# THE AUSTIN ADVISOR

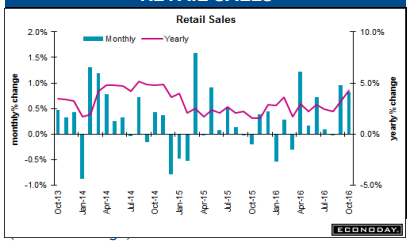
December 12, 2016

| Markets | 5-Dec | 6-Dec | 7-Dec | 8-Dec | 9-Dec | YTD% | 31-Dec-15 |
|---|---|---|---|---|---|---|---|
| DJIA | 19,216.24 | 19,251.78 | 19,549.62 | 19,614.81 | 19,756.85 | 13.38% | 17,425.03 |
| S&P 500 | 2,204.71 | 2,212.23 | 2,241.35 | 2,246.19 | 2,259.53 | 10.55% | 2,043.94 |
| NASDAQ | 5,308.89 | 5,333.00 | 5,393.76 | 5,417.36 | 5,444.50 | 8.73% | 5,007.41 |
| SNL Bank Index | 517.63 | 524.18 | 532.00 | 539.08 | 539.83 | 25.11% | 431.48 |
| Fed Funds Rate | 0.41% | 0.41% | 0.41% | 0.41% | 0.41% | | 0.35% |
| 1 Month LIBOR | 0.65% | 0.65% | 0.65% | 0.66% | 0.68% | | 0.43% |
| 3 Month LIBOR | 0.95% | 0.95% | 0.95% | 0.95% | 0.96% | | 0.61% |
| 3 Month T-Bill | 0.49% | 0.49% | 0.52% | 0.51% | 0.54% | | 0.16% |
| 1 Year Treasury | 0.82% | 0.83% | 0.85% | 0.84% | 0.85% | | 0.65% |
| 2 Year Treasury | 1.13% | 1.12% | 1.10% | 1.12% | 1.15% | | 1.06% |
| 3 Year Treasury | 1.42% | 1.41% | 1.39% | 1.40% | 1.43% | | 1.31% |
| 5 Year Treasury | 1.84% | 1.84% | 1.80% | 1.83% | 1.89% | | 1.76% |
| 10 Year Treasury | 2.39% | 2.39% | 2.34% | 2.40% | 2.47% | | 2.27% |
| 30 Year Treasury | 3.05% | 3.08% | 3.02% | 3.10% | 3.16% | | 3.01% |

## WEEKLY HIGHLIGHT

The Fed meeting this week is widely expected to result in an increase in managed rates

## RETAIL SALES




| Economy | Week of December 5, 2016 | |
|---|---|---|
| Trade Deficit | -$42.6 Bilion | The deficit widened as expected in October, after the unusual report for September on a surge in soybean exports |
| JOLTS | 5.534 Million | The job openings report remains very strong after the large upward revision for the September results |
| Consumer Credit | $16.0 Billion | Consumers continue to be willing to grow final demand, and are borrowing to do so, including growth in credit card debt |

## MONDAY MUSING

My fourth grade grandson asked me to read the speech he had written on an assigned topic by the his teacher. The speech extoled the virtues of drinking beer by claiming it warded off colds, was an indication you were an adult and helped make a social gathering more enjoyable. It was a good speech but I could not believe a fourth grade teacher would assign that topic. My grandson claimed she did and showed me the assignment. It said, 'give a speech about the benefits of drinking liquids'...not liquor. Of course this is the same grandson that told me he had been assigned to read a play by Shakespeare. I asked him which one and he told me William.

| Calendar | Release | Covering | Week of December 12, 2016 |
|---|---|---|---|
| Producer Price Index | Wednesday | November | After no change in October, wholesale prices are expected to be up 0.2% for November, for the total and the core rate |
| Retail Sales | Wednesday | November | Retail sales have surged in the last four months, with +0.4% expected for November, following the 0.8% reported for October |
| Industrial Production | Wednesday | November | A decline of 0.2% is expected following two months of only modest growth |
| Capacity Utilization | Wednesday | November | The operating rate remains at 75%, which leaves inflation pressures from tight supply very low |
| FOMC Announcement | Wednesday | | The Fed is expected to raise managed rates by 25 basis points, but new forecasts and the tone of the press conference is key |
| Consumer Price Index | Thursday | November | An increase of 0.2% is the consensus forecast while the core is forecast at +0.2%, dropping the YOY result at 2.1% |
| Housing Starts | Friday | November | The monthly data is very volatile with forecasts at 1.230M, down from 1.323M reported for October |

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## Commentary

The **FOMC** meets this week. It is a meeting where the results are all but certain. Investors expect **the Fed** to move the target for Fed Funds up by 25 basis points, taking it to 50-75 bp. The surprise would be a larger move. There is almost no chance they will not move, as that would risk the loss of any credability the Fed still has. This is a meeting which is followed by a press conference by the Chair. The tone of this conference will be the driver of financial markets going forward. The Fed is no longer alone in providing stimulus to generate faster economic growth. The election results mean there will be a level of fiscal stimulus to reduce the need to provide monetary stimulus. There has been very little fiscal stimulus since the recession of 2008-09. Tax cuts, reduced regulatory burdens and an infrastructure spending program will allow the Fed to continue the process of **normalizing monetary policy** to insure **inflation** does not reach unacceptable levels. The tone of the language in the statement following the meeting on Wednesday, the revisions to the Fed's economic and inflation forecasts released after the meeting, and detail offered by **Chairwoman Yellen** will be watched by investors. The Fed had provided guidence they anticipated two increases in managed rates in 2017. That was based on no help from fiscal policy. They were expecting **Real GDP** growth below 3%, which would require a very gradual approach to moving managed rates up. The important news from this meeting will be whether the Fed believes a boost from more stimulative fiscal policy will give them the room to move rates up faster than had been the case.

Investors are pricing rising inflation risks. **The curve** continues to steepen, with intermediate and long rates moving up more than short-term rates. This is in spite of no inflation pressures evident as of yet. Both the **PPI** and **CPI** are due out this week and are expected to report very small increases for November. The risk is rising **consumer final demand,** higher spending by the federal government, cutting tax rates and a larger deficit, at least in the short-run, will all contribute to rising prices. Should oil production actually be reduced as is being planned currently, additional pricing pressure will develop. The one area where prices have not risen is retail bank deposit products or loan rates. Perhaps banks are waiting until the Fed move this week to move some deposit pricing higher. Alternatives to bank deposits, such as money market mutual funds, have already begun to move higher driven by the move in national funding markets. Loan rates have been moved up by a few banks, but it is not widespread. A faster growth rate in the economy and improving business confidence should produce better loan growth than has been the case. Asset pricing will need to move higher to compensate for rising funding costs.

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