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Boenning Morning Comment

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Stocks fell on Friday but the negative reaction was much more muted than in was on Thursday when the Dow fell 274 points amid rising chaos in the White House. Over the weekend, there was little additional news and futures appear to be quiet in the early morning hours. Bullish market days more often than not end with late day strength. Conversely, negative days see markets tail off toward the close. Both Thursday and Friday saw very weak final 15 minutes. We will watch closely today's behavior. Any surge in selling into the close will make us more skittish near term. With that said, there is nothing fundamentally occurring to suggest any mid-long term change in investment strategy.

There are no important earnings reports or economic data coming this week. There are, however, three events to watch. The first is tonight when President Trump will make a speech to be broadcast nationwide outlining his strategy for Afghanistan. Most pundits predict a small rise in our troop commitment there. Mr. Trump, in his own unique way, will try to make this strategy sound both unique and highly likely to succeed but what it really represents is the best judgment of the military how best to stabilize the situation there and create space for a possible political settlement. Unfortunately, after 16 years, there still appears to be no end in sight. In all likelihood, this speech won't be market moving.

Tomorrow night, President Trump is scheduled to speak in Phoenix at one of his campaign-style rallies to a friendly base. Arizona is home to Senators Jeff Flake and John McCain, two Republicans who have built separation between themselves and the President. Some of his advisors have suggested speaking tomorrow, so close to his controversial remarks in the wake of the Charlottesville tragedy, may not be prudent. It is likely that his key advisors, notably General Kelley, will caution him many times to stay on script but one never knows what Trump will say. His speech will likely be media moving but, unless he chooses to raise the heat of the debate, it also won't be market moving. While some fret over what he might say regarding white supremacy, etc., my guess is that he will try to deflect the conversation to other topics which might include immigration (and the wall), a follow-up to tonight's Afghanistan speech, the strong economy (for which he will take full credit), jobs, and maybe even a word or two about the start of the NAFTA talks. I would think the last thing he would want to do is to keep any conversation focused on the aftermath of Charlottesville.

Finally, later this week central bankers and economists will be meeting for their annual conclave in Jackson Hole. On Friday afternoon, Fed Chair Janet Yellen will be speaking as will ECB head Mario Draghi. The combination of remarks they are scheduled to make will emphasize the following:

1. Collective central bank action to date has now firmly established an enduring economic recovery.
2. We are about to enter a transition period where collective monetary expansion ends. The U.S. has already begun to raise short term interest rates and is likely to begin reducing the size of its balance sheet later this year. The ECB is roughly 12 months behind meaning it will start to taper its quantitative easing measures relatively soon, could start to raise short term rates sometime later in 2018, and may begin to reduce the size of its balance sheet sometime around the end of 2018. Putting these paths together, it is likely that the collective size of central bank balance sheets will peak about a year from today.

3. Central bankers have been surprised that despite synchronous economic growth around the world, inflation remains missing in action. While that creates both some confusion and concern, any worries are muted given that growth is both sustained and improving. Clearly, collective central bank debt purchases have a negative impact on interest rates and one should expect rates to rise across the curve once most central banks begin to reduce the collective sizes of their balance sheets.
4. Ms. Yellen, in particular, will focus on financial stability now almost a decade since the end of the financial crisis. She will warn our government in particular to the dangers of easing Dodd-Frank restrictions too far, too fast. While some refinement is both likely and desirable, changes that would reduce necessary equity or allow too much risk taking will be targeted as misguided.

Once again, if statements match expectations, don't expect too much market response. Indeed, if there is one simple conclusion regarding the three events this week that I just highlighted, it would be that consensus is already baked into the market but we all need to be vigilant regarding the unforeseen. Given the lack of earnings and economic data this week, the events most likely to provoke a market response are these three. This is a late August week with lots of traders away on vacation. In the absence of news, markets should be quiet. But no one was ready for the political chaos and fallout of last week. In our new world order, we have learned that the unexpected should be expected.

With so much happening last week in Washington, and changes continuing inside the White House, I want to share a few observations regarding recent events. Again, I will note that I want to keep my comments to the economic implications. The lack of any conclusions regarding the social and political issues doesn't mean I am ignorant to them or don't have personal feelings but, rather, those are outside the scope of what these letters are all about.

Last week, we saw a lot of Republicans in Congress speak out on issues they probably didn't want to talk about. For many, their reactions forced them to separate themselves from the President. They were forced to react because they are beholden to their own electorates, not the President and not the media. Constituents demanded responses and the responses flowed. As we saw the actions, it became clear that, at least on some issues, the President and the White House was becoming more and more isolated. When you are a Republican and have a fractured majority in Congress to begin with, further schisms can't possibly be helpful. With a Congressional calendar already full, new diversions are the last thing needed. The only good news is that they are happening while Congress is in recess.

Congressional leadership will still have an economic focus. September is largely going to be taken up with the budget, spending resolutions and raising the debt ceiling. While passing these in a timely fashion won't be easy, and Republicans in both chambers are going to get very little help from Democrats, we are hopeful that everything will get done without excessive acrimony. Democrats will have nothing to gain if they are viewed as the cause of shutting down the government or creating a debt crisis. As the calendar moves to October, we will soon see whether all the damage done this past week plus has an enduring impact on the rest of the Trump agenda. While Congressional Republicans are no longer as bound to the President as they might have been before this summer's chaos began, they still want to get something done on taxes and infrastructure and Messrs. Cohn and Mnuchin need to be part of that effort. Ultimately, President Trump will need to be more engaged than he was in the healthcare debate. He will have to a take a firm stand and fight for any major piece of legislation.

Obviously, I am suggesting an effective roadmap that hasn't been followed to date. Certainly, it wasn't followed in the effort to repeal and replace Obamacare. It won't work if Trump tweets persistently undermine legislative efforts. It will only work if Congress and the White House are working together. It may only succeed with some bipartisan support.

Given the history to date of this administration and this Congress, the odds of success are small and there is little doubt that they became even smaller this past week. There is little evidence that stock prices today reflect any new political initiatives being accomplished. In that sense, there is no downside risk. Longer term, without any legislative accomplishments, the focus will turn to next year's midterm elections. All incumbents will be at risk. The reason Trump got elected is that he was viewed as a change agent. The reason Trump still has so much support among his base is that many view Congress more at fault than Trump. For now, the most likely outcome is gridlock now and gridlock later. We live through that in Obama's second term and it appears we might do exactly the same during Trump's current term. As the stock market has shown, that isn't exactly the worst possible outcome.

Today, Usain Bolt is 31. Kenny Rogers is 79. Notably, in 1987 he released an album entitled "I Prefer the Moonlight".

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