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Fed will Hike; Earnings Key; Election prospects

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Today's data on retail sales point to a mild slowdown in consumer spending. Although Q3 is apt to be the best quarter this year, MacroAdvisors has lowered its GDP growth estimate for last quarter to 2.6% and has only 1.8% penciled in for the fourth quarter. Combined with the 0.8% and 1.4% growth in the first two quarters, this year is coming in at a very disappointing 1.65%, the lowest growth rate since 2012. But the slowing growth will not stop the Fed from raising rate. Although the minutes of the FOMC were a touch more dovish than I expected (I thought I would see the words "many" or a "majority" of members felt an increase was appropriate soon if the economy remained on its current course), the "Dot Plot" released at that meeting showed only 3 votes for a unchanged funds rate at year end. January funds are trading at 56.5 bps, which shows a nominal probability of 76% although the rate signals an 85% or higher probability if the hedge properties of the contract are considered. Furthermore, despite the downbeat growth data, the PPI shows that inflation is firming. Eric Rosengren of the Boston Federal Reserve was interviewed by CNBC's Steve Leisman this morning and indicated that the upward blip in the participation rate, which has given the Fed a little more "room to run" is likely temporary and will resume its downward path that are dominated by demographic forces.

Earnings season started in earnest today, and the beats by JPMorgan, Citibank, and Wells have pushed the financial sector upward. I have stated for many weeks that earnings, not the Fed, will be the key to whether this market rallies into the year end. Although the equity market may shudder at the prospect of a 25 bps hike by December, earnings are far more important and the stocks could continue moving higher if earnings come through and, as I expect the ten year stays under 2%.

The election does matter and it appears risk markets prefer the "Devil We Know" in Hillary Clinton. But they do not want Congress dominated by the Dems. Trump's sharp fall in the polls has opened the possibility the House could slide to the Democrats. I do not believe that will happen but the Senate is a different story. The GOP has a 4 seat majority, but is likely to lose their seats in Wisconsin, Illinois and Indiana. They need to pick up one more (to achieve a tie and HRC wins to provide the tie-breaker). There are four races that are extremely close: Three of these involve a potential switch from the GOP to the Dems (Pennsylvania, New Hampshire, and North Carolina) and one to the GOP (in Nevada, where Harry Reid has decided not to run again.). If each of these is a coin toss, there is a 60% chance the Dems will get the seat they need. This is fairly close to the current betting odds. .
