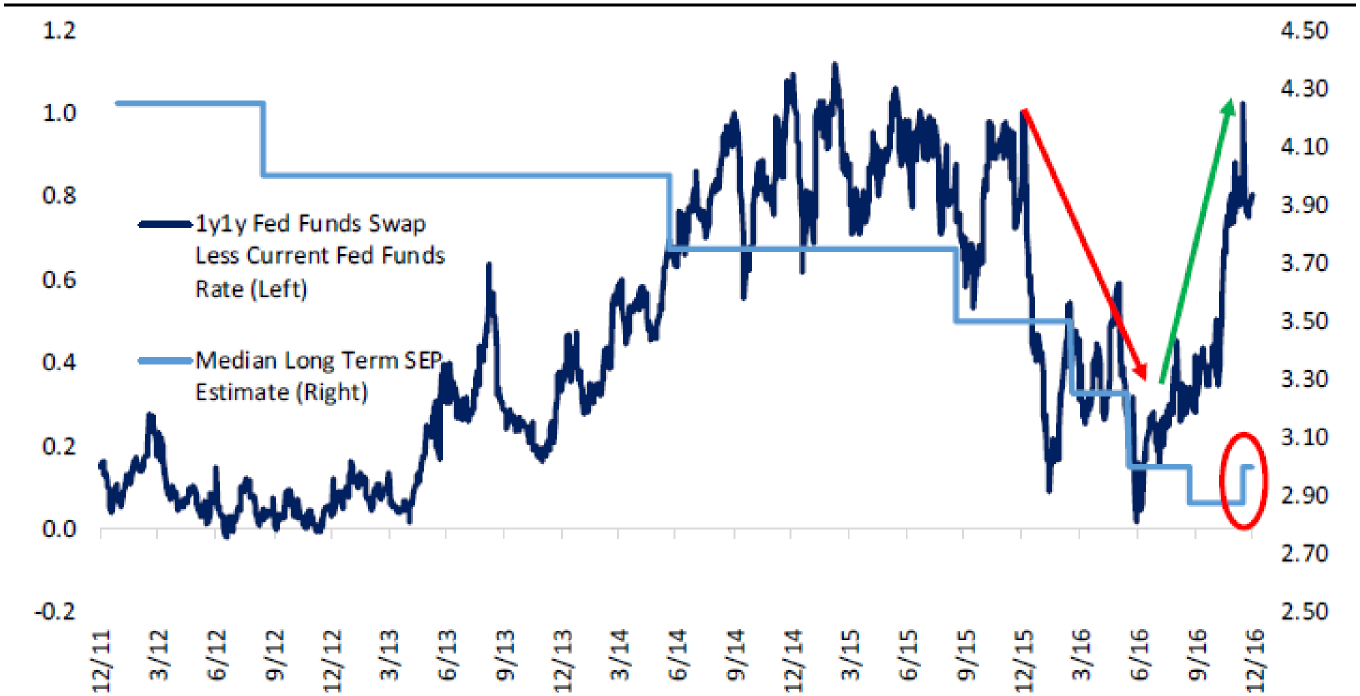
## Expectations for GDP Growth Have Leaped




Source: Bespoke Investment Group.

## Jeffrey Saut

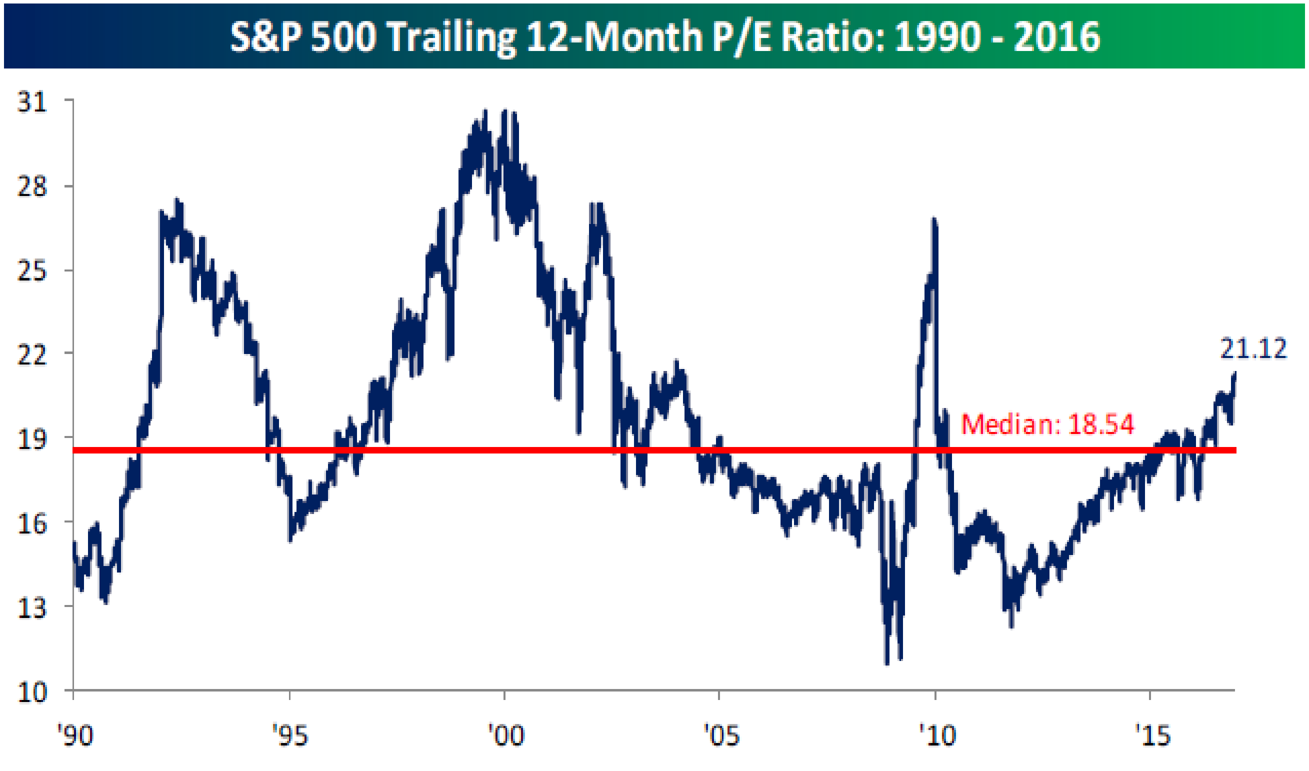
### The Federal Reserve Is Becoming Less Accommodative




Source: Bespoke Investment Group.

**Jeffrey Saut**

## Earnings Growth Should Allow Stocks to Grow Into Their Current Valuations, But Near-Term Stocks Are Expensive




Source: Bespoke Investment Group.

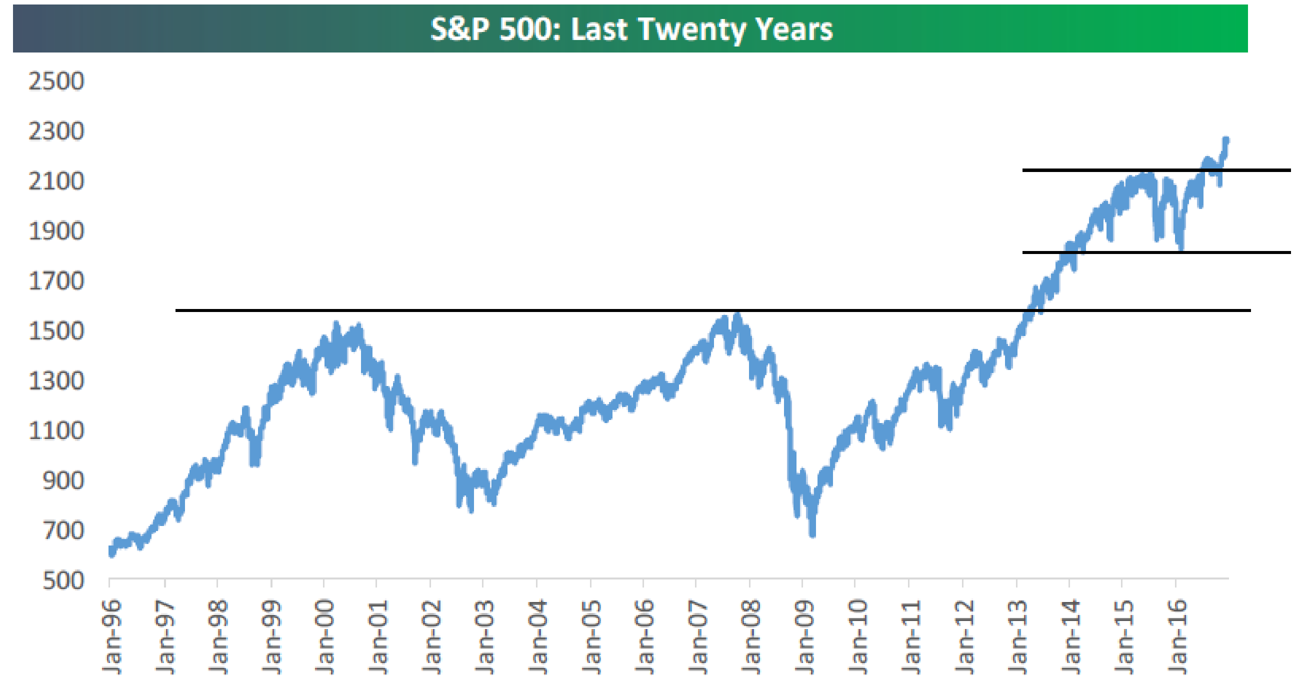
**Jeffrey Saut**

## Since the 2009 Bottom There Have Been Many Dow Theory "Buy Signals." Here Are But a Few


Source: Stockcharts.com, Raymond James Research.

