MORNING BRIEFING
February 1, 2017

Now the Hard Part

See the collection of the individual charts linked below.

(1) Trump hits the (muddy) ground running. (2) Mud is key feature of Washington's terrain. (3) Hill Republicans want 200 days to implement Trump's 100-day agenda. (4) Running out of momentum, for now. (5) Earnings picture remains bright. (6) Impressive rebound in commodity prices. (7) European economies looking better. (8) Consumer Optimism Index holds post-election gain in January. (9) The best and the brightest wheeler-dealers. (10) Let's make a deal!

Strategy: Mud Pit. President Donald Trump has certainly hit the ground running. He is moving fast to implement his agenda and to deliver on his campaign promises. However, it isn't only Democrats who are setting up lots of obstacles and even landmines to slow, if not stop, his momentum. Even the Republicans in Congress may be starting to rain on his parade so that his agenda will get bogged down in the mud that is a key feature of Washington's treacherous terrain. This might explain why the stock market rally since Election Day through last Wednesday is showing signs of bogging down too.

A 1/27 Reuters article observed: "When President Donald Trump was elected last November, Republican lawmakers enthusiastically joined his call to rewrite the tax code and dismantle Obamacare in the first 100 days of his presidency. But as congressional Republicans gathered for an annual policy retreat in Philadelphia on Wednesday, the 100-day goal morphed into 200 days. As the week wore on, leaders were saying it could take until the end of 2017--or possibly longer--for passage of final legislation. Trump had a different idea when he spoke to lawmakers in Philadelphia, telling them: Enough talk. Time to deliver. The divergent views on the timetable were among many indications of tensions that simmered just below the surface at the three-day Republican retreat."

Trump's popularity rating was the lowest of any incoming president in the history of such polling. If it doesn't improve quickly, Republicans may continue to drag their feet on implementing his controversial agenda. Already, some of them are questioning the need for and the cost of a wall on the border with Mexico, the impact of any new "border tax" that might raise prices to consumers and spark trade retaliation, and the advisability of completely repealing Obamacare.

No wonder the post-election rally has run out of momentum, as investors may be starting to worry that Trump is already running on increasingly muddy ground (*Fig. 1*). Then again, it might be refreshing to focus on other issues that might also be important to the stock market. For example, how about:

(1) *Earnings.* As Joe and I noted yesterday, forward earnings rose to record highs for the S&P 500/400/600 last week (*Fig. 2*). Among the S&P 500 sectors, forward earnings are at record highs for Health Care, Information Technology, and Utilities (*Fig. 3*). They've stalled recently at record highs for Consumer Discretionary, Consumer Staples, Industrials, Materials, and Telecom Services. They are in cyclical recoveries for Energy and Financials.

(2) *Commodity prices.* The CRB raw industrials stock price index continues its V-shaped recovery since bottoming on November 23, 2015 after falling 27% from April 14, 2014's high (*Fig. 4*). It is back to the highest readings since October 2014 and only 7% below 2014's high.

(3) *European economy.* In the Eurozone, real GDP rose 2.0% (q/q, saar) during Q4-2016, faster than the revised 1.6% expansion seen in the previous quarter, a flash estimate from Eurostat showed yesterday. The Eurozone Economic Sentiment Indicator (ESSI) rose to the highest since April 2011 last month (*Fig. 5*). That's a good sign for the growth in real GDP on a y/y basis, which is highly correlated with the ESSI.

In Europe, new passenger car registrations in the European Union plus the European Free Trade Association (Iceland, Norway, and Switzerland) rose to a record high of 15.1 million units last year (*Fig. 6*). In the Eurozone, the volume of retail sales excluding motor vehicles edged down in November from October's record high (*Fig. 7*). This measure of sales volume is up 2.2% y/y, a solid increase.

(4) *Consumer confidence.* Debbie and I average the monthly Consumer Sentiment Index and the Consumer Confidence Index to derive the Consumer Optimism Index (COI) (*Fig. 8*). In January, it held onto its big gain following Election Day. The COI current conditions index actually edged up to the highest since July 2007, while the COI expectations index moved ever so slightly lower.

