CORRIGAN FINANCIAL, INC.

Market Update: January 2017

Global stock markets advanced for the third straight month, returning just under 3% in January. Foreign stocks (+3.54%), aided by a declining dollar, outperformed domestic stocks (+1.88%). U.S. bond returns were relatively flat, with the yield on the 10-year U.S. Treasury note finishing the month at 2.451% - just slightly higher than the 2.446% rate at the start of the year.

The U.S. economy expanded at an annualized rate of 1.9% during the fourth quarter of 2016 … consistent with the 2.1% average since the financial crisis and resulting *great recession* ended in 2009. U.S. gross domestic product (GDP) advanced at a rate of 1.6% for the 2016 calendar year. Overall, this has been the slowest expansion on record (since WWII), but it has also been one of the longest.

It should be noted that history suggests that it generally takes about eight to ten years for a country to completely recover from a financial crisis.

> **In ways that few appreciate, the financial crisis that ushered Barack Obama into office in 2008 shaped all eight years of his presidency. It drove his regulatory and economic agenda, polarized politics and policy, hobbled output and wage growth, and ultimately helped make Donald Trump president. Ironically, Mr. Obama steps down as the recovery from that crisis is largely complete, which could leave Mr. Trump to preside over the longest expansion since World War II.**
>
> **Greg Ip – WSJ 1/11/17**

Investors are optimistic about the Trump administration's plans for overhauling the tax code, boosting infrastructure, reducing regulation, and narrowing the foreign-trade deficit.

> **Schwab Advisor Services (SAS) reminds us that there is considerable uncertainty in determining which policy proposals have a chance at becoming law, and when those changes might take effect. SAS offers the following considerations:**
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> - **Trying to predict what the new administration will do is a fool's game right now.**
> - **Moving from the talking points of a speech to producing detailed legislation is very difficult: The hard choices and compromises are always in the details.**
> - **President Trump may be underestimating just how hard it is to "change" Washington.**

Eurozone growth, which clocked in at a relatively strong 1.7% for 2016, could also help to support the overall global economy. **Still, the potential for a material slowdown and currency devaluation in China remains.** In January, China's foreign currency reserves unexpectedly fell below $3 trillion … the first time in nearly six years they have fallen below that level.

The Fed's preferred measure of inflation rose in December to the highest reading in more than two years. **Deflationary concerns appear to be on the decline** as commodity prices rebound, unemployment levels fall, and wage growth moves *modestly* forward.

Let's finish up by reviewing three of the most actively discussed topics of the month:

1. **What are the implications of The Dow Jones Industrial Average finally crossing the 20,000 mark?**

The U.S. stock market reached a significant milestone with the Dow surpassing the 20,000 mark. **The Dow reached 10,000 back in 1999, so it took 17 years to double … a less than inspiring run.** That's what happens when you run up against the headwinds of the 2000 technology collapse and the 2008 financial crisis. Consider the following:

- The Dow fell 38% from January 2000 through October 2002.
- The Dow peaked at 14,000 in July 2007.
- Having declined by more than 50% in 18 months, the Dow hit a low of 6547 in March 2009.
- After hitting 10,000 in 1999, the Dow seesawed above and below that milestone 33 times until finally breaking away in August, 2010.

> **Financial history looks more predictable than it is – or was. Those major cycles seem almost absurdly obvious when you look back at any chart of historical performance. It feels as if a child should be able to see such moves coming. But the market has always mapped its future trajectory in invisible ink. The clarity of past cycles is an illusion, a luxury of hindsight.**
>
> **Jason Zweig – WSJ 1/25/17**

When it's all said and done, Dow 20,000 is just a number. There is no reason to get all excited, and this is certainly not the time to become complacent.

2. **Are stocks getting too expensive?**

According to FactSet, the S&P 500 Index now trades at over 17 times expected earnings over the next year. The trailing price-to-earnings (P/E) ratio is at a multiple of over 20 times earnings. Both measures are at the highest levels in over a decade. The cyclically adjusted P/E ratio, based on the past 10 years of average earnings, is at the highest level since 2000, and is at levels not seen outside of the dot-com era and the late 1920s.

The recent run in equities was very hard and very fast in the U.S. The earnings recession is behind us. But that may not be enough to justify these valuations.

Stephen Wood, Russell Investments – WSJ 1/29/17

Valuation methods can vary and are always subject to debate. But after eight years of aggressive monetary policy, and related financial engineering, the markets are expensive under almost any methodology.

3. **Can the U.S. reach and sustain 4% economic growth?**

Our economy hasn't reached 3% growth in a full year since 2005. The last time we saw 4% growth was back in 2000 … and we know how that ended. Overall, the U.S. economy has grown on average about 3% annually since 1950.

The Congressional Budget Office projects growth of about 2% for the next decade. Further, the Committee for a Responsible Federal Budget considers 4% growth nearly impossible to achieve over a sustained period.

The Trump administration believes that 4% growth can be reached by reforming the tax code, boosting infrastructure spending, reducing government regulations, and cutting foreign trade deficits. Federal Reserve Chairwoman Janet Yellen talks about "a variety of forces depressing both supply and demand" … specifically the slow growth of our labor force and stagnant worker productivity.

A combination of across-the-board tariffs, corporate tax reform and lower tax rates, and infrastructure spending – the whole package could boost growth. The real question is, does that turn out to be a short-term boost, or does it improve productivity growth and rates of potential growth at the same time?

Michael Gapen, Barclay's Chief U.S. Economist – WSJ 1/27/17

If GDP growth was an elixir, it would be a potion with only two ingredients – hours worked and productivity. With an aging population and a puzzling productivity slowdown, the prospects for a sustainable 4% growth in GDP would appear to be extremely ambitious.

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