



Mitch on the Markets

Market Insights from Mitch Zacks



Forget Politics – Focus on Fundamentals

By Mitch Zacks
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Politics and policy could affect how stocks perform in 2017. But, the key word is *could*, because I don't think these dynamics will *determine* how stocks perform. Performance depends primarily on **economic fundamentals**.

Often, clients get swept up in political narrative or news stories and set aside the macro developments that drive stock performance. Instead of looking at the yield curve and leading economic indicators, many look at Greece's debt situation. Instead of looking at corporate earnings and consumer spending, many look at President Trump's latest executive order or tweet. You get the picture. There are so many media distractions that it's difficult to focus on what matters most - the boring, dense, and uncontroversial economic data that makes stocks go 'round.

Here's an overview of how the U.S. economy is progressing:

Strong and Confident Consumers

U.S. retail sales moderated at the end of 2016, but posted a solid January with

+0.4% growth. On an annualized basis, retail sales grew a sturdy +5.6%.

Consumer spending, which accounts for over two-thirds of U.S. economic activity, increased +0.5% in December after notching +0.2% higher in November. This reaffirmed the U.S. consumer continues to show strength in this expansion. Consumer spending increased 3.8% in 2016 following a 3.5% increase in 2015.

Additionally, the University of Michigan Consumer Sentiment Index came in at 98.5 in January. This is the highest reading since January 2004, even as wages and salaries have modestly ticked up over the last few years. Consumers may be anticipating tax cuts and fiscal stimulus as measures to boost economic activity going forward.

Modest Inflation with Favorable Interest Rates

Inflation has arguably been in a sweet spot here in the U.S. - not too hot, not too cold. This prevents the Federal Reserve from having to raise rates too

quickly, which can stifle economic growth. The personal consumption expenditures (PCE) price index rose 0.2% after 0.1% tick-up in November. With December's rise, that puts the PCE price index at +1.6% year-over-year; below the Fed's 2% target but still acceptable by any measure.

Modest inflation with moderate growth has kept interest rates low, maintaining a favorable borrowing environment. The National Association of Realtors said its pending homes sales index climbed 1.6% in December.

Corporate Profits and Investment

As of February 15, we have seen Q4 results from 375 S&P 500 members (or 75% of the index's total membership). Total earnings for these 375 index members are up +7.2% on +4.6% higher revenues, with 68.8% beating EPS estimates and 54.4% coming ahead of top-line expectations. The proportion of companies beating both EPS and revenue estimates is 40%. Not only is growth on track to reach its highest level in two years, but total earnings are on track to reach a new quarterly record - *yet no one talks about this!*

Forward looking estimates for the current period (first quarter of 2017) are holding up nicely. Total earnings for the S&P 500 index are currently expected to be up +7.4% from the same period last year on +6.8% higher revenues. This is down from

expectations of +10.3% earnings growth in early January, but is still robust.

Business investment continues to grow (see below) though capital is also flowing to share buybacks and mergers and acquisitions.

Private Non-residential Fixed Investment on the Rise



Source: Federal Reserve Bank of St Louis

Bottom Line for Investors

The economy grew +1.9% in the fourth quarter, affected notably by a wider trade deficit. Even though imports are a sign of strong domestic demand, they count against GDP in calculations. If you just look at consumption, business investment, and real estate, the GDP reading would be higher.

It's clear the U.S. economy is in fine shape entering 2017. For clients that focus on fundamentals and forget about politics, data suggests being stock investing is a wise choice. And I agree.

Mitch

About Mitch Zacks

Mitch is a Senior Portfolio Manager at Zacks Investment Management and has published two books on quantitative investment strategies. Mitch has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.



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