Trump World: Wheeler-Dealers. President Trump has nominated people to his Cabinet who are mostly business executives rather than professional politicians. Actually, several of them have made big bucks making big deals for a living, from Wall Street bankers to Hollywood producers. A 1/5 *FT* article by Gillian Tett, titled "Donald Trump unleashes business's animal spirits," reported that Trump's top eight officials (president, vice-president, chief of staff, attorney-general, and secretaries of State, Commerce, Defense, and Treasury) had only 55 years of government experience but 83 years in business. Obama's comparable team had 117 years in government, but ONLY five years in business IN TOTAL.

So far, my take is that Trump's Cabinet members will be focused on driving US economic growth. Led by these business professionals in government, corporate earnings soon should benefit from lower taxes and a relaxed regulatory environment. Fairer trade deals soon should calm protectionist sentiments among Trump's supporters. Trump's Cabinet will hustle to take action, because they're hustlers by nature. They like to make deals that work. I asked Melissa to provide us with background on a few of those Cabinet members who might have the most influence over US economic policy under Trump. She reports:

(1) *Steven Mnuchin (Treasury secretary)* was born with Wall Street in his blood. For 17 years, the financier and banker worked for Goldman Sachs, following in his father's footsteps at the same firm. Before starting his career, Mnuchin went to a wealthy prep school in New York, then attended Yale University. Mnuchin also happens to have experience working in Hollywood circles, having financially backed several films including Fox's "Avatar." Even so, several sources have described Mnuchin as one who avoids the limelight.

Nevertheless, Mnuchin seemed eager to jump into his new role and publically support President Trump's economic platform in a 11/30 CNBC interview. It immediately followed his nomination. The former banker echoed Trump's plan to prioritize growth. "I think we can absolutely get to sustained 3-to-4% GDP and that is absolutely critical for the country," he said. He added: "To get there, our number one priority is tax reform. This will be the largest tax change since Reagan … We're going to get [the corporate tax rate] to 15% and bring a lot of cash back into the US." However, he warned that there would be offsets in deductions and personal income taxes: "There will be no absolute tax cut for the upper class," Mnuchin emphasized.

On the other hand, Mnuchin seems more likely to favor a middle road on regulatory reforms, particularly for banks. That sounds less extreme than Trump's position; he pledged on Monday to "do a big number" on Dodd-Frank. During his congressional hearing for the nomination, Mnuchin said: "I support the Volcker Rule, but there needs to be proper definition around the Volcker Rule so banks can understand what they can do and what they can't do."

The hearing before the Senate Finance Committee got off on a contentious foot, with Republican Pat Roberts (KS) advising Democrat Ron Wyden (OR) to take a Valium. Democratic leaders heavily questioned Mnuchin's purported profiting from aggressive foreclosure practices during the financial crisis in his role as chairman of OneWest bank (formerly IndyMac, the distressed bank that Mnuchin bought from the FDIC in December 2008). Defending himself during a CNBC interview conducted earlier, Mnuchin had showed no shame--on the contrary: "We bought $150 billion mortgage servicing portfolio from the government that we took as part of the deal. Mostly all third party loans. We were the only bank to go through and have highly-rated servicing for the entire period of under our ownership and we're very proud of that."

(2) *Wilbur Ross (Commerce secretary)*. At a December victory rally in Cincinnati, Trump defended his nomination of Wilbur Ross for Commerce secretary as follows: "One of the networks said, 'Why, [Trump] put on a billionaire at Commerce!' Well, that's 'cause this guy knows how to make money, folks … I put on a killer." A very comprehensive BloombergBusinessweek piece titled "Wilbur Ross and the Era of Billionaire Rule" details Trump's defense of his choice of Ross.

Indeed, Ross is a wealthy man with an estimated net worth of $2.5 billion. Ross grew up accustomed to a respectable level of affluence with an attorney for a father and a school teacher for a mother. Even so, Forbes rates him with a self-made score of 7 on a scale of 1 to 10 (with 10 being the most "self-made"). His monetary success came primarily from investing in distressed businesses, restructuring failed companies in steel, coal, telecommunications, foreign investment, and textiles. Ross has been criticized for a lack of humanity in some of his dealings, including a fatal incident involving one of his coal investments. He's been described as "emotionless" when it comes to business.

