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REVIEW & OUTLOOK (Editorial)
The Tax-Reform Stock Rally

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Equity markets took a mild breather on Tuesday afternoon after another morning rally, pausing on what has been a remarkable runup so far in 2018, following eye-popping gains since Election Day in 2016 and throughout 2017. The latest gains look like a tax-reform rally, though it will pay to be mindful that markets inevitably correct, often hard.

We've been hosting an op-ed debate on stock prices, and last week financial consultant Donald Luskin made his case for the running of the bulls as expected corporate earnings are adjusted upward due to tax reform. Harvard economist Martin Feldstein makes the case for caution nearby, arguing that equity prices are fated to fall as the Federal Reserve reverses its long period of asset purchases and low interest rates, and inflation makes a comeback. Both men could be right, depending on your investment time frame.

The **bullish** case is based on expectations of capitalized profits, which have risen smartly with the cut in corporate tax rates. The higher after-tax returns flow into higher asset values, all else being equal. The surprise is that stocks have kept rising this year, with the **S&P 500** up some 4%. This suggests that many investors underestimated the possibility of pro-growth tax reform passing last year, and now they are catching up to the implications.

The harder question is whether rising stocks are also a harbinger of faster growth in the real economy. Business sentiment, from the Business Roundtable to the National Federation of Independent Business, is as **bullish** as we can recall. Business Roundtable chief Jamie Dimon, also CEO of J.P. Morgan, captured the mood last week when he said "animal spirits" have been unleashed.

He cited tax reform and "proper smart regulation," while the global economy is also growing in sync for a change. With investors willing to take more risks, emerging markets are seeing capital inflows as are Japan and Europe. This greater appetite may explain why the U.S. dollar has been relatively weak despite signs of better U.S. policy and faster growth. Maybe investors feel a reduced need to park money in the safety of dollar assets or Treasurys.

But don't forget Mr. Feldstein's warning about the Fed and its great monetary unwinding. Former Fed Chairman Ben Bernanke justified quantitative easing (QE) as a tool to drive investors into riskier assets, including stocks, which would create a "wealth effect" to spur the real economy. He succeeded on asset prices but failed on growth, which didn't accelerate until better tax and regulatory policies arrived. But if QE lifted stocks as it expanded, will the reverse happen as it unwinds?

It's certainly possible, and students of financial history know that sooner or later rising interest rates will weigh on stock prices. This is another way of saying that the biggest threat to growth and **financial markets** -- Donald Trump's trade agenda or a Speaker Pelosi aside -- may be the Federal Reserve as it reverses Mr. Bernanke's experiment. Mr. Bernanke has already taken a half dozen victory laps, but they'll have been premature if the unwinding leads to asset selloffs that create financial disruption and a recession.

All of which underscores the importance and timing of the GOP tax reform. The current expansion is already historically long, if also historically weak, and it has needed a second wind. Businesses have had plenty of capital, at home and abroad, but they had been reluctant to deploy it given the uncertainty of how and when the Obama regulators and taxers might strike next. Donald Trump's deregulators have removed the fear of arbitrary political punishment, and now tax reform is raising the expectations of returns on investment.

This is the cause for economic optimism, and **bullish** equities, but keep in mind that we've never lived through a monetary-policy reversal like the one that is coming.

(See related letter: "Letters to the Editor: Fed Should Unwind Its Asset Portfolio Quickly" -- WSJ Jan. 18, 2018)

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The New York Times

Business Day

9 Points to Guide Your Investments in 2018

By JEFF SOMMER
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Even if you don't follow **financial markets** closely, if you have money in those markets it is worth considering, every so often, where you have been and where the currents may be taking you.

We've selected nine articles with reporting and analysis on where the markets have been and some clues on where they may be heading. Together the selection provides an introduction to investing. We hope that at least some of these articles will entertain you as well.

Is the **Stock Market** Too Quiet for Its Own Good?

A rare calm has settled over the **stock market**, which has been prospering with barely any downturns. That condition is highly unusual, and some fear that it raises the odds that share prices will descend.

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Cutting Carbon Emissions While Earning Cash

Green bond funds seek securities with clear environmental benefits. Their managers chase the promise of a double bottom line: growing returns and falling carbon emissions.

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Blockchain or Blockheads? Bitcoin Mania Mints Believers and Skeptics

Investing in Bitcoin might make you rich, sure. But how much do you know about tulips? No bubble is too big to burst, our columnist says.

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Bargain Hunters Turn to Emerging Market Stocks

After a big year for stocks in China and India, emerging market stock funds are attracting attention from value investors who have been rummaging in staid sectors like manufacturing, mining and finance.

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A.I. Has Arrived in Investing. Humans Are Still Dominating.

Artificial intelligence programs are becoming increasingly useful. They are beginning to help fund managers run their portfolios. But will they be good enough to replace them?

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These 3 Mutual Funds Reaped Big Gains From Small Companies

There are many ways of scoring outsize returns. Three top-performing funds did it in the last three months of 2017 by focusing on small-cap stocks like a timber company, a cabinet manufacturer and an online lender.

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Personal Finance for Those Who Don't Have a Clue

A new book promises to be "a total beginner's guide to getting good with money." It does a good job, though our reviewer has a few misgivings.

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Stampede of Tech Giants Gives Rebalancing New Appeal

The breakaway climb of growth stocks like Facebook, Amazon, Apple, Netflix and Google has unbalanced many investor portfolios. Is it time to trim tech and tilt back to value?

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For Bond Investors, Low Expectations in a Low-Yield World

Bond yields have been rising but from very low levels, creating a challenging environment for money making. The recently enacted tax package could be a moderate benefit for corporate bonds. Small portfolio tweaks, emerging markets and money market funds are options — but prospects for big profits are rare.

Read more »

Minh Uong/The New York Times

Document NYTFEED020180117ee1h00565

The New York Times

Business/Financial Desk; SECTB
Oil Prices Hit a 3-Year High. Why?

By STANLEY REED
864 words
17 January 2018
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Late Edition - Final
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English

Tensions in Iran. Cold weather in the United States. A year of production cuts. With 2018 still young, there has been no shortage of reasons **oil prices** are pushing higher.

Prices for Brent crude, the international benchmark, have risen nearly 50 percent since June. They briefly passed $70 a barrel more than once in the last week -- the first time the per-barrel price has reached $70 since December 2014. Stockpiles of oil that built up for years are declining. And a buoyant global economy has bolstered demand, meaning prices could go higher still.

''The market has entered a new phase,'' said Richard Mallinson, an analyst at Energy Aspects, a research firm in London.

The dynamics at play are in sharp contrast with the situation just a year ago. The market has gradually realigned, in large part because of an agreement between Saudi Arabia and Russia -- two of the world's three largest oil producers -- to restrain output.

That deal, renewed in November through the end of this year, has removed around one million barrels of crude a day from the global supply. At the same time, demand for oil and its associated products has grown at a brisker clip than many analysts expected. As a result, the glut of energy around the world that once filled vast tank farms and enormous supertankers anchored at sea is gradually being worked off.

Without the buffer of that big inventory, the global energy market has become more sensitive to disruptions, whether real or prospective.

For instance, the shutdown in December of a British pipeline system in the North Sea removed an estimated nine million barrels of oil from the market over nearly three weeks. The move, which was made after the pipeline's new owner, Ineos, found flaws in the system, propelled prices higher. A record-breaking cold snap in the United States, meanwhile, pushed up demand for heating oil, bolstering demand.

But now, there are additional pressing issues.

Although the Trump administration grudgingly agreed on Friday not to reimpose comprehensive sanctions on Iran, there is concern that the recent crackdown on Iranian protests, coupled with Tehran's involvement in conflicts in Syria and Yemen, will eventually be met by tough sanctions from Washington. Such measures would again cut into Iran's ability to export oil.

For now, supplies from Iran have not been affected, but traders and analysts are nevertheless watching the rallies and their consequences.

Political risks elsewhere are also helping to push prices higher, including long-running tensions between Iraq's government in Baghdad and the autonomous Kurdish enclave in the north, and the collapse of Venezuela's oil industry. Both countries are major suppliers of crude -- Iraq produces 4.5 million barrels of oil, and Venezuela adds around 1.8 million barrels -- and any disruptions there could have a significant impact on global markets.

There are also factors mitigating a relentless rise in prices, though.

For one, the higher prices would most likely lead to increased investment and exploration for oil and, eventually, more production. This is especially true of smaller producers in the United States, whose output is already growing.

There is skepticism over whether drillers in Texas and elsewhere can increase output fast enough to create another glut. ''There is a natural limit to what shale can do,'' said Antoine Rostand, president of Kayrros, a market research firm. ''Trees don't grow to the sky.''

But these so-called swing producers have been crucial to previous price declines.

The International Energy Agency, in an Oil Market Report published in December, noted that new supplies coming onto the market, particularly from the United States, might still exceed growth in demand in the first half of the year.

On the whole, the oil industry appears to be well down the road of having adjusted to the steep price falls that began in 2014 and saw oil dipping to the $30-a-barrel range.

Among the shifts: OPEC has taken a more active role in managing global energy markets, with Russia -- which is not a member -- unofficially replacing weakened or uncooperative cartel members like Iran, Nigeria and Venezuela.

Oil companies have also reshaped themselves, sharply increasing efficiency and reducing costs to a point where they are profitable at current levels, or even lower ones. They have cut huge numbers of jobs, simplified the designs of their exploration infrastructure and embraced new technologies. Indeed, the availability of supplies at those lower costs may be the best bet for keeping recent price rises under control.

Follow Stanley Reed on Twitter: @stanleyreed12.

Rig platforms in Scotland were set to be sent to scrapyards. The oil industry seems to have adjusted to price drops that began in 2014. (PHOTOGRAPH BY JEFF J MITCHELL/GETTY IMAGES) (B2) CHART: From Peak to Trough and Back Up: Over the last four years, **oil prices** fell from well above $100 to less than a third of that, as a result of overproduction and inaction by the Organization of the Petroleum Exporting Countries. But greater discipline and increasing consumption have largely reversed the trend. (Source: Reuters)

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Banking & Finance: Foreign Firms Embrace 'Yankee Bonds'

By Ben Eisen
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Foreign companies have recently been smitten with the U.S. corporate bond market.

Firms outside the U.S., excluding financial institutions, sold $338.2 billion in "Yankee bonds" in 2017, according to data provider Dealogic. Such bonds are typically issued in the U.S. by foreign companies and denominated in dollars. Last year trailed only 2013 in terms of total issuance, and Yankee bonds have made up an increasing share of total U.S. debt offerings recently.

The rise in Yankee bonds has been more pronounced among banks. Financial institutions, including UBS Group AG, Sumitomo Mitsui Financial Group Inc. and Banco Santander SA, collectively issued a record $293.5 billion of such bonds last year, according to Dealogic. Such issuance is off to a fast start in 2018 as well.

The moves are indicative of a number of trends that have propelled corporate bond issuance recently, even after years of a red-hot market. Investors are demanding smaller premiums over Treasurys to own corporate bonds, making it more attractive for companies to sell Yankee bonds.

Yankee bonds have gained more widespread appeal in recent years. Transparency increased after the Financial Industry Regulatory Authority began tracking the trading on the bonds alongside other forms of corporate debt in 2014, bankers say. That has helped Yankee bonds to trade closer in line with comparable debt issued by U.S. companies, some say.

"One thing we've certainly done over the last year or so is we've become more comfortable with some of the European banks," said Mike Collins, senior portfolio manager at PGIM Fixed Income. He said his firm has bought more Yankee bonds issued by European banks for clients who want U.S.-denominated debt.

Financial institutions, which issue large amounts of debt to fund operations, typically sell bonds into many markets and make decisions about which market to use based on a variety of factors, including funding costs and the need to diversify issuance. Recently, those factors have been favoring issuance of Yankee bonds, bankers say.

One factor that has helped make dollar funding more attractive in some cases has been **volatility** in the market for swapping funding between currencies.

At the end of last year, the cost of obtaining dollar funding using other currencies significantly increased. That has made it cheaper for some companies to raise funding in the U.S. bond market at particular maturities and swap it back to euros and other currencies.

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The New York Times

Business Day; Economy
Poll Finds Upturn in Sentiment on Tax Overhaul and Economy

By BEN CASSELMAN and JIM TANKERSLEY
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English

Americans are warming to the Republican tax law, and becoming more confident in the economy as a whole. They just aren't sure that President Trump deserves much credit.

The tax overhaul that Mr. Trump signed into law just before Christmas remains relatively unpopular and highly polarizing, according to a new poll conducted for The New York Times by SurveyMonkey. But support for the law has grown significantly over the past month, and more Americans believe that they will receive a tax cut. Forty-six percent of Americans strongly or somewhat approved of the law in early January, up from 37 percent when the bill was nearing passage in December.

At the same time, falling unemployment, accelerating economic growth and a surging **stock market** have made Americans increasingly positive about both their own finances and the overall economy. That could be good news for Republicans hoping to overcome Mr. Trump's unpopularity in the midterm elections.

Michael Moran, a recently retired business executive in Georgia, said the economy in his town an hour north of Atlanta was "red hot." The job market is so tight, he said, that he can't even find an electrical contractor to perform repairs on his house.

"There's help-wanted ads everywhere — you see them on all the stores," Mr. Moran said. "In 2010, you could've just yelled out the door and had people lining up."

Mr. Moran said that he had initially been concerned that the president's shoot-from-the-hip style could be bad for **financial markets** and the economy. A year into his term, Mr. Moran still isn't a fan, but he said he was "pleasantly surprised" by Mr. Trump's stewardship of the economy. The corporate tax system was overdue for an overhaul, Mr. Moran said, and he applauded efforts to reduce regulations on businesses.

"I won't say that Trump deserves all the credit for that, but it is true that the economy just really picked up," said Mr. Moran, who described himself as a political moderate who leans Republican but voted for neither Mr. Trump nor his opponent Hillary Clinton in 2016.

Over all, 42 percent of Americans believe the national economy is better than it was a year ago, according to the Times survey, which polled 10,509 adults in the first week of January. Only 23 percent believe the economy has gotten worse. And a broader measure of consumer confidence, which combines five questions on economic and financial conditions into a single index, rose significantly in January after remaining flat for most of 2017.

Ordinarily, such figures would bode well for Republicans heading into the midterm elections this fall. Most Americans, however, said Mr. Trump's policies had either hurt the economy or had little effect on it; only 38 percent said his policies had made it better.

"The overall story remains that the president is not getting credit for an economy that has been continuing on an upward trajectory," said Jon Cohen, vice president for survey research at SurveyMonkey.

Other recent surveys show public confidence in the economy is rising, but less movement on the tax bill. A Quinnipiac University poll released last week found that two-thirds of Americans viewed the economy as excellent or good, up 3 percentage points from December. A Gallup poll published last week found that approval for the law had risen to 33 percent in January from 29 percent in December, an increase that was not statistically significant.

Supporters of the tax law dismissed its poor poll numbers in the fall, saying Americans would like it more once they began to see its benefits in their take-home pay. “The results are going to be what sells this bill,” House Speaker Paul D. Ryan, Republican of Wisconsin, told reporters in mid-December.

Many Americans won’t start to see more money in their paychecks until February, because the Internal Revenue Service issued new tax withholding guidance only last week. But a series of high-profile announcements, from companies such as Walmart and Wells Fargo, have cited the tax bill in decisions to raise wages or give employees one-time bonuses.

Many analysts, however, say the pay increases were more a result of the strong labor market than the tax law. A Morgan Stanley survey of Wall Street analysts released on Tuesday found that only 22 percent expected the companies they follow to direct at least some of their tax savings to employee compensation. By contrast, 83 percent of analysts said companies would increase share buybacks, dividends or merger activity. (Analysts could select multiple responses.)

Still, the law, which cut taxes for businesses and individuals while eliminating many deductions and credits, isn’t particularly popular. Forty-nine percent of Americans in the Times survey said they disapproved of it, and far more people said they were strongly opposed to it than strongly in favor. And deep political divisions are evident: 86 percent of Republicans approve of the law, but just 13 percent of Democrats do.

Most Americans still don’t think they will see their taxes go down under the new law. According to the survey, 41 percent of Americans expect a tax cut this year, up from 33 percent in December. Most independent analyses estimate that three-quarters or more of households will receive a tax cut in 2018, although those cuts are set to expire after 2025.

Doug Leichliter, a retiree in western Pennsylvania, questioned the wisdom of a big tax cut at a time when unemployment is already low, saying he worried that it could lead to inflation. And he said he doubted that middle-class Americans would see much benefit in any case.

“I think everybody’s going to see a little bump, but the vast majority of the money is going to go to the 1 percent,” Mr. Leichliter said. “I don’t necessarily think the money’s going to trickle down.”

About the Survey: The data in this article came from an online survey of 10,509 adults conducted by the polling firm SurveyMonkey from Jan. 1 to Jan. 5. The company selected respondents at random from the nearly three million people who take surveys on its platform each day. Responses were weighted to match the demographic profile of the population of the United States. The survey has a modeled error estimate (similar to a margin of error in a standard telephone poll) of plus or minus 1.5 percentage points, so differences of less than that amount are statistically insignificant.

Follow Ben Casselman on Twitter: @bencasselman.

* Walmart’s Bumpy Day: From Wage Increase to Store Closings

* Companies Are Handing Out Bonuses Thanks to the Tax Law. Is It a Publicity Stunt?

* A Middle-Class Tax Cut? Americans Aren’t Buying It

* Lower Corporate Taxes, Higher Wages? Voters Are Skeptical

The tax bill that President Trump signed last month remains relatively unpopular, although support for it has grown, according to a new survey conducted for The New York Times. | Doug Mills/The New York Times

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Heard on the Street
In Treasury Market, There Are Reasons to Expect Trouble

By Justin Lahart
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[Financial Analysis and Commentary]

The most important question in the **financial markets** is whether bond yields will keep rising and how high they will go. If you untangle the forces driving the market, it is reasonable to see **10**-**year Treasury** yields at 3.5% at the end of the year.

That prediction won't be precisely correct, of course, but just trying to understand what could push up yields and how that would play out in other markets is a crucial exercise right now. The first two weeks of 2018 have brought rising yields to the front of investors' minds as the **10**-**year Treasury** climbed to 2.56%. That puts it close to the 2017 high of 2.61% it reached last March.

Among the factors that have hit the Treasury market this year, two stand out. First, Treasury inflation-protected securities suggest that about half the move higher in yields is due to worries about rising inflation. Increasing **oil prices** and a wave of raises and bonuses paid by companies in celebration of the tax cut would push yields even higher.

Second is markets' skittish reaction to dubious reports that China would buy fewer Treasurys and the Bank of Japan would buy fewer long-term Japanese government bonds. Purchases by foreign central banks have helped keep yields low, so the worries make sense. When they do cut back, yields probably will rise. It doesn't help that the Federal Reserve will be rolling more Treasurys off its balance sheet.

There are other factors that should drive up yields that the market hasn't digested yet. The Treasury Department will soon start issuing more bonds to meet a growing government budget deficit, boosted in part by the tax bill.

The White House's aggressive stance on trade poses another danger. Trade restrictions could raise prices for imported U.S. consumer goods and damp global demand for U.S. assets. Both would be bad for the Treasury market.

Lastly, there is the "term premium," the extra yield that investors demand for the risk of lending for the long term. The premium is deeply negative, the Federal Reserve Bank of New York estimates, a sign that investors remain skeptical about how much the Fed will raise rates and that the distortionary effects of central-bank bond buying continue to weigh on yields. Take the term premium to zero, which is the still-low level it was at last March, and the 10-year yield would be about a half-point higher. Throw in some signs that the tax cut is boosting the economy or that inflation is heating up, and 3.5% is within reach.

To get to that yield, the price of the **10**-**year Treasury** would drop 8%, a big loss on a safe government bond. Nearly every other market -- stocks, commodities, emerging markets and other bonds -- are priced for low bond yields. The losses there could be bigger.

No matter where yields end up this year, understanding how they will get there is increasingly important.

