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The lead story: 20,000 leaps over D.C.

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Article Highlights

- The Dow tops 20,000 as global stocks rally, led by Materials and Financials.
- Markets are blocking out the daily political noise and focusing on concrete policy changes.
- Somewhat expensive U.S. valuations don't mean a correction is more likely in the near term but could exacerbate a selloff if and when one arrives.
- Despite lower headline GDP growth in 4Q16, stronger U.S. growth is confirmed.
- Cancellation of official visit from Mexico's president is a reminder of protectionism risks.
- Political uncertainty has arrived in the U.S. but has been a problem for China and Europe for years.

Editor's note: This week we welcome Brian Nick as the new author of the Weekly Market Update.

Quote of the week

"Starting today, you will enter a new element, you will see what no man has ever seen before." — Captain Nemo, *Twenty Thousand Leagues Under the Sea*

After flirting with the milestone for the better part of a month, the Dow Jones Industrial Average index closed above 20,000 on January 25 and held above that level for the rest of the week. While rarely used as a benchmark for professional investors, the Dow is still recognized by the investing public as the primary bellwether for the U.S. equity market. One week into Donald Trump's presidency and two weeks into Q4 2016 earnings season, the Dow broke out of what had been a very narrow trading range to finish the week up 1.34%. The S&P 500 Index, a broader measure of U.S. equity market performance, gained 1.03% while temporarily breaching the 2,300 level. The Materials and Financials sectors led the week's advance.

While Q4 earnings reports have been mixed thus far, policy changes in the early days of the Trump administration appear to be largely delivering on campaign promises.

Executive orders have cleared the way for, among other things, the development of the Keystone XL pipeline and the border wall with Mexico that served as a hallmark of candidate Trump's platform. Broadly speaking, investors have welcomed the potential for tax reform and regulatory forbearance as they count on continued profits growth over the next few years. Without that growth, the Dow at 20,000, S&P 500 at 2,300, and other recent milestones look less durable.

Milestones aside, U.S. stocks have risen by an average of just over 14% per year over the past five years, leaving them somewhat more expensive than their long-term average. While this doesn't necessarily indicate a market correction is imminent, corrections that begin from higher levels tend to be worse when they happen. That said, 10% drops in the S&P 500 occur about once per calendar year, historically, meaning it would be unwise to rule one out for this year. Declines of 20% or more, also known as bear markets, tend to occur only when the economy is in recession—a much-lower-likelihood event over the next 12 months. Overall, based

Current updates to the week's market results are available here.

In other news: interest rates back on the rise

Give investors credit for seeing through a series of unorthodox news cycles coming out of Washington, D.C., and focusing on concrete policy changes as well as the continued broad improvement in economic data both in the U.S. and around the world. The week's stock market rally came hand in hand with a renewed increase in bond yields, similar to the pattern we've seen since mid-2016 and symptomatic of a growth-driven rally built on a healthy mix of fundamentals and optimism. For the week, the 10-year U.S. Treasury yield was up modestly, closing at 2.49%.

Our fixed-income portfolio managers are quick to point out that rising yields haven't been limited to the U.S. Rates in Germany and Japan, while still well below their U.S. counterparts, have also moved up recently as demand for risk assets appears to be increasing. While the backup in yields has been orderly thus far, we are keeping a close watch on incoming inflation data for signs that monetary and fiscal policy may prove overly stimulative in the coming quarters.

Below the fold: Despite lower headline GDP, stronger U.S. growth is confirmed

- **U.S. GDP growth** slowed from 3.5% in the third quarter to 1.9% in the fourth, according to the government's advance estimate. This was lower than consensus expectations but in line with TIAA's forecast and the general pace of growth we've seen for several years. The main weakness in 4Q was net exports. Positive developments included growth in business spending and inventories. Final private demand (GDP minus inventories, trade, and the government sector) grew 2.8%, suggesting the economy is strengthening.

- **Global business activity** continues to firm, with preliminary Purchasing Managers Index (PMI) numbers for January exceeding already-solid December levels in the U.S. and Eurozone. The broad-based increase indicates that the era of the U.S. being the "only port in a storm" may be coming to an end, along with the two-year rally in the U.S. dollar.

- **The Mexican peso** rallied to its strongest level against the U.S. dollar since the start of the year on news that Congress would foot the initial bill for President Trump's border wall. It weakened slightly, however, after Mexico's President Enrique Pena Nieto cancelled his scheduled trip to the U.S. next week. The peso is trading below its fair value due to political concerns, having fallen 13% since the election, and appears attractive for long-term investors.

- **Volatility** in the U.S. equity market continued to fall, touching its lowest level since mid-2014. Because various sectors have responded differently to current macro trends, indexes have provided a cushion of sorts by virtue of their diversification benefits.

Back page: Policy uncertainty is back? Outside the U.S., it never left

U.S. equity markets have far outperformed their global counterparts over the past five years, and the U.S. dollar surge over that period has widened the gap even further. While numerous factors have contributed to superior U.S. returns, steadier policymaking has been one of the primary drivers. So while political uncertainty has undeniably risen here at home recently, in Europe it has been elevated for years—at least since the Greek debt crisis. It has also become a point of concern in China. The U.S. may simply be experiencing a reversion to the mean after a long period of "certainty" brought about by domestic policy gridlock.