THE AUSTIN ADVISOR

January 3, 2017

Markets	26-Dec	27-Dec	28-Dec	29-Dec	30-Dec	YTD%	31-Dec-15
DJIA	N/A	19,945.04	19,833.68	19,819.78	19,762.60	13.42%	17,425.03
S&P 500	N/A	2,268.88	2,249.92	2,249.26	2,238.83	9.53%	2,043.94
NASDAQ	N/A	5,487.44	5,438.56	5,432.09	5,383.12	7.50%	5,007.41
SNL Bank Index	N/A	541.41	535.82	530.88	532.65	23.45%	431.48
Fed Funds Rate	N/A	0.66%	0.66%	0.66%	0.66%		0.35%
1 Month LIBOR	N/A	N/A	0.77%	0.77%	0.77%		0.43%
3 Month LIBOR	N/A	N/A	1.00%	1.00%	1.00%		0.61%
3 Month T-Bill	0.52%	0.51%	0.53%	0.47%	0.51%		0.16%
1 Year Treasury	0.87%	0.89%	0.90%	0.85%	0.85%		0.65%
2 Year Treasury	1.22%	1.28%	1.26%	1.22%	1.20%		1.06%
3 Year Treasury	1.54%	1.58%	1.55%	1.49%	1.47%		1.31%
5 Year Treasury	2.04%	2.07%	2.02%	1.96%	1.93%		1.76%
10 Year Treasury	2.55%	2.57%	2.51%	2.49%	2.45%		2.27%
30 Year Treasury	3.12%	3.14%	3.09%	3.08%	3.06%		3.01%

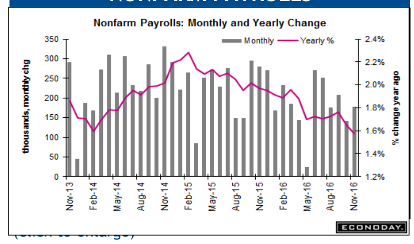
Economy		Week of December 26, 2016
Consumer Confidence	113.7	Another huge jump following the election, with the index up from 98 in October as consumers are poised to increase spending

Calendar	Release	Covering	Week of January 2, 2017
ISM Index	Tuesday	December	The index was at a 12 month high in November, and is expected to move up slightly to 53.8 from 53.2
Motor Vehicle Sales	Wednesday	December	Sales are running at very high rates, but are down from the huge 2015 results; with expectations at 17.7M, down from 17,9M
Unemployment Rate	Friday	December	The rate dropped to 4.6% in November, a post recession low and is expected to tick up to 4.7% for December
Nonfarm Payrolls	Friday	December	Another month of trend-line growth at +175,000 is the consensus forecast, but it depends on the size of the workforce
Avg. Hourly Earnings	Friday	December	The -0.1% decline reported for November is expected to be a quirk in the data, with a strong +0.3% expected for December
Trade Deficit	Friday	November	The deficit is expected to widen to -$44.4 Billion from -$42.6B and will have a big impact on 4th Qtr Real GDP

WEEKLY HIGHLIGHT

The new year brings many reasons to expect a much better economy in 2017

NONFARM PAYROLLS



MONDAY MUSING

From time to time, a reader of this weekly missile will submit a joke they think I can use. I have kept them in a file which I clean out at the end of the year. As I do, I look for the worst story submitted in the last year. Here it is. A group of chess champions gathered in the lobby of a hotel hosting a tournament. They spent an hour talking about each of their victories, at which point the hotel manager asked them to leave. The manager said, "I can't stand chess nuts boasting in an open foyer." It does not get worse than that.

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Commentary

Another year starts and I am looking forward to finding 52 different ways to the say the same thing each week. The U.S. economy is expanding at a faster rate than anytime since the recession of 2008-09. This expansion is being driven by higher levels of **consumer final demand** than has been the case in the past five years. Job growth has driven **consumer confidence** higher and has led to better growth in incomes. Consumers were unwilling to expand spending following the recession, and used the time to pay down debt and rebuild liquidity by increasing savings. The savings rate has run well above 5% over the past three years. The liquidity added to the economy by **the Fed** between 2010 and 2014 was not used to increase consumption. It has been used to increase deposits in the banking system and to refi mortgages to lower rates. This has resulted in excess liquidity in most banks.

This liquidity will keep banks from raising deposit rates as much as the increase in market rates in 2017. An increase in **consumer spending** and higher rates available in alternative products, such as money market mutual funds, should drain liquidity out of the banking system. Deposit rates will move higher as liquidity declines in the system. This will only get worse should the Fed decide to shrink their balance sheet by not replacing the cash flow from their current portfolio. That move will remove liquidity from the system. The increase in spending, some of which will be funded out of current bank deposits, will add to the change. While deposit rates have not changed since the surge in market rates and the increase by the Fed in mid-December, we do expect upward pressure on funding costs in the industry in 2017. We have been told by a few clients they have raised their loan pricing in the last month, but this is not universal and there are still loans being quoted well below a bank's current loan portfolio yield. This will drive earning asset yields lower. The rise in market rates will soon begin to offer an alternative to loans as an asset growth opportunity. Banks can raise their current earning asset yield by buying intermediate term bonds. Market rates are beginning to price in an inflation risk premium, even though inflation data remains stable at levels below the Fed's target.

Our forecast calls for inflation to increase in 2017, driven by higher labor costs. The **labor market** is tight with many employers unable to find qualified employees for the open positions they have. This should cause wage rates to rise at a faster pace. Continued job growth and rising wages is driving consumer confidence measures up to post recession highs. All of this is occurring without consideration of the possible fiscal stimulus from tax cuts, federal government spending programs and the lower cost of reduced regulations. We continue to see a strong growth of well above 3% for Real GDP this year.

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