DAVIS INVESTMENT GROUP

Registered Investment Advisor Firm

©ISSUE I, VOL. VI – JANUARY – 2017

2017 ECONOMIC PREDICTIONS

With the election over and a New Year starting, I thought I would make a few predictions based on my reading of many economic advisory groups. These are not consensus predictions. The predictions are preliminary as a new administration has not spelled out their specifics, but general direction they want to move. Their fiscal and trade policies are to be determined, but they should stimulate the economy and release the business "animal spirits" (1936 term used to describe human emotions that drive consumer confidence). All of the predictions affect assets differently.

The Economy – Real Gross Domestic Product (GDP) – one of the primary indicators to gauge the health of the economy- for all of 2017 should average 2.7% - 3.0%, up from 2.2% in 2016 and most advisors are looking at 2.5%.

Employment should continue to improve, with unemployment (U3) to fall to 4.7%. I continue to look at the U6 unemployment rate as a better guide to the health of the economy. This includes all unemployed, discouraged, part-time and marginally attached workers. This rate as of the end of November stood at 9.3%, dropping to 8.5% by the end of 2017.

Inflation, measured by the Personal Consumption Expenditures (PCE) chain price index, averaged 1.1% for 2016 and should rise above 2%. The PCE is a measure of goods and services targeted toward and consumed by individuals. A strong dollar and a soft global economy should limit pressure from commodities and housing costs will remain a concern.

Monetary Policy – The Federal Open Market Committee (FOMC) hiked rates at its December meeting, the only increase in 2016 despite an expectation of four. I agree with their planning three rate increases in 2017 as the economy and inflation heat up. The composition of the Board of Governors will be changing over the next two years as the new administration could pick as many as five.

Impact of Presidential Election – Corporate and personal tax policies, infrastructure spending, restriction on immigration, repeal and replacement of the Affordable Care Act, regulation reform, repatriation of overseas profits, tariffs and energy policy changes are likely. While the policy changes seem certain, the timetable for enactment and the results of the changes are uncertain. One current result is the increase in the consumer confidence, highest since 2004 as consumers expect a favorable impact of the new administration's policies on the economy.

Oil Prices – West Texas Intermediate (WTI) crude oil prices should be $45 to $65 a barrel during 2017. Moderate global growth, with offsetting American energy policies should keep the price range bound. Geopolitical crises could change that and the timetable by the incoming administration could also affect the price, as well as gasoline prices.

Interest Rates – On December 1, 2016, the 10-year U.S. Treasury yield was 2.45%. By the end of 2017 it should be 3.0%. The biggest factors to impact the Treasury yields will be inflation, inflationary expectations, FOMC interest rate policy and foreign bond yields.

Risks to Growth – Business confidence is considered the most important factor impacting U.S. economic growth followed by fiscal policy and private credit markets conditions. Additional factors affecting growth is consumer strength and tariffs.

Fiscal stimulus, deregulation and tax reform provide upside risks. Protectionist trade policy is the leading cause for concern, as is the uncertainty over fiscal and other policies, such as immigration.

FED Watch

The FED raised rates at its December meeting. They are projecting to raise three more times in 2017, we will wait and see.

Market observers give a 4% chance of a quarter point rise in the Fed Funds at the next meeting.

The next meeting is January 31st and February 1st.

Davis Investment Group

Davis Investment Group is a fee-based Registered Investment Advisor firm servicing the needs of clients across the United States.

Davis Investment Group custodies all client assets at Charles Schwab & Co. Davis Investment Group's home office is located at 714 Marin Street, Suite #C, Vallejo, CA 94590. The telephone number is (707) 648-2024.

If you have questions or would like further information on this month's topics or any other financial or investment related subjects, including Social Security claiming strategies, please contact me by phone or through my email address at: bob@davisinvestmentgroup.biz