Ross' expertise lies in bankruptcies, and that is where his connection to President Trump first began. Ross ran the bankruptcy division of Rothschild & Sons for 24 years. During the 1980s, when he was senior managing director of the shop, Ross helped Trump to avoid foreclosure on several of his casinos. Fast-forward to recent times: Ross was a close adviser to Trump during his campaign, co-authoring with economist Peter Navarro two influential white papers (one on trade and one on infrastructure) that are expected to become the basis for important policies under the new administration.

Now, "Ross is positioned to become the most powerful Commerce boss in years," explained the BloombergBusinessweek article: "Ross would oversee the census, patents, economic analysis, the development of minority-owned businesses, and even … the monitoring of the effects of climate change. In addition, Trump has said he'll direct Ross to identify every violation being committed under existing trade agreements, and a Trump spokesman has said Ross will be the administration's leader on setting trade priorities, a role usually reserved for the U.S. Trade Representative."

It's interesting that Ross doesn't seem to have a hard stance for or against free trade. BloombergBusinessweek observes that Ross historically has chosen the side that will make him the most money. "I am not anti-trade. I am pro-trade. But I am pro-sensible trade, not trade that is detrimental to the American worker and to the domestic manufacturing base," Ross told the Senate Commerce, Science and Transportation Committee, as reported by Reuters. In any event, Ross is viewed as pro-business. David Butters, the CEO of Navigator Holdings, said that having a fellow executive on the inside track of the White House will finally allow business leaders to make a difference.

(3) *Gary Cohn (National Economic Council director)* is another Goldman Sachs alumni in an influential position at the White House. Two former colleagues of Gary Cohn described the 6-foot-3, 200-pound banker as intimidating. He would sometimes "plant his foot on a trader's desk" and "ask how markets were doing," they told Bloomberg. President Trump seems to appreciate that style. "Gary is brash; he has no trouble interrupting Trump," a source told *New York Magazine*.

Cohn had modest beginnings, growing up in Ohio with his mother and father, an electrician, and graduating from American University. A trader at heart, Cohn started out his career on Wall Street as an options dealer on the New York Mercantile Exchange. He got the job by lying to the hiring manager about his experience during a chance meeting, then taught himself about options before the interview. Goldman Sachs recruited Cohn in 1990, and he worked his way up to president and co-chief operating officer by June 2006.

Since becoming the sole president and COO in 2009, Cohn made at least $123 million in total compensation. The investment banker will receive a cool $285 million exit package upon leaving his post. Goldman is accelerating a portion of that pay to allow him to comply with conflict-of-interest standards. Even so, the ethics of the move is now being questioned. Cohn was expected to succeed Lloyd Blankfein as CEO of Goldman. That was until December 12, when Trump announced Gary Cohn as his pick for director of the National Economic Council. So far, Cohn hasn't made many public statements since accepting the nomination other than a vague one provided by the Trump transition team.

(4) *Anthony Scaramucci (liaison)* will coordinate the administration's engagement with the US business and political community, cultivating relationships between the White House and executives in the financial and technology sectors. His position is similar to the job held by one of President Obama's most powerful advisers, Valerie Jarrett, who directed the Office of Public Engagement and Intergovernmental Affairs. Scaramucci was a hedge fund manager and a top fundraiser for Trump's campaign.

Scaramucci was the sole representative of the new administration at Davos, and spoke on January 17. He has a sense of humor, saying, "This is my 10th year here, but my first year here with a food taster." On trade, he said, "The United States and the new administration does not want to have a trade war," Mr. Scaramucci said. What Trump does want is trade that has more "symmetry."

In response to the keynote speech by Chinese President Xi Jinping on that same day, Scaramucci said, "We want to have a phenomenal relationship with the Chinese." But he added, "they have to reach now towards us and allow us to create this symmetry because the path to globalism for the world is through the American worker and the American middle class."

