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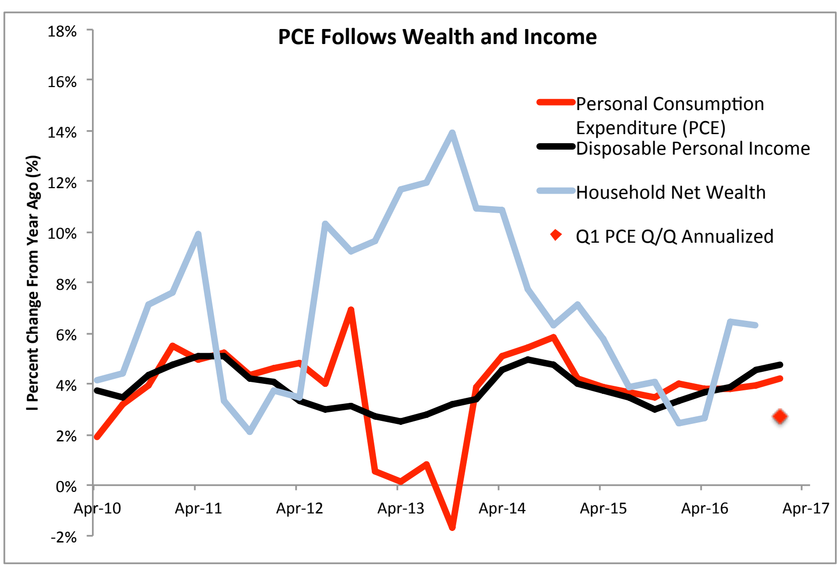
Alan Brazil

State of the Markets: Macro Commentary

Consumption Growth Will Escape The Bermuda Triangle of Weak US Q1 GDP

Clearly, weak Q1 GDP number. However, take out inventories, and GDP is 1.6%. Autos and the related sector played havoc with Q1 GDP. Having said PCE added only 0.23% to GDP, down from the 2% average of the last 8 quarters. Consumer credit growth reflected this slowdown with growth roughly half of the pace of the last two years. Yep, not good. So, does it my risk-on view? No. I still believe that risk-on and economic growth trades—equities up and rates up—provides substantial asymmetries. I believe that economic growth will rebound from strongly from Q1 levels. Trumpanomics could give this economic upturn givens substantial convexity to the upside.

First, my general view is that the US economy is still growing in the 2% real, 4.0% nominal range without factoring in Trumpanomics. First and foremost, Q1s are a Bermuda triangle of economic growth, this quarter is no different. Look at the gyrations of the components: PCE + 0.23% from Q4s +2.4%, fixed investment adding 1.6% to GDP, almost 4 times the growth of Q4, inventories subtracting almost 1% from growth after adding 1% the previous quarter. Big swings. You saw it in autos, with sales down but production down so inventories were flat versus the scenario of inventory growth in the 4th quarter. So, I am calling the weak print noise, for now. I am relying on consumption growth accelerating reflecting the still strong growth in income and wealth. The other tailwind to US growth is from the synchronized growth of the rest of the world for the first time in almost 10 years. So, US growth will be strong enough to push up equity prices and keep the Fed on track for more rate hikes and likely reversal of QE.



Second, of course, is the potential impact of Trumpanomics on the economic growth from tax reform and regulatory reform. First tax reform, particularly corporate tax reform. Last week Trump—actually Mnuchin and Cohn--presented the first iteration of tax reform. Pretty much the same plan that was released at the end of the 2016. I have spent a significant amount of time this plan, so see the piece on my web site. The potential impact of tax reform on the economy could be substantial (BTW potentially more of GDP prints with fixed investment growth driving economic growth rather than PCE). Clearly plenty of debate ahead of the implementation of the plan. Keep in mind what Mnuchin said that they would still implement their tax reform even if could only last 10 years. Beyond tax reform is the potential upside of regulatory reform. The push for financial reform seems to be accelerating. Trump issued a number of executive orders while Hensarling released his financial reform plan. Much of reform both financial and energy could be implemented without congress. So, here are some of the ideas I am pitching:

1. *Buy Sept 5% OTM strike calls on S&P*
    a. *Upturn in economic growth and catalyst of Trumpanomics, which will push up 2019/20 earnings*
    b. *Vol is cheap so why go outright long?*
2. *Buy regional banks*
    a. *Banks are fair to a little cheap at current levels reflecting impact of rising rates, and rote.*
    b. *Trumpanomics both tax reform and regulatory reform are both positive catalyst for upside*
3. *Buy payers 1/10 yr, 25 bp OTM*
    a. *Longer dated interest rates move above 3%, if nominal growth gets to 4.5 to 5.5% (2.5-3% real and 2/2.5 inflation)*
    b. *Market pricing in little change in longer term rates*
4. *Buy Steel, chemical companies, and mortgage related equities*
    a. *Steel tariffs, cheap nat gas from energy reform, and loosening of mortgage credit standards generate a surge in housing starts and mortgage growth*

I would do pretty much the same for Europe but replacing regionals with larger European banks, and just short negative rate government bonds. I'm constructive on the euro so would not hedge back into dollars. Economic growth in Europe is rebounding even in the GIIPs, and the downside from the French election has been reduced. This should give the ECB more room to roll back QE and ZIRP. I will be out later this week with the piece.