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Stocks Struggle to New High; Upgrading Trump's Chances

Friday 4:45 p.m., EDT

Today the S&P 500 closed at another all-time high, but the broader market indexes have barely scaled their earlier peaks. I would call earnings “good,” but not great. Although a large number of firms are beating expectations, forward earnings guidance has been tepid. Recent highs have wrung a lot of shorts out of the market, as the VIX fell last week to 11.40, an 11 month low after reaching nearly 27 immediately following the Brexit vote. Further market gains will have to be based on accelerating GDP and although Q2 GDP growth is apt to be reported next week around 2.5%, this quarter’s growth looks barely over 2%. It is hard to get excited about earnings with the economy just limping along.

In addition to GDP, next week we have the July FOMC meeting on the docket. Of course, the Fed will hold rates steady, but I think the market may be surprised that the Fed will not rule out an increase in the September meeting. Although an increase in September is less than 50-50%, the recovery of the equity markets has greatly reduced downside risk from the world economy. The market may already be gearing up to that reality, as the ten year yield have risen from a 1.318% intra-day low on July 7 to a high of 1.627% last Thursday. One reason the Fed need not act is that the market sufficiently tightens on the hint of Fed action – through the strengthening dollar and rising bond yield – so that actual action is deferred. But if the economy begins to meaningfully accelerate, the Fed will likely have to ratify the market’s expectations so as to preserve credibility

Political Update: As a result of careful analysis of recent polls, I have significantly raised my assessment of the chances of a Trump victory in November. As readers remember, I thought early polls were too optimistic about Trump’s prospects, but now I do not. It is true that US demographics continue to go against Republican candidates – the percentage of non-Hispanic white voters continues to decline. However, this shift can be offset by an increase in the turnout rate of white voters. Trump’s primary run greatly increased voter turnout in the Midwest – Ohio, Illinois, Michigan, and Pennsylvania and it possible that Trump could turn these swing states that Obama won 4 years ago into red states.

Let me emphasize that I am not calling a Trump victory. I still think HRC will pull it out in November with ads showing Trump saying that “wages are too high” and women who seek abortion “should serve jail time.” But I now rate the chances of a Clinton victory at only around 3-2, not 3 or 4 to 1 as I previously calculated.

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