**Jeffrey Saut**

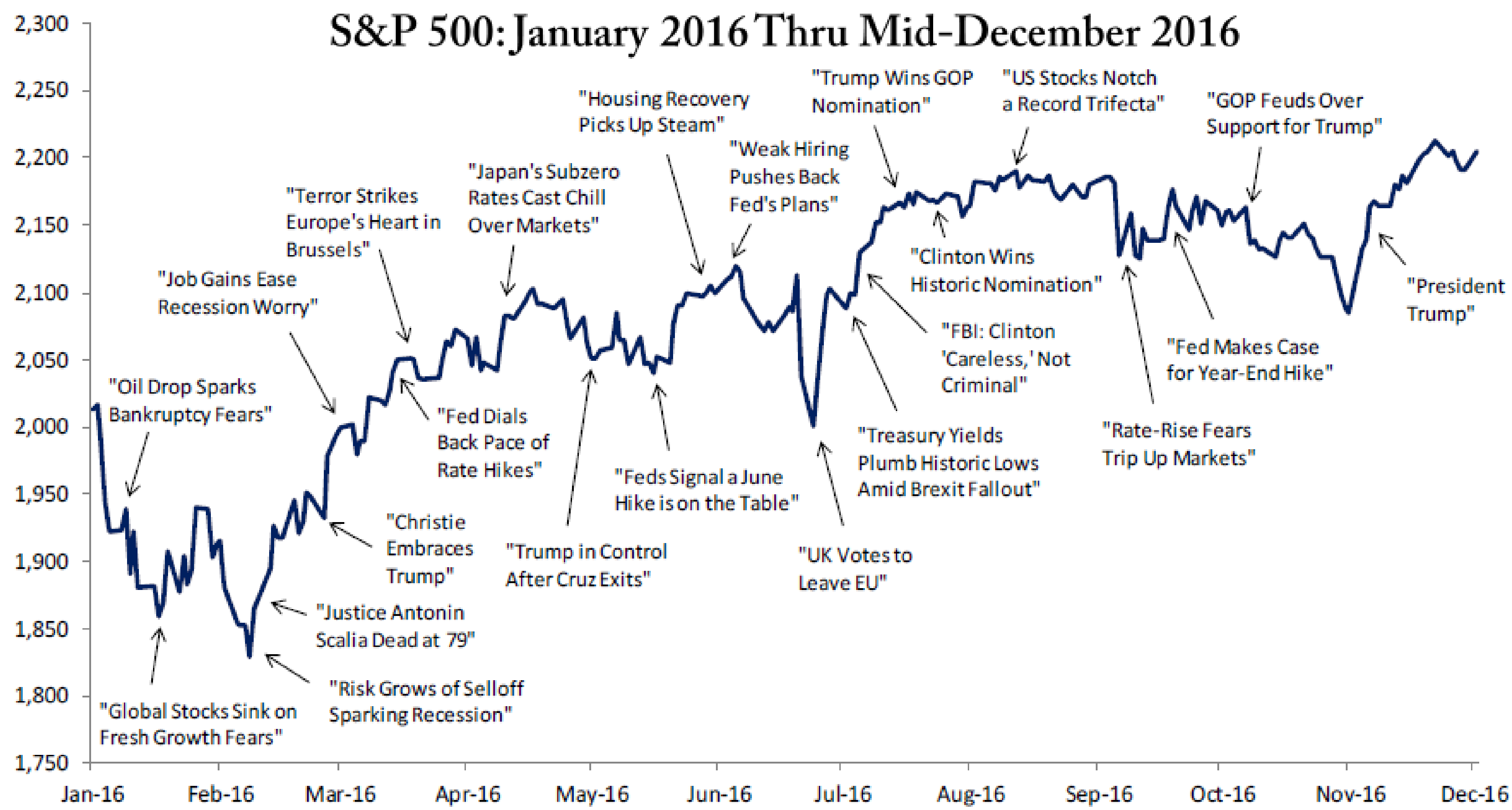
## We Still Believe the Equity Markets Are in a Secular Bull Market That Has Years Left to Run




Source: Bespoke Investment Group.

**Jeffrey Saut**

## 2016: The Year in Headlines




Source: Bespoke Investment Group.

## Economic & Market Update

### Equity Markets/ Technical Analysis

- **Market Outlook –** Despite rich valuations and fiscal stimulus that may be longer in coming, all of the major indices recently broke out to new all-time highs fueled by President Trump following through on many of his campaign trail promises, strong earnings reports, and positive economic data. Both upside and downside appear limited in the near term.
- **Earnings –** Thirty-four percent of the companies in the S&P 500 have reported actual results for 4Q16, 65% of S&P 500 companies have beat the mean EPS estimate and 52% of S&P 500 companies have beat the mean sales estimate.

  **S&P 500 Earnings estimates***: **2017** - $130.75, **2018** - $147.23

  **S&P 500**
  **Key support:** 2282, 2260, 2250, 2233
  **Key resistance:** 2300, 2335
- **Sectors** – Cyclical sectors are leading the way, with most breaking out to new 52-week highs, while defensive sectors have lagged.
  **Positive:** Energy, Financials, Industrials, Tech
  **Neutral:** Healthcare, Consumer Discretion, Telecom, Materials
  **Negative:** Real Estate, Utilities, Consumer Staples

### Monetary Policy, Inflation, FX

- **Janet Yellen speech** (January 18) – In her prepared speech "The Goals of Monetary Policy and How We Pursue Them" at the Commonwealth Club in San Francisco, the Fed Chair presented a broad defense of the Fed and its independence. She noted that the Fed is getting closer to its goals, but will proceed gradually and re-evaluate along the way. Tone a bit more hawkish.
- **FOMC Minutes** (December 13-14 policy meeting) **-** Nothing surprising here, but buried in the SEP narrative, **there was some indication that fiscal policy stimulus and/or higher inflation could lead the Fed to raise short-term interest rates more aggressively**. Still, FOMC members viewed the risks to the growth outlook as "roughly balanced."
- The **Consumer Price Index (CPI)** rose 0.3% in December (+2.1% y/y), up 0.2% excluding food & energy (+2.2% y/y). Gasoline prices rose 3.0% (+1.8% before seasonal adjustment, and +9.1% y/y). The CPI was up 2.1% from a year ago. Ex-food & energy, the CPI rose 2.2% y/y. **Bottom line:** We saw deflation in consumer goods, ex. energy & food, but upward pressure in shelter and medical care.
- **Exchange rates** (January 27):

  EUR/USD: $1.066
  GBP/USD: $1.252
  USD/JPY: ¥121.8
  USD/CAD: $1.310
  CHF/USD: $1.000

### U.S. Economy

- **4Q16 Advance Estimate GDP** – January 27 (Bureau of Economic Analysis) – Real GDP was 1.9% vs. expectations for 2.1%. Consumer spending was strong, business fixed investment picked up, and homebuilding bounced back after falling two consecutive quarters.
- **December Employment Report** (Bureau of Labor Statistics) – Nonfarm payrolls rose by 156K vs. expectations for +175K. The unemployment rate edged up to 4.7% (median forecast: 4.7%), vs. 4.6% in November, and 5.0% a year ago.
  Not a big miss and the two previous months were revised higher (making it about a wash). How much slack remains in the job market is the big question.
- **December Retail Sales** (Census Bureau) **-** Growth in retail sales were concentrated in autos and gasoline – mixed and generally flat otherwise (with unusual softness in food) – but it was still a relatively good quarter overall.
- **Homebuilder Sentiment** (National Association of Home Builders/Wells Fargo) was stronger than expected in January (67 vs. 63 median forecast). Homebuilders' post-election optimism continued, although the level of enthusiasm was a bit less than in December.
- **Producer Price Index (Bureau of Labor Statistics) -** The PPI rose as expected in December (median forecast: +0.3%), boosted by higher energy costs.

### Global Economy

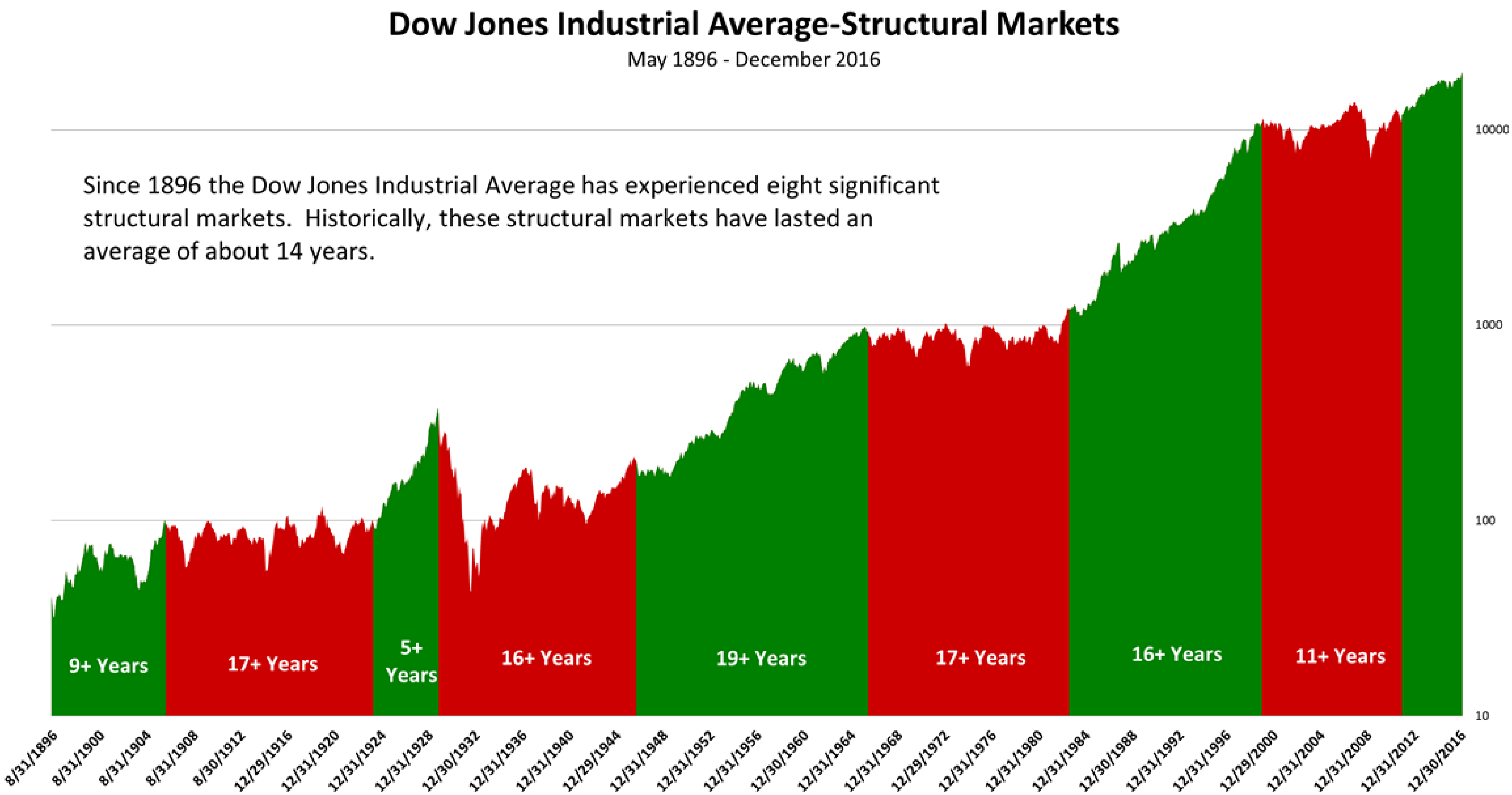
- **Brexit –** On January 24, Britain's Supreme Court ruled that a parliamentary vote on the decision to leave the EU is necessary before Article 50 of the Lisbon Treaty could be triggered, effectively starting the process that would initiate what is likely to be a two-year negotiation process. The opposition Labour party is unlikely to block the measure in the House of Commons, but this could delay PM May's end of March timeline to invoke Article 50. As a reminder, PM May met with President Trump Friday, January 27.
- **BOE** – The Bank of England's Monetary Policy Committee will convene Thursday, February 2nd and is expected to keep rates on hold at 0.25%. This comes after 4Q16 GDP rose by 0.6%, confounding many who expected a significant slowdown after the referendum to leave the EU last June.
- **ECB –** Hawkish ECB Executive Board member Sabine Lautenschlager calls for ECB to exit its stimulus program. This is contrary to ECB President Draghi's comments that tapering has not been discussed.

