Weekly Market Review

***e*Research Corporation** is pleased to provide a review of the markets by Eddy Elfenbein of **Crossing Wall Street**.

Mr. Elfenbein introduces his commentary with the following quote from Peter Lynch.

"The natural born investor is a myth."

Read Mr. Elfenbein's analysis and market comments on the following pages.

Information about **Eddy Elfenbein** and **Crossing Wall Street** is provided at the end of this article. You can also learn about **Crossing Wall Street** by going to its blog website at: http://www.crossingwallstreet.com/.

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Bob Weir, CFA
Director of Research

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March 17, 2017

Crossing Wall Street: Weekly Market Review

by Eddy Elfenbein

BW: We have taken only an extract of Mr. Elfenbein's latest weekly article. If you wish to read the entire article, which includes stocks in his recommended portfolio, there is a link provided below.

On Wednesday, the Federal Reserve decided to raise interest rates by 0.25%. This is only the Fed's third rate increase since the financial crisis. The new range for the federal funds rate is 0.75% to 1%. That is still rock bottom by almost any standard.

But what is interesting was Wall Street's reaction. Obviously, they knew the rate hike was coming. I told you so, and Janet Yellen all but said so. Still, stocks rallied on the news. In fact, some folks on Wall Street have taken to calling this move a "dovish hike," meaning that even though the Fed raised rates, the central bank was cautious on the need for further rate hikes. Bonds rallied, and in the commodity pits, gold rallied as well. That does not normally follow rate increases.

At her press conference, Fed chairwoman Janet Yellen said she did not share Wall Street's enthusiasm. While Yellen noted that the economy has got better, she was clear that her outlook for gradual economic growth has not changed at all. What is going on? It seems like the Fed and Wall Street are headed in different directions.

In this week's *CWS Market Review*, we will see why we have little to fear from higher rates. At least, so far.

The Fed Gives Us A Dovish Rate Hike

This week's Fed rate increase was hardly a surprise. Officials at the Fed have become quite good at telegraphing their moves to Wall Street. So, the big news was not this week, as the expectation for what was in the pipeline was formed over the last few weeks.

Despite the news being well planned, the reception was unexpected. Stocks rallied on the higher rates, but the long end of the bond market rallied as well. In other words, long-term rates went down on the news that short-term rates went up. Gold also rallied. That is not what the playbook says is supposed to happen.

The best way to square this circle is to believe that Wall Street expects higher rates, but perhaps not as quickly as they assumed. Wall Street had been very optimistic about the economy, not just regarding stocks' going up, but regarding which sectors this was going to happen in (tech, cyclicals). That is what the Trump Trade was all about.

But in her press conference, Janet Yellen was very cautious, "We have not changed the outlook. We think we are moving on the same course we have been on." I think the Fed's view is that Wall Street simply has not been listening to them. The Fed sees gradual growth, but the Trump Trade was predicated on rip-roaring growth. In that battle, my money is on the Fed largely because they are the ones who make the money.

Along with the Fed's policy statement, its members also updated their economic forecasts. I should add that the Fed is notoriously bad at forecasting. I mean, even for economists, they are really, really bad. Still, their outlook—the famous blue dots—tells us where they think the economy is going.

For this year, the Fed expects two more rate increases. Not too long ago, I thought that prediction was far too optimistic. Now it looks quite reasonable. The Fed sees another three rate hikes coming next year as well. In fact, the median is only one vote away from seeing four rate increases next year. If that is accurate, it would bring the range for Fed funds to 2.25% to 2.5% in months.

The Fed sees inflation holding at 2%. That means that real short-term interest rates will remain negative for nearly two more years. There are few factors that are as bullish for stock investors as negative real rates. Effectively, the Fed is giving us no alternative but to invest in stocks. While much of the bull rally has been helped by share buybacks, there has been real investment as well. It has taken a while to wind its way to the real economy, but it is there.

What happens next? The Fed meets again in May, and it is doubtful that they will raise rates. After that, the Fed gets together in mid-June, and another rate hike is very possible. The futures market currently thinks the odds are roughly 50-50. Right now, I would say it is 70-30 in favor of another rate increase in June.