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Streetwise: Momentum Returns to Stock Market

By James Mackintosh
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Forget fundamentals: Momentum is back in the **stock market**. For the first time since the 2008 financial crisis a simple strategy of buying the stocks that had already gone up the most delivered a remarkable outperformance last year. Is it a sign of excess or the start of a new bull run?

Momentum is a formal way to capture two old Wall Street dictums: The trend is your friend until the end, and let your winners run. It can be measured over any period from microseconds to years, but investment strategies typically look for three-, six- or 12-month trends.

MSCI's momentum index and the exchange-traded funds that follow it buy stocks that have risen the most over six and 12 months. In the U.S., the index delivered a thumping 44% gain since the start of last year, almost double the **S&P 500**.

It is easy to make the case that the momentum is a sign of frothy markets. Momentum investors ignore profits, the economy and valuations, buying based purely on price. If they are doing better than investors who focus on fundamentals, the market may be losing touch with reality -- and is bound to reconnect, painfully, at some point. The last time MSCI's momentum index for U.S. stocks beat the market by this much was the 12 months up to the summer of 2008, shortly before Lehman Brothers collapsed.

Short-term momentum is also looking excessive. The relative strength index -- a popular way of smoothing 14-day momentum -- is the highest since 1996 for the **S&P 500**, signaling to those who use it that the market is heavily overbought and vulnerable to a reverse.

Bets on momentum also seem to be spreading beyond stocks. Commodities, bonds and currencies haven't shown a lot of momentum over the past year, but speculators in futures are buying into positions that already look crowded compared with the past, suggesting they expect momentum to build. Alain Bokobza, head of global asset allocation at Societe Generale, said hedge funds' bets on a rising euro and on a flattening U.S. yield curve -- the gap between short-term and long-term Treasury note yields -- are about the most stretched ever.

"No one wants to be against the wind," he said.

An alternative explanation is that a new bull run is just beginning. The U.S. might be nine years into its **bull market**, but it is only now that optimism is really returning to the economy. It has taken time for cautious investors to price in the effects of tax cuts and to accept that the global economy is doing well, but now they are piling cash into the market.

According to Bank of America Merrill Lynch analysts, last week was the sixth-biggest for equity fund sales on record, with $21.7 billion going into ETFs tracking stock indexes and $2.7 billion to equity mutual funds.

There are two prevalent explanations for momentum, and today the choice will make you more or less worried about the power of the trend.

The **bearish** explanation is that investors put far too much weight on the past, and buy what has gone up without properly assessing whether that is likely to continue. Momentum is created by this blind buying, and pulls prices further and further away from where they should be, until they snap back and crush those chasing gains.

The **bullish** explanation is that it takes time for investors to price in a new environment.

On this view prices rose as investors slowly woke up to the unexpected global economic strength and slowly came to believe in higher profits. Perhaps company analysts still haven't included U.S. corporate tax cuts in their profit forecasts due to their complexity, which could mean still more good news to come as the earnings season brings tax guidance from CFOs.

Goldman Sachs's chief U.S. equity strategist, David Kostin, said profit forecasts for the entire **S&P 500** produced by strategists such as himself are, unusually, higher than the sum of individual company forecasts partly because analysts haven't yet included tax cuts.

Both these explanations are plausible, although I find it hard to justify today's valuations even on the bull case. But it is worth noting that the current momentum portfolio perfectly captures today's consensus: heavily overweight banks (for interest-rate rises and deregulation) and technology companies (for low-inflationary growth); heavily underweight real estate (hurt by higher rates) and consumer staples (who needs downside protection?).

Inflation is the biggest risk to this consensus, and bondholders are rightly concerned about the recent pickup. But momentum investors also need a steady supply of new buyers wanting to jump on some quite old trends. The dot-com bubble is a reminder that trends can always go on longer than you expect, and timing a bust is hard. Still, it doesn't require a marketwide problem to hurt momentum. All it takes is an inflation-driven rotation out of tech and into cyclicals, which are already picking up, if you'll forgive me, momentum.

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Money and Business/Financial Desk; SECTBU
Small-Cap Stocks Pay Big for 3 Mutual Funds

By TIM GRAY
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In an era that rewards outsize personalities and grandiose dreams -- ''Go big or go home,'' as the saying goes -- staying small seldom brings kudos.

But for the managers of three of the top-performing mutual funds of the fourth quarter, investing in the market's mice -- small-capitalization stocks -- gave enormous gains. The trio define their mandates differently, but all often favor smaller fare.

Scott L. Barbee, portfolio manager of the Aegis Value Fund, calls himself a deep value investor: He typically sleuths for shares in sectors other investors have fled. ''We're trying to catch cyclical stocks at the trough or companies that are undergoing some kind of stress that's created a lot of negative bias in the media and among other investors,'' he said.

Mr. Barbee wants to buy stocks at steep discounts to his estimates of their worth. In particular, he assesses how a company's book value -- the net accounting value of its assets -- compares to market values. The assets can serve as a floor for a **stock price**, because, in theory, a company shouldn't be worth less than the net value of its assets.

Several years ago, Mr. Barbee's digging led him to gold. ''The gold miners, from 2011 and 2015, they were down something like 90 percent,'' he said. ''If you think about the broader market, in the Great Depression, it fell something like 90 percent. So you had this extraordinary collapse in valuation as the price of gold dropped.'' When the metal price rebounded over the last couple of years, so did the stocks.

A willingness to wager on the unloved also prompted his investment in Resolute Forest Products, a lumber, paper and pulp company based in Montreal. ''There'd been a tremendous investor focus on declining newsprint sales,'' he said. ''The advent of the internet and digital delivery has changed the news business, and this was causing huge declines in newsprint demand.''

Resolute is the world's biggest producer of newsprint. But, having emerged several years ago from a bankruptcy, it had restructured, emphasizing tissue making and lumber production. As a result, Mr. Barbee said, ''People are now seeing this as a lumber company instead of a declining newsprint business.'' That translated into a fourth-quarter surge, when the stock rose more than 100 percent.

That jump contributed to an overall fourth-quarter gain for Aegis Value of 21.66 percent, compared to 6.64 percent for the **Standard & Poor's 500-stockindex**. The fund, whose retail shares have a net expense ratio of 1.75 percent, will celebrate its 20th anniversary this year. Over its life, it has returned an annualized average of more than 10 percent.

Resolute also helped propel the fourth-quarter gains of the Chou Opportunity Fund. Like Mr. Barbee, the fund's manager, Francis S. M. Chou, is value investor. He said he aims to buy a stock for no more than $60 a share if he estimates its value at $100. ''That's my margin of safety.''

Resolute, for example, ''was really cheap,'' he said. ''The book value was about $20 a share, and I bought at about $4. Even if you took the value of the newsprint away, it was still worth more than $4.''

Mr. Chou's United States funds are relatively new -- Opportunity began in 2010, as did his United States bond fund -- but he has managed money in Canada for more than 30 years. His biography is unusual. He didn't attend business school or toil at another investment company. Rather, he was a telephone-company technician, enamored of the **stock market**, and persuaded several friends to start an investment club. The club evolved into his first Canadian mutual fund.

He likens his investing style to bargain hunting at the store. "When you go shopping, you try to buy at a discount," he said. "I do the same thing. I just need to understand accounting to evaluate the companies." He'll hold off buying unless he sees what he considers a great deal. "You have to have patience and buy when stocks are selling off for some negative temporary reason -- like Resolute. Its valuation seemed as if it was totally dependent on newsprint."

Morningstar, the investment information company, classifies Mr. Chou's fund as a small-cap value offering, based on its holdings. But the fund can invest more broadly. Lately, for example, it has held large quantities of bonds and cash -- the cash accounted for about one-fifth of its assets at September's end.

"If you're really picky, you may not be able to buy anything for a while," he said. "If I can't find anything I like, I'll stay in cash."

Mr. Chou's fund returned 16.94 percent in the fourth quarter. It has a net expense ratio of 1.2 percent. For the last several years, Mr. Chou has not taken a management fee because he said he has been unsatisfied with the fund's performance -- the fund lost money in 2015 and 2016. He said he plans to begin taking the fee again.

Unlike Mr. Barbee and Mr. Chou, Alex Ely, portfolio manager of the Delaware Smid Cap Growth Fund, doesn't obsess over cheapness. Rather, he seeks companies that can increase their earnings at well-above-average rates. "We're fanatic growth investors," he said. (Smid is a neologism for "small and mid cap," though Morningstar groups the fund with small-cap growth offerings.)

To find potential investments, he first identifies big economic themes -- two recent favorites are "money in motion" and "high-quality construction" -- and then buys stocks that stand to benefit.

"Money in motion" means online banking, especially enabled by smartphones. While banks have offered online services for several years, Mr. Ely said consumer acceptance has advanced as the services have become easier to use. "I don't think my son has ever been to a bank," he said. "And soon we're all going to do our banking online." That's why his fund holds both Epam Systems, a tech company whose offerings include financial-services software and LendingTree, an online lender and financial marketplace.

"High-quality construction" is Mr. Ely's shorthand for where he sees growth in home building. Residential construction has been sluggish since the financial crisis, but the market is providing pockets of promise, he said. People continue migrating to places with "lower taxes and better weather," like Tampa, Fla., Charleston, S.C., and Austin, Texas. So home building there is picking up, as are the stocks of builders that operate in the region, like LGI Homes, a recent top holding of the fund. Even in parts of the country where new construction remains slow, like the Northeast, people are increasingly renovating homes, he said.

By investing in American Woodmark, a cabinet manufacturer, Mr. Ely said, he aims to exploit both trends. New houses need cabinetry, and cabinet-heavy kitchens and bathrooms are "the leading areas people look to for improvements to their homes," he said.

The Delaware fund, whose A shares carry an expense ratio of 1.21 percent, returned 18 percent in the fourth quarter.

Alex Ely, above, manager of the Delaware Smid Cap Growth Fund, looks for companies that can increase their earnings at well-above-average rates. Scott L. Barbee, right, who manages the Aegis Value Fund, wants to buy stocks at steep discounts. (PHOTOGRAPHS BY HIROKO MASUIKE/THE NEW YORK TIMES; JULIEN BOURGEOIS FOR THE NEW YORK TIMES) CHARTS: Ahead of the Market: How three of the better performers of the fourth quarter of 2017 fared against the market -- and against their peer groups of funds. (Source: Morningstar Direct)

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The New York Times

Money and Business/Financial Desk; SECTBU
An Eerie Kind of Calm

By CONRAD DE AENLLE
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A rare calm has settled over the **stock market**. Whether it turns out to be the one before the storm is a compelling question after a year of conditions so placid that investing has begun to look deceptively simple.

In all of 2017, the **Standard & Poor's 500-stockindex** experienced no decline greater than 3 percent, the first time that had happened. And a widely followed **volatility** index known as the VIX closed below 10 on more than 40 days in a six-month period through late November, according to Citi Research. Before that, the VIX had not closed below 10 on more than six days in any six-month period.

The peaceful trading backdrop helped the **S.&.P 500** rise 19.4 percent on the year and 6.1 percent in the fourth quarter. Factoring in dividend payments and additional appreciation from the reinvestment of those dividends in the constituent companies' stocks, the index returned 6.6 percent in the quarter and 21.7 percent throughout 2017. And, despite some rumblings in the bond market, stocks moved even higher in the early days of 2018.

But the drastically reduced trading **volatility**, a condition sometimes called metastability, worries some Wall Street strategists.

It's not just that persistent buying has sent stocks to valuations exceeded only on a few occasions that preceded spectacular plunges. Billions of dollars have been committed to vehicles that seek to profit from the extraordinary degree of stability and depend on it persisting. If and when things change, the storm after the calm could be sudden and violent.

''Increasingly, people of a certain age who have seen enough cycles say, 'We've been here before. We know the party's going to end,''' said Rebecca Patterson, chief investment officer of Bessemer Trust, a firm that advises wealthy families. ''It won't end well.''

The year ended well for domestic stock funds, with the average one in Morningstar's database gaining 5 percent in the fourth quarter and 18.3 percent on the year. Portfolios that focus on technology, natural resources and economically sensitive consumer issues were especially strong in the quarter. Health care and real estate funds were noticeably weaker.

A **stock market** that never goes down except by a negligible amount -- at least lately -- has been widely perceived as less risky. Vehicles known as risk-parity funds seek to capitalize on the lack of price swings by allocating more money to stocks as **volatility** diminishes. Mutual funds that employ risk-parity strategies held about $8.6 billion at the end of 2017, according to Morningstar.

But nothing lasts forever. When the metastability ends and **volatility** returns to more normal levels, risk-parity funds will view stocks as riskier and begin to take their bets off the table. The more sudden the return of **volatility**, the faster the funds will sell. If it happens quickly enough, the market could go from metastable to not at all stable, turning a virtuous circle vicious.

''The whole thing could unravel very quickly,'' Ms. Patterson said, although she is merely concerned, not alarmed.

''We don't see enough red flashing lights to get out,'' she said, ''but we see yellow caution lights.''

For Komal Sri-Kumar, president of Sri-Kumar Global Strategies, the hue is more crimson.

"I see risk preference shifting significantly to risk taking," he said. "The low-**volatility** trade is characteristic of a euphoric market."

But, he added, "There are uncertainties present in global markets, and investors are also ignoring how highly valued equities are. They don't seem to care. In terms of what the **equity market** is telling you, they have no concern that a problem or a massive correction lies ahead. They think central banks will save them."

The bond market is sending a more unsettling message, Mr. Sri-Kumar warned. Despite steady and stronger economic growth in recent quarters and low unemployment, yields on long-term Treasury securities haven't risen very much, even as short-term rates continue higher. That combination has led the yield curve, or the difference between short and long rates, to flatten.

The yield on two-year Treasury issues at the end of December was 0.51 percentage points below **10**-**year Treasury** yields, close to the narrowest spread in 10 years. The spread has widened slightly but if the yield curve should invert, pushing short-term rates above long-term ones, it would be an ominous sign, because an inverted curve often heralds a recession.

"It's very instructive that the bond market is giving a completely opposite story," Mr. Sri-Kumar said. "It has gone from being somewhat cautious to excessively cautious. I think it will invert over the next few months."

The average bond fund rose 0.5 percent in the fourth quarter and 4.8 percent on the year.

"The fixed-income rally still has a way to run," Mr. Sri-Kumar predicted. "If we do have a massive **stock market** correction, we will see the **10**-**year Treasury** and investment-grade bonds going down in yield."

He would reduce holdings of stocks and focus on defensive sectors and foreign markets, and he would allocate as much as 20 percent of a portfolio to cash.

The low **volatility** and overvaluation in the **stock market** have lasted a long time and might do so until a catalyst arises. That could be the continuing shift in Federal Reserve policy that kept short-term interest rates close to zero percent for nine years and led the central bank to buy trillions of dollars of bonds in its quantitative easing program.

The Fed has already raised rates five times in the last two years, including in December, and it announced in September that it would begin selling the bonds in its enormous inventory. The impact of such changes on the markets could depend on what investors focus on: how much support the Fed continues to provide, or how quickly it is removing support.

James Paulsen, chief investment strategist at the Leuthold Group, cautioned in a note to clients that while economic conditions may seem close to ideal, small changes could threaten that benign outlook.

"Perhaps we are in the early stages of a melt-up similar to the late stages of past bull markets," Mr. Paulsen wrote. "However, several economic and **financial market** indicators are on the cusp of eye-catching levels, which could shatter the 'sweet spot' scenario." Long-term Treasury yields in early December were 0.25 percentage points below three-and-a-half-year highs, for instance; wage and consumer price inflation were near multiyear highs; and unemployment was a couple of tenths of a percentage point from 50-year lows.

One recent development that caught the eyes of investors was the most sweeping overhaul of the federal tax code since the 1980s, including a drastic reduction in corporate income tax rates. But there are other matters of policy and politics that could send stocks lower if a more aggressive Fed does not.

Mr. Sri-Kumar advised investors to "watch for a possible cancellation of Nafta in the first quarter." If the North American Free Trade Agreement is torn up, American multinationals may face retaliation abroad.

"The rising risk of a trade war will be a more important factor to consider for 2018 than any positive impact of the corporate tax cut," he said.

Concern that American stocks may be expensive and accident-prone is sending some investors packing. Foreign stocks comfortably outpaced their American counterparts during 2017 when returns are expressed in dollars.

The SPDR **S**.**&P**. **500** exchange-traded fund rose 19.4 percent last year, while iShares MSCI EAFE, which tracks foreign developed markets, rose 23.8 percent, and iShares MSCI Emerging Markets gained 35.2 percent.

The average international stock mutual fund was up 4.5 percent in the fourth quarter and 25.9 percent for the year. Specialists in China and India rose more than 40 percent on average for 2017.

The comparative strength overseas "has probably got to do with the starting points in terms of valuations and interest rates," said Benjamin Beneche, one of the managers of the AMG Managers Pictet International fund. American stocks are so expensive that, even with the recent underperformance, they remain considerably more expensive than foreign shares.

At the end of the year, the **S**.**&P**. **500** E.T.F. traded at 22.7 times the earnings of the constituent companies over the preceding 12 months, according to Morningstar. Valuations were 17.5 times earnings for the EAFE fund and 14.4 times for the emerging markets E.T.F.

Jeremy Richardson, a portfolio manager at RBC Global Asset Management, attributed the strength abroad to evidence that President Xi Jinping was consolidating power in China; recent increases in commodity prices, which help the many emerging economies that export them; and "a firming of economic growth, in Europe in particular, amid some signs of central bank and fiscal policy taking hold."

His advice for investors scouting around for foreign assets is "to emphasize equities because they're better in the long run" and "to pay close attention to the quality of companies you're buying."

Mr. Richardson finds particularly good opportunities in cloud computing, where "the size of the market is underappreciated by most investors," and businesses related to electric transportation, such as battery and motor manufacturers.

Mr. Beneche likes the auto industry, too, but the old-fashioned one.

"There's a myopic focus on electric vehicles and ride sharing," he said. "The electric transition might take longer than people are expecting." He especially likes companies that make parts for cars already on the road, such as Hyundai Mobis.

Other niches he favors include Asian consumer technology companies like SoftBank, Alibaba and JD.com, a Chinese e-commerce business, and businesses with a large controlling shareholder, such as Vivendi and Richemont.

Ms. Patterson is less sanguine about foreign stocks. She said much of the outperformance has been caused by a weak dollar, which raises the value of foreign assets. She expects the dollar to recover and prefers American stocks, particularly technology issues. Nevertheless, the risks that have lain dormant have persuaded her to remain well diversified in bonds, foreign stocks and gold, which has "kind of been left for dead."

The **stock market** has had plenty of life in it, even if trading has not been lively. For Ms. Patterson, "the base case is that Goldilocks continues," she said, meaning conditions will be just right, with low inflation and benign central bank policies. But with that outlook ubiquitous on Wall Street, as implied in the eerie calm in the **stock market**, she is reluctant to state her case too strongly.

"The idea that the party will continue for quite a long time is creating more risk-taking, and that's what worries me more than anything else right now," she said. "Will this year be more of the same, or will a big bear come out and ruin us?"

Above, crates of American-made parts being prepared for shipment into Mexico in Pharr, Tex. "The rising risk of a trade war will be a more important factor to consider for 2018 than any positive impact of the corporate tax cut," one investment consultant said. (PHOTOGRAPH BY NATHAN LAMBRECHT/THE MONITOR, VIA ASSOCIATED PRESS) CHARTS: FOURTH-QUARTER MUTUAL FUND RETURNS: OCT. 1-DEC. 31, 2017 (Source: Morningstar); DRAWING (DRAWING BY MINH UONG/THE NEW YORK TIMES)

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The New York Times

Money and Business/Financial Desk; SECTBU
Tech Giants' Rise Gives Rebalancing a New Appeal

By NORM ALSTER
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English

Index-based investing is appealing partly because it promises to simplify decision-making. Buy a fund that tracks a major index like the **Standard & Poor's 500-stockindex** and you can sit back knowing you don't have to switch in and out of sectors and stocks.

You own a balanced portfolio that should perform well in all sorts of market conditions.

But do you really?

If you think you're protected from market swings by holding index-based investments, think again.