Source: FactSet, Raymond James Research. *S&P 500 earnings estimates are bottom-up operating earnings as of 1/19/17 market close, provided by Standard & Poor's.

## Andrew Adams

### Secular Bull Market

The secular bull market continues, which means any dips or corrections should still be viewed within this construct and could offer great buying opportunities.

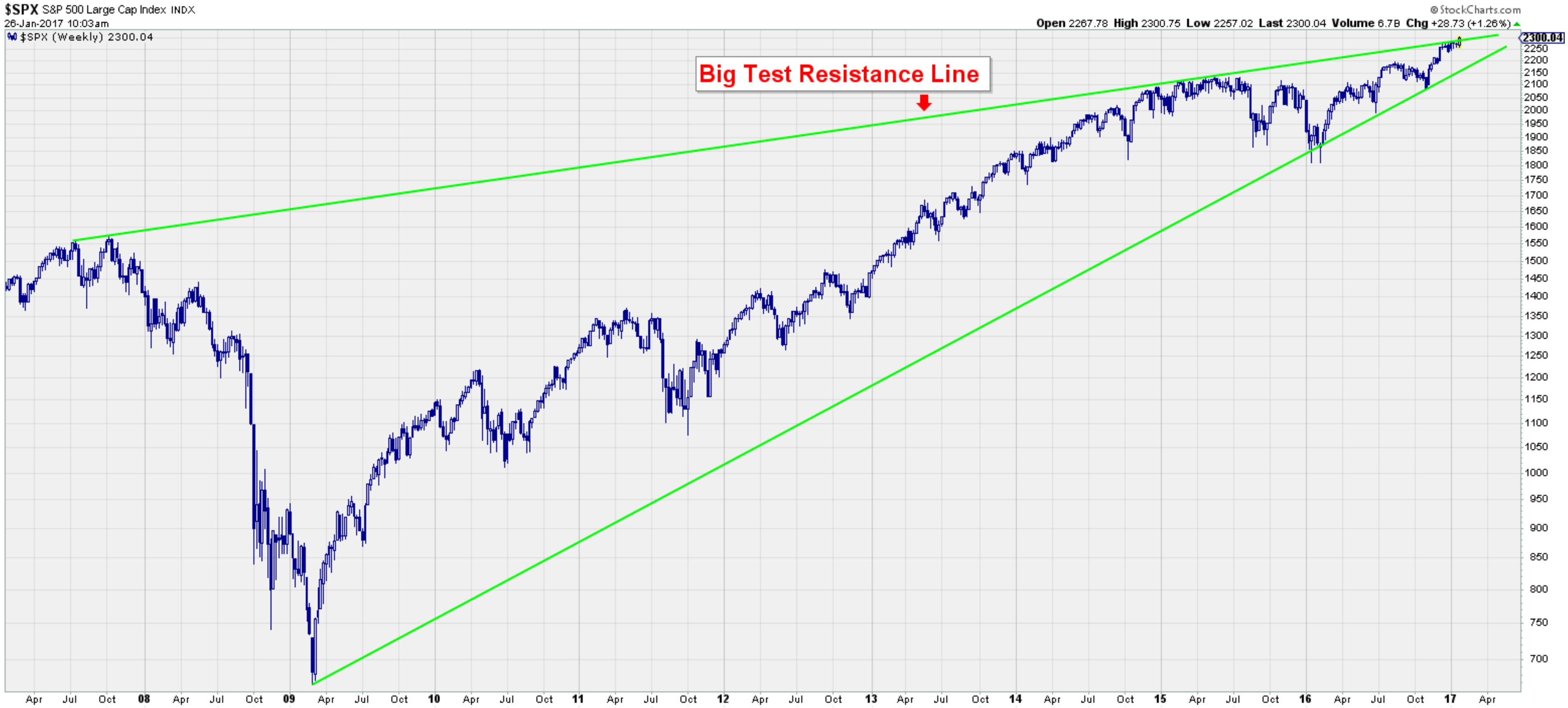



Source: Raymond James Research.

## Andrew Adams

# Big Test Has Broken

For weeks, we have referenced the S&P 500's "big test" resistance line drawn from the 2007 and 2015 highs and explained how it might cap prices in the short term. That has largely been accurate, but now the index has broken above this resistance line, possibly signaling that this market wants to once more trade higher. Since this is a long-term line, however, it is important that the S&P 500 remains above it for a few days and does not immediately trade back into the prior range. Doing so would largely negate the signal and would possibly lead to a larger pullback in prices.

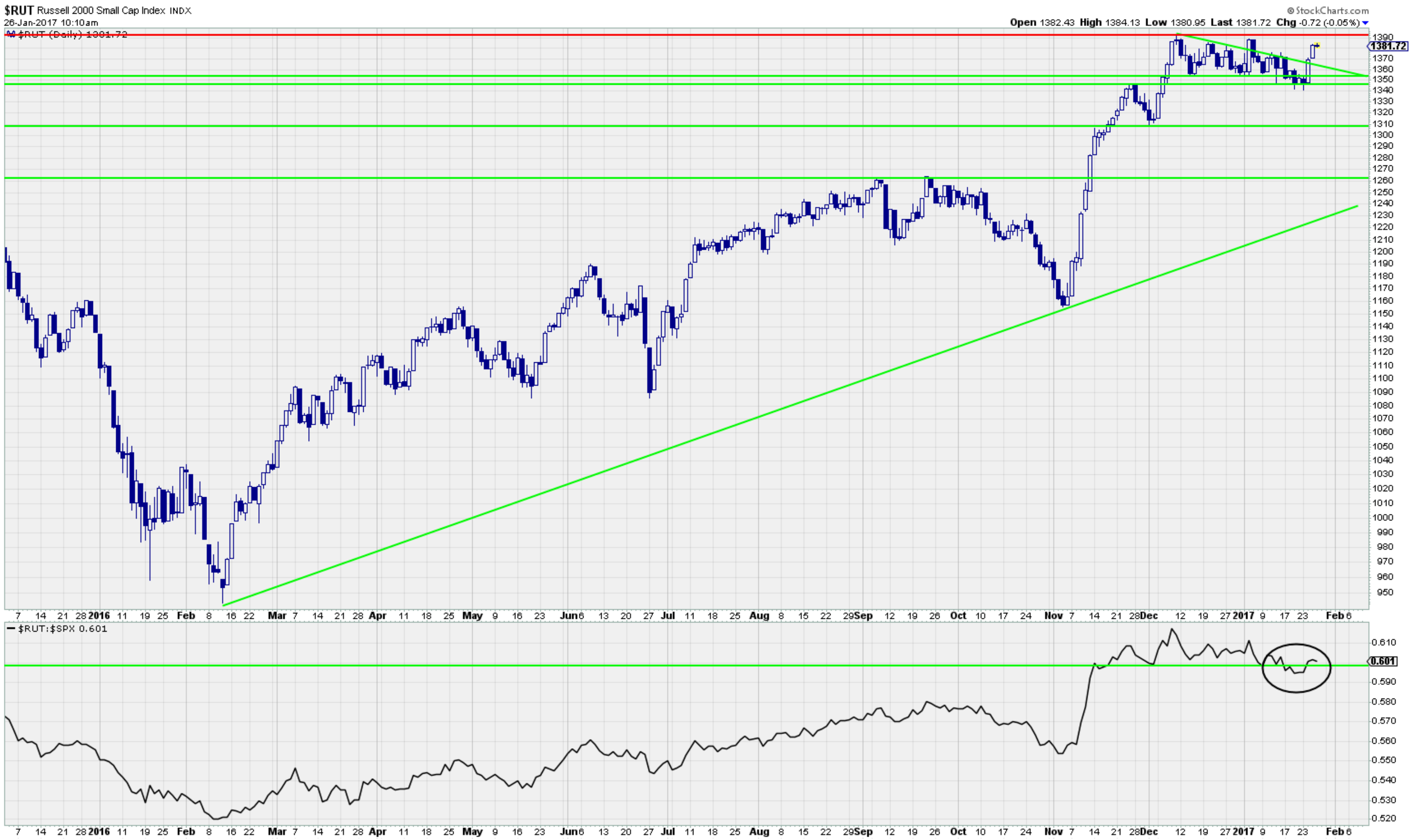



Source: Stockcharts.com.

## Andrew Adams

# Small Caps Remain in Flux

Small cap stocks have not made it easy to predict their next move, either, with the Russell 2000 index first looking like it was breaking down both on the price chart (top panel) and when compared to the S&P 500 (lower panel). But over the last few days, as the overall market has rallied, so have the small caps and now the Russell once again approaches its early December high. It remains range-bound so we don't have a clear signal yet, but the increase in volatility may mean a move is coming soon.