CALENDARS

US. Wed: ADP Employment 168k, Motor Vehicle Sales 17.7mu, Construction Spending 0.2%, MBA Mortgage Applications, ISM M-PMI 55.0, EIA Petroleum Status, FOMC Meeting Announcement. **Thurs:** Jobless Claims 253k, Productivity & Unit Labor Costs 1.2%/1.8%, Weekly Consumer Comfort Index, Challenger Job-Cut Report. (Bloomberg estimates)

Global. Wed: Eurozone, Germany, France, and Italy M-PMIs 55.1/56.5/53.4/53.3, UK M-PMI 55.9. **Thurs:** Japan Consumer Confidence, BOE Rate Decision 0.25%, BOE Asset Purchase Target 435b, BOE Inflation Report, ECB Publishes Economic Bulletin, BOJ December Minutes, Draghi, Carney.

(DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Earnings Season Monitor (*link*): With 35% of S&P 500 companies finished reporting Q4-2016 results, their revenue and earnings surprise metrics are weaker than at the comparable point of the Q3 season. On a mixed note, their y/y earnings growth comparisons are stronger, but y/y revenue growth has slowed. Of the 175 companies in the S&P 500 that have reported, 66% exceeded industry analysts' earnings estimates by an average of 2.7%; they have averaged a y/y earnings gain of 9.1%. At the same point in Q3-2016, a higher percentage of companies (78%) in the S&P 500 had beaten consensus earnings estimates by a larger 7.1% and earnings were up a smaller 4.3% y/y. On the revenue side, 49% beat sales estimates so far, coming in 0.2% above forecast and 3.2% higher than a year earlier. During Q3, a higher 63% were above forecast, which exceeded estimates by a similar 0.2% and rose a smaller 2.7% y/y. Q4 earnings results are higher for 75% of companies versus 69% at the same point in Q3, and revenues are higher for 70% versus 72%. These figures will continue to change markedly as more companies report Q4 results, but early data suggest Q2-2016 was indeed the bottom for y/y earnings growth.

US ECONOMIC INDICATORS

Consumer Confidence Index (*link*): Consumer confidence in January retreated a bit from December's 15-year high, as expectations eased. The Consumer Confidence Index slipped to 111.8 in last month after soaring from 100.8 in October to 113.3 in December--the highest since August 2001! It's up 19.4 points from last year's low of 92.4 in May. The present situation component recovered to 129.7 in January after slipping from a cyclical high of 132.0 in November to 123.5 in December. The expectations component dipped to 99.8 after jumping 20.4 points the final two months of 2016 from 86.0 to 106.4--the highest reading since December 2003. According to the Conference Board, "Despite the retreat in confidence, consumers remain confident that the economy will continue to expand in the coming months." The current job outlook improved, with jobs plentiful (to 27.4% from 26.0%) slightly higher and jobs hard to get (21.5 from 22.7) slightly lower; the former is fluctuating around cyclical highs, the latter around cyclical lows. Consumers' six-month job outlook has soared since the election, with those expecting more jobs (19.8 from 21.7) exceeding those expecting fewer jobs (14.0 from 14.1) for the third month last month. That result follows a long string of declines--with January's spread (5.8 from 7.6) holding near December's reading, which was the largest margin since May 2002.

Employment Cost Index (*link*): Gains in compensation costs remained subdued last quarter. Private industry compensation increased 2.2% y/y during Q4, slowing slightly for the second quarter from Q2's 2.4%, which had accelerated from 1.8% during Q1. The rate for wages & salaries eased from 2.6% to 2.3% y/y during the final two quarters of last year, while the rate for benefits' costs ticked up slightly from 1.7% to 1.8%. For Q4, increases remained in line with prior quarters, with compensation costs climbing 0.5%--fluctuating between 0.5% and 0.6% the past six quarters. The quarterly gain in wages & salaries held at 0.5% last quarter, down from 0.7% at the start of 2016, while benefits costs slowed from 0.5% to 0.4% during Q4, in line with the prior five quarters.

GLOBAL ECONOMIC INDICATORS

Eurozone CPI Flash Estimate (*link*): January's CPI rate is expected to be 1.8% y/y, according to the flash estimate--the highest since February 2013 and near the ECB's inflation target of just under 2.0%. That would be the eighth straight reading above zero following sub-zero readings the prior four months. Of the main components, energy (to 8.1% from 2.6% y/y) by far is expected to have the highest annual rate in January--having turned positive in December for the first time since summer 2013--followed by food, alcohol & tobacco (1.7 from 1.2), services (1.2 from 1.3) , and non-energy industrial goods (0.5 from 0.3).

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