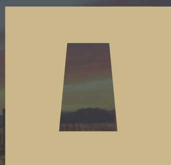

AN Unobstructed View

SPRING 2017

QUARTERLY INVESTMENT INSIGHT FROM HIGHTOWER LAS VEGAS

THE FED RAISED RATES AND MORTGAGE RATES FELL. WHAT'S UP WITH THAT?

After the Federal Reserve Board raised rates by a quarter point to 0.75% in March, many Americans assumed that mortgage rates would follow suit. On the surface, that makes sense. However, the 30-year mortgage rate fell by almost a quarter of a point over the next several days. After fielding questions from puzzled friends and family members, we thought this would be a good topic to tackle in our quarterly insights piece.

Rather than being determined by the Fed Funds rate, mortgage rates are driven by the 10-year treasury yield. In fact, the relationship between the 30-year mortgage rate and the 10-year treasury yield is rock solid, with a 94% correlation. The graphic below shows just how similarly they move over time.

Longer-term rates are driven by market actions. One of the most important factors driving market action is future expectations. When market participants expect the economy to weaken, the demand for treasuries increases, as treasuries are considered a "safe haven" asset. Greater demand leads to higher prices, which in the world of bonds means lower rates. Inflation is also an important consideration. When inflation is expected to accelerate, bond investors demand higher compensation, as inflation will eat away at the value of their investment. As a result, higher inflation tends to lead to higher rates. Other factors, such as foreigners buying our bonds, also impact the 10-year treasury yield. Yes, the Fed Funds rate is the base component of long-term rates, but there are other considerations that the market must factor in when pricing treasury bonds.

So the next time the Fed raises rates, take a look at the 10-year treasury yield before you get too worried about the cost of that mortgage you're about to lock in. It may not be as bad as you think. Of course, it could also be much worse.

If you've watched much financial news in the past few months, you may have heard the terms soft and hard data thrown around. Soft data generally refers to metrics that measure sentiment and beliefs, while hard data is focused on actual improvements in the economy, such as wage gains and employment growth. In that sense, soft data is really about how people and businesses feel, while hard data is about how they act. Usually these two types of indicators go hand in hand as people and businesses end up spending more when they feel optimistic about the future. However, in the aftermath of the U.S. presidential election, the two have diverged significantly.

"Feel" indicators such as consumer confidence and small business optimism have surged post-election. Consumer confidence is at levels unseen since the end of 2000 and small business optimism has not been this rosy since 2004. The surge is mainly attributable to the belief that the new administration will deliver on its promise of substantial tax cuts, infrastructure spending, and regulatory roll-backs.

> "WHY AREN'T PEOPLE PUTTING THEIR MONEY WHERE THEIR MOUTH IS?"

While it is still early, "Act" indicators, such as real consumer spending and business investment have not followed suit and exploded to the upside. In fact, overall economic growth has been quite weak. First quarter GDP growth was just 0.7% This begs the question: Why aren't people "putting their money where their mouth is?"

Uncertainty may be to blame. The small business uncertainty index is sitting near all-time highs. Political polarization and government gridlock are deep. The recent health care legislative blunder did not help and has likely pushed back the timeline on tax reform. In addition, any tax plan that gets through Congress and the White House is unlikely to live up to original expectations.

Anticipated infrastructure spending has also fueled optimism. There is a one trillion-dollar proposal on the table, but it lacks details and clear sources of funding, which leads to further uncertainty. On the regulatory front, President Trump has taken initiative and signed executive orders rolling back many regulations. However, it is difficult to predict the effects of changes in the regulatory environment and it will take time for those changes to be reflected in corporate earnings.

Uncertainty is like kryptonite for investors and, as a result, businesses seem to be taking a "wait and see approach." The longer they wait and fail to act on their optimism, the higher the possibility that their optimism fades. The reason such a development is significant is that "Feel" indicators have moved in-line with the stock market. As such, a correction in the "Feel" indicators is likely to be accompanied by a correction in the stock market, which is one of the reasons we have taken a more defensive position in our portfolios.

