THE DANA VIEWPOINT

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Dow:20,915

All Aboard

It looks like the Federal Reserve is awakening from their long slumber. They just raised rates at their March meeting, and expect to raise rates twice more in 2017. Why the abrupt shift in sentiment? It's very simple really. The election has brought about a shift from the monetary policy of the last eight years to the current fiscal policy. Monetary policy dictates low interest rates and an expanding money supply which the Fed provided in spades for the last eight years. It has worked in the past. Why not this time (unless you consider a 1.8% average growth in GDP for the last eight years a strong economic growth)? In the past, coming out of a recession, the Fed provided easy money through low interest rates and corporations did their part by borrowing and spending to increase their business. Well, most of us learned a thing or two about money supply this time. It isn't just the supply of money that counts; it is the movement of that money and this time it was different. Businesses borrowed money at low rates alright, but this time they didn't use the money to expand their business. They used the money to clean up their balance sheets and to buy back shares of their common stock. They improved their financial structure and by reducing their number of shares of common stock outstanding, boosting earnings per share. The result was an increase in the wealth of those who owned stocks. This is the wealth effect that Fed Chairman Ben Bernanke said he would create to stimulate the economy. It didn't really work, as increased government spending more than doubled our national debt to $20 trillion and created the income disparity that led to a change in political parties in the White House. Why didn't it work? Well the wealth destruction in the housing market and additional banking and other regulations limited consumers' willingness to spend and businesses' willingness to expand.

That brings us to the current strong stock market (up almost 3,000 Dow points since the election). Why?... Because market participants expect almost all of the new legislation will be pro-business. Stocks rose on previous instances of income tax cuts in the 1960's and 1980's. Trump has plans to restructure our tax code and cut taxes for businesses and consumers. In addition, he wants to reduce the regulatory burden that forced business to the sidelines. We are seeing that

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Congress wants to have a say as well, both Republicans and Democrats. If the tax code can be reformed and regulations on business can be greatly reduced, it should be sufficient to boost economic growth over 3%. Growth we need to continue new job creation and generate tax revenue. Investors seem confident at this point that this administration can pull it off, we'll have to wait and see.

The last two months have shown a sorely needed rebound in the monthly jobs report. The private sector reported an increase of 235,000 jobs for February and 238,000 in January, the highest two-month total since last summer. The market has stayed near all-time highs even as it digested the latest Fed rate increase and promises of more to come. Everyone expects a market correction, and that usually means it doesn't come. It is slightly concerning that we have not even seen an outline of a tax reform plan. The administration is still looking at Dodd/Frank trying to decide whether to repeal it all or just some parts of it. In addition, repeal and replacement of the ACA (Affordable Care Act) is running into pushback from some Republicans. Odds are these plans will come to fruition, but it may take more time than investors expect. Our economy is a big ship and doesn't just turn on a dime. The recovery is still on, and we are only seeing the first phase. The next phase will identify the industry groups that will take over from the first phase leaders.

Random Thought for March 2017: "Life is a progress, not a station". So is the economy.

-Ralph Waldo Emerson

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