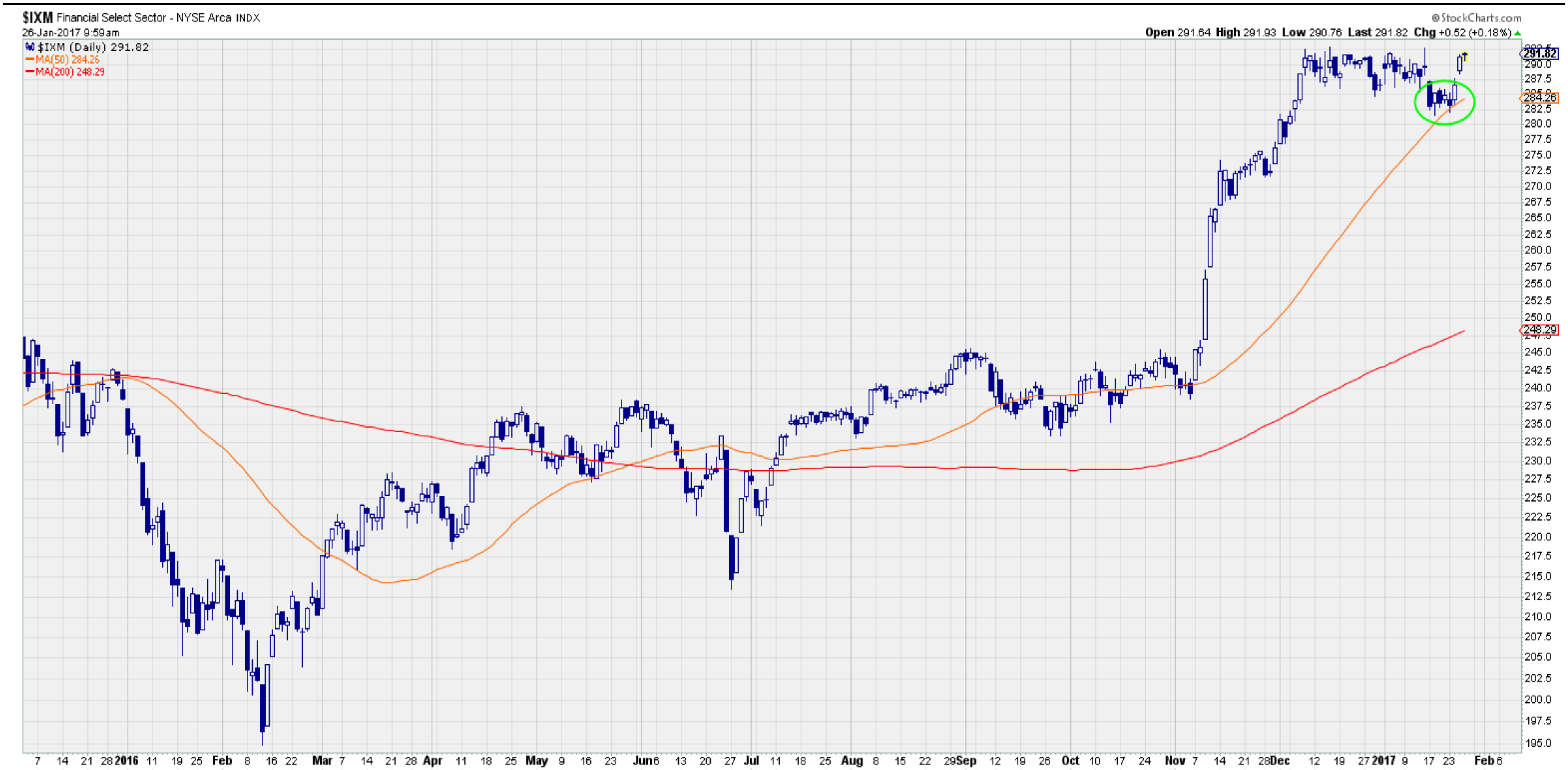



Source: Stockcharts.com.

## Andrew Adams

### Financials Are Bouncing Off 50-DMA

The Financial sector has been one of the biggest beneficiaries of the Donald Trump election win, but even it really made no further progress after early December. In fact, it had actually pulled back a bit to its 50-day moving average before bouncing from this dynamic support level. Now, the sector looks to build on this bounce and make a new high, which is important since it remains well above its 200-day moving average and it would take quite a near-term drop for it to revert to that mean.

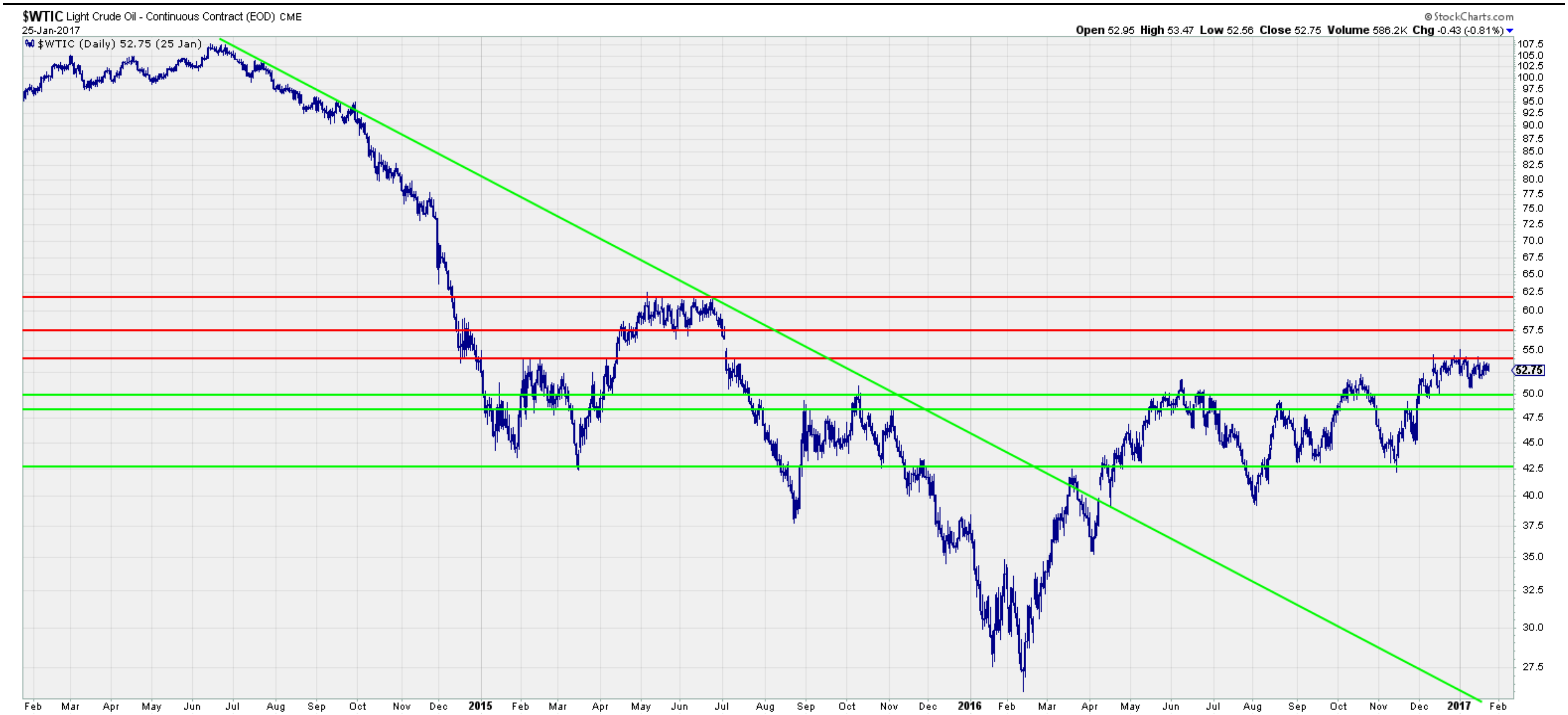



Source: Stockcharts.com.

## Andrew Adams

# Crude Oil Still Pausing

U.S. stocks aren't the only part of the market that has largely been range-bound lately. Crude oil has bounced in the low $50s now for several weeks after initially looking like it was ready to take off after breaking out above resistance in early December. After the pain Energy sector investors went through during the oil collapse, many are likely just happy oil is remaining stable, but it does appear to be trapped for now and only a breakout above $55 or below $50 will indicate the next likely direction.




Source: Stockcharts.com.

**Andrew Adams**

## Gold Hit Long-Term Support

Gold has experienced a crazy last 12 months, after the metal initially shot up in early 2016 before giving back most of those gains in the second half of the year. However, it may have hit a couple of long-term support lines that could continue to give it a boost. The long-term trend going back to 2011 still remains down, so investments continue to be risky, but it could offer a decent trade opportunity here, especially on a slight pullback, as it possibly looks to rise back up to that red resistance line.


Source: Stockcharts.com.

## Andrew Adams

# World Stocks May Be Breaking Out Too

It can be tough to determine what the world's stocks are doing as a whole, given all the various marketplaces, but the MSCI World Index (ex-USA) appears to be joining the U.S. averages by breaking out above former resistance right now. Unlike the U.S. though, the World index remains well below its previous high made back in 2014 and is still struggling to confirm that the long-term downtrend has been broken.


Source: Stockcharts.com.

## Andrew Adams

# China Bouncing Off Support

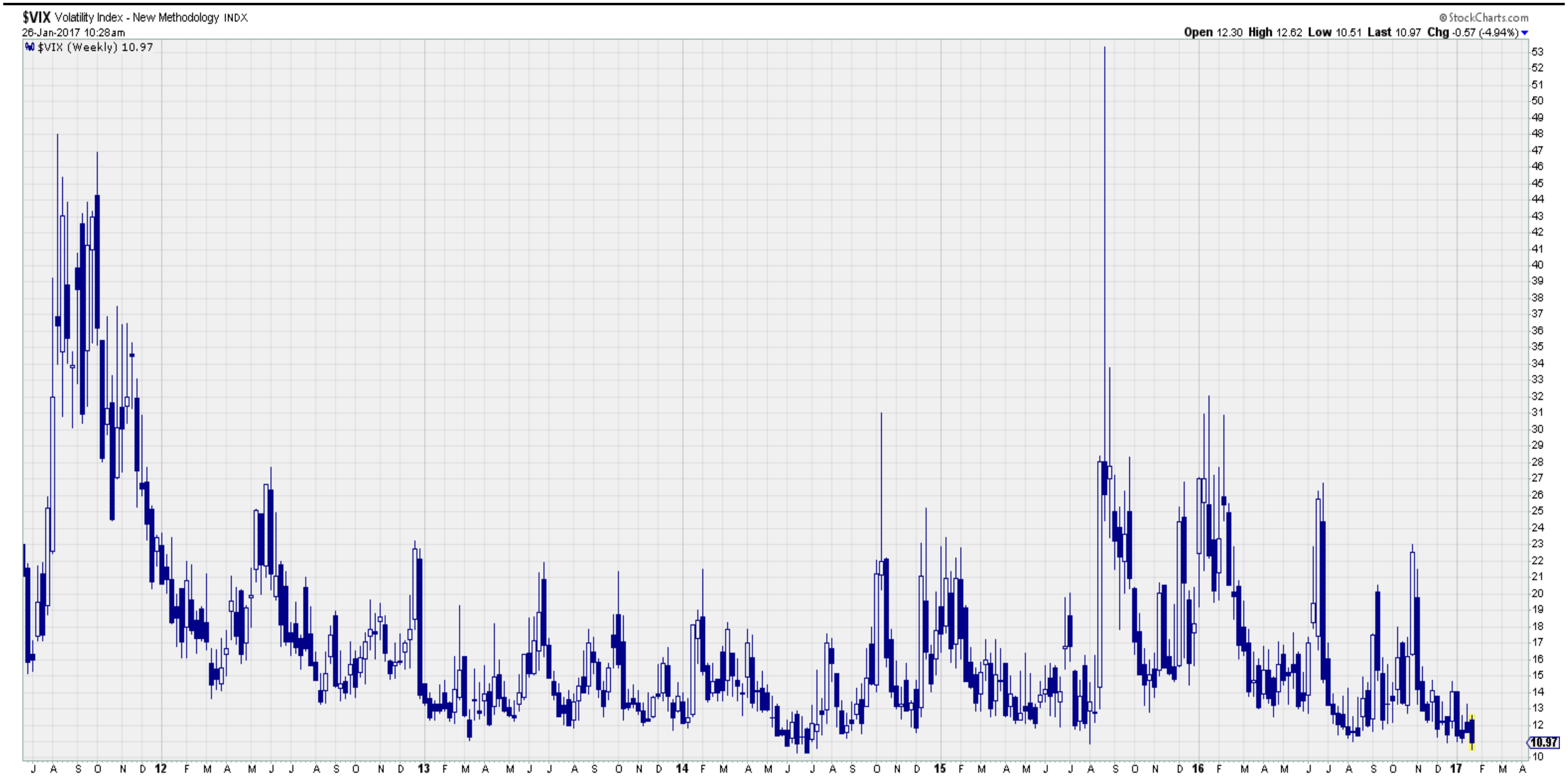
China is obviously getting a lot of attention in the news, with all the trade talk going on, but its stock market is actually at a fairly important point right now too. After pulling back to support, the Shanghai Composite Index is rallying and could offer opportunity despite the global uncertainty. Given the support and the tremendous amount of space above that remains after the crash of 2015, China could be worth a trade as long as losses are cut quickly.


