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US Market Commentary

The S&P 500 rose 3.1% in November, bringing year-to-date gains to 20.5%. After 13 straight monthly gains—the second-longest on record—some question whether the streak can continue. However, markets aren't serially correlated, and they move on fundamentals. Streaks like this are fun trivia, but they aren't predictive.

Trade and taxes dominated policy discussions in November, but they are unlikely to derail stocks. President Trump went to China in early November, but anyone expecting harsh anti-trade campaign rhetoric to carry through was left disappointed. Trump met with President Xi Jinping without rancor and praised China instead. Rather than announcing punitive tariffs, Trump touted over $250 billion in new bilateral investment and spending deals. This is a far cry from worries over rising trade barriers when Trump entered office, and is emblematic of how the Trump administration's actions on trade differ from tough campaign rhetoric. It is also fairly typical. Every president since Lyndon Johnson has talked tough on trade on the campaign trail only to change tune once in office.

While NAFTA talks got tougher during November, the deal still seems unlikely to collapse. The negotiations' fifth round—concluded November 21—failed to resolve issues such as rules of origin, investor dispute resolution and how government contracts are awarded. With talks scheduled to conclude in March, many fear the clock is ticking, but this is an arbitrary deadline—easily extendable. Although it is possible US trade negotiators walk away and Trump invokes NAFTA's six-month withdrawal notice, threats to do so are likely a negotiating tactic. As discussed in past writings, many states that voted for Trump—including Texas—are among NAFTA's biggest beneficiaries and cheerleaders. Alienating these voters by abandoning NAFTA would be an odd move politically. Trade talks are often contentious, but all parties have a vested interest in compromise.

Tax reform remained in the spotlight as the House passed a bill early in the month and the Senate was finalizing its own bill at month's end (it passed in December's opening days). Despite the apparent progress, however, we believe it remains premature to assess the potential impact. The House and Senate's bills are quite far apart—the differing number of individual tax bands is only one notable difference—and Trump has implied the final corporate tax rate might exceed the 20% in both bills. Lawmakers hope to reconcile the bills, pass the revised plans and have a final package on Trump's desk by Christmas. Perhaps they do, or perhaps it takes longer (or falls apart). Either way, the likelihood of meaningful market impact (for good or ill) appears low. As is usual, the debate has played out publicly, weakening potential surprise power, and lawmakers have already watered their plans down heavily. As for economic impact, history shows temporary tax changes—as these will likely be—have little impact, as businesses focus on gaming the short-term cuts rather than executing new long-term business plans. Plus, taxes are only one driver of investment decisions. Other factors—economic outlook, customer demand, etc.—matter much more.

On that note, economic drivers remained strong in November. Q3 GDP growth was revised up to 3.3% annualized, faster than the preliminary estimate's 3.0% and Q2's 3.1%. While better than expected, it is also two months past, and the upward revision came mostly from inventories, which are always open to interpretation. Yet more recent data show ongoing growth in Q4, even as the economy works through hurricane-related skew. October retail sales rose 0.2% m/m, slowing from September's 1.9%. The slowdown mostly reflects a return to normal spending behavior after a rebuilding and replacement surge to repair hurricane damage. This was also visible in broader personal consumption expenditures, which moderated to 0.3% m/m growth in October from September's 0.9%. October industrial production accelerated to 0.9% m/m from September's 0.4%, but much of the jump stemmed from hurricane effects. Excluding those, industrial output advanced 0.3%.

More forward looking, in our view, the Institute for Supply Management's manufacturing purchasing managers' index (PMI) hit 58.7 in October (readings over 50 indicate expansion). Although a bit lower than September's 60.8, a high-50s reading indicates manufacturing growth is broad based. It should also continue, as forward-looking new orders hit 63.4. Furthermore, ISM's non-manufacturing PMI rose to 60.1 in October from September's 59.8. This was the highest level since its 2008 inception and suggests the US's services-based economy is in fine shape. The outlook remains strong, too, with New Orders at 62.8. Also looking ahead, the Conference Board's Leading Economic Index (LEI) rose 1.2% in October, while September's reading was revised to 0.1% from -0.2% m/m, extending its positive streak to 14 months. No recession has ever occurred in the LEI's nearly 60-year history when it is high and rising.

Outlook:

While we will unveil our formal 2018 forecast in the coming weeks, we see no signs of a bear market forming. Economic growth continues in the US and globally, with leading indicators pointing positively. With the GOP spending significant political capital on tax reform efforts, the likelihood of sweeping legislation from here appears low. And sentiment, while more optimistic, remains short of the euphoria that usually accompanies market peaks.

Sources: The Conference Board, FactSet, US Bureau of Economic Analysis, US Census, US Federal Reserve, Institute for Supply Management.

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