The central story of 2017's thundering **bull market** was the relentless advance of shares of fast-growing companies, particularly in the technology industry. The so-called Faang stocks (Facebook, Amazon, Apple, Netflix and Google) rose so far so fast that index-based investments that were once balanced now seem top-heavy with risky highfliers. Faang stocks made up just 6 percent of the **S**.**&**.**P**. **500** in 2013. By the end of last year, they accounted for 12.3 percent, noted Joe Abbott, chief quantitative strategist with Yardeni Research.

Over all, large growth stocks soared 25.4 percent in 2017. Large value stocks, whose earnings and revenue grow more slowly and which are typically cheaper by such metrics as price-to-earnings ratio, tacked on 12.6 percent.

So is now the time to rebalance by adding value and trimming growth?

For investors with long horizons, ''rebalancing is an excellent strategy,'' said Chris Brightman, chief investment officer for Research Affiliates. ''Wealth is built long term with periodic rebalancing,'' he added.

One way to offset the heavy weighting of tech stocks in exchange-traded funds and index funds that reflect market advances is through an index like the Guggenheim Equal Weight **S**.**&**.**P**. **500** E.T.F., Mr. Brightman said. Equal weight indexes own the same amount of all stocks and so are not overexposed to market highfliers. Over the last decade, the **S**.**&**.**P**. **500** Equal Weight index has returned just over 10 percent annually, while the market-cap-weighted **S**.**&**.**P**. **500**. has returned less than 9 percent annually.

Tom Galvin is lead manager of the Columbia Select Large Cap Growth fund. Though his mandate requires holding growth companies, he has been lightening up on some highfliers. ''We have been trimming back some of the winners,'' Mr. Galvin said. The fund has sold off roughly 20 percent of its Amazon stock and roughly one-third of its position in Facebook, he said.

Still, Mr. Galvin emphasizes that the tech rabbits have raced ahead largely because they've met or exceeded expectations. Apple's year-over-year revenue growth has accelerated in recent quarters. Apple cited its revived strength in China, along with better-than-expected unit sales of iPhones, iPads and Macs, in its most recent quarterly report.

Similarly, a year ago, analysts expected Facebook to earn about $4 a share over the next 12 months, Mr. Galvin said. But Facebook succeeded so well in making its gigantic membership an audience for ads, it earned over $5 a share in the last four quarters.

Growth stocks may also have fared well because they are suited to current economic conditions. ''I think growth stocks do very well in a low-inflation environment, when pricing power is elusive and therefore unit growth is the key driver to profit growth," Mr. Galvin said. There is a flip side, though: "If you felt strongly we were moving to a sustained reflationary environment, you'd want more value," he added.

Sebastien Page, head of the Global Multi-Asset division within T. Rowe Price, also sees merit in increasing value holdings. "As a general statement, value should benefit more than growth from the tax cut," he said. Financial companies, typically considered value stocks, pay relatively high taxes and will benefit from a tax cut.

But because the market has risen almost nonstop since 2009, value stocks are also fairly expensive, some argue. "You don't want to buy your beaten down, distressed deep value stocks," said Mike Fleisher, lead portfolio manager of the Legg Mason BW Dynamic Large Cap Value fund. "You want to buy a value stock with a catalyst."

Mr. Fleisher cited Citigroup as a worthwhile stock. "They're buying back shares," he noted. "Our quantitative research finds that when a company has bought back shares over the previous 12 months, it tends to outperform the next 12 months," he said.

For investors disinclined to pick through hundreds of stocks to find the right value catalyst, there is another way to rebalance. Mr. Page of T. Rowe Price favors stocks in Europe, Japan, Australia and Canada. "Non-U.S. stocks have only been this cheap relative to U.S. stocks 7 percent of the time in the last 15 years," he explained. Two E.T.F.s that invest in such developed market stocks are the iShares MSCI EAFE E.T.F. and the Vanguard FTSE Developed Markets E.T.F.

Mr. Brightman also favors rebalancing across more than just the growth-value axis. "Every sector of the U.S. **stock market** is expensive," he said. "The fascination of the public with a narrow group of tech stocks is beginning to look a little bubbly."

So-called value stocks are also no bargain, he said. "You will not escape a **bear market** by being in value stocks," Mr. Brightman said.

The market won't necessarily decline simply because prices are high, he added. "It just means over the longer term you would get lower returns," he said.

Mr. Brightman urges very broad diversification. He includes United States equities, other developed market equities, emerging market stocks, real estate investment trusts, commodities and government bonds.

"If you have a long horizon, equal weighting and rebalancing are your friends," he said.

The Apple store on Fifth Avenue in Manhattan. The shares of large technology companies have risen so much in the last year that some index-based investments may now seem overloaded with them. (PHOTOGRAPH BY KATHERINE TAYLOR FOR THE NEW YORK TIMES)

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THE WALL STREET JOURNAL.
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Heard on the Street
Europe Is a Place Where Stocks Still Have Reason to Rally

By Richard Barley
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[Financial Analysis and Commentary]

The breadth of the global economic growth pickup is lifting even longstanding laggards. European stocks are a case in point, but the potential for catch-up remains appealing.

Even as U.S. stock indexes have set record after record, Europe has missed out. A vast gap has opened up between the performance of the **S&P 500** and the Euro Stoxx, both in price and valuation terms.

Indeed, on a forward price/earnings basis, the gap between the two is at a level not seen for more than a decade.

But things seem to be changing. In 2018, the Italian benchmark index is up 6.9% and Southern Europe is broadly outperforming the North: Greek stocks are up about 5.5%; Portuguese shares, 4.5%.

Breadth of growth is turning into breadth of performance, and eurozone stocks -- or exchange-traded funds that give U.S. investors exposure, like the iShares MSCI Eurozone ETF -- are benefiting.

In part, that may be because a key trade after the euro crisis has finally begun to run out of steam. Investors eyed the huge rally in bonds from Southern Europe rather than stocks: Once the sovereign-debt turmoil was tamed, there was a big opportunity in beaten-up eurozone bond markets as yields fell.

Now, stock markets are where greater opportunities may lie.

The Euro Stoxx forward dividend yield of 3.2% is far in excess of German government bond yields and European investment-grade corporate bond yields. By contrast, the **S&P 500** dividend yield, at 1.91%, is now below the two-year **U**.**S**. **Treasuryyield** and far below corporate bond yields and this week touched its lowest since 2007, according to FactSet data.

There are reasons to think carefully about European stocks. The euro for one might still pose a problem, as its rise in 2017 weighed on European stocks, although it gave dollar-based investors a big boost. Thursday's account of the European Central Bank's December meeting suggested a gradual shift in policy guidance could be coming. Politics matters, too; Friday's news of a potential breakthrough by Angela Merkel in forming a government in Germany lifted the euro to a three-year high above $1.21. But Italy will also face a test in coming elections.

Set against that is strong growth momentum and the way recent European stock gains have been driven by earnings, not multiple expansion like in the U.S. Even laggards can put on a burst of speed.

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The New York Times

Business/Financial Desk; SECTB
Led by Retailers, Indexes Keep Pushing Higher

By THE ASSOCIATED PRESS
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English

Rising retailers pushed U.S. stock indexes further into record territory on Friday, as the market's robust start to 2018 carried through its second week.

Interest rates also climbed after a report showed that a key component of inflation accelerated last month. But stocks absorbed the gains without a hiccup, unlike earlier in the week when rate worries helped send the Standard & Poor's 500-stockindex lower for its lone blemish this year.

The S.&P. 500 rose 18.68 points, or 0.7 percent, to 2,786.24 on Friday to close out its seventh week of gains in the last eight. The index is already up more than 4 percent this year.

The Dow Jonesindustrial average climbed 228.46, or .9 percent, to 25,803.19; the Nasdaq composite rose 49.28, or 0.7 percent, to 7,261.06; and the Russell 2000 index of small-cap stocks gained 5.18, or 0.3 percent, to 1,591.97.

Retailers led the way after a government report confirmed that the holiday shopping season was a strong one, with retail sales rising 0.4 percent last month after a .9 percent surge in November. The numbers fit with what individual retailers have said recently, and several retailers have raised their profit forecasts as a result.

Shares of Kohl's, Target, Nordstrom and Dollar Tree all jumped more than 3 percent.

Treasury yields rose after a key measure of inflation increased more last month than economists expected.

Overall inflation slowed in December, but that was mostly because of gasoline and other items that are prone to quick changes in price. ''Core'' inflation, which looks at the steadier components of the Consumer Price Index, accelerated more than expected last month.

That pushed the yield on the two-year Treasury to 2 percent from 1.98 percent late Thursday. The yield on the 10-year Treasury note held steady at 2.54 percent after climbing as high as 2.59 percent in the morning.

Investors have been preparing for a gradual rise in rates, as the Federal Reserve slowly removes the aid it provided the economy after the Great Recession. The worry is that a surprise increase in inflation would prompt central banks to move more quickly on rates than investors expect and upset markets.

Stocks have been remarkably calm and strong for more than a year. Sandy Villere, a partner and portfolio manager at Villere & Co., says he is optimistic stocks can rise even further because the economy is strengthening and Washington's move to cut tax rates last month will boost corporate profits, among other reasons.

But some caution is starting to creep in as prices keep climbing. Mr. Villere said he was holding more cash than prior years as the types of stocks he prefers become more difficult to find: companies with strong growth but low prices relative to their earnings and growth.

''We're not fully invested at this point, but we haven't switched to pure defense yet either,'' Mr. Villere said. ''Things are good enough to keep things going solidly, at least for the first half of 2018.''

The next tests for companies will arrive in coming weeks, as they report their results for the last three months of 2017. Expectations are generally high.

Financial companies are some of the earliest to report, and BlackRock jumped $17.61, or 3.3 percent, to $555.53 after it reported stronger earnings than analysts expected.

The euro jumped to $1.2181 from $1.2036 late Thursday. The British pound rose to $1.3734 from $1.3536, and the dollar held steady at 111.09 Japanese yen.

In the commodities markets, benchmark U.S. crude rose 50 cents to settle at $64.30 per barrel.

Natural gas gained 12 cents to $3.20 per 1,000 cubic feet, heating oil added a penny to $2.09 per gallon and wholesale gasoline rose 1 cent to $1.85 per gallon.

Gold rose $12.40 to settle at $1,334.90 per ounce.

CHART: The **S**.**&P**. **500 Index**: Position of the **S**.**&P**. **500 index** at 1-minute intervals on Friday. (Source: Reuters)

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U.S. News: Prices Data Bolster Inflation View

By Ben Leubsdorf and Nick Timiraos
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English

A modest rise in consumer prices in December and solid growth in retail sales bolstered expectations that inflation is firming after a long run of softness and that U.S. economic growth ended 2017 on a robust note.

Forecasters on Friday raised their expectations for fourth-quarter growth after the Commerce Department reported sales at U.S. retailers, restaurants and websites rose a seasonally adjusted 0.4% in December from the prior month.

Macroeconomic Advisers estimated a 2.7% annual growth rate for gross domestic product in the final three months of 2017, up from its 2.3% estimate as of Thursday.

Forecasters also saw signs of inflation picking up after the Labor Department reported stronger-than-expected growth last month in core prices, which exclude often-**volatile** food and energy. The consumer-price index rose just 0.1% from November, but core prices jumped 0.3%, the most in 11 months.

"We've been seeing stronger gains in core inflation, and I think there are good reasons to expect core inflation will be stronger this year as well," said Michael Pearce, senior U.S. economist at Capital Economics.

U.S. inflation has been largely subdued for the past half-decade, perplexing Federal Reserve officials who predicted bigger wage and price increases as the supply of labor and other economic resources became more scarce.

Many central bankers say inflation is finally poised to strengthen a bit.

Investors, too, appear to be anticipating higher inflation. The yield on the benchmark 10-year U.S. Treasury note closed above 2.5% this past week for the first time since March. The 10-year breakeven inflation rate, derived from Treasury inflation protected securities, has climbed since November.

Friday's report on consumer prices offered the latest evidence to support the Fed's view that decelerating price pressures last spring would prove transitory.

On a six-month annualized basis, core consumer prices rose 2.2% in December, up from a 0.9% gain in July and the strongest such increase since declines in prices for wireless-phone plans last March and prescription-drugs in April led to a string of soft inflation readings.

At their latest meeting in December, Fed officials revised up their forecasts for economic growth this year and lowered their forecast for the unemployment rate.

But they didn't change their projections for gradually raising interest rates, citing in part restrained inflation pressures.

Friday's Labor Department report didn't show a broad breakout for inflation. A 0.4% rise in shelter costs from the prior month accounted for much of December's uptick.

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The Intelligent Investor: The Stock Market Is Clawing the Bears

By Jason Zweig
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English

Imagine losing 80% or more while, all around you, investors are basking in the glory of one of the biggest bull markets in history. Imagine racking up year after year of losses while stocks are going up nearly 400%.

That's what it's like to run a short-selling fund that hedges against the risk of a falling **stock market**.

If you're a contrarian who is naturally attracted to parts of the market that have been losing money on the grounds that they are ripe for recovery, bear this in mind about these funds: On average, in the long run, you will lose money if you hold them.

Over time, stocks tend to go up more, and more often, than they go down. "So one would not expect an investor to be permanently short and, in fact, most should be permanently long," says Mohsen Fahmi, co-manager of the $2.1 billion Pimco StocksPlus Short Fund.

"I'm pretty sure that 99.9% of our investors understand that the fund is designed to make money when the market goes down," he says. "Perhaps, after nine years of a **bull market**, if any didn't know what they were getting into, they do now."

The **S&P 500** hasn't had a down year since 2008, when Taylor Swift was 19 years old.

Ever since stocks began trading in Amsterdam around the beginning of the 17th century, some investors have sought to profit when the market falls. Bears, or short sellers, typically seek to borrow stock, sell it and then buy it back at a lower price, locking in the difference as profit.

That works brilliantly when stocks drop. In 2008, the average **bear-market** fund gained 30%, according to research firm Morningstar Inc., even as the **S&P 500 stock index** fell 37%.

If you had invested in the average bear fund on Sept. 15, 2008, the day Lehman Brothers collapsed, and then sold your position on March 9, 2009, the absolute bottom of the financial crisis, you would have gained 59%. Meanwhile, the **S&P 500** lost 45%.

What if you had hung on? From March 9, 2009, through this past week, the average bear fund lost 93%, according to Morningstar. Over that period, the **S&P 500** is up 390%, including dividends.

On average, bear funds have lost money nine straight years, exactly as they should have in a rising market. Every single one of the 148 such funds with assets of at least $2 million had negative returns in 2017, according to Thomson Reuters Lipper.

Mr. Fahmi's Pimco Stocks-Plus Short Fund seeks to improve performance by using the money left over after it bets against stocks to forage across the bond and currency markets. As of now, the fund should benefit if 10-year U.S. Treasury inflation-protected securities appreciate and if emerging-market currencies rise against the dollar and other currencies issued by developed nations.

Is Mr. Fahmi bothered that Pimco StocksPlus Short has lost money nine years in a row? "Sorry to disappoint you," he laughs. "It doesn't cause [me] any sleepless nights. I'm very proud of our performance."

The fund has done its job and then some.

It lost 14% last year, even as the **S&P 500** went up 22%. A direct bet against the S&P should lose as much as 22% in a year when the market goes up by that amount, so a loss of only 14% is impressive. Pimco StocksPlus Short gained 49% in 2008, the last time the S&P had a down year.

Another **bear-market** portfolio, the $190 million Grizzly Short Fund, gained 74% in 2008 but has lost money in eight of the nine years since.

"We recognize the market goes up more than it goes down," says Greg Swenson, the fund's co-manager at Leuthold Weeden Capital Management in Minneapolis. "As long as clients know that and we know that, it takes a lot of the stress out of it."

Mr. Swenson isn't predicting an imminent crash. However, high profits, low unemployment and **bullish** sentiment suggest "things are so good, they can't get much better, and they could turn very quickly."

As the market has kept surging, he says, minimizing losses "has been the battle for the past couple of years." The fund gained 3.8% in 2015 but lost 14% in 2016 and 20% last year.

His fund, unlike the Pimco portfolio, doesn't short the **S&P 500**. Rather, it bets against specific companies based on such factors as how much stock management is selling, whether the supply of shares outstanding is increasing, and the extent to which other short sellers are angling for the price to fall.

Investors looking for cheap companies nowadays might as well be opening hens' mouths looking for teeth. But bears seeking to profit when overpriced stocks collapse need at least as much patience, or uncanny clairvoyance, along with a high tolerance for pain.

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The New York Times

U.S.; Politics
Global Elite? At Davos? That's News to Mnuchin

By ALAN RAPPEPORT
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WASHINGTON — President Trump's decision to attend the World Economic Forum, a global gathering of industry titans, government ministers, celebrities, activists and others at the mountain resort of Davos, Switzerland, raised eyebrows in Washington, given Mr. Trump's professed disdain for the "globalists" who typically attend the retreat.

But on Friday, one of his top economic advisers suggested that so-called Davos Men are closer to Average Joes.

"I didn't realize that it was the global elite," Treasury Secretary Steven Mnuchin, the administration official who will lead the delegation to Davos, said during an event sponsored by the Economic Club of Washington at the Ritz-Carlton hotel.

Mr. Mnuchin went on to explain that the World Economic Forum was no more elitist than the Group of 20 gathering of finance ministers or meetings such as the annual Milken Institute conference, which brings together financiers and executives for discussions about the global economy.

"If you look at the list, there's an awful lot of world leaders, there's an awful lot of finance chairs, there's an awful lot of business people," Mr. Mnuchin said. "This is an important economic agenda."

The World Economic Forum is not just any economic conference. The cost of a basic membership and ticket is more than $70,000, and attendees tend to incur heavy expenses on luxury cars or helicopters to get from the airport in Zurich to the resort in Davos, where panel discussions on subjects like global income inequality and the threat of climate change are held.

Those attending include top executives like Sheryl Sandberg of Facebook, Bill Gates of Microsoft and Ginni Rometty of IBM, along with Christine Lagarde, the head of the International Monetary Fund, and scores of other executives, economists and academics. Celebrities are also a mainstay, and last year's forum included interviews with Matt Damon, Shakira and Forest Whitaker.

The parties surrounding the conference also feature celebrities such as Bono and Leonardo DiCaprio. As for more interactive entertainment, one popular event is a simulation of a refugee's experience, where attendees crawl on their hands and knees to better understand what it is like to evade an advancing army.

The World Economic Forum has in the past drawn scorn from anti-globalization groups as a symbol of lavishness and elitism, and at times attendees have tried to be less conspicuous. In the wake of the financial crisis in 2009, Gary D. Cohn, who is the director of Mr. Trump's National Economic Council and was then chief operating officer at Goldman Sachs, was among the banking executives who opted to fly commercial to get to the forum.

Mr. Trump will be the first president since Bill Clinton to attend. As a candidate, he lashed out at his opponent, Hillary Clinton, for being a patron of "globalists" and elite bankers. In 2014, Stephen K. Bannon, who went on to be Mr. Trump's chief political strategist, said that working-class men and women were tired of being dictated to by "the party of Davos."

Some supporters of Mr. Trump have cast him as a populist "party crasher" at Davos, while others think the journey is unwarranted and unwise. Stephen Moore, the Heritage Foundation economist who advised Mr. Trump's campaign, told CNN that he was not pleased by the decision.

“I was disappointed that he’s going to Davos because I think it’s a lot of self-important people who have a totally different view of the world than he does,” Mr. Moore said.

In an interview with The Wall Street Journal on Thursday, the president suggested that he was going to Davos to be “a cheerleader for the country” and highlight his economic success. Mr. Trump is expected to use the platform to boast about the improving American economy, including the rise in the **stock market** and the low jobless rate, and to deliver the type of protectionist message on trade that he gave during his Asia trip.

Mr. Mnuchin, who has never attended the forum himself, said at a White House briefing on Thursday that the gathering was a good place to talk about the administration’s “‘American first’ economic strategy.”

“I don’t think it’s a hangout for globalists,” Mr. Mnuchin said.

