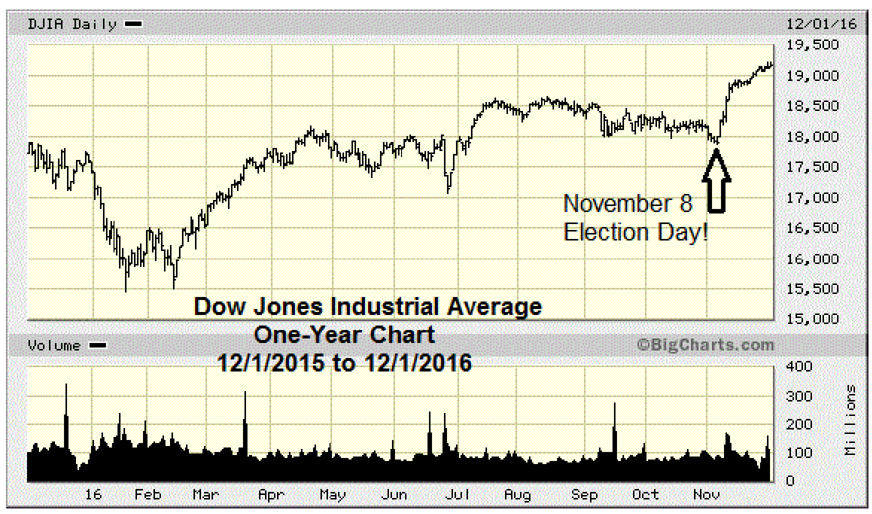
American Heritage Financial

December **Update** **December 1, 2016**

A New Era

Long-time Akronites know ***New Era*** as an iconic but unusual Hungarian restaurant specializing in *Chicken paprikash*. The *New Era* that financial markets seem to have entered since the presidential election is also unusual—and might also prove to be a bit spicy!

The financial world could be getting ahead of reality by considering the post-election period as the start of a *New Era*. There have been plenty of past episodes of irrational market action and this could be another of those times. On the other hand, based on proposals coming out of the new administration, there is a chance we may be entering an entirely *New Era for the markets and economy*.



Since the election, investors have aggressively thrown money at stocks that are expected to benefit from a new vitality in the economy. From the day after the surprising victory of "businessman" Trump, to the end of November, the Dow Jones Industrial Average gained 4.3%. Better evidence that *investors are being driven by expectations of Trump polices* is the move in the Russell 2000—an index of smaller companies which are **more U.S. focused** than the Dow. The Russell 2000 index gained a whopping 10.7% in the post-election November period. The dollar has moved to multi-year highs while **the most dramatic change has been in the bond market**—more on that below.

The thinking is that investors turned bullish because Trump, along with a Republican-controlled Congress, is likely to lower and reform taxes, reduce regulation, initiate massive infrastructure spending and renegotiate trade deals—and all will be done in ways to boost the economy and favor (mostly) U.S. focused corporations. Growth has been frustratingly meager since the financial crisis of 2008. Artificially low interest rates have been the only tool used to help the economy but low rates have not been enough to spur true growth in the face of corporate bashing, increasing regulation and a focus on social issues over economic problems. It is easy to see that breaking the gridlock which has suppressed the economy for so many years could result in a huge boost in economic growth. (One caveat to the post-election euphoria is that the economy had already been showing a significant pick-up over the past two months—see our comments on the jump in third quarter GDP in last month's *Market Comment*.)

We share the optimism that has overtaken financial markets but, as with all things in the market, *caution that expectations have gotten ahead of future reality, is a big concern.* There definitely will be roadblocks ahead for both the economy and the stock market.

Two clear, factual financial roadblocks are in the market reactions mentioned above: the **U.S. Dollar** and **interest rates**. The dollar's value hit a 13-year high recently, rising about 4% against the world's most popular currencies in just three weeks. A stronger dollar will be a challenge for U.S. manufacturers because it makes America's exports, such as cars, more expensive and less attractive to foreign buyers. At the same time, it makes imports cheaper—conditions which won't make it any easier for Trump to deliver on trade promises.

Short-term interest rates, controlled by the Federal Reserve, had already been certain to rise in December due to encouraging economic data. Much more significant is **skyrocketing long-term interest rates.** We mentioned in last month's *Market Comment* that Ten-year Treasury rates rose from 1.55% to 1.85% in October. The Ten-year yield is **2.4%** (and still rising) as of December 1. It is truly refreshing to think that we may soon get a reasonable rate from bonds, CD's and money market funds but those higher yields will increase the cost of borrowing for all Americans, especially those who want to buy houses and cars.

Interest rates are spiking due to concerns that a massive infrastructure-spending plan, on top of tax cuts, will add to America's already-massive debt load as well as spur inflation. Of course, increased deficits could also create a roadblock from the more fiscally conservative Republicans in Congress.

Infrastructure spending is the most problematic of the proposals supporting the notion of a new financial era but re-writing regulations relating to health-care (Obamacare) and banking (Dodd-Frank) along with tax code revisions and new trade deals will also be much **more difficult to implement than they were to promise.** There is no question, a new approach to our economic malaise is needed and, like him or not, Trump seems to be a man who get his way. Maybe we are entering a new financial era of organically functioning free markets without the Fed's artificial haze of low rates. **Only time will tell**. In the meantime we have made adjustments to portfolios in anticipation of better growth and higher interest rates and we will continue to monitor the outlook as we attempt to differential *New Era* promises from *reality*.

We hope you and your family will take a break from your busy world, non-stop politics and the confusing economy to relax and enjoy the upcoming Holidays! All of us at American Heritage Financial extend our Best Wishes for a healthy and prosperous 2017!

Best regards,

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Questions or comments?

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