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John Dessauer's market review and update as of Wednesday February 8, 2017

The post-election victory celebration is over. Markets are settling down, taking measure of how difficult it will be to govern, to accomplish needed reforms.

The post-election surge in consumer confidence and broad stock market indices was a celebration that the dismal economic days under Obama are over. According to data from the Bureau of Economic Analysis (BEA) average annual economic growth during Obama's eight years was worse than during any of the previous ten presidents. The average annual growth rate during Obama's tenure was 1.46%. That is far below the 3.47% during Reagan's eight years and below the 2.10% during Bush II's eight years. It is also below Johnson (5.29%), Kennedy (4.33%), Clinton (3.87%), Carter (3.25%), Eisenhower (3.00%), Nixon (2.81%), Ford (2.56%), and Bush I (2.25%). Even more telling, Obama is the only president in this group of eleven that did not have a single year when the economy grew at a 3.00% rate. In sharp contrast Clinton and Reagan had six years when growth was 3% or better and Bush II had two years.

It is hard to accept excuses about the 2008 financial crisis being to blame. Reagan took over just as the economy plunged into the worst recession since the great depression. Yet his administration was able to deliver a strong recovery with the economy growing at 3.00% or better for six out of his eight years. In the 1980s, during the Reagan economic recovery, as unemployment declined, the cry from the left and much of the media was to accuse the president of creating "hamburger flipping" jobs. At first there were many part-time jobs being created. Later the job situation improved markedly and the "hamburger flipping" accusation died away. The left today tries to cover up the Obama job situation by focusing on the low unemployment rate. There has been no "hamburger flipping" accusation leveled at Obama even though the low wage, part-time job creating has persisted right up to his last days in office.

In January non-farm payrolls increased by 227,000 jobs, the best gain in four months. While that sounds good, the details are disappointing. Unemployment rose one-tenth of one percent, to 4.8%. November and December job creation figures were revised down by 39,000 jobs. A broad measure of unemployment that includes people who want to work but have given up searching and those working part-time because they cannot find full-time employment rose two-tenths of a percent to 9.4%. The biggest disappointment of all was the 0.1% average hourly wage gain. That was far below expectation of a 0.3% increase. And December's wage gain was revised down to 0.2%. Minimum wage increases took effect in 19 states in January. That was supposed to boost overall wage gains, but it did not. No wonder the anemic January wage gain came as such a big disappointment to so many.

President Reagan was in office during and right after the deep recession of 1982. President Trump takes office eight years after the recovery began. Arguably his economic challenge is greater than was Reagan's. The economy has suffered a painfully slow recovery due at least in part to Obama administration policies. Trump will have to both change policies that have hampered growth and adopt new measures in hopes of repairing the damage and boosting growth. That will take time.

Both President Trump and the Republicans in Congress are currently working to sort out priorities. At the moment they are focusing on health insurance reform because the financial structure of the Affordable Care Act (Obamacare) is falling apart. Insurance companies have dropped out of the exchanges. Hundreds of millions of dollars owed to insurance companies that lost money because they participated in the Affordable Care Act have not been paid. Both health insurance deductibles and premiums are rising fast. The cost of subsidies is greater than anticipated. It is understandable that Republicans are absorbed in dealing with what could soon become a national health insurance crisis.

President Trump and the Republicans are also working on tax reform. But as Professor Mark Perry of the University of Michigan points out, President Trump would fail Economics 101 when it comes to international trade. He is not alone. Others in the House and Senate also do not understand that imports and exports are two sides of the same coin. Taxing imports and subsidizing exports risks pushing the already strong dollar to new heights. Beyond trade issues, the President has expressed his displeasure with some tax reform proposals calling them "too complicated." Experts at Morgan Stanley looked at the current tax reform discussions and came away with two conclusions: "Tax reform may contain disruptive elements that blunt its economic positives, and tax reform is not a given." Governing a nation the size and complexity of the United States is never easy. Given today's long standing anemic economy and the sharp divisions among politicians and voters, reforming health insurance and taxes will be difficult even though Republicans control all three branches of government.

The bottom line, according to Morgan Stanley is: In the end, we still see Republicans delivering tax-reform-driven stimulus, supporting US GDP growth at 2% in 2017 and 2018, as compared with the slowdown we envisioned prior to the election."

Personally, I think forecasting growth in 2018 is premature. There are just too many moving parts. I agree that 4% is way too optimistic for this year and that 2%-2.5% is far more likely.

The evidence from quarterly earnings is that companies are doing quite well in this slow growth environment. The earnings recession is over and a new cycle of earnings growth has begun. With earnings in from more than half the S&P 500 companies, year-over-year profit growth for the fourth quarter is now estimated at 8.0%, up from 6.1% forecast at the beginning of January. The final quarter of 2016 is on track to be the best for earnings growth since the third quarter of 2014. Analysts are now forecasting this quarter's earnings growth at 11.5%. Earnings growth will be followed by dividend growth. Stocks are likely to trade in a narrow range while earnings catch up with the stock market's post-election surge. However, if quarterly earnings continue to grow at double digit rates, stocks will move higher in coming quarters. If President Trump and the Republicans successfully negotiate health insurance and tax reform, then the long term outlook for stocks will be very bright.

I will have the next market review and update for you one week from today on Wednesday February 15, 2017.

All the best,

John Dessauer