* Trump Plans to Attend the World Economic Forum in Davos

Davos, Switzerland, where the price of entry to the World Economic Forum is about $70,000. | Arnd Wiegmann/Reuters

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The New York Times

Essay
Business Day
Blockchain or Blockheads? Bitcoin Mania Mints Believers and Skeptics

By JOHN SCHWARTZ
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Sometimes life shows you what absurd really is. This is one of those times. I'm talking about the phenomenon known as Bitcoin, a monetary system based on computation, complex algorithms and — let's face it — communal delusion.

You've probably heard about this funny money, digital tokens that can be sent securely from computer to computer, with records kept through an online accounting system known as blockchain. (My colleague Nathaniel Popper has been writing great stuff about it.)

Millions of people now have accounts with Coinbase, the leading marketplace for digital currencies. And the rush into the market has helped push prices up. At the beginning of last year, you could pick up a Bitcoin (not literally, because they're virtual, DUH) for about a thousand bucks. Its gyrations briefly brought its price near $20,000, according to Blockchain.info, which tracks such things.

So what's the problem?

Let me answer that question with a question: What do you know about tulips? Yes, I am referring to the Dutch tulip craze back in the 17th century, and the speculative bubble that preceded the **stock market** crash of 1929, and the dot-com boom and crash that started in the late 1990s. Remember that last one, when learned analysts told us that advancing technology had eliminated the business cycle?

Good times. No bubble is too big to burst.

But hey, no regrets! Carpe Bitcoin! (But not literally.)

Signs of a bubble seem to be everywhere in the Bitcoin world today. Companies are trying to cash in by sprinkling themselves with a little Bitcoin fairy dust. Take the company called Long Island Iced Tea, which makes, you know, tea. The price of its shares nearly doubled one day last month after it announced that it would change its name to "Long Blockchain Corp." The company's announcement claimed it would "pursue opportunities" in blockchain technology. Which makes it sound as if some of those teas they brew are highly caffeinated. Or that people are indulging in that other kind of Long Island Iced Tea.

I called Christian Day, a professor at Syracuse University law school who has written about bubbles and panics. He said that comparing Bitcoin to the tulip craze was unfair to tulips: "The Dutch were not as crazy as they've been portrayed."

For one thing, the tulip bulbs were real, he said, and the hybrids that were the subject of speculation could be extremely valuable. What's more, much of the trading was done by people who knew their horticulture. With the modern techno-tulips, he said, "I don't think there's anything there."

Some of the most skeptical folks are experts in cryptography and computer security. Steven Bellovin, an adept in computer security and a professor at Columbia University, told me that the technology is still too buggy, "a lab experiment that escaped into the wild." It's hard to trust a currency, he said, that's "backed by the full faith and credit of software that has to be updated monthly."

Another security expert, Matt Blaze, recently tweeted, "Cryptocurrency somehow combines everything we love about religious fanatics with everything we love about Ponzi schemes."

Ouch, currency guys. Well, you can afford some very expensive salves for those burns. For now.

For another point of view — because I'm all about even-handedness, people! — I checked with Jim Harper, executive vice president of the Competitive Enterprise Institute. He served on the board of the Bitcoin Foundation and says the promise of Bitcoin is to create a payment system people can use anywhere in the world with privacy and security. He says its true value will be in commerce, not speculation.

Well, that hasn't happened yet; the price is too unstable. He said the currency will move beyond some of the early notorious uses in illegal commerce. As for the tulip comparisons, he joked, "Laugh all you want: My initial coin offering for cryptotulips will be worth billions!"

I have discovered that the cryptocurrency revolution has reached my own family. My 22-year-old son told me that he had tried to buy a bit of a Bitcoin a few weeks ago and actually lost the money. It was his cash to spend, so there was no lecturing him about it. But I did ask why he had tried to invest in Bitcoin when he's shown little interest in, say, mutual funds.

He said that he had been unaware of the speculation in Bitcoin. Instead, he said, he was trying to use it for precisely what Mr. Harper says it will be best for: currency transactions with vendors who do not accept, for example, debit cards or PayPal.

"What I was actually trying to do was buy porn," he said patiently. "From Japan."

As I said, he's a millennial, full of that generation's bracing honesty. I'm glad he told me, but I sure don't need to know more about the particular transaction, except for the clarifying fact that this vendor would take Bitcoin.

He said he followed the instructions and created a "wallet" and went to an exchange and, after entering a great deal of personal information, bought a small fraction of a bitcoin — in fact, 0.005 of one, "the lowest quantity you could purchase" on the site. Then he found that he couldn't figure out how to get to his money, grew frustrated and gave up. Well, I told him, losing 70 bucks is hardly ruinous; it's more like the cost of an education.

As we discussed the aborted transaction, he grabbed his laptop and took another look at the exchange site.

"Oh," he said. "I got in." A calmer state of mind had led to success.

The result? "I've got 0.00545679 Bitcoin," he said, reading off the screen, "which is now worth … $96." In the time the money had been locked up, it had jumped in value by about a third. "This has been a profitable evening!"

Tell me about it. In sheer percentage terms, his little investment outperformed my 401(k)'s return for an entire year.

Now I am trying to figure out how to cash in on all of this, though without buying Bitcoin myself. It's exactly the kind of market that a fool like me might be tempted to rush into, but I've learned enough over the years to know that by the time I finally try the hot new thing, it is already cold and old. I am the maker of markets, the loser who helps to create winners.

Instead, maybe I'll just pull a Long Island Iced Tea and change my name to Blockchain Schwartz. It has a nice ring to it! But that's just a start.

I think I'll write all of my articles from now on in an encrypted form and publish them via blockchain. This means, unfortunately, that no one will be able to read them.

You may say that nobody can read your stuff anyway! You can be cruel, reader. But I say that the exclusivity and security built into my cryptoprose will make each article surge in value. Until I lose my passwords.

John Schwartz is a New York Times reporter and author of "This Is the Year I Put My Financial Life in Order," coming in April. Follow him on Twitter: https://twitter.com/jswatz

* What Is Bitcoin, and How Does It Work?

* The Can't-Lose Way for Your Business to Pop: Add Bitcoin to Its Name

* How the Winklevoss Twins Found Vindication in a Bitcoin Fortune

* Bitcoin Exchange Was a Nexus of Crime, Indictment Says

Glynis Sweeny
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The New York Times

Business Day
For Bond Investors, Low Expectations in a Low-Yield World

By CARLA FRIED
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The prospect of a strong economy in the United States and a strengthening one in much of the rest of the world is good news for workers and for many companies. But for bond investors, it is a headache.

“We’re not of the view that there is any sector that stands out as extremely cheap on a valuation basis,” said Ashok Bhatia, senior portfolio manager in Neuberger Berman’s Fixed Income Multi-Sector Group.

Yet in 2017, many investors turned to bonds anyway. Nearly $380 billion found its way into bond funds, nearly double the flow into stock funds, according to the Investment Company Institute.

That makes a certain amount of sense in Year 9 of a **bull market** that has lifted the **Standard & Poor**’**s 500**-**stockindex** more than 370 percent since the 2009 low. When stocks seem risky, core bonds are safer havens.

But despite a recent surge, bond yields are still fairly low and don’t scream opportunity, either. The Vanguard Total Bond Index , the largest index portfolio, has a yield of about 2.5 percent. The actively managed Dodge & Cox Income fund had a recent yield of 2.75 percent And investors are getting paid less to take on risk. The 5.6 percent yield of the SPDR Bloomberg Barclays High Yield Bond E.T.F. is nearly half a percentage point lower than a year ago.

What’s worse, if the economy remains strong, there is a good chance that yields will move higher. That is a problem for fixed-income investors because rising bond yields mean falling **bond prices**. For people holding bond mutual funds and exchange-traded funds, total return is a combination of yield and price. It all makes it less likely that core bond funds — those that focus on high-quality securities — will be able to match the 3.7 percent average gain for 2017, which was 1.5 percentage points ahead of the inflation rate.

“We are in a transition market,” Mr. Bhatia said.

As evidence, consider that the difference between short and long-term rates is less than it has been since 2007. In bond market parlance, the yield curve has flattened.

Why has this happened? Shorter rates are being pulled upward by the Federal Reserve from the near-zero level that the Fed instituted during the financial crisis.

Longer term rates, on the other hand, are constrained by the expectation that inflation will remain very low in 2018.

Rick Rieder, global chief investment officer of Fixed Income at BlackRock, says inflation could surprise the market next year. It is possible that a falling unemployment rate at a time of solid economic growth could put ample pressure on wages that would, in turn, raise inflation off the floor. “I think we can get to 2 percent,” Mr. Rieder said. The Federal Reserve’s preferred inflation measure has crawled along below 1.5 percent since the financial crisis.

A 2 percent inflation rate would most likely just nudge long-term rates higher, he said, adding that he expects a “slow and low trajectory” for long-term rates. His base case is that the **10**-**year Treasury** rate, now at about 2.5 percent, won’t rise much beyond 2.7 percent.

Unless inflation surges unexpectedly, a 3 percent yield for the **10**-**year Treasury** note may not be likely. Julien Scholnick, a fixed income manager at Western Asset Management, which manages $435 billion in global bond portfolios, notes that a year ago, the **10**-**year Treasury** bill rose briefly to 2.6 percent. And that was after the surprise election of Donald J. Trump spurred an expectation of quick stimulus materializing through tax changes, infrastructure spending and regulatory easing.

“We don’t see higher inflation as probable,” in 2018, Mr. Scholnick said. With an expectation that long-term rates will not venture far from current levels, the Western Asset Core Plus Bond fund currently has an average duration — a measure of risk to changing interest rates — that is slightly higher than the six-year norm for the benchmark Bloomberg Barclays U.S. Aggregate Bond index.

Shifting economic and market dynamics in 2018 may raise the value of small tweaks to basic bond portfolios.

The high-quality United States bonds in the aggregate bond index will deliver on their main purpose in your 401(k): When stocks falter, these bonds will hold their ground, and they may even rally. But the aggregate index will also be very sensitive to Federal Reserve interest rate increases, as 37 percent of the index is invested in Treasuries and another 27 percent in government agency bonds.

Mr. Bhatia at Neuberger Berman recommends adding high-quality corporate bonds, which will not be as sensitive to rising rates as government bonds. The flattening yield curve makes short-term issues attractive; you get a solid yield without the higher **volatility** of a fund invested in longer-term bonds. The 2.5 percent recent yield for the Vanguard Short-Term Corporate Bond Index fund is about half a percentage point more than the yield for comparable short-term Treasuries.

The recently enacted tax package could also be a moderate benefit for corporate bonds. With a lower corporate tax rate, businesses are expected to bring more foreign earnings home, increasing the cash available to pay for dividends and share repurchases. That could mean the supply of new corporate bonds will shrink a bit, as companies lose some appetite for issuing debt to bolster shareholder returns.

Basic math suggests that there is less reason to invest in lower quality corporate bonds. Kathy A. Jones, chief fixed income strategist at Charles Schwab, points out that high-yield bonds pay about 3.4 percentage points more than similar maturity Treasury issues, in contrast to the 5.4-percentage-point spread investors have typically been paid for taking on the risk of junk bonds. That’s not much compensation, given that junk bonds tend to behave a lot like stock in bad markets.

Investors who enjoyed the strong 6 percent return for multisector bond funds in 2017 should take note that on average, more than one-third of the assets of these go-anywhere bond funds is invested in junk bonds, according to Morningstar.

Mr. Scholnick says Western Asset Management has reduced its high-yield holdings and increased its investment in bank loans. These securities are a form of low-quality corporate bonds with two compelling value propositions over standard junk bonds. In the event of a default, bank loan investors are paid before regular bond investors. In addition, the interest rate on bank loans fluctuates along with a benchmark index, such as the London Interbank Offer Rate, or Libor, and prospects for an increase are viewed as good.

Emerging market bonds may be the best relative value for bond investors these days, considering that in many countries, economies are growing, inflation is low and central bank policy is reasonably strong.

“In the past, it was emerging markets that held all the debt, but now all the debt is in Japan, Europe and the U.S.,” said Mr. Rieder of BlackRock. In 2018, the best opportunities for positive returns after accounting for inflation could be in emerging markets.

Emerging markets also are often more **volatile**. So for less adventuresome investors, money market funds may be appealing. The Federal Reserve’s rate increases are slowly pushing these yields off zero. Mr. Bhatia says such funds will probably pay 1.5 to 2 percent by the end of this year.

Even if the returns in money market funds are low, you are paid something to park your money on the sidelines while waiting for sell-offs in bonds and stocks to present better prices to reinvest.

“Suddenly, it’s an asset class to consider,” he said.

* Money Market Funds and C.D.s Show Signs of Life

* The Muni Market Turns Toward Washington

* Emerging Market Bonds Are on a Roll. But How High Is the Risk?

* Signs of Strain in the Stock and Bond Love Affair

Craig Frazier | With inflation low and the economy strong, economy, the profitabilty of investing in bonds is not expected to increase anytime soon. | Victor R. Caivano/Associated Press

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THE WALL STREET JOURNAL.
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Streetwise: Stocks Are Expensive But Better Than Bonds

By James Mackintosh
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Bond yields are on the rise again, and it is making shareholders jittery. They are right to worry, as low yields are the main support for historically high stock valuations, but bonds aren't creating serious trouble for the **equity market** yet.

Bonds matter to shareholders in many ways, with the most obvious being that they are the main alternative investment, along with cash. Shares are very expensive compared with their own history on almost every measure, but compared with locking in a paltry 2.5% for 10 years they don't look so bad. Analyst estimates of forward-looking operating earnings are 5.4% of the price of the **S&P 500** and forecast to keep rising in future years. Why settle for 2.5% from bonds when the earnings yield on stocks is double that?

The question comes down to one of reward for risk. Earnings are uncertain, so shareholders should get an extra reward for the risk of holding stocks compared with the certainty offered by Treasurys. That reward, known as the equity risk premium, shrinks if bond yields rise faster than the outlook for profit.

Working out this equity risk premium is contentious. The principle is to estimate how much companies will generate for shareholders in the future and compare it with bonds, but there is little agreement on how to do that. We care about the future, and we want something long term, so typically the focus is on estimates for operating earnings, stripping out one-offs. Unfortunately, managements know this, and artificially boost operating earnings via one-off losses -- not just once, but year after year. Overall earnings also overstate how much investors benefit, as much corporate investment is wasted.

Worse, we know that when investors are overly optimistic they overestimate earnings, making it look like the reward for holding equities is higher. Most methods of calculating the risk premium suggested equities in 2007 were the most attractive relative to bonds in at least a decade, shortly before shares crashed and **bond prices** soared.

Even the comparison to bonds is tricky; earnings have a loose connection to inflation, so perhaps we should compare them with inflation-linked Treasurys, where the 10-year yield is just 0.5% above inflation.

Wall Street's favored approach is to compare the earnings yield -- 12-month forward earnings as a proportion of the **S&P 500** -- to the 10-year yield, which suggests U.S. shares have the lowest risk premium since January 2008. On this basis, investors need a lot more confidence than usual that economic and profit growth will continue to be strong -- confidence that isn't lacking at the moment.

Bullish investors may argue that the equity risk premium was a lot lower during optimistic periods in the past. It even turned negative during the dot-com bubble, when bond yields were much higher and investors preferred clicks to profit. Bulls can also point to soaring earnings last year, and the synchronized global recovery ought to boost global earnings further if it continues.

Meanwhile, bears worry that the U.S. economy is close to or at full capacity, crimping the prospect of low-inflation growth continuing, that companies are investing far too little to maintain the rate of earnings growth and that profit margins are unsustainable.

But even bulls ought to worry about the way that bond yields have been rising. Nominal yields have been advancing since mid-December while real, inflation-linked, yields haven't. That suggests the Treasury market expects higher inflation but no improvement to growth. So far the changes have been fairly small, but the direction suggests higher yields without an offsetting boost to the economy and profit. If it continues,it would compress the equity risk premium further, reducing the appeal of shares compared with bonds.

A critical question, then, is whether bond yields will keep going up. Investors believe in a not-too-hot, not-too-cold Goldilocks economy, where inflation stays under control and the Federal Reserve ends its increases at a lower level than in the past. If the narrative changes, bond yields could rise rapidly. Perhaps 2018 is the year inflation fears finally arrive.

Former Pimco "bond king" Bill Gross, now managing funds at Janus Henderson Investors, said this week that the break of a quarter-century downtrend in yields confirmed bonds are in a **bear market**. Such technical analysis appeals to those who like lines on charts, but it is hard to believe that many investment decisions are based on a line drawn through five peaks on a chart since 1989, especially since it has been broken before (in 2007).

Perhaps the most powerful case for higher bond yields is that central banks are pulling away support. The Fed has begun to reduce its bondholdings, the European Central Bank has halved its purchases, and even the Bank of Japan has slowed bond buying.

Forecasts of a sharp rise in bond yields have proven wrong year after year. However, continued low yields wouldn't be a reason to think shares are great -- just that they are better than bonds. High stock valuations tend to mean lower returns in the future, and valuations are very high compared with history.

Since 1900, U.S. stocks with dividends reinvested have returned 6% a year after inflation, according to Credit Suisse. Investors should be able to damp down their expectations and plan for something closer to 2% after inflation over the next decade as valuations drop back to more reasonable levels. That is still far better than bonds, just terribly disappointing for those who hope to repeat the 13% annualized real return of the past nine years' bull run.

Shares vs. Bonds

Wall Street's preferred comparison of shares and bonds estimates the smallest reward for holding equities since early 2008.

U.S. equity risk premium, weekly*

The U.S. 10-year Treasury yield has risen above a downtrend drawn through its peaks in 1989 and 2000. But it is yet to rise above a line passing through its 1990 and 2007 peaks.

10-year Treasury yield

*S&P 500 forward earnings yield minus 10-year Treasury yield

Sources: Thomson Reuters Datastream (risk premium); Federal Reserve Bank of St. Louis

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U.S. News: In Survey, President Seen as Tailwind

By Ben Leubsdorf
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12 January 2018
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English

Economists surveyed by The Wall Street Journal say President Donald Trump has had generally positive effects on U.S. economic growth, hiring and the performance of the **stock market** during his first year in office.

The professional forecasters also predicted 2018 would see solid growth and a continued decline in the jobless rate. One factor: the tax cuts signed into law by Mr. Trump in December, which most economists say will boost the economy for several years at least.

More broadly, most forecasters surveyed by the Journal suggested Mr. Trump's election deserves at least some credit for the economy's recent strength.

Asked to rate Mr. Trump's policies and actions to date, a majority of economists said he had been somewhat or strongly positive on net for job creation, gross domestic product growth and the **stock market**. Most also said he had been either neutral or positive for the country's long-term growth trajectory, while his influence on financial stability was seen as largely neutral.

"There is definitely a sense in the business community that the president's actions on taxes and regulations have led to a more pro-growth environment for them to operate," said Chad Moutray, chief economist at the National Association of Manufacturers.

Still, it is early yet to evaluate Mr. Trump's performance. He inherited an economy that had already experienced years of falling unemployment and durable if slow growth.

