I spent the week in my home state, first speaking at the beautiful Nemacolin Woodlands Resort a few hours away and then the next day, to an all-women’s group at the historic Bradford Club in picturesque Bradford, Pa., on the border with New York. It was supposed to be less than a 3-hour drive but we got stuck behind a double-wide on the interstate and were forced to take the back roads, making for a 4-hour journey. Despite a gloomy rain, my amiable Federated wholesaler showed me spectacular scenery. Our drive dissected the Allegheny National Forest, with its huge trees, winding streams and little mountains. Both Bradford (home of the Zippo lighter) and Nemacolin (in largely rural Fayette County, south of Pittsburgh) were big-time Trump country, with campaign posters and U.S. flags everywhere. Again this week, I was told with 100% certainty that long-term (l-t) interest rates and inflation are going up. I don’t see that. Headline and even core inflation rates have risen to levels that should make the Fed comfortable with continuing on its normalization path. But with oil prices recently reversing and wage growth remaining sluggish—average hourly earnings rose a below-consensus 0.2% in February and at 2.8% year-over-year (y/y) were still well short of the 4% level typical for this stage of an economic cycle—it's difficult to see troublesome inflation. And as famed hedge-fund manager David Tepper said this week on CNBC regarding concerns for rising l-t interest rates, “Wake me at 4%.”

My Wall Street research this week has more and more pundits 100% certain a correction has begun. Perhaps, but big corrections in stock markets mainly happen when we have a recession, which is nowhere in sight. The 100% concern du jour is an overheating economy with a Fed behind the curve. The so-called Taylor rule, created by Stanford professor John Taylor, would have the federal funds rate at 3% now, maybe higher. Evercore ISI expects the 10-year yield to soon break through last December’s 2.6% ceiling, with the yield curve flattening in this year’s second half and the 10-year yield reaching 3% by year-end (that’s far from 4% and we’re still sleeping). Measures of global breadth suggest broadening global growth—86% of individual-country PMIs are in expansion territory, the most since January 2014 and well above the long-term average of 70%—while the OECD U.S. Composite Leading Indicator is signaling strengthening momentum in the U.S. In fact, all the fundamentals for the market look fine—an improving economy, a strong labor market (more below), modest inflation (more below), low interest rates and decent corporate earnings. With the Fed almost certain to raise its target rate next week, Dudack Research offers this observation: Although the last cycle of easy money, from June 2006 to December 2015, was the longest in history, rising interest rates has been the predominant policy over the last 70 years and rarely has hurt equities unless, or until, rates are high enough to trigger a recession. That said, there is truth to the Wall Street adage “three steps and a stumble.” This refers to the fact it usually takes 3 Fed rate hikes to negatively impact stock prices. A rate increase next week would be the third hike in a row and a possible source of anxiety for investors. However, a study of all post-WWII monetary cycles suggests it usually takes 4 hikes in a row before equity prices trend lower 6 and 12 months forward.

All of the attention being placed on Obamacare repeal-and-replace can be boiled down to this: it has to happen before tax reform can happen. Why? Tax reform/relief is next in line in the budget reconciliation queue (meaning it will require only 51 votes to pass). But as Cowen & Co. notes, for that process to start, a 2018 fiscal budget must be passed. So if Obamacare replacement isn’t done by mid-spring or so, it’s almost certain to get dumped into the 2018 fiscal budget with everything else, creating a political quagmire that gums up the works across all fronts. This essentially would make the entire legislative agenda for 2017 a binary event at year-end, with the potential for debt-ceiling fights and no progress on taxes et al as Republicans head for their 2018 midterm elections. Try selling that to voters demanding change. What this means, says political commentator Charles Krauthammer, is Republicans are going to have to realize they must take what they can get on Obamacare changes (not repeal) and move on, appreciating the reality that, “You cannot retract an entitlement once it’s been granted.” The way I see it, the Fed will likely take its time and the Republicans will not let this historic change fall through their fingers. It’s like the long and winding road I took this week; it may take more time, but it can be beautiful.

