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WEEKLY PERSPECTIVE ON CURRENT MARKET SENTIMENT

Some of What's Good is Bad…For Now

February 28, 2018

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Last Week's S&P 500 Index:
+0.6%

Key takeaways

» *Typically, at some point in an economic cycle, investors look at economic data in terms of how if might affect Federal Reserve (Fed) monetary policy.*

» *Currently, better-than expected economic data might well be frowned upon by equity investors as it might give the Fed a reason to hike rates more than three times this year.*

The U.S. economy appears to have hit a bit more of a positive stride over the course of the last 12 months. Most of the economic reports we hear each week and each month suggest the pace of growth in this long, long expansion has picked up a bit. The new tax code should help increase capital expenditures in many industries as well as put more money in the pockets of consumers, which will likely result in more incremental discretionary spending this year. And keep in mind that in two of the last three quarters the American economy grew 3% or more. This year, we continue to look for economic growth in the 2.9% area as the tax benefits broadly accrue. Another plus is that we see slightly higher, but still modest, inflationary pressure over the balance of the year. As my grandfather, a farmer and cattleman, used to say, "A little inflation is a good thing." The Fed obviously agrees.

Just three weeks ago, the stock market was tumbling downward, in part, due to fears the domestic economy was picking up enough speed to cause inflation to rise too quickly and push the Fed into hiking rates more than three times this year. Just last week, in the midst of the bounce back from the February 9 low, the Federal Open Market Committee briefly spooked investors with its Wednesday release of the minutes from the January monetary policy meeting. The market interpreted the text as carrying a bit more of a hawkish tone than most expected, even though the actual post-meeting press release was quite neutral. In response, the S&P 500 Index turned on a dime and fell almost 1.5% from the intraday high on that day.

But net-net, over the last 10 trading days, market participants have had a change of heart. After six days of selling following the release of the January employment data on the first Friday in February, which took the S&P 500 down just over 10% from its recent record high, the stock market staged a rally that has carried the index to within 3.5% of its all-time record high. Did investors stop worrying about the Fed hiking rates too many times this year? Did the concerns over the potential for higher general inflation and a surge in wages suddenly evaporate? Not quite. This strategist would argue that all of those worries and concerns still exist.

The stock market is going to be laser-focused in coming months on any news that potentially affects inflation, wages, or Fed monetary policy. That means, for the time being, that equity traders could very well take better-than-expected economic data as bad news. The January employment report was a perfect example. More jobs were created than the average economist projected, and wage growth was higher. News like that sounds pretty good to most Americans. But an improving economy that is creating jobs and paying workers higher wages could very well lead to higher inflation and a Fed that is more prone to boost the pace of future rate hikes. And that, to put it simply, is being perceived by the equity market as bad.

Be prepared, because for now, good news on the economy might be bad news for the stock market.

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Definitions

An index is unmanaged and not available for direct investment.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

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