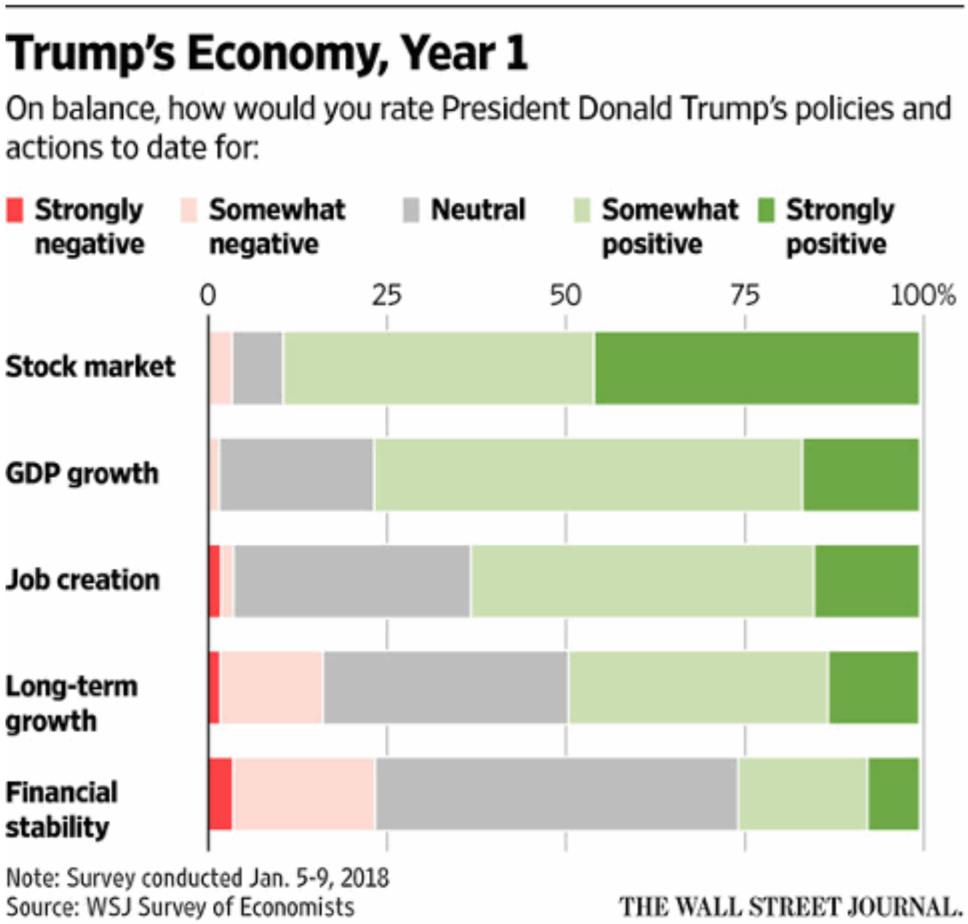
"We have to be cautious about giving Trump too much credit for the economy's strength," said Bernard Baumohl of the Economic Outlook Group. "Job creation and business capital spending were on the rise prior to his presidency."

A year ago, President Barack Obama got mixed grades as he prepared to leave office. Most economists surveyed by the Journal in January 2017 saw his policies as positive for financial stability, positive or neutral for job creation, negative or neutral for GDP growth and negative for long-term potential growth.

Looking forward, the economists surveyed in recent days had high hopes for 2018.

On average, the forecasters predicted GDP would expand 2.7% this year. They saw the unemployment rate, which was 4.1% in December, falling to 3.9% by midyear and 3.8% in December.The pace of hiring was expected to slow further, with monthly nonfarm payroll gains set to average 165,000 in 2018.

More than 90% of economists said the tax cuts would increase GDP growth over the next two years, similar to their thinking in earlier months when the details of the legislation were still in flux.



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The New York Times

Business/Financial Desk; SECTB
Markets Brush Off the Year's First Wobble to Return to Record Highs

By THE ASSOCIATED PRESS
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English

Stocks in the United States brushed aside their first wobble of the year and got back to setting records on Thursday. Energy stocks led the way after the price of oil touched its highest level since 2014.

The gains for indexes marked a return to calm, after a whiff of nervousness wafted through markets a day earlier as interest rates rose. After rates held steady on Thursday, the **Standard & Poor's 500**-**stockindex** marked its seventh gain in the last eight days.

The **S**.**&P**. **500** rose 19.33 points, or 0.7 percent, to a record 2,767.56. The **Dow Jonesindustrial average** rose 205.60 points, or 0.8 percent, to 25,574.73, the **Nasdaq composite** gained 58.21 points, or 0.8 percent, to 7,211.78.

Optimism about a strengthening global economy and growing corporate profits have helped propel markets even though stocks have become more expensive than they have historically been relative to earnings.

The market's smooth ride upward hit a bump Wednesday when worries rose that a jump in interest rates could derail the ascent. Rates have been ultra-low since the Great Recession, a culmination of a decline in bond yields over the last three-plus decades.

''Everyone's on edge about waiting for what's to come,'' even though central banks have promised to take a slow path toward higher rates, said Marina Severinovsky, investment strategist at Schroders.

''There shouldn't be a falling-off-the-cliff mentality, but we're so primed,'' she said. ''We're 30 years into this, waiting for the trigger.''

Rates retreated on Thursday after China's foreign exchange regulator challenged a report that had helped drive up yields, which said China may slow or halt purchases of U.S. Treasury bonds. A United States government report on Thursday also showed that inflation was weaker on the wholesale level last month than economists expected.

The yield on the **10**-**year Treasury** note dipped to 2.54 percent from 2.56 percent late Wednesday. It had climbed as high as 2.59 percent on Wednesday.

While a quick jump in rates could easily jolt markets out of the calm ride they have been on, investors say markets are prepared for a gradual rise.

''We're all anticipating rising rates, and have been for some time,'' Severinovsky said. ''Given where global growth is, we should have higher rates than we do today.''

Energy stocks were the day's biggest stars after the price of oil touched its highest price in more than three years. Benchmark United States crude gained 23 cents to settle at $63.80 per barrel after earlier climbing as high as $64.77. Brent crude, the international standard, gained 6 cents to $69.26 per barrel.

That helped drive energy stocks in the **S**.**&P**. **500** to a 2 percent gain, the largest among the 11 sectors that make up the index. They are at their highest level since the end of 2016.

Anadarko Petroleum had one of the biggest gains in the index after jumping $3.09, or 5.6 percent, to $58.50.

The **stock market** has repeatedly shrugged off concerns through its placid ride to records. Whether investors are worried about a pickup in rates or about how stocks have become expensive, any dip for the market over the last year has been shallow and short.

The next test for markets may arrive in coming weeks as companies report how much profit they made at the end of 2017.

Businesses will need to produce strong growth to justify their stocks' gains, and expectations are also high that chief executives will unveil encouraging profit forecasts for 2018 after Washington cut their income-tax rates.

The dollar dipped to 111.09 Japanese yen from 111.35 late Wednesday. The euro rose to $1.2036 from $1.1957, and the British pound rose to $1.3536 from $1.3509.

Gold gained $3.20 to settle at $1,320.60 per ounce.

CHARTS: The **S**.**&P**. **500 Index**: Position of the **S**.**& P**. **500 index** at 1-minute intervals on Thursday. (Source: Reuters); **30**-**Year Treasury Bond**: High yield at auction. (Source: Treasury Department)

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Tax Reform Has Released the Bulls

By Donald L. Luskin
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A15
English

As markets around the world surge to all-time highs, everyone is wondering anxiously whether stocks are overvalued. That's a pretty good sign they're not. Stocks are overvalued when hardly anybody is worrying.

By traditional measures of value, stocks do seem expensive right now. But those metrics have flaws, the worst of which is a tendency to look at the past rather than the future. Markets, by their nature, do the opposite.

Consider the venerable price/earnings ratio. The typical P/E ratio shows today's **stock price** as a multiple of the company's earnings over the past year. Yes, an investor wants to understand how much he is paying for earnings. But what counts isn't last year's earnings, it's next year's -- and all the years to come.

The most flagrant offender here is Yale economist Robert Shiller's widely followed cycle-adjusted price/earnings ratio, or CAPE. In a misguided attempt not to be fooled by short-term fluctuations, the CAPE ratio is based on average earnings over the entire previous decade. At the moment, using earnings from 2007-17, the CAPE shows stocks to be valued like they were in 1929, right before the market crashed. But that's only because the past decade of earnings includes the catastrophe of 2008-09. This makes earnings look artificially low, even though it has little relevance for today.

One way to solve this problem is to use earnings estimates for the year ahead in the calculation. By that measure, today's P/E ratio is a bit above average, but nothing scary. It's well below the figures for 1999 and 2000, during the tech bubble, and generally consistent with the levels that obtained from the late 1950s to the early 1970s.

Even this more forward-looking approach, though, doesn't necessarily capture the full reality of the current historical moment. The U.S. could be at an inflection point where far higher corporate earnings become the new normal. When President Trump signed tax reform on Dec. 22, he effectively increased after-tax earnings for American companies. At a corporate tax rate of 35%, a dollar of earnings turns into 65 cents after Washington takes its cut. At the new 21% rate, the same dollar becomes 79 cents. That's earnings growth of 21.5% with the stroke of Mr. Trump's pen.

Only 15 market days have passed since the Senate passed the tax bill, ensuring it would become law, and Wall Street analysts have already upgraded their consensus forward earnings for the **S&P 500** by an unprecedented 4.6%. Is it any wonder that stocks have rallied?

Moreover, this is probably just a down payment on future earnings growth. It's true that a plurality of earnings across the whole **S&P 500** comes from business conducted outside the U.S., which won't be affected by the tax cuts. But my rough-and-ready estimate is that the lower corporate rates ought to raise after-tax earnings on business already being conducted by about 10% overall.

That figure actually may be low, because it leaves aside activities that the previous 35% tax rate had made unprofitable. No one can predict what new businesses, factories and jobs -- not to mention earnings -- will be created now that companies bear a tax cost of only 21%.

My estimate also doesn't consider business migration. Some American companies with operations in low-tax jurisdictions may bring these activities home. Some foreign companies may decide to forward-deploy their facilities into the U.S. market. All of this again will create new businesses, factories, jobs and earnings.

Finally, my estimate doesn't factor in the competitive global response to American tax reform. Nations afraid to be left behind may cut their own taxes in what could turn into a world-wide competition. That would be the delightful opposite of protectionism. Instead of trying to punish each other with reciprocal tariffs, nations could engage in a race to the top to see who can more completely liberate their productive sector from the deadweight costs of corporate taxation. Again: new businesses, factories, jobs and earnings.

Put it all together, and before you know it, that "E" in the time-honored P/E ratio will have grown so much that today's stock valuations won't look out of line at all.

Truth be told, valuation metrics are always oblivious to our dynamic world. The **stock market** was a great buy at the bottom, in March 2009, but not because stocks were undervalued. They only seem so in hindsight because the global economy pulled out of an existential financial crisis. If the central banks hadn't saved the world, those seemingly undervalued stocks could have gone to zero.

There's no crisis today, thankfully. But as in 2009, the economy is facing a fundamental turning point driven by profound changes in economic policy. Once again, it's policy, not valuations, that is determining stock prices. If Mr. Trump's corporate tax cuts turn out to be as powerful as I think they will be, expect a new **bull market**, no matter what the P/E ratios say.

Mr. Luskin is chief investment officer at Trend Macrolytics LLC.

Document J000000020180112ee1c00011

THE WALL STREET JOURNAL.
U.S. EDITION

U.S. Government to Sell $148 Billion in Debt

192 words
12 January 2018
The Wall Street Journal
J
B11
English

The U.S. Treasury Department will auction $148 billion in securities next week, comprising $55 billion in new debt and $93 billion in previously sold debt. Details (all with minimum denominations of $100):

-- Tuesday: $45 billion in four-week bills, a reopening of an issue first sold on Aug. 17, 2017, maturing Feb. 15, 2018. Cusip number: 912796NS4.

Also, $48 billion in 13-week bills, a reopening of an issue first sold on Oct. 19, 2017, maturing April 19, 2018. Cusip number: 912796PB9.

Also, $42 billion in 26-week bills, dated Jan. 18, 2018, maturing July 19, 2018. Cusip number: 912796MK2.

Noncompetitive tenders for the 13-week and 26-week bills must be received by 11 a.m. EST Monday and competitive tenders, by 11:30 a.m. For the four-week bills, the deadlines are noon and 1 p.m., respectively.

-- Thursday: $13 billion in **10**-**year Treasury** inflation-protected securities, dated Jan. 31, 2018, maturing Jan. 15, 2028. Cusip number: 9128283R9.

Noncompetitive tenders must be received by noon EST Thursday; competitive tenders, by 1 p.m.

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THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Real News on Fake Data in China

By Nathaniel Taplin
435 words
11 January 2018
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

There was some bad news from Inner Mongolia last week: Apparently its headline economic statistics are nonsense. The remote northern Chinese province said its 2016 industrial growth had been overstated by 40%, while government revenue was inflated a mere 26%.

This latest revelation on Chinese data malfeasance, following a similar admission by Liaoning province last year, is likely to renew hand-wringing in the West about the -- cough -- unique nature of Chinese economic statistics. Academics incessantly dispute the meaning of U.S., European and Japanese economic data, but few question their essential fairness. In China, the prevailing assumption is the opposite: Headline GDP and industrial-growth figures are widely considered to be unreliable. The lack of trust has spurred the development of a cottage industry of independent surveys and alternative metrics.

Unfortunately, Chinese officials have a strong incentive to overstate growth -- particularly in the poor, heavy-industry-dependent north and west.

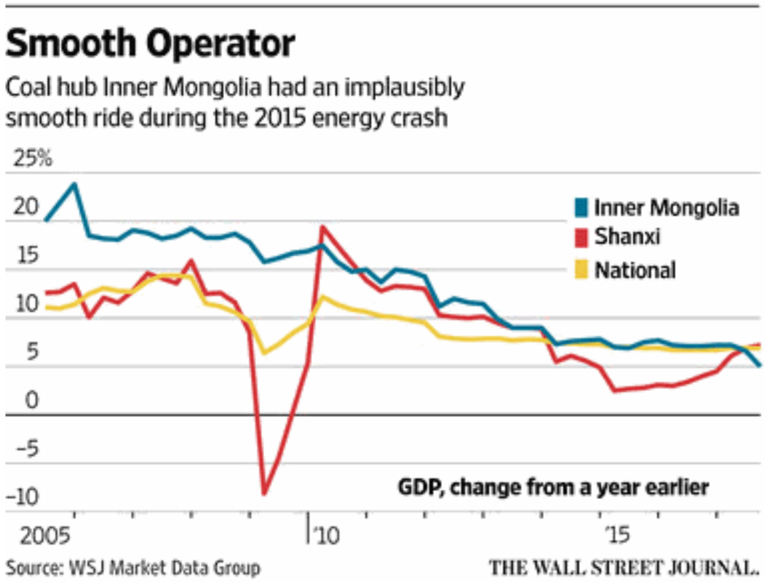
Chinese national growth figures are almost certainly smoothed -- meaning they are a lagging indicator -- but they still line up relatively well with independent metrics such as changes in nighttime light intensity tracked by satellite. So do certain other official figures, like bank lending. Lending has grown at a faster pace than output since the global financial crisis, resulting in China's well-known debt problem, but the overall direction looks similar.

The really big data problem is in the poor, commodity-and-industry-dependent hinterlands where growth is more cyclical and whose officials are under more pressure to polish figures. Inner Mongolia's headline growth figures show the coal-and-infrastructure hub outperforming during the commodity and housing boom in the late 2000s, but then doing implausibly well during the 2015 commodities crash. Growth in rival coal province Shanxi cratered during the period. And more granular Chinese national data such as freight traffic and electricity production also show a steep fall.

The lesson is that Chinese GDP represents a reasonable long-term indicator of overall trends, but isn't particularly helpful in capturing cyclical shifts, in part because figures from the more **volatile**, less diversified inland economies may be fudged during sharp slowdowns.

Instead, investors should watch Chinese data that line up better with global trade and price trends -- such as lending, freight traffic, real-estate investment and output of key Chinese exports like telecom equipment.

China's economy often still looks like a black box to outsiders, but there are plenty of pinpricks of light if you know where to look.



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Document J000000020180111ee1b00016

THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News -- Capital Account: For Fed, Stock Boom Brings Bubble Deja Vu

By Greg Ip
817 words
11 January 2018
The Wall Street Journal
J
A2
English

Any central banker watching the **stock market** today should get a queasy sense of deja vu.

A housing boom preceded the last recession. A tech stock bubble ushered in its forerunner.

Today, stock and property prices are once again setting records, in absolute terms and relative to household incomes. That may leave the Federal Reserve and Jerome Powell, nominated to succeed Janet Yellen as Fed chair next month, confronting some agonizing trade-offs in the next year or two: What if low inflation calls for low interest rates but those low interest rates make an eventual, destructive asset bust more likely? Should he lean against an incipient bubble by raising rates faster now, or plan to mop up the mess if assets collapse later?

Unfortunately, the past isn't much help as a guide to the present. The 2008 cataclysm resulted not just from falling housing prices, but the knock-on wave of mortgage defaults that then brought down the institutions that held the debt. Today, the financial system has much thicker buffers against loan losses and is more closely regulated. Credit growth isn't excessive.

Stock price-to-earnings ratios are by some measures the highest since 1999, but today's are more justifiable. In 1999, government bonds yielded 6%; today, they yield 2.6%, which makes them a less appealing alternative to stocks. Moreover, even if stocks fell, that wouldn't necessarily destabilize the financial system.

"When we look at other indicators of financial stability risks, there's nothing flashing red there, or possibly even orange," Ms. Yellen said in December.

Yet it doesn't take a crisis for an asset bust to hurt. The 1990s tech stock run-up fueled a surge in investment and spending via higher wealth and easier financing conditions. When the bubble burst in 2001, that surge reversed, dragging the economy down. The damage was contained because the Fed quickly slashed interest rates by nearly 5 percentage points. Today, it can at most cut them by 1.5 points.

The **stock market**'s 23% rise since the end of 2016 has been a powerful economic tailwind. Increased wealth has encouraged consumers to spend more and save less of their paychecks, driving the personal saving rate below 3%, the lowest since 2007. Both spending and stocks have gotten an added kick from the recent tax cut.

It isn't a stretch to see allthose factors switching into reverse within a year or two. And if dangerous excesses are simmering in the financial system, they may not appear until the boom goes bust.

In the old days, recessions occurred because an overheating economy led to higher inflation, then higher interest rates and a pullback in spending. In such a world, getting interest rates correct could achieve both low, stable inflation and sustainably low unemployment, which economists dubbed the "divine coincidence."

But, as Mr. Powell noted a year ago, no divine coincidence dictates that the same interest rate will achieve both 2% inflation and a stable financial system.

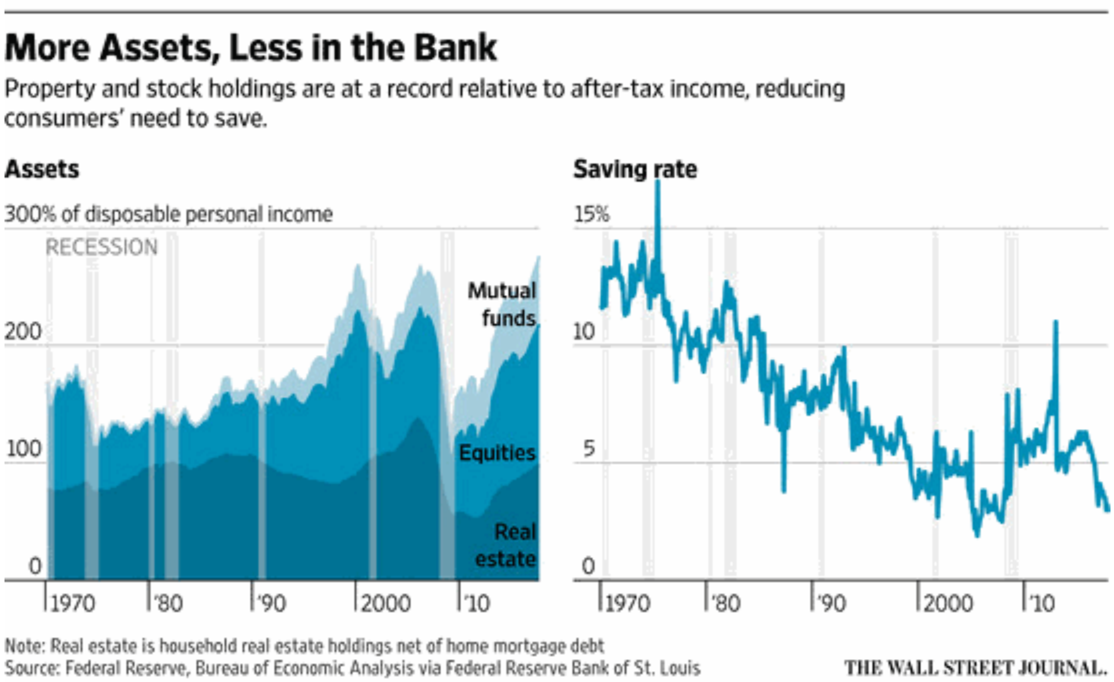
Whether that means the Fed should stop bubbles from forming in the first place has long vexed officials. Before the global financial crisis, they concluded no: pre-emptively pricking bubbles seemed much riskier than letting them burst of their own accord. They are less dogmatic now. Though officials' first choice is to use regulatory authority to ensure any such bust doesn't sink any financial institutions, Ms. Yellen said in 2010 she couldn't "unequivocally rule out" using higher interest rates to pre-empt a bubble. But she set the bar quite high.