Positives

Strong jobs report should not precipitate hostile Fed Breadth was strong in February’s jump in nonfarm payrolls, with 63% of industries reporting growth, the highest since December 2015. Goods-producing industries logged an exceptional performance—they jumped the most in the 16 years ADP has been collecting data and in the government’s
monthly report, construction payrolls surged 58K, the strongest 1-month gain since March 2007 (undoubtedly aided by unseasonably warm weather). However, online help-wanted ads sank the most since January 2009 to a 4½-year low, suggesting job growth may moderate in coming months. Importantly, wage inflation remains range-bound at historically modest levels and growth in both y/y household and establishment surveys remain below their l-t averages—a sign of a job market that is growing but is far from robust.

**Inflation Watch** U.S. import prices rose more than expected in February and are now up 4.6% y/y, an improvement from the strong deflationary trend in 2014 and 2015 as the drag from dollar appreciation has faded. Unit labor costs, up 2.6% on a y/y trend basis in Q4 2016, also have strengthened over the past two years, implying modest upward pressure on core PCE inflation. But inflation expectations remain low by historical standards, there are few signs of overheating in the labor market and bank credit has slowed markedly in recent months.

**Lean inventories a plus** Factory orders rose a second straight month and on a y/y trend basis are up the most since September 2014. Nondurables led the increase, although core durables (ex-transportation) had their first y/y gain since November 2014. With the core book-to-bill ratio its highest level since August 2014, the inventory-to-sales (I/S) ratio its lowest since September 2014 and the wholesale I/S ratio also its lowest since December 2014, manufacturers are having to boost production.

**Negatives**

**Trade’s a drag** January’s trade gap widened to a 5-year-high, driven by the second-highest deficit in real goods since 2007. Led by consumer goods, capital goods and automotive categories, ex-petroleum imports have now risen 4 straight months, lifting the non-petroleum trade deficit to its second highest level on record. Trade carved 1.7 percentage points off Q4 2016 GDP and, without improvement, could represent a similar hit to Q1 2017.

**Sagging productivity a headwind, too** The final take left Q4 2016 nonfarm productivity unchanged at a subpar 1.3% annual rate, keeping trend productivity growth at 0.6% y/y, close to its slowest pace since 1983 and a fraction of its historical 2% average. This translates into slower potential growth. It’s expected that tax and regulatory reforms, if they come, will lift this number as businesses feel encouraged enough to ramp up capital spending.

**We can’t blame the weather!** Even with confidence and sentiment gauges at multiyear highs and the best Christmas season in 5 years, there are signs consumers may be taking a breather. The latest was this week’s report on consumer credit, with revolving credit (mainly credit cards) falling for the first time in 11 months and by the largest amount since December 2012. While nonrevolving credit rose respectably—this category includes car financing and student loans—the drop-off in revolving credit caused overall credit to increase by the smallest amount since July 2012.

**What else**

‘You like to-may-toe, I like to-mah-toe’ U.S. sellers of equity mutual funds have appeared on the West Coast and in the Northeast; almost everywhere else, there are net buyers. This is a new phenomenon, the Institutional Strategist says—people investing quite assertively based on either their politics or at least their perceptions of what a change in the political arrangements in the country will do to the economy.

**We passed a few Cracker Barrels on our drive** Cook Political Report observes that Trump won the White House by winning 76% of counties with a Cracker Barrel Old Country Store and 22% of counties with a Whole Foods Market. This 54% gap is the widest ever recorded. When Clinton was elected in 1992, the difference between the 2 was 19%; when Dubya was elected in 2000, it was 31%; and when Obama was elected 2008, it was 43%.

**The women did show up!** All of the increase in last month’s labor force participation rate came from a surge in women in their prime working-age (25-to-54). Interesting, given that this Wednesday was “A Day Without a Woman” day, put together by same groups that organized the Jan. 21 Women’s March on Washington. I showed up at work that day, riding in with the Mister and talking to him over his precious sports radio. He grumbled, “What happened to the day without women?” Another promise broken!
Weekly Update: All over the place in N.C.

Weekly Update: Trump, Trump, Trump ad nauseam

Weekly Update: It's annual review time!

Recent Equity

Orlando's Outlook: Another solid jobs report
Philip Orlando

Orlando's Outlook: Striking the right balance on immigration
Philip Orlando

Orlando's Outlook: Has the post-election consumer turned the corner?
Philip Orlando

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

Personal Consumption Expenditure (PCE) Index: A measure of inflation at the consumer level.

The Markit PMI is a gauge of manufacturing activity in a country.

The OECD composite leading indicator is designed to provide early signals of turning points between expansions and slowdowns of economic activity in member countries.

Yield Curve: Graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.