MAINSTREET ADVISORS

FINANCIAL MARKET UPDATE 12/16/16

THE WEEK IN REVIEW

After a longer-than-expected wait, the Federal Reserve announced Wednesday it would increase U.S. interest rates by 0.25% to a range of 0.50%-0.75%. Simultaneously, the Fed signaled it now anticipates three rate hikes in 2017, an increase from the prior forecast of two hikes. Fed Chair Janet Yellen noted, “Economic growth has picked up since the middle of the year. We expect the economy will continue to perform well.” Higher inflation and lower unemployment than expected were said to be factors in the hawkish rhetoric for the decision.

A rate hike signals the Fed believes the U.S. economy has strengthened to where it no longer needs as much stimulus in the form of low rates. With 74 consecutive months of job growth and the U.S. unemployment rate currently at 4.6%, the lowest level since 2007, the Fed believes consumers and businesses can afford to pay more to borrow. Some economists speculate the Fed may need to raise rates more frequently should Present-elect Trump’s plan for infrastructure spending be enacted. The spending plans may cause inflation to accelerate from its current low levels, spurring the need for more frequent or larger rate hikes.

The U.S. dollar (USD) surged as a result of the rate hike, sending the Bloomberg US dollar index to a 14-year high. The U.S. Dollar Index has increased more than 9.0% since its 2016 lows in late April. The Chinese yuan fell to its lowest level versus the USD in more than eight years while the Japanese yen declined to its weakest level against the USD in ten months.

Domestic retail sales increased 0.1% last month, lower than consensus expectations. Auto sales, which had been strong in previous months, fell 0.5% for the sharpest drop since March. Restaurant sales advanced 0.8% for the month, their largest gain since February. With incomes rising and household wealth near record highs, retail sales look to rebound in December. On Thursday, the U.S. manufacturing PMI hit its highest reading in 21 months at 54.2. The index has been increasing steadily from September’s reading of 51.5. Positives from the report include a rise in hiring and a large build in inventories. New orders were strong but slowing due to weak foreign sales.

U.S. inflation, as measured by the consumer price index, rose 1.7% over last year’s reading in November. The core measure, which excludes volatile food and energy prices, rose 2.1% over the same time period. Rising rents appeared to be the driving force behind the uptick. Additionally, inflation has been boosted by rising oil prices and a tight job market. Currently, the Federal Reserve estimates annual price increases of 1.8% next year, slightly below the target of 2.0%. A steady increase in pricing pressures throughout the economy could support more interest rate increases next year.

ECONOMIC INDICATOR	LATEST	3MO PRIOR	CHANGE
Producer Price Index (PPI) YoY	1.3%	0.0%	▲
Retail Sales MoM	0.1%	0.0%	▲
Consumer Price Index (CPI) YoY	1.7%	1.1%	▲
Housing Starts Annualized (Millions)	1.09	1.16	▲

INDEX	LEVEL	WEEK	YTD	12 MO
DJ Industrial Average	19843.41	0.44%	13.88%	11.80%
NASDAQ	5437.16	-0.13%	8.58%	7.22%
S&P 500 LargeCap	2258.07	-0.06%	10.48%	8.92%
MSCI EAFE	1664.36	-0.81%	-3.03%	-1.72%
Barclays Aggregate US		-0.51%	1.62%	1.75%

KEY BOND RATES	WEEK	1MO AGO	1YR AGO
3-Month T-Bill	0.50%	0.46%	0.25%
10-Year Treasury	2.60%	2.22%	2.30%

REPORTS DUE NEXT WEEK	LATEST
3Q16 GDP QoQ Annualized (Final Revision)	3.2%
Initial Jobless Claims	254K
EIA Crude Inventories (Weekly Change)	-2.6M
Existing Home Sales	5.6M

Price returns as of the last available closing data. Source data: Bloomberg and Morningstar are believed to be correct but not verified.