In actions, if not words, Fed monetary policy already does respond to financial stability concerns and asset prices. In a 2016 study, Federal Reserve Bank of Boston President Eric Rosengren and two co-authors counted how often words such as "bubble," "bust," "crisis" and "**volatility**" appeared in transcripts of monetary-policy discussions at Fed meetings. They found that such worries tended to move interest rates more than mere considerations of inflation and unemployment could justify, although the influence was stronger when rates were falling than rising.

Mr. Powell largely agrees with his predecessors that monetary policy should be a last resort for dealing with financial excess. Yet his bar doesn't appear to be as high. When Mr. Powell joined the Fed in 2012, he told colleagues he worried that the Fed's bond-buying program could fuel risk-taking down the road, according to meeting transcripts released last week.

In a 2015 speech, he said: "Tighter monetary policy might eventually be necessary" if dangerous risk-taking reappeared. A year ago, he went further: "The current extended period of very low nominal rates calls for a high degree of vigilance."

The case for vigilance has only grown since.



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The New York Times

STOCKS & BONDS
Business/Financial Desk; SECTB
Worries About Interest Rates Pull the Market Lower for the First Time in 2018

By THE ASSOCIATED PRESS
846 words
11 January 2018
The New York Times
NYTF
Late Edition - Final
5
English

The **stock market**'s fantastic start to 2018 stalled on Wednesday after real-estate companies and other dividend payers sank on concerns about rising interest rates.

The losses knocked indexes a bit off their record highs and provided the first minor hiccup for a market that had climbed six straight days to start the year. Stocks fell after the yield on the **10**-**year Treasury** reached its highest level since March, but they ended up recovering most of their losses as the day progressed and rates pulled back.

The **Standard & Poor**'**s500 index** fell 3.06 points, or 0.1 percent, to 2,748.23 after being down as much as 0.6 percent in the morning. The loss snapped the index's longest winning streak to start a year since 2010.

The **Dow Jonesindustrial average** dropped 16.67, or 0.1 percent, to 25,369.13, the **Nasdaq composite** fell 10.01, or 0.1 percent, to 7,153.57 and the Russell 2000 index of small-cap stocks slipped 0.30 points, or less than 0.1 percent, to 1,559.80.

"Last year was an investor's dream and a nightmare" for short-term traders because of how calm and strong the market was, said Kirk Hartman, global chief investment officer for Wells Fargo Asset Management. "I think this is going to be a better year for traders because you're going to get some **volatility**."

That's in part because he expects interest rates to climb as the government's need to borrow rises and as the Federal Reserve increases rates and pulls back from bond purchases it made to aid the economy.

Low interest rates have been one of the main propellants for the **stock market**'s calm rise to records. They make borrowing easier for companies and people, which greases the skids for economic growth. Low rates also make bonds less attractive, which pushes investors into stocks.

Investors have long been preparing for a gradual increase in bond yields, and Hartman said stocks can keep climbing as long as rates do rise at a measured pace. But a sudden or sharp jump in rates could easily upset markets.

The yield on the **10**-**year Treasury** went as high as 2.59 percent in the morning before falling back to 2.55 percent, the same level it was at late Tuesday. That's up from 2.40 percent at the start of the year.

A report from Bloomberg News said that China is considering a slowdown or halt to its purchases of Treasurys, which helped push rates higher. Investors are also speculating about whether Japan's central bank will slow its bond purchases to keep rates low.

The rise in rates sent companies that pay big dividends to the biggest losses. Real estate, utility and telecom stocks tend to move in the opposite direction of interest rates because higher bond yields can lure away investors seeking income.

Real-estate stocks fell 1.5 percent for the sharpest loss of the 11 sectors in the **S&P 500**. Utilities lost 1.1 percent, and telecoms fell 0.9 percent.

On the opposite end were banks, which can make bigger profits from loans when interest rates rise. Financial stocks in the **S&P 500** rose 0.8 percent.

United Continental jumped to the biggest gain in the **S&P 500** after the airline said a key revenue trend last quarter was better than it had earlier forecast. It credited stronger demand and fares. United rose $4.60, or 6.7 percent, to $73.08.

Signet Jewelers had the largest loss of the **S&P 500** after it reported weaker sales for the holiday season than a year earlier. Signet dropped $3.90, or 6.9 percent, to $52.69.

The dollar fell to 111.35 Japanese yen from 112.61 yen late Tuesday. The euro rose to $1.1957 from $1.1933, and the British pound fell to $1.3519 from $1.3534.

In the commodities markets, gold rose $5.60 to settle at $1,319.30 per ounce, silver added 3 cents to $17.04 per ounce and copper gained 2 cents to $3.24 per pound.

Benchmark U.S. crude added 61 cents to settle at $63.57 per barrel. Brent crude, the international standard, gained 38 cents to $69.20 a barrel.

In overseas stock markets, Japan's Nikkei 225 index fell 0.3 percent, South Korea's Kospi lost 0.4 percent and the Hang Seng in Hong Kong added 0.2 percent.

France's CAC 40 fell 0.3 percent, the FTSE 100 in London added 0.2 percent and Germany's DAX lost 0.8 percent.

This is a more complete version of the story than the one that appeared in print.

CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Wednesday. (Source: Reuters)

Document NYTF000020180111ee1b0005h

The New York Times

Business/Financial Desk; SECTB
Investors Fear End Of Binge On Bonds

By LANDON THOMAS Jr.; Emily Flitter contributed reporting from New York, and Keith Bradsher from Shanghai.
907 words
11 January 2018
The New York Times
NYTF
Late Edition - Final
1
English

For nearly a decade, central banks around the world have been the biggest buyers of bonds, sending interest rates plummeting and stock markets soaring.

Now, investors are starting to worry about what would happen if the richest nations start to scale back on a buying binge that most of them began to stimulate economies hurt by the global financial crisis.

The most immediate fear: A sharp falloff in **bond prices** would rattle equity markets that are now trading at record highs. Beyond that, there is a looming concern that as the global economy heats up, inflation, a bond investor's main worry, will start to inch up, fed by higher wage demands on the part of workers everywhere.

''Your largest investor might be stepping back, that's what spooked people,'' said John Briggs, a bond strategist at NatWest Markets. ''The market is very vulnerable to any change in supply and demand.''

That vulnerability has been on display in recent weeks, with many investors selling out of their bond positions, pushing the yield -- which rises as **bond prices** fall -- on the benchmark 10-year United States Treasury bill up to a high of 2.59 percent on Wednesday from 2.3 late last year.

Bond markets appeared to be further spooked on Wednesday by a report that China's central bank, which owns $1.2 trillion in United States Treasury bonds, may be poised to slow or even halt its buying of United States debt. China has total reserves of just over $3 trillion.

Yields on **10**-**year Treasury** notes climbed in early trading, and the dollar weakened at the prospect of lessened demand tied to a selling of United States bonds by a large holder like China. The rising yields led Bill Gross of Janus Henderson, whose renown as a bond investor came to define the multidecade **bull market** for fixed-income securities, to pronounce the start of a **bear market** for bonds, although he said on Wednesday that he did not foresee drastic losses.

Officials at the agency that manages China foreign reserves on Thursday issued a statement that media reports about suspending purchases of Treasuries ''may quote the wrong source of information, or may be fake information.''

Analysts do not believe that the country, which under President Xi Jinping has taken pride in its standing as an elite member of the club of wealthy nations, would rashly unload the securities it has amassed over the years.

Not only would such a step hurt China by decreasing the value of its bond holdings, it would wreak havoc in a global economy that the country is now fully integrated into through deep trade and financial links.

To some experts, a move by China to pull back on its bond-buying could simply be seen as responsible-reserve management by one of the world's richest central banks. ''The boring explanation here is that China just has enough Treasuries in its portfolio,'' said Brad Setser, an expert in global capital flows at the Council on Foreign Relations.

But there is another interpretation that gets at the simmering tensions between the United States and China over North Korea and trade. ''It is possible too that China wants to signal to its people that it will not keep financing the U.S. when the U.S. is not treating China with respect,'' Mr. Setser said.

There is also a belief among many economists that the tax cuts recently signed into law by President Trump could worsen the United States' financial position and make its debt less attractive as an investment.

For now, investors appear to have accepted the benign view. Major stock indexes in the United States were down only slightly on Wednesday, and the VIX index, which measures investor expectations of a sharp market move in the future, remained just over 10, a very low level.

Nevertheless, the mere thought that China might choose to unload some of its Treasuries fed broader concerns about how the markets react as central banks in the United States, Japan and Europe normalize policies adopted to prop up faltering economies.

All told, the three central banks are sitting on $14 trillion in securities they have bought since 2009: a $4.4 trillion mix of Treasuries and mortgage securities held by the Federal Reserve; the European Central Bank's $5 trillion in corporate and government bonds; and $4.5 trillion worth of bonds and exchange traded funds accumulated by the Bank of Japan.

Moreover, the view that the United States government, in the wake of the tax cut package, will have to issue more securities to finance a larger budget deficit is giving bond investors pause.

''The U.S. is about to issue a whole lot more debt in an environment where the demand for that debt is about to go down,'' said Daniel W. Drezner, a professor of international politics at the Fletcher School of Law and Diplomacy at Tufts University. ''What that means is interest rates are about to go up.''

And that is bad news for bond investors.

A man checking the **stock index** at a brokerage house in Beijing. Some economists say that new tax cuts could make United States debt less attractive as an investment. (PHOTOGRAPH BY ANDY WONG/ASSOCIATED PRESS) (B4)

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THE WALL STREET JOURNAL.
U.S. EDITION

Drilling in Alaska Is Good for the Earth

By Thomas Landstreet
600 words
11 January 2018
The Wall Street Journal
J
A13
English

It has been a good month for American energy development. The tax reform signed by President Trump contained a provision allowing for oil exploration in the Arctic National Wildlife Refuge. Last week the Interior Department proposed opening up wide swaths of territory offshore.

This is good policy for a lot of reasons, but the least obvious is that it will help the environment. Despite howls from the green lobby, the truth is that it's less hazardous to drill for oil on land and in shallow waters using conventional rigs.

BP's Deepwater Horizon was drilling in about 5,000 feet of water when it exploded in 2010. If the accident had occurred on land or in shallow seas, the spill could have been contained in three days instead of three months.

The company took the blame for the disaster, paying $19 billion, but I blame U.S. environmental policy for chasing oil producers further and further out on the risk curve. For more than 40 years, the U.S. government has had a moratorium on drilling in shallow water, putting nearly 100 billion barrels out of reach.

This overregulation has been neither prudent nor partisan. President George H.W. Bush, a former oilman, enacted a separate and redundant moratorium in 1990; Bill Clinton extended it in 1998. And approval rates for drilling permits on federal lands plummeted during the Obama administration.

The ANWR is thought to hold at least 10 billion barrels of crude oil, according to the U.S. Geological Survey. The actual number is likely greater. The nearby Trans-Alaska Pipeline is ready to go, with the capacity to move ANWR oil 800 miles to the Port of Valdez. That pipeline operates at 25% of capacity and could use the extra flow for efficiency's sake.

Drilling in the ANWR poses less risk to the environment than fracking. It would also be cheaper. Fracking was invented in response to drilling restrictions, as a way to produce oil from shale formations on private land, where government restrictions don't apply.

But fracking is no walk in the park. A fracked well consumes an average of 4.2 million pounds of sand and between two million and nine million gallons of water. The sludge created as a byproduct requires careful handling and underground disposal. From an environmental standpoint, drilling in the ANWR ought to be attractive by comparison.

Environmentalists have long believed that high **oil prices** drive down demand, so restricting drilling will reduce overall energy consumption. This view would be realistic in a free market. But the global oil market is not free. Asian nations have responded to rising **oil prices** by subsidizing consumption. Even while gasoline prices in the U.S. went from $1.35 a gallon in 2002 to more than $3.50 a gallon from 2011-13, Asian consumption surged.

As long as the global economy demands hydrocarbons, companies will produce them, even if they must go to great lengths to do so. Scarcity leads to high prices, which makes fracking and high-risk deep-water drilling possible. Boosting the supply of oil from land and shallow-water rigs would reduce these hazards.

Deregulating government-controlled territories like the ANWR and the U.S. Outer Continental Shelf is a step in the right direction. If a freer market can prevent another tragedy like Deepwater Horizon, environmentalists should see it as a win.

Mr. Landstreet is founding partner of N3L Capital Management and founder of Standard Research.

Document J000000020180111ee1b0000e

The New York Times

STOCKS & BONDS
Business/Financial Desk; SECTB
Another Day, Another High In New Year For the S.&P.

By THE ASSOCIATED PRESS
888 words
10 January 2018
The New York Times
NYTF
Late Edition - Final
4
English

Stocks pushed further into record territory Tuesday, and the **Standard & Poor**'**s500 index**'s immaculate start to the year extended to a sixth day.

Health care stocks and banks led the way, as calm continues to reign over markets around the world. The strong gains overshadowed weakness for dividend-paying stocks and other areas of the market hurt by rising interest rates after **10**-**year Treasury** yields hit their highest level since March.

The **S&P 500** rose 3.58 points, or 0.1 percent, to 2,751.29 to equal its longest winning streak leading off a year since 2010.

The **Dow Jonesindustrial average** rose 102.80 points, or 0.4 percent, to 25,385.80, the **Nasdaq composite** gained 6.19 points, or 0.1 percent, to 7,163.58 and the Russell 2000 index of small-cap stocks slipped 1.71, or 0.1 percent, to 1,560.10.

They're the latest steps higher for stocks, which have been rising at a remarkably steady pace for more than a year as investors bask in a global economy that's strengthening in sync. Corporate profits are also on the upswing, and Washington's recently approved tax cut should goose earnings even higher.

The powerful combination has kept markets marching higher, even though stock prices have grown to become more expensive than usual, relative to corporate profits.

"I would like to say that there's something onerous coming, just because it would be different from what everyone is talking about," said Nate Thooft, senior portfolio manager at Manulife Asset Management. But he expects the market to continue gliding higher as the economy and corporate profits strengthen.

Health care stocks rose 1.1 percent for the biggest gain among the 11 sectors that make up the **S&P 500**.

Boston Scientific was at the front of the pack after it gave preliminary results for its revenue last quarter that were stronger than Wall Street was expecting. The medical device company's shares rose $2.15, or 8.3 percent, to $27.96.

Illumina likewise reported preliminary results for fourth-quarter revenue that topped analysts' expectations. Shares of the company, which makes tools for genetic analysis, jumped $15.74, or 6.9 percent, to $242.80.

Companies are set to begin reporting their results for the last three months of 2017, and the pace will pick up later this week. They'll need to deliver strong profit growth to justify the big moves they've made already.

Investors, though, are also interested in what CEOs say about how Washington's overhaul of the tax system last month will affect their bottom lines.

Strategists at Goldman Sachs say the tax changes will account for more than a third of the 14 percent growth they're forecasting for **S&P 500** earnings per share in 2018.

Target cited taxes on Tuesday as one reason for raising its profit forecast for the year. It also became the latest retailer to say it enjoyed a strong holiday season, and its shares rose $1.96, or 2.9 percent, to $69.14.

On the losing end of the market were stocks that pay big dividends, which tend to move in the opposite direction of bond yields.

The yield on the **10**-**year Treasury** note rose to 2.55 percent from 2.48 percent late Monday. That makes dividend-paying stocks less attractive relative to bonds for investors seeking income.

Telecom stocks in the **S&P 500** fell 1.8 percent for the worst performance in the index. Real-estate stocks lost 1.1 percent, and utilities dropped 1 percent.

Some areas of the market can benefit from rising interest rates. Banks can make bigger profits from making loans, for example, and financial stocks in the **S&P 500** climbed 0.7 percent.

In markets abroad, Japan's Nikkei 225 added 0.6 percent, Hong Kong's Hang Seng rose 0.4 percent and the Shanghai Composite inched up 0.1 percent. South Korea's Kospi lost 0.1 percent.

The CAC 40 in France rose 0.7 percent, the DAX in Germany rose 0.1 percent and the FTSE 100 in London gained 0.4 percent.

The dollar fell to 112.61 Japanese yen from 113.07 yen late Monday. The euro fell to $1.1933 from $1.1965, and the British pound dipped to $1.3534 from $1.3564.

Benchmark U.S. crude oil rose $1.23 to settle at $62.96 per barrel. Brent crude, the international standard, rose $1.04 to settle at $68.82 per barrel.

Natural gas gained 9 cents to $2.92 per 1,000 cubic feet, heating oil rose 2 cents to $2.07 per gallon and wholesale gasoline climbed 4 cents to $1.84 per gallon.

Gold fell $6.70 to settle at $1,313.70 per ounce, silver dropped 13 cents to $17.01 per ounce and copper slipped a penny to $3.22 per pound.

This is a more complete version of the story than the one that appeared in print.

CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Tuesday. (Source: Reuters)

Document NYTF000020180110ee1a0005c

International New York Times

us
As Economy Strengthens, Fed Ponders New Approach

By BINYAMIN APPELBAUM
1,479 words
9 January 2018
International New York Times
INHT
English

Corrections Appended

WASHINGTON — In the wake of a deep economic crisis and a disappointingly slow recovery, a growing number of experts, including some Federal Reserve officials, say it is time for the Fed to consider a new approach to managing the economy.

Since the mid-1990s, the Fed has focused on keeping inflation slow and steady, at about 2 percent a year, in the belief that it was the best way to nurture economic growth and avoid painful downturns. Those pushing for a new approach do not agree on the best alternative — the ideas range from minor tweaks to tossing the current rule book — but there is broad agreement that the Fed should seize the moment now, before the next crisis hits.

"Monetary policy has not been as successful as we might like over the last decade," Christina Romer, an economist at the University of California, Berkeley, said this weekend at the annual meeting of the American Economic Association in Philadelphia. "Now really is the time for every monetary economist to say, 'Is there something better?'"

The stakes are high: The Fed pursues its goals by raising and lowering borrowing costs to influence economic growth and stability. Effective management allows the economy to prosper: Employment grows, wages rise and people enjoy better standards of living. Mistakes cause recessions.

The Fed has faced questions about its methods in the decade since the 2008 crisis, but in recent weeks, officials have shown a willingness to welcome the debate. John Williams, president of the Federal Reserve Bank of San Francisco, said it was time to talk about approach because the Fed is finally wrapping up its response to the last crisis, which entailed unprecedented steps to lower borrowing costs and get **financial markets** moving.

"The right timing of this debate is really now because the U.S. economy has fully recovered from this recession," Mr. Williams said.

Patrick Harker, president of the Federal Reserve Bank of Philadelphia, told attendees at the economics gathering in Philadelphia that there was an urgent need for more and better research on the available alternatives.

"The most important issue on the table right now is that we need to consider the possibility of a new economic normal that forces us to re-evaluate our targets," he said. "It is a question for the profession itself, and we do need people thinking about this."

The Fed's current approach is known as inflation targeting. It works in large part by training the public to expect a certain level of inflation, disciplining the pricing decisions of businesses and the wage demands of workers. It is, in other words, a self-fulfilling prophecy.

The Fed announced in January 2012 that it would seek to keep inflation at a 2 percent annual pace, formalizing its implicit target since the mid-1990s.

The rise of inflation targeting reflected a consensus among academics and policymakers that central banks did not have direct control over broader economic performance but did exercise direct control over inflation, and that keeping inflation low and stable was the best way to support growth.

Most central banks in developed nations similarly target a low rate of inflation, taking the view that unpredictable increases in prices are economically disruptive. The European Central Bank, for example, aims to keep inflation "below, but close to" 2 percent.

But the Fed's focus on inflation in the real economy did not prevent asset prices like mortgage-backed bonds from soaring to unsustainable heights before 2008, and concern about keeping inflation low limited the scope of its post-crisis stimulus campaign.

