Haddonfield, NJ
30 S. Haddon Ave
Haddonfield, NJ 08033
P 856-482-8700
F 856-482-0096

PLANNING CAPITAL MANAGEMENT

Allentown, PA
7540 Windsor Dr, Ste 201
Allentown, PA 18195
P 610-820-0240
F 610-820-5011

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To Our Clients, Partners, and Friends –

Recently, studying economic charts is like playing a game of “which one does not belong with the others?” Survey-based data is showing positive sentiment—both the Consumer Confidence Index and the Small Business Optimism Index are at their highest levels since 2000 and 2005, respectively[1]. The ISM Manufacturing Index, compiled based on responses from purchasing managers of U.S. corporations, has reported expansionary activity in the manufacturing sector for the 94th consecutive month[2]. These charts each show an especially dramatic increase since the U.S. presidential election.

The chart that does not belong is the Gallup Presidential Approval Rating. It would stand to reason that this indicator would correlate with movement in the “soft” economic data, such as confidence readings, consumer sentiment, and business surveys. However, the approval rating dropped from 59% to 45% on inauguration day, and even further to 40% as of last week[3].

The current political environment creates a tendency to explain market movements in partisan terms. Trumponomics, the Trump Trade, the Trump Rally—and more recently Trumpocalypse—are just a few of the phrases coined by the “Monday morning economist”. It is probable that the anticipation of pro-growth policies has boosted confidence readings, and that the anxiety from impulsive political speech has created market volatility. However, barring a new exogenous shock, these explanations are unlikely to have any substantial, long-term implications in the market.

Sir John Templeton once remarked, “bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria.” The recent jolt of optimism is attempting to thrust the bull market into the mature territory. This has created a wide spread between the soft and “hard” economic data, such as sales growth, capital expenditures, and industrial production. These numbers directly translate into economic growth or loss, and increasing or decreasing profitability. While the hard data is improving, it is not doing so as quickly as the soft data indicates.

Typically, the spread between the two data types will narrow in both directions—sentiment retreats while growth catches up. In their March 15th meeting minutes, the Federal Open Market Committee cited a strengthening labor market, an expanding GDP, and a growing housing market in their decision to raise interest rates. Then, the market experienced investor skepticism on March 21st, as the S&P 500

[1] Liz Ann Sonders, “Market’s Moves Not All About Trump”, *Schwab Expert Insight*, April 10 2017
[2] Lauren Thomas, “ISM Manufacturing Index Hits 57.2 In March”, *CNBC Economy*, April 3 2017
[3] Database, “Presidential Job Approval Center”, *Gallup Politics*, April 8 2017

snapped a 109-day streak of not declining by 1% or more[4]. We will likely see more of a see-saw between optimism and skepticism as the economy continues to experience growing pains.

Under the surface of the recent pullback, there was a larger technical indicator amongst individual stocks. 24% of the S&P 500 has already experienced a correction of 10-20% from their 52-week highs, while another 14% are down more than 20%[5]. This potentially sets the stage for the next move higher as the secular bull market remains intact.

Globally, the U.S. dollar continues to play a major role in the growth outlook. The direction of currency value is primarily influenced by relative interest rates. All else being equal, countries with higher interest rates have their currencies appreciate compared to countries with lower interest rates. This swell continues until major macroeconomic or monetary policies are shifted.

Over the five-year period ending this past February, the difference between international returns expressed in dollars versus local currency was approximately 4.5% annually[6]. In other words, dollar strength has caused international equity investments to underperform domestic equity investments by approximately 4.5% annually.

During that same five-year period, the average yield on a 10-year Treasury note was 2.15%[7]. This is historically low for the U.S., but is relatively high across the globe. Near-zero and negative interest rate policies, as well as geopolitical strife, have created an environment where international investors are pouring assets into the U.S. to chase yield and hold higher quality paper.

The Federal Reserve anticipates rate increases of 0.25% at least two more times in 2017. All other major developed market countries are not expecting interest rate hikes in 2017, and are forecasting modest probabilities to increase rates in 2018. The result is a widening spread which should continue to push both the dollar and U.S. equity markets higher. However, there are ancillary factors which deserve further consideration—U.S. trade policy, corporate tax reform, and the Fed's balance sheet.

From a trade policy perspective, relations with China are at the forefront. The rhetoric about China being labeled a "currency manipulator" sums up the situation well. An aggressive stance on China, or trade in general, could create weakness for the dollar. But recent developments, such as his comments regarding NATO, suggest that Donald Trump has softened his initial position on trade.

Corporate tax reform can have long-lasting effects and the ultimate goal of this administration is lowering the corporate tax rate. This typically has a positive effect on wage growth, and in turn, inflation. We will curb our enthusiasm for the moment, as the failure to repeal the Affordable Care Act shows the risks associated with such a bold agenda. The hallmark of the corporate tax plan proposal is the border adjustment tax, or BAT. This legislation would essentially disallow tax deductions for companies that import goods to the U.S., and allow tax deductions for companies that export goods

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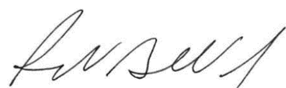
[4] Ben Levisohn, "Divided We Fall", *Barron's Blog*, March 21 2017
[5] Schwab Market Perspective, "Working Off The Froth", *Schwab Center for Financial Research*, March 31 2017
[6] Matthew Peterson, "Currency Matters—Eddies In The Interest Rate River", *LPL Research*, March 27 2017
[7] Database, "10-Year Treasury Constant Maturity Rate", *Federal Reserve Bank of St. Louis*, February 28 2017

from the U.S. A change will likely be controversial, but there is a precedent under global trade law. Most European countries and many other developed countries employ a value-added tax system, which operates in a similar fashion.

Lastly, the Federal Reserve has become increasingly hawkish on an additional measure of contractionary monetary policy; tightening the money supply. The Fed's balance sheet has grown from $750 billion in 2007 to $4.2 trillion as of last month[8]. This reflects bond purchases under quantitative easing, designed to lower yields and boost the economy. Currently, the principal from these bonds is reinvested at maturity. The Fed is proposing that reinvestment will be halted by year-end in a "gradual and predictable" fashion. This adds another layer of complexity to the already delicate balance between interest rates, currency movements, inflation, and economic growth.

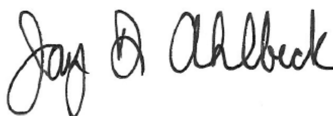
We hope you enjoyed our comments. If you have any questions, please do not hesitate to contact us. We welcome the opportunity to discuss our thoughts in greater detail. Thank you for your continued confidence in Planning Capital Management.

Sincerely,



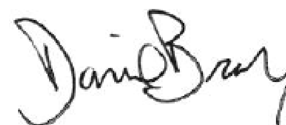
Richard W. Bell, Jr.

President, Senior Advisor



Jay Ahlbeck, **CLU®, ChFC®**

Senior Advisor



Daniel Brady, **CFP®, CLU®**

Director of Financial Planning

[8] Joe Rennison, "Fed's Desire To Shrink Balance Sheet Leaves Investors Guessing", *Financial Times*, April 6 2017