Source: Stockcharts.com.

## Andrew Adams

### Volatility Index Remains At Low Levels

Not surprisingly, given the limited downside moves in the stock market, the VIX Volatility Index continues to hold near the lowest levels of the last few years. This complacency, therefore, could be a sign of caution, as prolonged periods of low volatility are often followed by bursts of activity; activity that very well could come on the downside. So, remain cautious and keep an eye on your portfolio.




Source: Stockcharts.com.

## Scott Brown

## U.S. Economic Outlook – Key Themes

**Moderate growth**

- Domestic economy
  - Consumer fundamentals remain strong (jobs, wages)
  - Housing fundamentals are strong, but affordability and supply issues will linger
  - Business fixed investment may get a boost from improved sentiment
- Long-term restraints
  - Slower labor force growth
- Rest of the world
  - Brexit negotiations to begin in March (a two-year process)
  - China economic restructuring likely to be uneven
  - Global labor force growth is slowing
- New administration
  - Expecting a roll-back of regulations (more "business-friendly")
  - Infrastructure spending (private-sector funding)
  - Tax cuts (possible in 2017, but more likely effective in 2018)
  - Foreign trade (possible disruptions, higher import costs)

**Federal Reserve**

- One to three rate increases expected in 2017
  - Still data-dependent, but likely to be gradual
  - Focus is on job market and inflation outlook
- Long-term interest rates seen higher (restrained by low rates abroad)

## Scott Brown

# New Administration Economic Outlook – Key Themes

**Fiscal Stimulus (very uncertain)**

- Infrastructure Spending
  - Added government spending likely to be resisted in the House
  - Expectations of "private" funding
  - Privatization of airports (roads and bridges?)
- Tax cuts easier to get through the House, but the Senate path is difficult
  - Path 1: Tax reform bill
    - Needs 60 votes in the Senate
    - Possible to get eight democratic senators on board
    - But likely to be watered down
- Path 2: Budget Reconciliation (instructions for tax reform included in Budget Resolution)
  - Constraint: only one set of instructions per year (already used on ACA repeal in 2017)
- Priorities: Business tax cuts before individual tax cuts, lower rate on foreign earnings

**Spending Cuts?**

- Non-defense discretionary spending is small
- Can't do anything about interest payments; defense spending to rise
- Will the new administration try to cut Social Security and Medicare benefits?

**Foreign Trade (NAFTA renegotiation, tariffs, possible trade wars)**

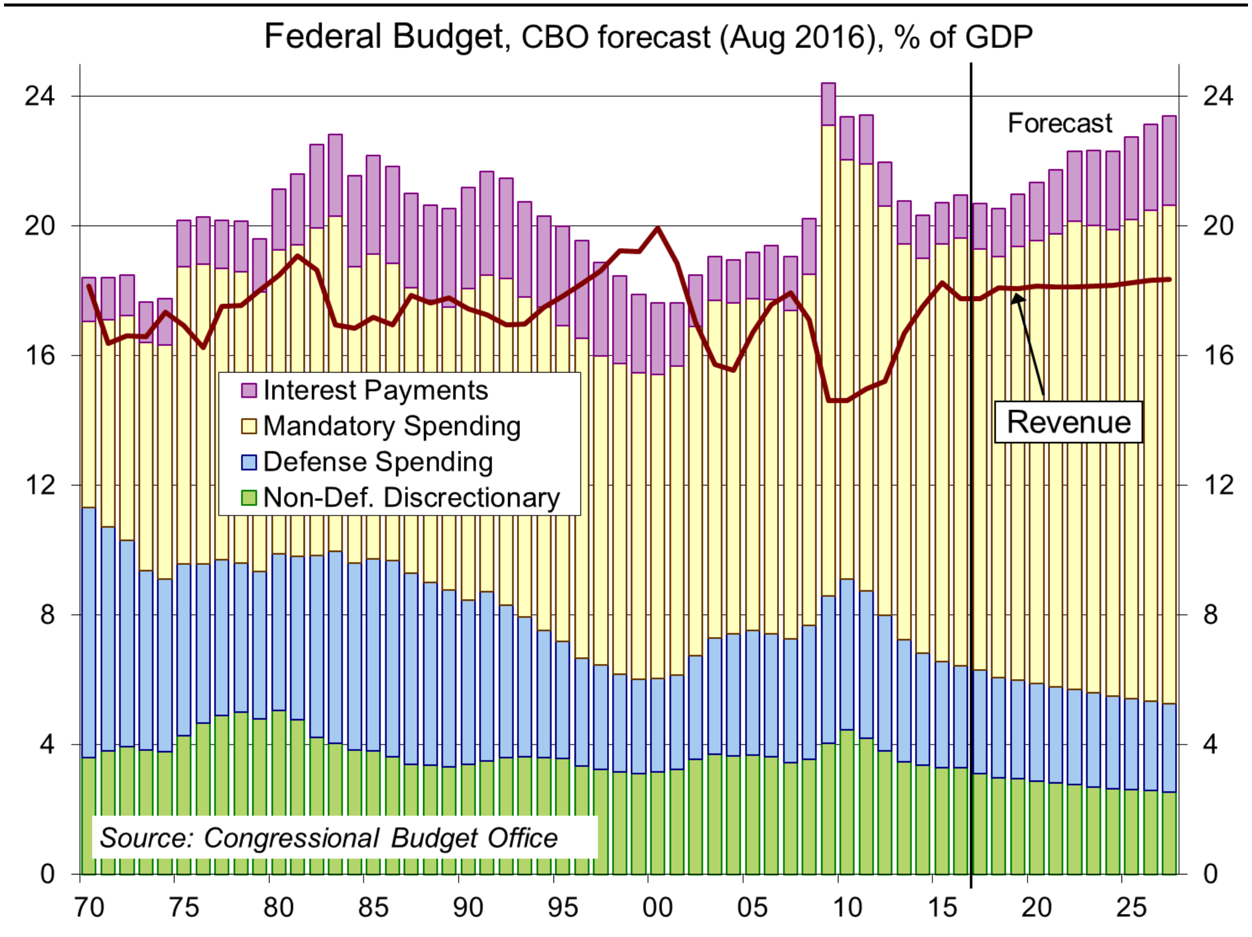
- A chance of major trade conflicts, supply chain disruptions

**Regulation (expecting a more "business-friendly" environment)**

- Principals matter: a complete change in leadership within 18 months
  - SEC, FINRA, CFTC, FDIC, OCC, CFPB
  - Fed Governor positions, including Chair and Vice Chair of Regulation and Supervision