The Traffic Light

How do we manage the funds entrusted to us by our clients? We utilize a top-down approach that starts with our view of where the world is headed. Each quarter, we complete an exhaustive study of many different economic indicators and trends. The Traffic Light is a quarterly summary of these macro-economic issues, and our opinion of them, that form the basis of our research and portfolio management process. While not everything in life can be easily categorized, in this piece we attempt to look for the hopeful (green light) signs in the world economy as well as the more worrisome (red light) issues and everything in between (yellow light).

GREEN	YELLOW	RED
Fiscal Stimulus	Dollar Strength	Protectionism
Elevated Confidence	Rising Inflation	Geopolitical Risk
Stable Energy Prices	Chinese Growth	Tightening Lending Standards
Strong Labor Market		Overall Valuation Levels

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All data and information reference herein are from sources believed to be reliable.

As we head into the summer, not a lot has changed on the economic front. We continue to see many important factors firmly in "green light" territory. The labor market remains strong, with the unemployment rate at 4.4% and total job creation in the past twelve months of over 2.2 million. Consumer confidence and small business confidence remain near multi-year highs, while energy prices have stabilized at levels that benefit both energy companies and consumers of energy.

Another positive development in recent months was stronger than expected growth of the Chinese economy, the second largest in the world. While China still has a tremendous amount of excess capacity to work off, their recent economic strength should allay near-term concerns in the region. In addition, the dollar's ascent appears to have taken a breather, which has also positively impacted the international markets.

On the flip side, tightening lending standards could slow economic growth. Several measures show banks have less of an appetite to lend, which could impact a variety of businesses. We may already be seeing the impact in the auto market, as auto sales have declined from an annualized rate of 18.3 million units at the end of 2016 to around 16.5 million units.

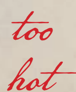
Protectionist trade actions continue to be our greatest concern. Recent actions related to Canadian lumber suggest that President Trump is willing to place tariffs on even our closest allies. Rhetoric surrounding NAFTA has largely been discounted by the market, but definitive action against the trade agreement would likely be a strong negative for stock prices. With valuation levels elevated and the economic risks balanced, we continue to believe a more defensive posture is warranted and have taken steps to reduce risk in all of our portfolios.

WHAT ARE THEY TALKING ABOUT?

GOLDILOCKS

We're probably all familiar with Goldilocks from the classic children's book. But what does Goldilocks have to do with financial markets? A Goldilocks scenario has conditions that are not too hot and not too cold, just like in the book. The Goldilocks scenario is characterized by low inflation and easy monetary policy, which creates the perfect environment for asset prices to rise.

The U.S. stock market has been the beneficiary of the Goldilocks scenario over the past several years. However, the Fed is now raising interest rates and inflation has begun to tick higher. Europe, on the other hand, is a few years behind the U.S. with respect to stimulus and is just now starting to feel the positive effects of the Goldilocks scenario. As a result, market returns in Europe could be in for a strong period of outperformance.



In the Media

Mike
Featured on KNPR
Quoted by The Nevada Independent

Adam
Featured on MoneyLife

Hugh
Quoted by The Nevada Independent

Check out our other publications for insight into our thoughts and process:

ruminATions:
http://www.hightoweradvisors.com/who-we-are/hightower-advisors/las-vegas/blog/

Thinking & Thriving:
http://www.hightoweradvisors.com/who-we-are/hightower-advisors/las-vegas/thinking-and-thriving/

The Stat Pack:
http://www.thestatpack.com

What's New?

HighTower Las Vegas is pleased to announce the launch of the new Tamarac client portal. The new client portal is a comprehensive tool that allows you to look at a host of information related to your accounts, on demand and at your leisure. The new client portal is a big step up in user friendliness, which should allow you to stay in tune with your assets and overall plan. The new format is easy to digest at a glance, thanks to improved graphics and visuals. Reports are also easy to find and utilize. If you are interested in learning more about the client portal, please don't hesitate to reach out.