Moreover, the combination of low inflation and modest growth has left the Fed with very little room to respond to future downturns by reducing interest rates. During past downturns, the Fed lowered rates by an average of five percentage points. But the Fed's benchmark rate currently sits in a range between 1.25 percent and 1.5 percent. That would make cutting the rate a less effective tool than in previous firefights.

Janet L. Yellen, the Fed's outgoing chairwoman, has emphasized that the Fed has other weapons in its arsenal. After 2008, the Fed bought large quantities of Treasuries and mortgage bonds and promised to keep interest rates low for years at a time, encouraging borrowing by businesses and consumers.

Ms. Yellen is expected to be succeeded by Jerome H. Powell, a Fed governor who is awaiting Senate confirmation as the next Fed chairman.

Some outside economists say the Fed is putting a brave face on a bad situation.

"We are living in a singularly brittle context in which we do not have a basis for assuming that monetary policy will be able as rapidly as possible to lift us out of the next recession," said Lawrence H. Summers, a Harvard economist and former Treasury secretary.

The proposed alternatives to inflation targeting can be sorted into two categories. The first contains one simple idea: The Fed should permanently embrace higher inflation. The second is full of complicated ideas for temporarily embracing higher inflation during downturns.

Olivier Blanchard, a fellow at the Peterson Institute for International Economics who began his term as president of the American Economic Association at the Philadelphia meeting, said the choice of a 2 percent target had no particular economic logic to recommend it. Raising the target to 4 percent would give the Fed more room to operate without significantly larger economic costs, he said.

Many economists, however, are wary of the simple solution.

Ben S. Bernanke, the former Fed chairman, has warned that the costs of dropping a new anchor would be significant. On Monday, at a Brookings Institution conference convened to discuss alternatives to the 2 percent target, Mr. Bernanke dismissed a 4 percent target as politically untenable.

"The Fed is not going to adopt a 4 percent inflation target," he said. "It's just not going to happen."

But Mr. Bernanke has added his name to the list of those seeking an alternative to the current system. Last year, he proposed that the Fed should announce that it would temporarily tolerate higher inflation during future economic recoveries.

A mechanized version of that idea, popular in some academic circles, would instruct the Fed to target an alternative economic measure, nominal gross domestic product, or N.G.D.P., which sums inflation and real economic growth. Under a 4 percent N.G.D.P. target, for example, the Fed would aim for a combination of inflation and growth that equaled 4 percent, such as 2 percent inflation and 2 percent growth. During a period of lower inflation, like the last decade, such a target would require the Fed to dictate more aggressive stimulus.

Some are skeptical that the Fed can improve the economy by trying harder. Atif Mian, an economist at Princeton University, has argued in his research that high levels of household debt are limiting the impact of monetary policy because many households cannot or will not continue borrow.

"There is this implicit assumption that things will have traction if you just push hard enough," Mr. Mian said. "But what is the mechanism through which this will raise actual G.D.P.?"

Indeed, the Fed and other central banks have not even succeeded in hitting their 2 percent targets in recent years, for reasons that remain unclear. Inflation in the United States has been below that level for the last six years, although most Fed policymakers continue to predict that higher inflation is around the corner.

Ms. Romer said more ambitious targets might encourage central banks to try harder to stimulate inflation.

In practice, she said, the Fed could have purchased more Treasuries and mortgage bonds as part of its response to the crisis, or even engaged in direct lending to businesses.

“We should not just assume that what we’ve done for the last 25 years is right,” she said.

Follow Binyamin Appelbaum on Twitter @bcappelbaum.

Correction: January 9, 2018, Tuesday

This article has been revised to reflect the following correction: An earlier version of this article misidentified Patrick Harker’s position. He is president of the Federal Reserve Bank of Philadelphia, not New York.

Correction: January 9, 2018, Tuesday

This article has been revised to reflect the following correction: An earlier version of this article also described incorrectly Olivier Blanchard’s term as president of the American Economic Association. His term began at the association’s Philadelphia meeting, it did not conclude there.

PHOTO: Jerome H. Powell has been nominated by President Trump to replace Janet L. Yellen as chairman of the Federal Reserve. (PHOTOGRAPH BY CAROLYN KASTER/ASSOCIATED PRESS) (B4)

* Fed Plans to Raise Rates in 2018 but Lacks Consensus on Frequency

* Fed Predicts Modest Economic Growth From Tax Cut

* Fed, Perplexed by Low Inflation, Is Still Ready to Raise Rates

Document INHT000020180110ee1900004

THE WALL STREET JOURNAL.
U.S. EDITION

Intel CEO's Sale of Stock Risks Scrutiny

By Ted Greenwald
668 words
9 January 2018
The Wall Street Journal
J
B2
English

The sale of Intel Corp. stock by Chief Executive Brian Krzanich while the company was handling concerns about security flaws in its chips was a highly unusual move that risked attracting regulatory scrutiny, according to lawyers and analysts who follow executive stock sales.

The trade took place on Nov. 29, nearly six months after Intel was informed about the vulnerabilities, which could enable hackers to access user data in chips made by Intel and others. Mr. Krzanich sold shares and exercised stock options valued at a total of $39 million, netting him nearly $25 million, according to regulatory filings made at the time.

Word of the flaws didn't become public until last week, sending Intel's shares down.

The timing of Mr. Krzanich's sale "is really odd," said Dan O'Connor, an attorney specializing in securities with the law firm Ropes & Gray. "The timing, the size, the unusual nature compared to prior sales -- that's going to get this a lot of scrutiny."

The trade took place under a Securities and Exchange Commission rule that allows officers and directors of public companies to prearrange sales of specific numbers of shares at particular times. The rule prohibits insiders from setting up such transactions while possessing undisclosed information that might affect the **stock price**, Mr. O'Connor and other securities experts said.

A spokesman for Intel said Mr. Krzanich's divestiture was unrelated to the chip-security issue and the sale was based on a prearranged trading program. Intel declined to make Mr. Krzanich available for an interview.

Regulatory filings show that Mr. Krzanich established the divestiture plan about a month before the trade, on Oct. 30, long after Intel learned of the chip vulnerabilities in June. Intel hasn't said when Mr. Krzanich was informed of the issue.

Intel's stock was up about 20% year-to-date when Mr. Krzanich put the trading plan in place, with almost all of those gains occurring in the prior two months.

Mr. Krzanich's trade stands out because it deviated from the CEO's previous pattern of incremental sales of Intel stock, according to Ben Silverman, a researcher at InsiderScore LLC, a clearinghouse for information about trades made by corporate and institutional insiders. The CEO had exercised options and sold shares generally at monthly or quarterly intervals in the prior two years, involving no more than 80,000 shares in any given transaction, according to Mr. Silverman's analysis.

On Nov. 29, Mr. Krzanich sold more than 245,000 shares, nearly 50% of his unrestricted stock, reducing his unrestricted holding to 250,000 shares, the minimum set by Intel's executive-stock-ownership guidelines, according to the company's most recent proxy statement. That was an unusual move by a CEO, Mr. Silverman said. Moreover, Mr. Krzanich liquidated all of his options, more than 644,000 shares valued at more than $28 million in total.

Mr. Silverman and other securities experts said they would expect U.S. regulators to examine Mr. Krzanich's trade to see if it violated insider-trading regulations, although such cases are difficult to win. A spokesman for the SEC declined to comment.

For an insider trade to violate the rule, the information held by Mr. Krzanich about the security vulnerabilities at the time he made the trade would have to be deemed material to Intel's business, the securities experts said. Intel said last week that it didn't expect the issue to have any material impact.

At the time of Mr. Krzanich's sale, Intel was working with chip rivals and software partners to patch the security flaws. The companies had planned to announce the problem and their fixes Jan. 9, but news of the security flaws leaked earlier. Intel shares then fell over 5% total on Wednesday and Thursday. The stock rose less than 1% Friday and closed flat at $44.74 Monday.

Document J000000020180109ee1900027

THE WALL STREET JOURNAL.
U.S. EDITION

Banking & Finance: Signs of Unease on High-Yield Bonds

By Gunjan Banerji
325 words
9 January 2018
The Wall Street Journal
J
B10
English

The high-yield bond market could be in for some turbulence.

Among 30 exchange-traded funds analyzed by Goldman Sachs Group Inc., options investors are the most **bearish** on the high-yield, or junk, sector and the most **bullish** on oil for 2018.

Across all the ETFs, Goldman found that an options measure called "skew" was the highest in the iShares iBoxx $ High Yield Corporate Bond ETF, or HYG. The gauge, which measures the cost of protecting against share declines, is sitting at a one-year high, Trade Alert data show.

What's more, options investors are positioned for a gain or loss of 7% for HYG over the next year. Options markets forecast a similar outcome for the SPDR Barclays High Yield Bond ETF.

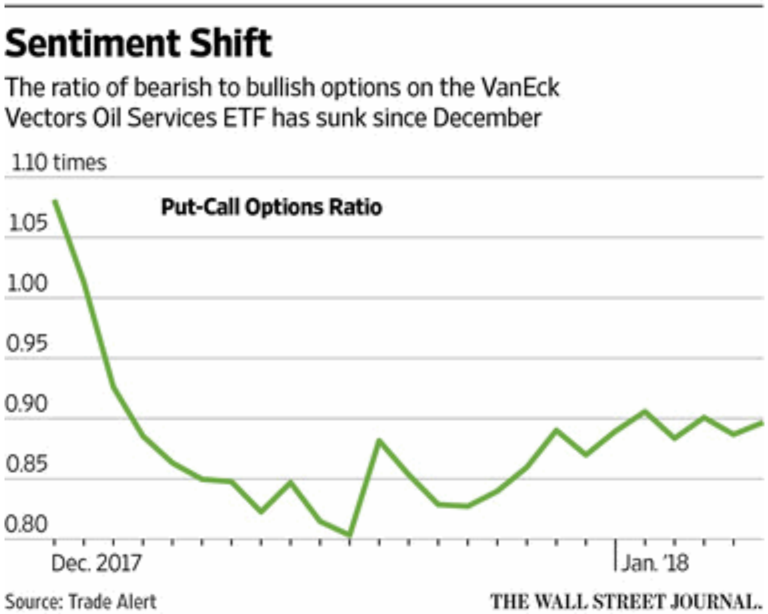
Morgan Stanley Wealth Management recently recommended chopping high-yield exposure this year and putting cash toward safer and higher-rated bonds like Treasurys and municipal debt. U.S. high-yield bonds earned a 7.5% return in 2017, according to the firm.

"Any softness in corporate credit may portend greater **volatility** and headwinds for other risky assets, particularly equities," wrote Morgan Stanley's Steve Edwards in a note.

Investors also expect higher turbulence for some of last year's most beloved sectors and stock indexes. The options market is positioned for higher **volatility** in the **Dow Jones Industrial Average**, consumer and technology stocks, the Goldman analysts wrote, all of which have soared over the past 12 months.

Meanwhile, the ratio of **bearish** options to **bullish** options on the VanEck Vectors Oil Services ETF has sunk since early December, Trade Alert data show. The oil fund has gained almost 9% in 2018.

Energy stocks in the **S&P 500** fell about 4% last year but **oil prices** ended 2017 above $60 a barrel, the highest level in at least two years.



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Document J000000020180109ee190000j

THE WALL STREET JOURNAL.
U.S. EDITION

Streetwise: Four Ways to Survive a Stock-Market Bubble

By James Mackintosh
883 words
9 January 2018
The Wall Street Journal
J
B12
English

Let me be clear: Stocks, even go-go technology stocks, aren't in a bubble. But there are increasing signs of euphoria, and it is plausible that a true blowout end to the **bull market** could be on the way soon. If a bubble is finally developing, investors will have a chance to make a ton of cash, to lose it again or to miss out entirely. How best to play a euphoric market?

Start with the signs of frothy behavior. For years, stocks have been going up without wild exuberance. Investors have felt compelled to buy shares because bond yields are so low, but this deliberate engineering of a **bull market** by the central banks didn't engender excitement. The narrative of the market was one of caution. Investors for a long time bought the safest stocks they could, pressed chief executives to return cash rather than boost capital spending, avoided big glitzy takeovers and worried about a repeat of the 2008 financial crisis.

Ten years on from Lehman Brothers' failure, that worry is finally dissipating. The market's story line has changed to one of disruptive, low-inflation growth fueled by easy money.

Shareholders are cheering on corporate capex and less excited about buybacks, as they bet on a synchronized global economic boom. There are few fears of financial excess, even as some of the precrisis financing tricks make a comeback.

So far, so **bullish**. What marks out a bubble is people buying things they know are overpriced in the hope of selling them on at even higher markups to a greater fool. We aren't there yet, bitcoin-related stocks aside, but as the euphoria grows, this becomes ever more likely -- with the tech sector the most likely beneficiary.

The first few days of 2018 certainly point toward high spirits in the tech sector. The FANG stocks of Facebook Inc., Amazon.com Inc., Netflix Inc. and Google parent Alphabet Inc. all rose more than 5% last week, double the wider market's gains.

The American Association of Individual Investors survey of its members shows the most bulls and the fewest bears since the end of 2010. Investors Intelligence's survey of financial newsletters is even more positive, with the highest number of bulls since the start of 1987. Investment-bank surveys say record or near-record proportions of fund managers are holding more risky portfolios than usual.

It is too soon to call this a bubble. U.S. equities are among the most expensive they have ever been on many measures, with the median stock matching valuations that were reached during the dot-com peak. With interest rates and bond yields still depressed, a case can be made that this merely points to low returns ahead, not an effervescent market.

Jeremy Grantham, co-founder of Boston fund manager Grantham, Mayo, Van Otterloo & Co., says he sees early signs of the "touchy-feely" measures of excess that go with a bubble, such as media focus on a clutch of fashionable stocks. He thinks a melt-up of the **S&P 500** to between 3400 and 3700 in the next year or two is more likely than not.

The prospect of gains of 24% to 35% sounds easy to trade. Just buy! Even better, buy the big tech stocks that should go up by a multiple of those in a true bubble (from the start of 1999 to the dot-com peak in March 2000, U.S. tech stocks more than doubled).

The problem is timing the exit. The tech sector lost 80% when the tech bubble popped, as investors scrambled to dump shares at any price. Those who held from mid-1996 on gave back all their bubble gains by October 2002. That leaves four options:

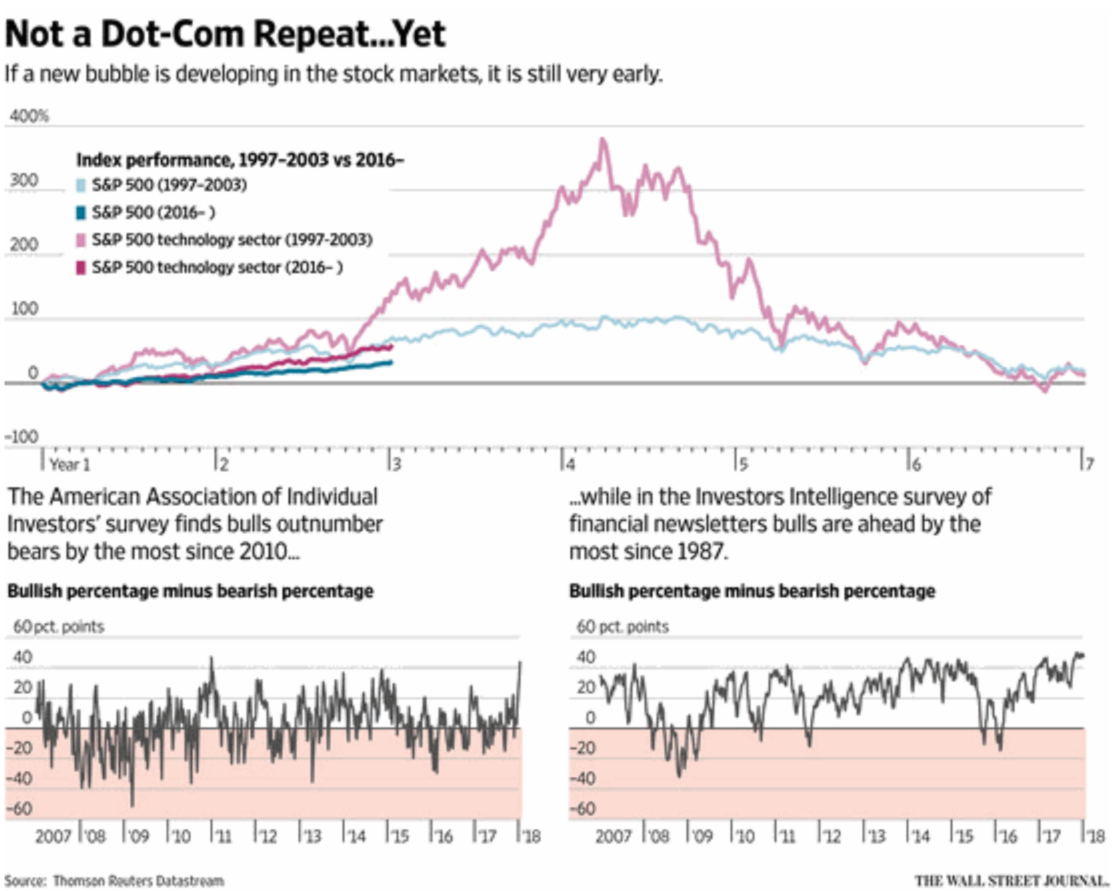
-- Get out early. As the bubble builds, sell into strength. You will feel increasingly stupid while the bubble builds, so only do this if you can resist the fear of missing out.

-- Get out late. Buy into the bubble, but be ready to sell quickly after it pops. Timing is tough, as there is no way to be sure if even a big drop is the end or just a pause, as with the 20% tech drops in 1997 and 1998 and the 10% fall in 1999. It is easy to sell too early thinking the bubble is done.

-- Stay in, stay cautious. Buy high-quality companies less affected by tech enthusiasm, or cheap value stocks shunned by those chasing growth, perhaps with a bit of tech to share in bubble gains. Unfortunately, quality stocks are already expensive, and value stocks could easily fall a lot more before they come back into fashion.

-- Look elsewhere. Mr. Grantham favors loading up on emerging-market stocks, which are cheaper. They probably would be hit in the short run by a U.S. bubble popping, however.

If a bubble develops, pick a strategy and don't get greedy; always think of what will be left after it bursts. For the long-term investor, bubbles are about survival, because most of those who get rich quick on the way up get poor quick again on the way back down.



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THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Why Global Markets Are Still Strong

By Richard Barley
384 words
9 January 2018
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

The calendar has rolled over, but global markets are still thriving on the 2017 playbook. That means, however, that big questions over why growth and inflation are so out of whack with each other remain unanswered.

The first week of 2018 delivered more good times for investors: gains for risky assets, a soft U.S. dollar, low **volatility** and government-bond yields locked into a narrow, low range. That was matched by a continuation of the economic-growth story, with strong readings globally for purchasing managers' indexes released last week, in particular signaling continued gains in employment.

Still, the pace of the gains might raise some eyebrows. The MSCI World index of developed-market stocks rose 2.5% in the first week of 2018; its emerging-market peer climbed 3.7%.

In credit markets, U.S. high-yield corporate bonds gained, with the spread over Treasurys falling below 2017's tightest point already.

The question that perplexed many investors in 2017 hasn't gone away: What is going on with developed-market inflation, particularly in the U.S.?

The combination of greater optimism on growth but no sign of accelerating price rises has meant supportive conditions for both bonds and stocks. For equities, stronger growth has been the dominant factor; for bonds, the absence of inflation. In turn, central banks such as the Federal Reserve and European Central Bank have been able to stick to clearly communicated plans.

This happy situation will face a challenge at some point. It still seems likely that bonds may face harder times rather than equities; right now, a rise in inflation looks more likely than a slowdown in growth. The gap between yields on U.S. Treasurys and inflation-protected securities has widened in recent weeks, signaling a rise in inflation expectations.

One clear concern is that there is already plenty of inflation, all of it in asset prices. Markets are expensive. But that hasn't stopped them from becoming more expensive; in the short term, valuations aren't a good guide to market action. Until investors get a clearer signal on the balance between growth and inflation, the old playbook is the one to go by.