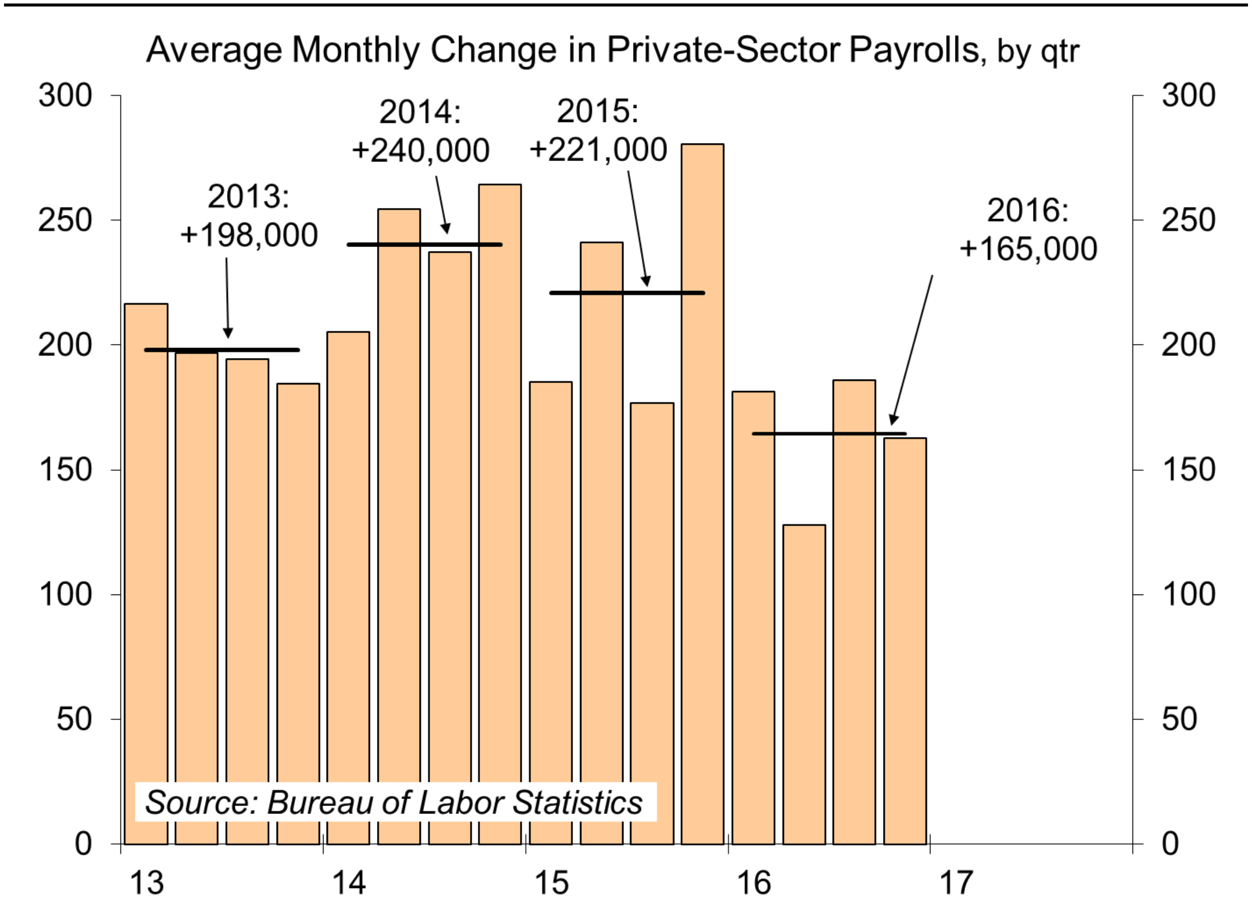
**Scott Brown**

## Federal Budget Deficit to Increase (Before Any Stimulus)



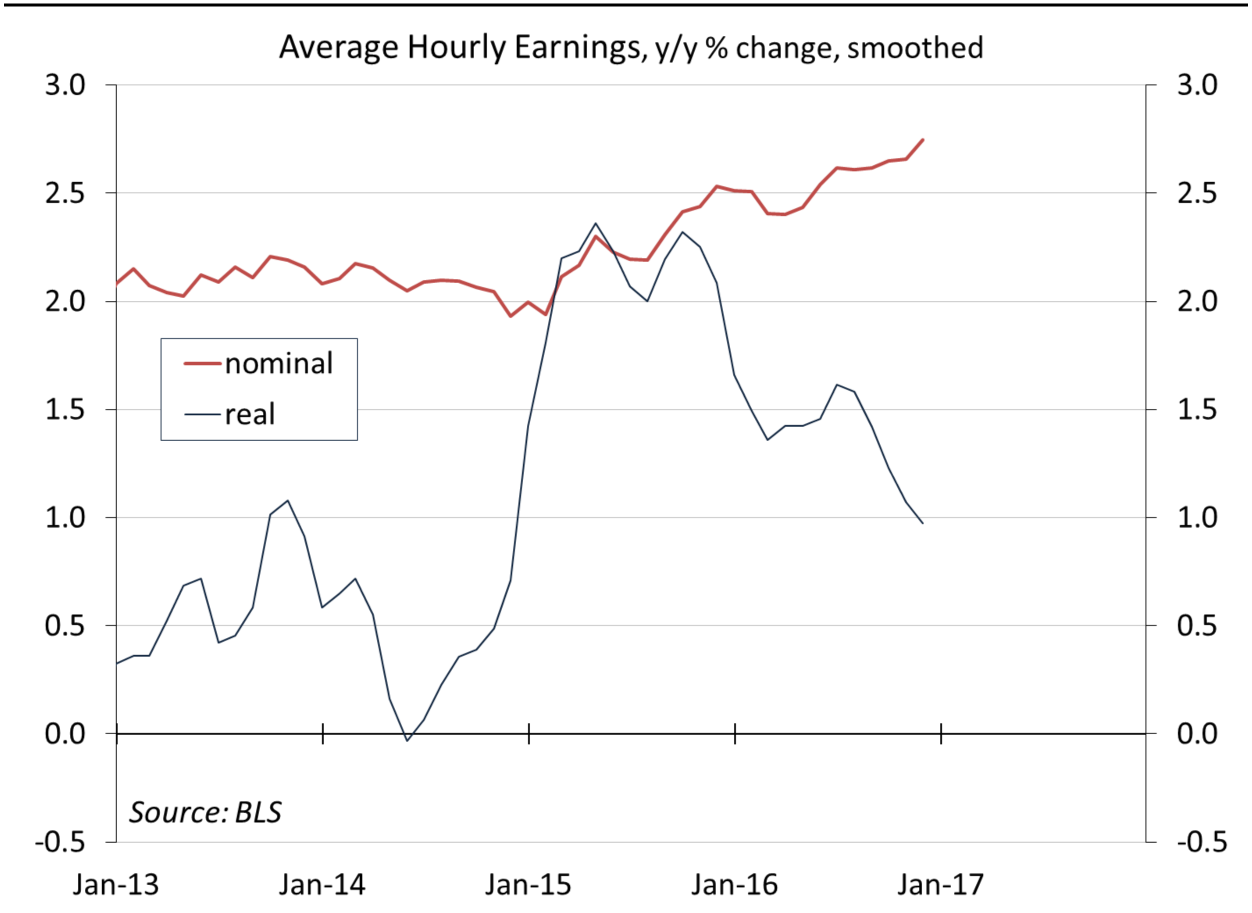
**Scott Brown**

## Job Growth Still Strong, But Slower in 2016



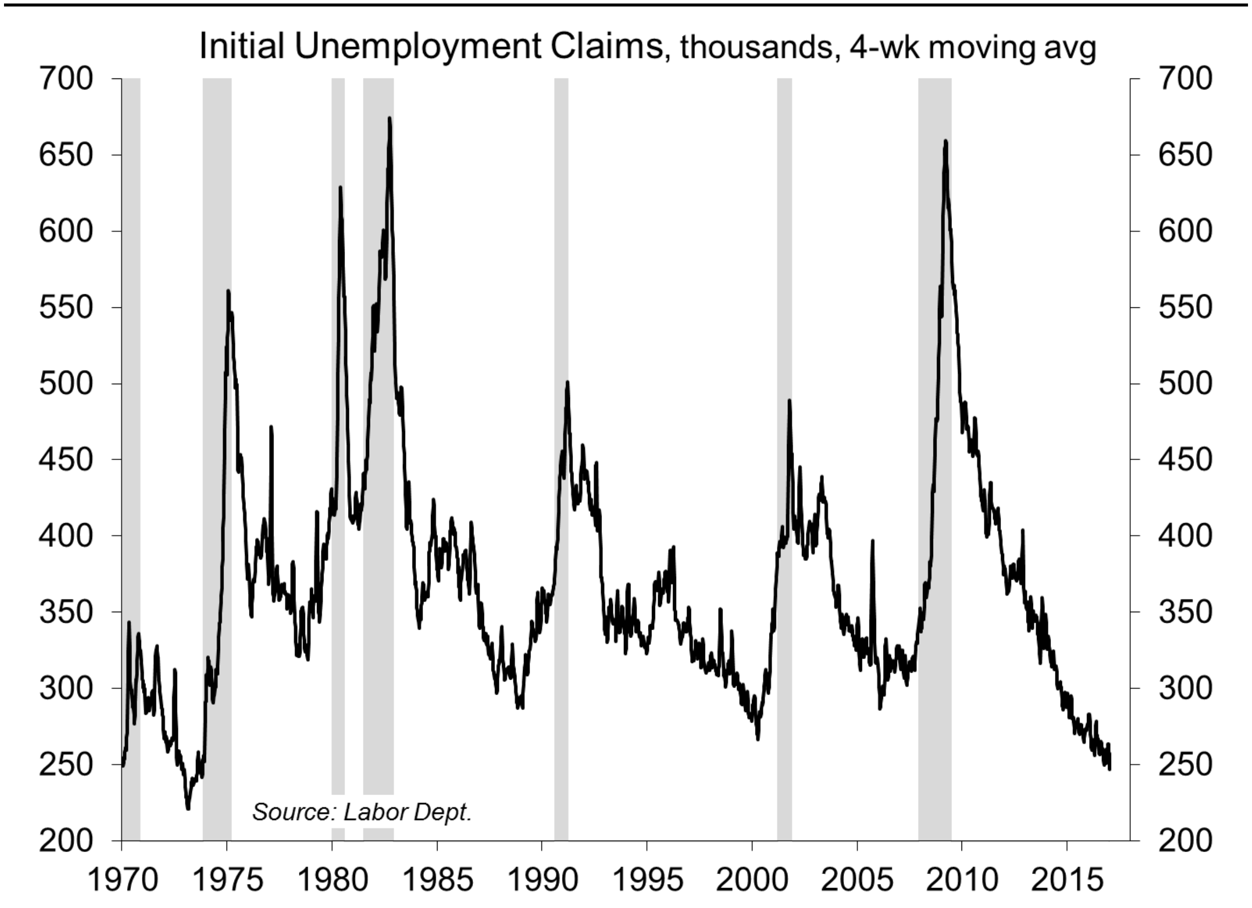
**Scott Brown**

## Nominal Wage Growth Up, Real Wage Growth Slowing



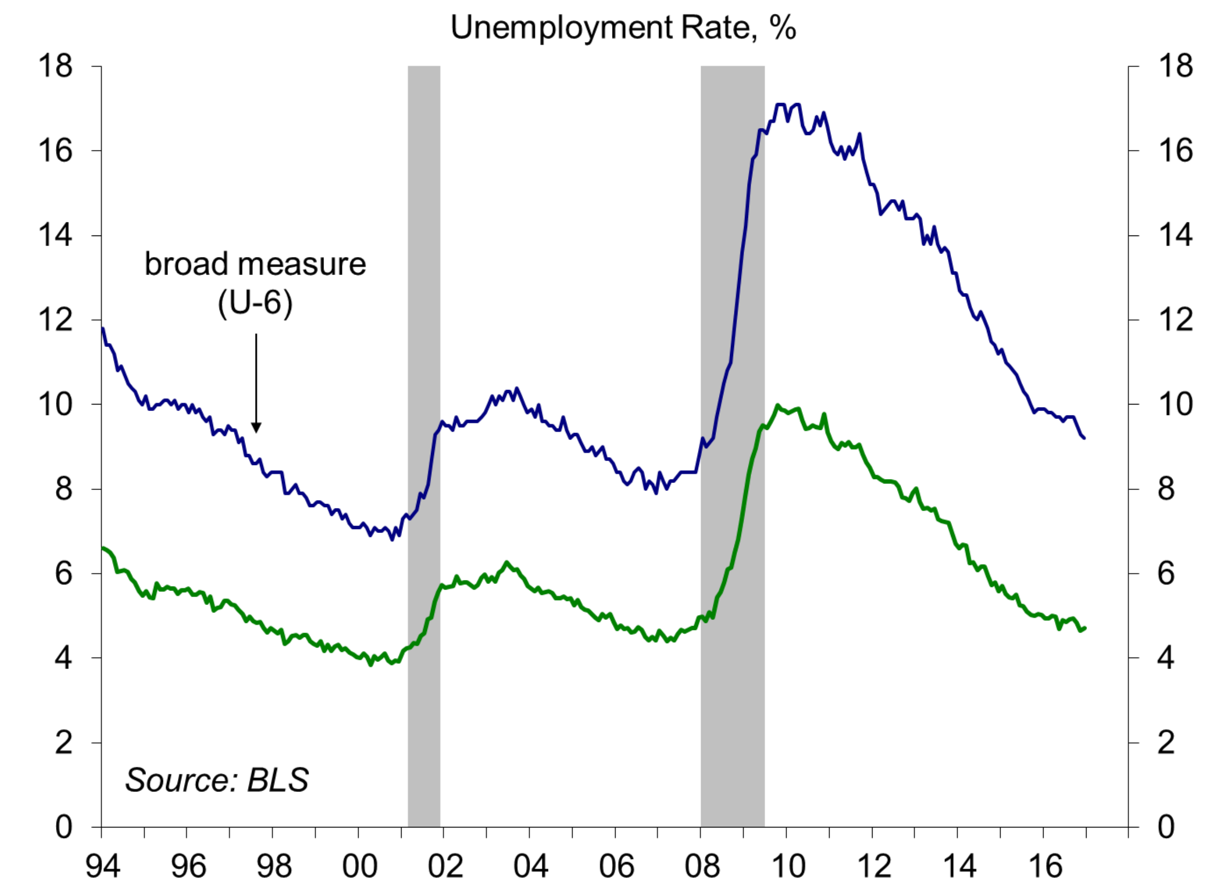
**Scott Brown**

## Jobless Claims Trending At Lowest Level Since 1973



**Scott Brown**

## The Unemployment Rate Is Low

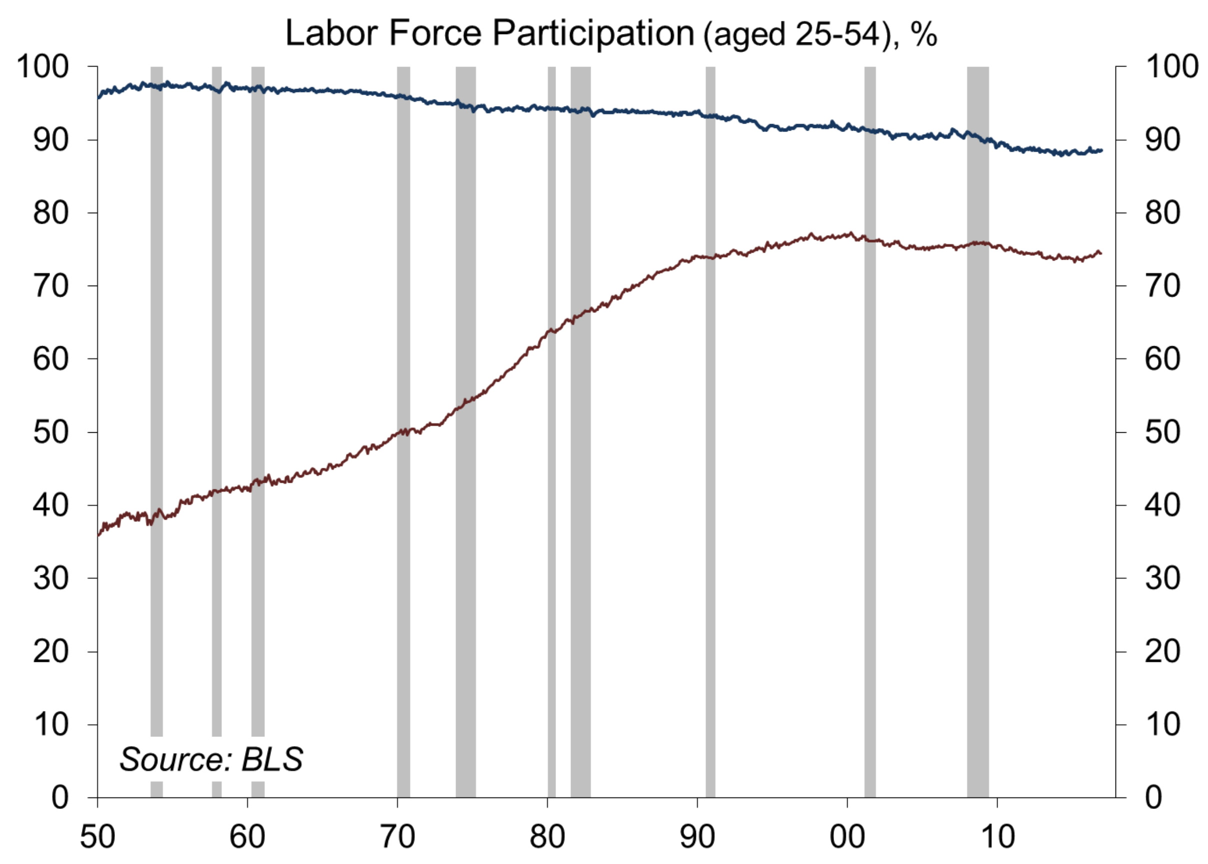


**Scott Brown**

## Labor Market Slack Is Being Reduced

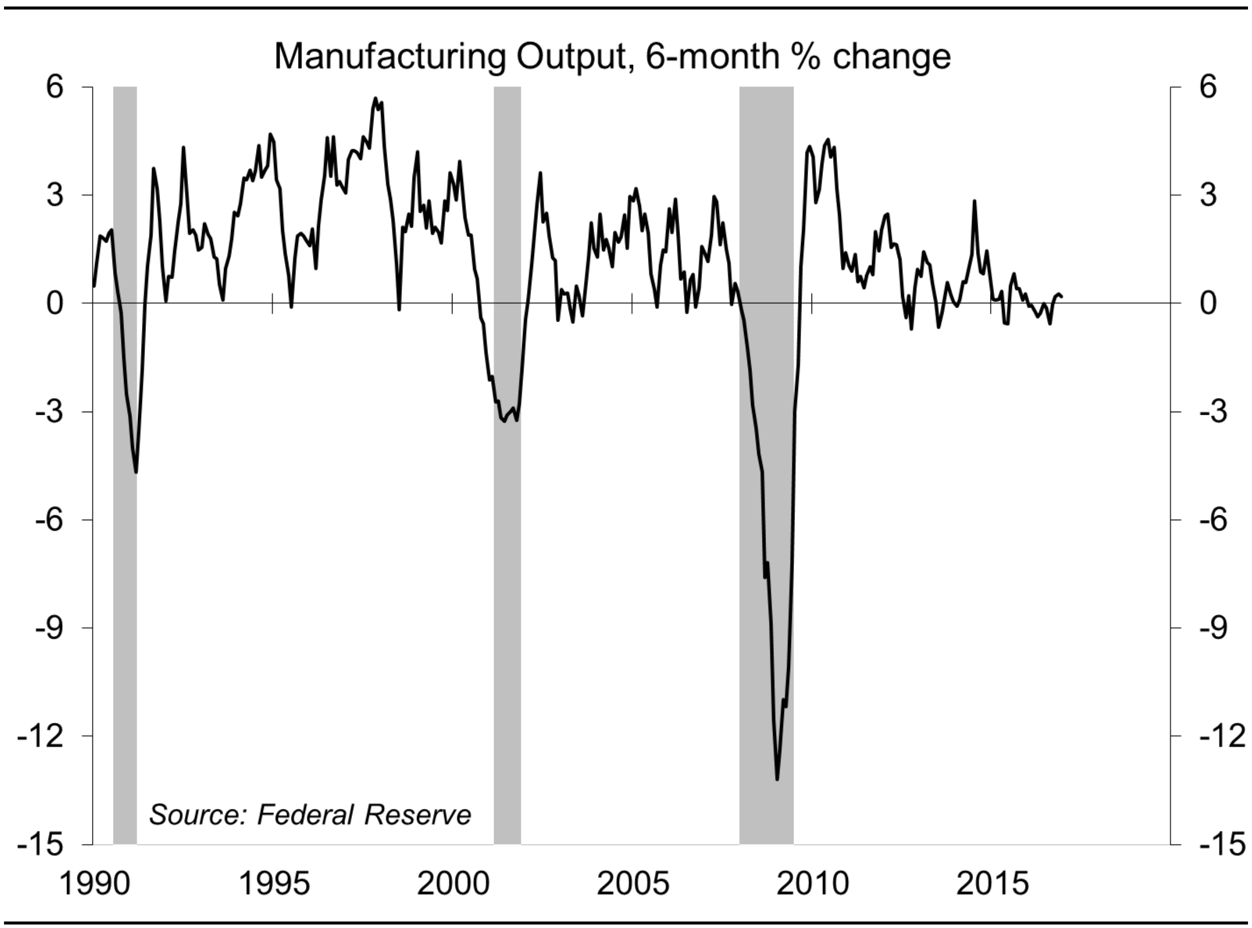
**Scott Brown**

## Labor Force Participation Reflects Demographic Changes and Longer-Term Downtrend For Prime-Age Males



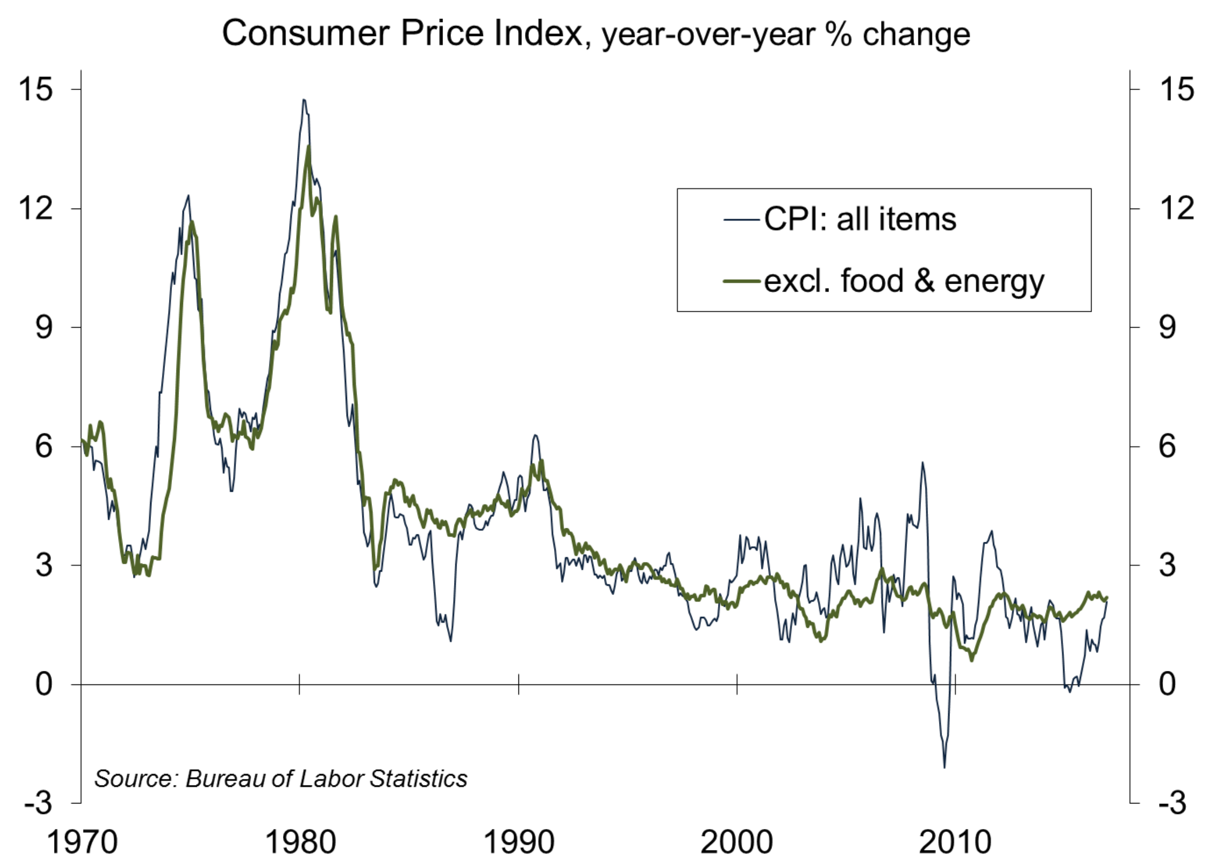
**Scott Brown**

## Factory Output Trending About Flat



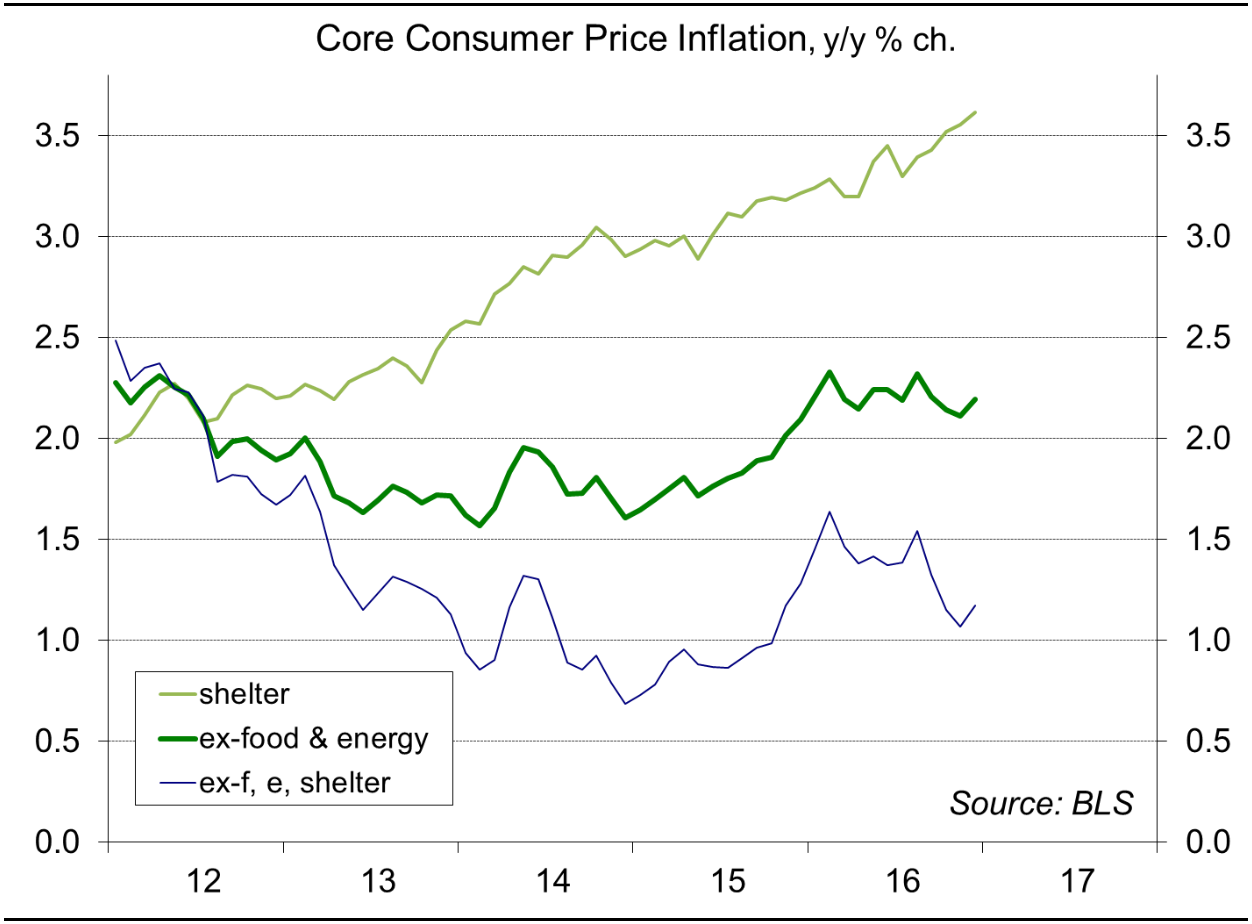
**Scott Brown**

## Inflation Picking Up As Energy Prices Firm



**Scott Brown**

## Inflation Pressure In Rents



## Scott Brown

# Federal Reserve Policy

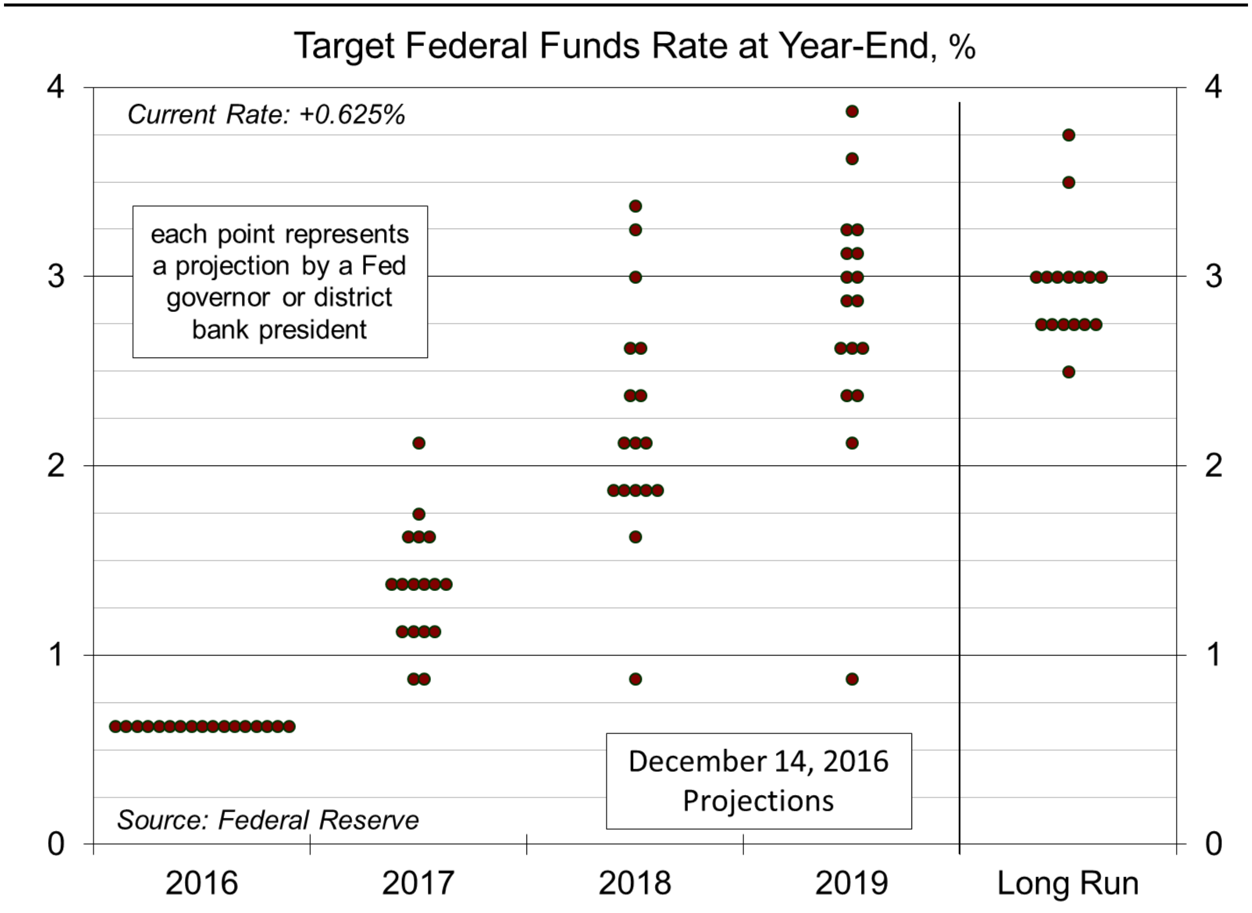
On December 14, 2016 the Federal Open Market Committee raised the target range for the federal funds rate to 0.50-0.75% (from 0.25-0.50%) and the Fed's Board of Governors approved a 25 basis point increase in the discount rate (the rate the Fed charges banks for short-term borrowing), to 1.25%. The FOMC cited realized and expected improvement in the job market.

Fed policy decisions will remain data-dependent, with a focus on the job market and the inflation outlook. Fed policy will not anticipate changes to fiscal policy, but will react to the economic implications of changes once they occur. Fed economists view a tight labor market as a constraint on 2017 GDP growth.