But there are a lot of moving parts to this forecast. The keys to watch are inflation and the labor market. Last Friday, the government reported that the economy created 235,000 net new jobs. That is a strong number. The unemployment rate dipped to 4.7%. Over the last year, average hourly earnings are up 2.8%. That is not much, but at least it is 0.6% ahead of core inflation. During much of the period from 2011 to 2014, wages basically stayed in line with core inflation. This means that workers saw no real wage increase. Now they are seeing one, even though it is small.

Inflation is still not a threat. On Wednesday morning, ahead of the Fed's announcement, the government reported that consumer prices rose 0.1% last month. That is what economists had been expecting. The "core rate," which excludes food and energy prices, rose by 0.2%, which also matched expectations. So, while the labor market has been expanding, there has been only modest inflation pressure. That helps explain the Fed's cautious approach.

All of this will have an impact on the stock market. I think it is very likely that we will see better relative performance from defensive areas of the market. This includes areas like healthcare and consumer staples. When traders see a better economy, these areas tend to get left behind. I still hold to my belief that stocks may face a modest pull-back soon. Say 5% to 7%. Nothing too serious, but enough to scare off some momentum traders. We have nothing to fear. In fact, it may give us some good buying opportunities.

Until then, I encourage investors to focus on a list of high-quality stocks.

Next week will be a fairly quiet week for economic reports. The existing home-sales report comes out on Wednesday. The report for January was a 10-year high. The report for new home sales will be released on Thursday.

Be sure to keep checking the blog for daily updates, and I will have more market analysis for you in the next issue of *CWS Market Review*!

- Eddy

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BW: In the rest of the newsletter, Eddy reviews the earnings announcements of the companies on his Buy List. You can read about them and the entire article by clicking on the following link:

http://www.crossingwallstreet.com/archives/2017/03/cws-market-review-march-17-2017.html

Named by CNN/Money as the best buy-and-hold blogger, Eddy Elfenbein is the editor of Crossing Wall Street. His free Buy List has beaten the S&P 500 for the last six years in a row. This email was sent by Eddy Elfenbein through Crossing Wall Street.

BW: Information on Eddy Elfenbein and Crossing Wall Street follows on the next page.

ABOUT THE AUTHOR

Welcome to Crossing Wall Street

I started this Web site to help individual investors. I have to admit that I *love* the stock market. I think I must be an addict. In my opinion, the stock market is one of the greatest inventions in history. The stock market is simply the most consistently successful way to make money over the long term. Even after the financial crisis, stocks have still beaten every asset category over the long haul—bonds, commodities and real estate.

While the stock market may bounce around from day to day, and even month to month, the long-term trend has always been higher. Over the last 35 years, stocks have gone up 35-fold. And since the end of World War II, the stock market is up an amazing 120,000%. I wish I had been around! That was the beginning of an American financial revolution. Today, we're at the beginning of a *global* financial revolution. That is why I think the next 70 years will be even better.

The key to doing well on Wall Street is actually very simple: Buy and hold shares of outstanding companies. But too many investors never learn this valuable lesson. Or if they do learn it, they learn it the *hard* way. That is where I come in. I want to help investors avoid the mistakes that separate successful investors from those who always find themselves spinning their wheels.

There are lots of pitfalls on Wall Street. From shady companies that are more popular than they are profitable to a mutual fund industry that is more interested in its fees than serving investors. Todayis investors must be careful.

At Crossing Wall Street, I give investors my free and unbiased view of the market. I probably analyze dozens of companies every week. I am always looking over income statements and balance sheets. I've spent several years collecting my list of the best companies to own. This is my current Buy List. I've included a description of each company and its current share price. These are the ones that I make the most effort to follow on the site, but please feel free to ask me my opinion on any stock. I don't receive compensation from any of the stocks I recommend. Also, I don't "short" any of the stocks I criticize. At any time, I may own the companies on my Buy List. All of the information on this site is free and unbiased. I also have a section for Frequently Asked Questions that will help you learn more about Crossing Wall Street.

Please feel free to e-mail me. I enjoy getting feedback from investors. I am happy to give you my opinion on any stock or investing in general. I should warn you that I cannot give out personal portfolio advice, but all other topics are fair game. You can also check out some of my favorite links.

- Eddy Elfenbein

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