First Trust
Monday Morning OUTLOOK
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"Risk Off" Trade Returns… Remain Calm

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After strong gains in 2013, equities have struggled this year. Thursday and Friday felt a little panicky. US stocks were down close to 3%, gold was up, and the 10-year Treasury yield fell below 2.75% for the first time since November. Investors are on edge, short-sellers are a little giddy and we even heard a TV host mention the infamous "Black Swan" again.

It's hard to tell exactly what triggered the "Risk Off" trade, but last Thursday, even though 15 out of 20 S&P 500 companies beat earnings estimates, weakness in the Chinese purchasing managers' index set off some selling.

So, is this a moment to "run for the hills" or to "pull on your parka and wait it out?" We opt for the latter. Right now, there's a mad rush for a narrative to explain the recent market stumbles. One is that Chinese weakness hurts commodity exporters. Another is Federal Reserve "tapering" is shrinking global liquidity, hurting emerging markets.

The Argentine peso fell 15% last week. Other emerging market currencies fell as well, including the Russian ruble (-2.7%), Turkish lira (-4.3%) and South African rand (-2.1%). None of this currency weakness started spontaneously last week. The Turkish lira is down 23% in the past year. The Rand fell 35% from mid-2011 to December 2013.

Argentina has a 50% tax on any Amazon.com purchase over $25 and forces items to be picked up at customs. The Argentine peso is down 38% in the past year and 46% in the past two years. In other words, currency troubles in Turkey, Argentina and South Africa are nothing new. It's wrong to pin the blame solely on Chinese economic data or tapering.

We have been through these "Risk Off" trades many times in the past few years. Dubai, Greece, Italy, Spain, Cypress, the government shut-down, BP oil spill, and the first fears of tapering in May 2013. All of them eventually turned out to be inconsequential for US equities and it's highly likely the same is true this time around.

The fundamentals haven't changed. QE didn't lift global liquidity; it just boosted unused, excess reserves held by banks. The M2 measure of money has grown at an average annual rate of 6.0% over the past four years, 6.1% in the past year, and 6.3% in the past three months. In other words, there has been no change in US monetary policy in spite of tapering.

Meanwhile, government spending in the US has fallen from a peak of about 25% of GDP in 2009 to under 21% today. And while the Sequester deal was broken and Obamacare will boost government subsidies, the share of GDP devoted to government is likely to remain flat or fall slightly. This is good news, creating more room for private sector growth.

And, in the private sector today good things are happening. Housing is on the rise, while incomes and jobs are strengthening. Most importantly, new entrepreneurial technology is boosting productivity, growth, and profits.

The bottom-line is that the negative sentiment of the past few trading sessions might turn into a full-fledge correction, but this would not be the end of the bull market, or the economic recovery. While investors will hear many fearsomely bearish forecasts, nothing fundamental has changed in our outlook for the US economy. Please, remain calm.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-27 / 9:00 am	New Home Sales – Dec	0.455 Mil	**0.470 Mil**	0.414 Mil	0.464 Mil
1-28 / 7:30 am	Durable Goods – Dec	+1.8%	**+1.5%**		+3.4%
7:30 am	Durable Goods (Ex-Trans) – Dec	+0.5%	**+0.8%**		+1.2%
9:00 am	Consumer Confidence – Jan	78.0	**80.0**		78.1
1-30 / 7:30 am	Initial Claims – Jan 25	329K	**329K**		326K
7:30 am	Q4 GDP Advance Report	3.2%	**3.0%**		4.1%
7:30 am	Q4 GDP Chain Price Index	1.2%	**1.5%**		2.0%
1-31 / 7:30 am	Personal Income – Dec	+0.2%	**+0.3%**		+0.2%
7:30 am	Personal Spending – Dec	+0.2%	**+0.3%**		+0.5%
8:45 am	Chicago PMI – Jan	59.0	**61.2**		60.8
8:55 am	U. Mich Consumer Sentiment- Jan	81.0	**81.0**		80.4