THE AUSTIN ADVISOR

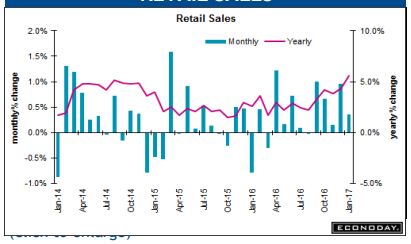
February 21, 2017

Markets	13-Feb	14-Feb	15-Feb	16-Feb	17-Feb	YTD%	30-Dec-16
DJIA	20,412.16	20,504.41	20,611.86	20,619.77	20,624.05	4.36%	19,762.60
S&P 500	2,328.25	2,337.58	2,349.25	2,347.22	2,351.16	5.02%	2,238.83
NASDAQ	5,763.96	5,782.57	5,819.44	5,814.90	5,838.58	8.46%	5,383.12
SNL Bank Index	544.93	554.25	560.01	558.50	557.50	4.67%	532.65
Fed Funds Rate	0.66%	0.66%	0.66%	0.66%	0.66%		0.55%
1 Month LIBOR	0.77%	0.77%	0.77%	0.78%	0.78%		0.77%
3 Month LIBOR	1.04%	1.04%	1.04%	1.06%	1.05%		1.00%
3 Month T-Bill	0.52%	0.54%	0.54%	0.53%	0.53%		0.51%
1 Year Treasury	0.82%	0.84%	0.86%	0.82%	0.82%		0.85%
2 Year Treasury	1.20%	1.25%	1.27%	1.22%	1.21%		1.20%
3 Year Treasury	1.48%	1.53%	1.57%	1.50%	1.48%		1.47%
5 Year Treasury	1.92%	1.98%	2.01%	1.95%	1.92%		1.93%
10 Year Treasury	2.43%	2.47%	2.51%	2.45%	2.42%		2.45%
30 Year Treasury	3.03%	3.07%	3.09%	3.05%	3.03%		3.06%

WEEKLY HIGHLIGHT

Economic data was strong across the board last week, bringing a possible move in March by the Fed

RETAIL SALES



Economy	Week of February 13, 2017	
Producer Price Index	0.6%	The large monthly increase was a function of higher energy prices, but the core rate was up a big 0.4%
Consumer Price Index	0.6%	The biggest one month jump in the last four years, bringing the YOY increase up to 2.5% and the core at 2.3%
Retail Sales	0.4%	Sales were well above expectations, even as auto sales growth slowed, with sales up 0.8% excluding autos
Industrial Production	-0.3%	The decline was all due to a warm January and lower utility output, with manufacturing up 0.2% and +0.5% excluding auto's
Capacity Utilization	75.3%	The industrial sector remains sluggish, with a low operating rate keeping inflation pressures very low
Housing Starts	1.246 Million	This data was down from a large upwardly revised 1.279M for December, with multi-family the sector reporting weakness
Leading Indicators	0.6%	The index jumped in January following a strong 0.5% rise in December, indicating a strong economy through year end

MONDAY MUSING

The weather we have been having has been great. Who can complain about 60 degree days in February, but sometimes I get a little ahead of myself. I was on the deck of our house this last weekend enjoying the sun but most of all I loved the sweet aroma of the warm air. I called my wife out of the house so she could experience this same joy. She was not impressed and told me I was standing by the dryer vent inhaling the scent of the fabric softener.

Calendar	Release	Covering	Week of February 20, 2017
Presidents Day	0.00		Financial Markets Closed
Existing Home Sales	Wednesday	January	The lack of inventory of homes for sale is the limiting factor, but this is expected to change with this report at 5.575M
FOMC Minutes	Wednesday		The minutes from the January meeting will be reviewed to determine the consensus view on the board towards policy
New Home Sales	Friday	January	This data is very volatile but is expected to rise to 576,000, after dropping from over 630,000 last summer

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Commentary

Another week of strong economic data. The data last week was strong across the board. The highlights include **retail sales** up 0.4%, housing starts at 1.246 million and manufacturing activity up 0.3%. All of these were well above expectations and the results of the fourth quarter of last year. The retail sales data was very strong. December was revised up to a 1% increase, with much stronger auto sales for the month. The better measure of **consumer final demand** is retail sales, excluding auto sales. That increase was a positive 0.8% for January. Along with faster growth came the higher inflation data. The **CPI** rose 0.6% for the month and now has risen 2.5% YOY. The core rate was up 0.3%, bringing the YOY increase up to 2.3%. This measure of **inflation** is now above the Fed's target of 2%. The **PPI,** which has been held down with low energy prices, was also up 0.6% for the month. This index is now up 1.6% YOY and the core rate is up 1.2%. This is only one month of price data, but the risk is this is the beginning of higher inflation as the economy continues to expand at a faster rate and the **Fed** gets behind this increase with changes in **monetary policy**.

Chairwoman Yellen testified before Congress last week. She did not send a stronger signal the might move again at its March meeting. The data did cause the probability of another managed rate hike as reflected in the Fed Funds futures market to move up to 25% from near zero. **Market interest rates** did move up the upper end of their trading range of the last three months. The two-year finds resistance at 1.25%, the five-year at 2% and the ten-year at 2.5%. The spread between the two-year and the ten-year has remained at 125 basis points since year-end. Given the strong start to the year, we continue to believe the risk is for more Fed increases than the three they have signaled to date for this year. The inflation data does not yet reflect the rise in **labor costs** we have been forecasting, with wage rates remaining well contained. We expect that to change as a tight labor market forces employers to raise wages to retain and attract the employees they need. It is getting more difficult to find qualified workers in this environment.

We do expect market interest rates to break out of the current trading ranges on the upside. Even with the turmoil in the political sector, **consumer confidence** is high due to the strong job market and that is spreading to **business confidence**. Loan rates have moved up in the first two months of the year, while deposit pricing has been little changed. We are noting that many banks are selectively offering higher deposit rates to large deposit customers and more special CD offering rates are beginning to appear. The key to net interest income growth this year will be strong net new loan demand, higher pricing for those loans and a disciplined approach to what will be higher funding costs.

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