THE AUSTIN ADVISOR

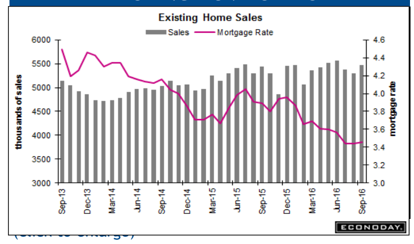
November 21, 2016

Markets	14-Nov	15-Nov	16-Nov	17-Nov	18-Nov	YTD%	31-Dec-15
DJIA	18,868.69	18,923.06	18,868.14	18,903.82	18,867.93	8.28%	17,425.03
S&P 500	2,164.20	2,180.39	2,176.94	2,187.12	2,181.90	6.75%	2,043.94
NASDAQ	5,218.40	5,275.62	5,294.58	5,333.97	5,321.51	6.27%	5,007.41
SNL Bank Index	494.11	494.69	486.27	493.06	494.79	14.67%	431.48
Fed Funds Rate	0.41%	0.41%	0.41%	0.41%	0.41%		0.35%
1 Month LIBOR	0.54%	0.55%	0.55%	0.56%	0.57%		0.43%
3 Month LIBOR	0.91%	0.91%	0.91%	0.91%	0.92%		0.61%
3 Month T-Bill	0.55%	0.51%	0.47%	0.44%	0.44%		0.16%
1 Year Treasury	0.77%	0.78%	0.76%	0.77%	0.77%		0.65%
2 Year Treasury	1.00%	1.02%	1.00%	1.04%	1.07%		1.06%
3 Year Treasury	1.27%	1.28%	1.28%	1.31%	1.36%		1.31%
5 Year Treasury	1.66%	1.68%	1.68%	1.73%	1.80%		1.76%
10 Year Treasury	2.23%	2.23%	2.22%	2.29%	2.34%		2.27%
30 Year Treasury	2.99%	2.97%	2.92%	3.01%	3.01%		3.01%

WEEKLY HIGHLIGHT

The possibility of fiscal stimulus being passed in Washington allows the Fed to act

EXISTING HOME SALES



Economy		Week of November 14, 2016
Retail Sales	0.8%	The fourth quarter started with strong consumer final demand, with retail sales much stronger than expected
Producer Price Index	0.0	No change in wholesales prices overall and a decline of 0.2% on a core basis
Industrial Production	0.0	No growth for the month due to warm weather, keeping utility output low as manufacturing increased by 0.2%
Capacity Utilization	75.3%	The operating rate remains low, keeping supply side inflation pressures low
Consumer Price Index	0.4%	While wholesale prices remain low, consumer prices jumped for the second month in a row keeping core above 2.0% YOY
Housing Starts	1.323 Million	This is a 25% increase for the month, which will add to Real GDP expectations in the fourth quarter
Leading Index	0.1%	This indicator of future growth remains mired at a low, non-inflationary level

Calendar	Release	Covering	Week of November 21, 2016
Existing Home Sales	Tuesday	October	A small decline from 5.470 million to 5.420 is expected, but this is still a high level limited by lack of inventory
Durable Goods Orders	Wednesday	October	Consensus forecast is for a 1.5% rise as companies begin to invest in their own business with higher confidence
New Home Sales	Wednesday	October	New home sales are soaring as consumers spend some of the liquidity accumulated over the last five years
Thanksgiving Day	Thursday		All Markets Closed

MONDAY MUSING

I was happy to learn that at least one college campus was happy with the results of the election. The medical school at Harvard was excited. The sleep research department believes they have, for the first time, the opportunity to study nightmares lasting four years. Concepts like "free speech" and "diversity" are only appropriate if you agree with someone. It is going to be a long four years.

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Commentary

We have long maintained banks needed not just an increase in **market interest rates**, but a steeper **yield curve** to grow earnings in 2017. That is exactly what has happened in the last two weeks. The yield on the ten-year treasury has risen to 2.35%, while the two-year yield is up to 1.06% since the beginning of the month. The spread between the two has widened from less than 80 basis points to over 125 bp. Clearly investors are pricing in expectations of inflation rising going forward. They are selling the intermediate and long end of the curve and buying the short end. The three month bill dropped by 10 bp in the last week. Investors are expecting a massive fiscal stimulus from the new administration by getting support from Congress for these programs. Investors are expecting a tax cut to add to the spending programs. There has been very little fiscal stimulus and it has been left to the Fed to provide monetary stimulus to generate faster economic growth. The burden has been lifted from the Fed by the election and allows the Fed to resume its effort to **normalize monetary policy**. This fiscal stimulus on its own would increase budget deficits and put even more pressure on market interest rates. In order for this plan to work, economic growth must jump. Tax revenue increases from a faster growth rate at lower tax rates must grow or the deficit will get even larger. The economy is already accelerating before execution of this change in fiscal policy.

The **housing data** from last week and what is due out this week reflect a strong housing sector. **Retail sales** have jumped, with two consecutive months of big gains. The October data released last week was much better than expected, and gets the fourth quarter off to a strong start. **Real GDP** forecasts will need to be increased given this surge in **consumer final demand** and a strong housing market. Lower corporate tax rates and incentives to bring capital back from overseas will jump start business fixed investment, a sector that has been weak in the last year. **Business** and **consumer confidence** should improve as the uncertainty of the election process is over. The issue now becomes how much and how soon will this environment be reflected in higher loan pricing. Funding costs are going to rise and banks need to be very disciplined in loan pricing in order to compensate for these higher funding costs. A faster growth in the economy should produce a surge in loan demand. Several clients have already said projects which were not being started have now begun to be executed in the last two weeks. All of these changes have driven the probability of a Fed increase in managed rates at the December 14 **FOMC** meeting to 95%. The outlook for bank earnings have improved significantly in this new environment.

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