Janet Yellen's term as Fed Chair ends February 3, 2018 (she could stay on as a Fed Governor until January 31, 2024, but that seems doubtful). Her replacement may be less independent and more hawkish. Stanley Fischer's term as Vice Chair ends June 12, 2018 (his term as Governor ends in 2020). The Vice Chair of Supervision seat is still open. Governor Tarullo (term ends 2022) is acting in that capacity, but may leave once that position is filled.

## Scott Brown

### Fed's Policy Path Remains Uncertain, Data-Dependent



## Scott Brown

# Economic Indicators

| Economic Indicator | Status | Comments |
|---|---|---|
| **Growth** | Green | Growth is expected to be a little above 2%, restrained by labor market constraints. No signs of recession on the immediate horizon. |
| **Employment** | Green | Job growth is expected to remain moderately strong in the near term, but should slow as the labor market continues to tighten. |
| **Consumer Spending** | Green | Job gains and wage growth remain supportive, but the impact of low gasoline prices is fading. Auto sales are likely to plateau. |
| **Business Investment** | Yellow | Businesses are more optimistic, which should lift capital spending levels in the near term. Higher wage costs ought to lead to more productivity-enhancing investment. |
| **Manufacturing** | Yellow | A strong dollar and a soft global economy have restrained exports. Trade policy conflicts may lead to supply chain disruptions in many industries. |
| **Housing and Construction** | Green | Still generally improving, but mixed. Tax cuts are expected to boost demand at the high end. The low end is constrained by affordability issues and high building costs. |
| **Inflation** | Yellow | Mixed. Energy prices have firmed, pushing headline inflation up. Core inflation remains moderate, with some deflation in consumer goods and some upward pressure in shelter and medical care. Wage pressures, while still moderate, are building. |
| **Monetary Policy** | Green | In recent comments, Fed Chair Janet Yellen has appeared a bit more hawkish. However, Fed policy decisions will remain data-dependent. The central bank will not try to anticipate fiscal policy changes, but will react once those changes become clear. |
| **Long-Term Interest Rates** | Yellow | Expectations of further Fed rate increases and a substantially larger federal budget deficit have put upward pressure on long-term interest rates, but low rates abroad ought to check the upward pace of long-term interest rates here. |
| **Fiscal Policy** | Green | State and local government budgets are in better shape and spending should add a bit to GDP growth over time. At the federal level, the scale of infrastructure spending and tax cuts is very much in doubt, but will likely add to the federal budget deficit. |
| **The Dollar** | Green | Monetary policy has contributed to dollar strength. A strong dollar should keep some downward pressure on commodity prices, but will also make it harder for U.S. exporters. |
| **Rest of the World** | Yellow | The global outlook looks a bit brighter, but is also uncertain. The Brexit pain lies ahead for the U.K. China's transition is likely to be uneven. The possibility of trade conflicts is a major risk. |

Scott Brown

## Key Calendar Dates

| | |
|---|---|
| **January 30** | Personal Income and Spending (December) |
| **January 31** | Employment Cost Index (4Q16)<br>CB Consumer Confidence (January) |
| **February 1** | ADP Payroll Estimate (January)<br>ISM Manufacturing Index (January)<br>FOMC Policy Decision (no Yellen press conference) |
| **February 3** | Employment Report (January)<br>ISM Non-Manufacturing Index (January) |
| **February 7** | Trade Balance (December) |
| **February 15** | Consumer Price Index (January)<br>Retail Sales (January)<br>Industrial Production (January) |
| **February 20** | Presidents Day (markets closed) |
| **Mid-February (tbd)** | Yellen Monetary Policy Testimony |
| **February 28** | Real GDP (4Q16, 2nd estimate) |
| **March 15** | FOMC Policy Decision (Yellen press conference) |

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