Document J000000020180109ee190001m

The New York Times

Business/Financial Desk; SECTB
Tech and Utilities Power S.&P. 500 Into a 5th Straight Day of Gains

By THE ASSOCIATED PRESS
830 words
9 January 2018
The New York Times
NYTF
Late Edition - Final
6
English

The market's perfect start to the year rolled on, as the Standard & Poor's 500-stockindex shook off a bit of weakness on Monday to tick further into record territory.

Stocks had dipped in early trading, and the S.&P. 500 appeared to be on pace for its first down day of the year. But accelerating gains for dividend-paying and technology stocks helped offset losses in the health care industry, and the S.&P. 500 eked out a fifth straight gain. Other United States indexes edged higher or held close to their record levels.

''We're getting a bit tired hearing ourselves talking about the solid economic backdrop and strong earnings growth, but that is the backdrop,'' said Jon Adams, senior investment strategist for BMO Global Asset Management.

He is optimistic that stocks can continue to rise from their record levels, even though the market is more expensive than it usually is relative to corporate profits. ''Everyone is talking about the synchronized economic growth'' around the world, he said, ''but it's something we haven't seen for 10 years.''

The S.&P. 500 rose 4.56 points, or 0.2 percent, to 2,747.71. The last time the index led off a year with more consecutive gains was in 2010, when it had six.

The Dow Jonesindustrial average slipped 12.87, or 0.1 percent, to 25,283.00. The Nasdaq composite index rose 20.83, or 0.3 percent, to 7,157.39, and the Russell 2000 index of smaller companies' stocks gained 1.80, or 0.1 percent, to 1,561.81.

One of the biggest gains in the S.&P. 500 came from the retailer Kohl's, which jumped after it raised its earnings forecast for the year. The company said its sales climbed nearly 7 percent in November and December from a year earlier, and its new profit forecast easily topped Wall Street's expectations.

Kohl's rose $2.54, or 4.7 percent, to $56.90.

High-dividend stocks were also strong, with utilities up 0.9 percent, for the biggest gain of the 11 sectors that make up the S.&P. 500.

On the losing end for stocks was GoPro, which plunged after it said its revenue fell sharply last quarter. The company had to slash prices on cameras to drive more sales, and it reported preliminary fourth-quarter revenue that fell far short of Wall Street's expectations.

The stock lost 96 cents, or 12.8 percent, to $6.56. GoPro also said it would cut more than 20 percent of its work force.

Earnings are one of the best predictors for long-term performance of stocks, and a number of companies are set to begin reporting their results for the last three months of 2017. The pace will pick up later this week, and analysts and investors will be focused on what chief executives say about their expectations for future earnings.

That is because Wall Street is looking for profits to rise even higher after Washington approved cuts in corporate tax rates last month. The overhaul of the tax system may help some areas of the market more than others, and investors want to see how much companies will raise their forecasts. Stocks tend to track the trend of corporate profits more than anything else over the long term.

In the United States bond markets, the yield on the **10-year Treasury** rose to 2.48 percent from 2.47 percent late Friday, and the price dropped to 9731/32.

In overseas trading, the South Korean Kospi index rose 0.6 percent, and the Hang Seng in Hong Kong gained 0.3 percent.

In Europe, the French CAC 40 rose 0.3 percent, and the German DAX was up 0.4 percent. The FTSE 100 in London dropped 0.4 percent.

The dollar slipped to 113.07 Japanese yen from 113.14 yen late Friday. The euro fell to $1.1965 from $1.2050, and the British pound edged down to $1.3564 from $1.3565.

Benchmark United States crude rose 29 cents to settle at $61.73 a barrel. Brent crude, the international standard, gained 16 cents to settle at $67.78 a barrel.

Natural gas rose 4 cents to $2.84 per 1,000 cubic feet, heating oil fell 1 cent to $2.05 a gallon, and wholesale gasoline added 1 cent to close at $1.79 a gallon.

Gold fell $1.70 to $1,318.60 an ounce, silver lost 14 cents to $17.14 an ounce, and copper dipped a penny to $3.22 a pound.

CHARTS: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Monday. (Source: Reuters); 3-Month Treasury Bills: High rate at weekly auction. (Source: The Bond Buyer)

Document NYTF000020180109ee190005f

THE WALL STREET JOURNAL.
U.S. EDITION

Investors Drop Shields Against Stock Downturns

By Gunjan Banerji
891 words
9 January 2018
The Wall Street Journal
J
A1
English

Big **stock-market** gains are leading a number of investors to abandon defensive positions taken to protect against a market downturn, the latest sign that many doubters are shedding caution as the long rally rolls on.

Investors with significant ownership of stocks often look to offset that risk by buying put options on stocks or major stock indexes, like the **S&P 500**. These contracts are a form of insurance that pay out when stocks fall.

But with the **Dow Jones Industrial Average** breaking through 25000 for the first time, the **Nasdaq Composite** crossing 7,000 and market **volatility** falling to near all-time lows, many investors have decided that spending cash to hedge against big declines is a waste of money. While the Dow Industrials slipped 0.05% Monday, the **S&P 500** and **Nasdaq Composite** closed again at records.

Stock pickers are already feeling squeezed by competition from lower-cost passive investments such as exchange-traded funds and worry that they can't risk falling behind in a rally. Purchasing market protection through hedges eats into their returns.

"I haven't seen hedging activity this light since the end of the financial crisis," said Peter Cecchini, a New York-based chief market strategist at Cantor Fitzgerald. "It started in late 2016 and accelerated in the second half of the year."

Others signs of skeptical investors acknowledging the pull of the powerful **bull market** have also cropped up in recent days.

Jeremy Grantham, a **bearish** investor at Boston money managers Grantham Mayo Van Otterloo & Co. with a history of spotting market tops, said last week that investors ought to brace for explosive short-term stock gains.

He dubbed this phase a "melt-up," or climactic late-rally jag higher that might push prices up an additional 50% over the next six months to two years.

A University of Michigan survey in October showed that consumers saw a nearly 65% chance on average that the **stock market** would rise in the next 12 months, the highest share on record. That measure remained near record levels in the following months.

New data indicate that either demand for protection against a downturn is low or investors are favoring **bullish** options on the **S&P 500** instead. A measure called "skew," gauging the cost of insuring against short-term stock declines, recently hit a one-year low, data from Credit Suisse Group AG show.

Bets by hedge funds against **volatility** -- similar to a **bullish** wager on stocks -- outnumber bets on rising **volatility**, recent Commodity Futures Trading Commission data show. At 12 of the biggest banks in the world, revenue in their equity-derivatives businesses that focus on listed options shrank during the first half of 2017.

The **S&P 500** has gone 386 trading days without a selloff of 5%, its longest stretch since 1996, according to The Wall Street Journal's Market Data Group.

By letting their hedges expire, investors would feel the full brunt of a market selloff. While that would intensify the pain for any individual trader, some analysts and brokers worry that the cumulative effect of more investors giving up their protective positions could itself become a source of **volatility**.

Many investors could rush to sell their positions and limit their losses during the next period of market weakness, exacerbating any plunge in prices.

"When the ultimate disruption occurs, the market is less prepared for it," Dean Curnutt, chief executive at New York brokerage Macro Risk Advisors, said. "That becomes an amplifier of the risk."

Howard Marella, founder of broker Icon Alternatives, had been a regular buyer of put options on individual stocks and indexes to protect his portfolio.

Heading into last year, he changed his mind. Persistently low interest rates and the big **stock market** rally that followed the presidential election prompted him to abandon most of the options that had shielded him against drops in share prices.

Now, he views a market decline as an opportunity to buy cheaply, rather than spending his cash to hedge against it. That strategy paid off handsomely in 2017, when major **stock-market** indexes repeatedly rose to records.

Hedging against an unexpected surge in market turbulence, meanwhile, was a money loser. The **S&P 500** jumped 19% in 2017, and the Cboe **Volatility** Index, known as the VIX, had its quietest year in history. That meant investors who bought such options were often stuck with worthless contracts. It was "a really difficult year to be a hedger," said Macro Risk Advisors' Mr. Curnutt.

Minor spikes in the VIX did crop up, but the gauge remained entrenched below its historical average throughout 2017.

"The first four Fed hikes in a decade have failed to generate the revival of volatilities that many had expected at the end of last year," wrote Marko Kolanovic, a quantitative and derivatives analyst at JPMorgan Chase & Co., in a December note.

Placid markets could continue into 2018, Bank of America Merrill Lynch wrote in a recent report. "The behavior of **volatility** has entirely changed since 2014," because major central banks have kept interest rates near historic lows, analysts wrote.

It suggested that the VIX would be hard-pressed to return to its long-term average of 20 "in a low rates world."

Document J000000020180109ee1900022

THE WALL STREET JOURNAL.
U.S. EDITION

Investing in Funds & ETFs: A Quarterly Analysis --- Fundamentals of Investing: Muni Bonds May Not Be The Safe Bet Any Longer --- Investors need to understand how the risks have changed, and perhaps alter their strategy

By John Coumarianos
967 words
8 January 2018
The Wall Street Journal
J
R5
English

Corrections & Amplifications

Interest on municipal bonds is exempt from taxes at most state and local levels if investors own bonds issued by a government entity within their state of residence. An Investing in Funds & ETFs report article on Monday about muni bonds incorrectly implied that all states exempt such income from taxes.

(WSJ Jan. 10, 2018)

The historical default rate of municipal bonds has been only 0.03% for AA- and A-rated bonds from 1970 through 2009, according to a Moody's study; a Journal Report article on muni bonds on Jan. 8 incorrectly said 0.30%. Also, the article incorrectly referred to Jefferson County, Ala., which filed for bankruptcy in 2011, as Jefferson City.

(WSJ Jan. 16, 2018)

(END)

Can investors still use municipal-bond funds as core holdings in their taxable accounts?

For a long time, many have done just that -- taking advantage of the bonds' big tax benefits, and using their low risk as a haven in times of **stock-market** turmoil.

But munis aren't looking like such a reliable bet anymore. Since the financial crisis, some big municipalities have defaulted on their obligations, while a number of states, cities and now Puerto Rico are currently facing financial woes. And bankrupt municipalities are increasingly making bondholders scrounge for what's left after paying employee pension funds.

So while it may still be possible to keep a muni fund as a core holding, investors should understand how the asset class has changed.

Municipal bonds offer investors interest that's tax-free at the federal level and at the state and local levels, if investors own bonds issued by any government entity within their state of residence.

When deciding whether to buy muni bonds, investors usually make a comparison between the yields of a muni bond and a U.S. Treasury note or bond of similar maturities. The "taxable yield equivalent" to a municipal bond is the municipal bond's yield adjusted for the investor's tax bracket.

So if an investor is hypothetically in a 50% bracket, including both federal and state taxes, a taxable yield twice that of a municipal yield -- or a municipal yield half that of a taxable bond -- would make two bonds equivalent. In that case, if a highly rated muni bond offered more than half the yield of a comparable U.S. Treasury , an investor could consider the muni bond the better choice in a taxable account.

For decades, that was a reasonable comparison, and largely all that investors had to consider about munis. The chance of losing an investment was not even an issue: The historical default rate of the roughly $3.8 trillion market with more than 80,000 issuers has been low -- 0% for AAA-rated bonds and only 0.30% for AA- and A-rated bonds from 1970 through 2009, according to a Moody's study.

Unfortunately, municipal profligacy has begun to result in more high-profile distress and bankruptcy in recent years, including Jefferson City, Ala.; Detroit; Harrisburg, Pa.; Central Falls, R.I.; and Vallejo, San Bernardino and Stockton in California. Now the fate of more than $70 billion that creditors have lent to Puerto Rico is in doubt, as Hurricane Maria battered the island already struggling with manufacturing and population loss.

An updated Moody's study from 2016 notes that the "sector has changed over the past decade and more profound changes may be in the offing. The once-comfortable aphorism that 'munis don't default' is no longer credible, although default rates remain low."

In some cases, investors betting on munis have gotten burned. Recently, Franklin Double Tax Free Income fund merged with Franklin High Yield Tax Free Income fund (FHYVX) after it inflicted significant losses on investors. The fund had more than half its assets in Puerto Rico bonds.

Some analysts warn that many bond issuers are heading into precarious financial situations. In a 2016 research report from PNC Capital Markets, Tom Kozlik argues that around 20% of issuers haven't adjusted their spending to reflect diminished revenue after the financial crisis.

Mr. Kozlik doesn't cite names, but other observers have pointed fingers at issuers at risk.

"Though I'm not warning of an industrywide municipal-bond crisis, I think investors have to think carefully about individual credits and what, exactly, they're investing in," says Nicole Gelinas of the Manhattan Institute think tank. In the case of Chicago, "it's difficult to see, 10 years from now or even sooner, how, exactly, Chicago figures out [its problems with underfunded pensions] without bondholders having to take some sort of hit, as well." (Chicago officials declined to respond to a request for comment.)

And when a municipality goes bankrupt, investors aren't always first in line to recover their money. Stockton and San Bernardino honored their obligations to state-employee pension funds at the expense of bondholders in their bankruptcies. "General obligation" bondholders, once thought to be above revenue bondholders in the case of defaults, aren't necessarily ahead of unions.

Not all municipal-bond experts are pessimistic. Tracy Gordon, a senior fellow at the Urban Institute think tank, says investors shouldn't be alarmed about munis' safety, emphasizing their low historical default rates. "It's unfair to paint the whole sector with a broad brush," she says.

But if investors choose munis as a core holding, many analysts advise using a diversified fund to lessen the risk of issuers defaulting. What's more, investors shouldn't expect the bonds to rally during a **stock-market** decline, as U.S. Treasurys often do.

That's because munis have become closely tied to the health of state-employee pension funds. If stocks fall and pension funds lose money, the funds often turn to municipalities to make up losses -- which makes muni bonds less attractive and hurts muni investors.

Indeed, the Bloomberg Barclays Municipal Index lost nearly 2.5% in 2008 during the stock crash -- instead of providing municipal-bond investors with protection. That's hardly catastrophic, but it might not have represented the resilience that the bond investors were expecting. And results might be less benign during the **stock market**'s next wipeout.

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THE WALL STREET JOURNAL.
U.S. EDITION

Investing in Funds & ETFs: A Quarterly Analysis --- Q&A: Mr. Long-Term --- Baron sticks with what works

By Chuck Jaffe
534 words
8 January 2018
The Wall Street Journal
J
R9
English

Corrections & Amplifications

Investor Ron Baron started his mutual-fund firm in the 1980s. A Journal Report interview with him published Jan. 8 incorrectly said the 1990s. Also, $10,000 invested in Baron Growth Fund when it opened in 1994 would be worth $163,000 today, compared with $57,000 for the Russell 2000 Growth Index. The article incorrectly referred to the overall Russell 2000 index, and used a figure for the index comparison of $85,000, which is what a $10,000 investment in the **S&P 500** would have become in that time.

(WSJ Jan. 20, 2018)

(END)

Ron Baron started his mutual-fund firm in the 1990s and estimates he has generated $23.5 billion in investment profits since then.

He expects to double that number in the next five or six years. That's not a market call, because the 74-year-old investor doesn't make them. He expects to do what he has always done, which has involved beating the market long term at a point when most investors have given up on active management.

His version of active management isn't that active at all; it's mostly buy-and-hold. But $10,000 invested in Baron Growth (BGRFX) when it opened in 1994 would be worth $163,000 today, compared with $85,000 for the Russell 2000.

"The hard part for most people," he says, "is just ignoring everything else that is happening to stick with what you know works. I tried those other things early in my career and they didn't work."

Edited excerpts from a recent interview:

WSJ: You are one of the few fund managers with a long-term record of beating the indexes, yet you advise millennials to buy index funds.

MR. BARON: What millennials -- and really investors of any age -- should be thinking is that the **stock market** basically doubles every 10 to 12 years since 1960, because the economy doubles every 10 or 12 years over that time. The other side of the equation is that the value of your money falls in half every 17 years.

If you're a millennial and you want to provide for yourself for the long term, then invest for the long term; if you can take $5,000 a year and invest it in an S&P index fund through a low-cost place like Vanguard, Schwab or Fidelity, after 10 years it would be worth $110,000. You can become a millionaire by just investing $5,000 a year in your index funds.

WSJ: But then why don't you buy index funds, or run one?

MR. BARON: You can't beat an index fund if you are trying to beat the market at all times, and most people are. They want to fire managers when their fund falls behind, and that's why managers try to figure out whether interest rates are going up or down or **oil prices** are going up or down or bitcoin is going up or down, or who will be the president, or will they pass the tax bill, and whether there will be a Brexit or will we attack Korea.

WSJ: You have said that the real difference is the process. So what's your process?

MR. BARON: The reason the **stock-market** index goes up 6% or 7% or 8% a year is business grows at that rate. But the reason we have done better than that, historically, is we have bought businesses that grow at closer to 15%.

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THE WALL STREET JOURNAL.
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Investing in Funds & ETFs: A Quarterly Analysis --- Exchange-Traded Funds: What to Look for in ETFs in 2018 --- Investors should expect an increase in the types of products

By Ari I. Weinberg
927 words
8 January 2018
The Wall Street Journal
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English

Corrections & Amplifications

The first name of Jay Batcha, Optimal Capital's chief investment officer, was incorrectly given as Ray in an article on exchange-traded funds in Monday's Investing in Funds & ETFs report.

(WSJ Jan. 12, 2018)

(END)

Exchange-traded funds are taking over. Many industry observers say that the party will continue, even if a downturn hits the **stock market**, and especially if a pullback hits the bond market.

U.S. ETF investing had another record year in 2017, with net flows at $463 billion, of which $330 billion went into stock funds and $119 billion into debt and fixed-income funds. Total U.S. assets under management now top $3.4 trillion, though that is still one-fifth of the total assets in long-term mutual funds (excluding money markets).

During the year, 275 new products were launched and 136 products were delisted, according to research firm XTF. The announced acquisition by Invesco Ltd.'s Invesco PowerShares of Guggenheim Investments' ETF business has brought the slow but steady consolidation toward the top of the ETF pyramid. The fourth-largest issuer at $177 billion in assets, when combined, will still trail State Street Corp.'s State Street Global Advisors ($567 billion), Vanguard Group ($851 billion) and BlackRock Inc. ($1.35 trillion). Additionally, three issuers -- Global X, Goldman Sachs and Exchange-Traded Concepts -- experienced more than 100% asset growth in 2017, according to Toroso Asset Management.

Here are five trends to watch in 2018.

1. The time for fixed-income ETFs has come. This argument is made every year, but rising short-term interest rates and a flattening yield curve in the U.S. will shine a spotlight on fixed-income fund performance and drive more investors to consider ETFs, both active and passive, according to Todd Rosenbluth, senior director of ETF and mutual-fund research at CFRA. For investments where outperformance is measured more in basis points than percentage points, the fact that 2017 flows equaled 21.5% of total fixed income ETF assets (compared with 12.3% for equity ETF assets) is an indicator of the growth that should continue this year.

2. More products and issuers. Even with 123 fund sponsors already in the U.S. market, Toroso's Michael Venuto sees room for even more entrants. Last year, the asset-management units of several insurance companies (USAA, Transamerica, Principal) launched a number of funds, while established asset managers without significant ETF businesses were emboldened to cut fees and ramp up marketing on new products or previous acquisitions. Mr. Venuto says new issuers and products will fall into three categories: hot ideas, catch-up by existing asset managers and insurers, and registered investment advisers converting separate accounts to ETF-based strategies.

3. ETF "innovators" will continue to push the envelope of investible assets. Empowered by fringe investment trends in the legal-marijuana industry and bitcoin/blockchain ecosystems, new and established ETF issuers alike have applied to list at least six marijuana-investment products and 16 bitcoin/blockchain-related strategies, according to Bloomberg ETF analyst Eric Balchunas. And, following the launch of bitcoin futures in December, two exchanges -- NYSE Arca and Cboe Global Markets -- have applied to list bitcoin ETFs in the U.S. While these products are still waiting for approval from the Securities and Exchange Commission (approval which for

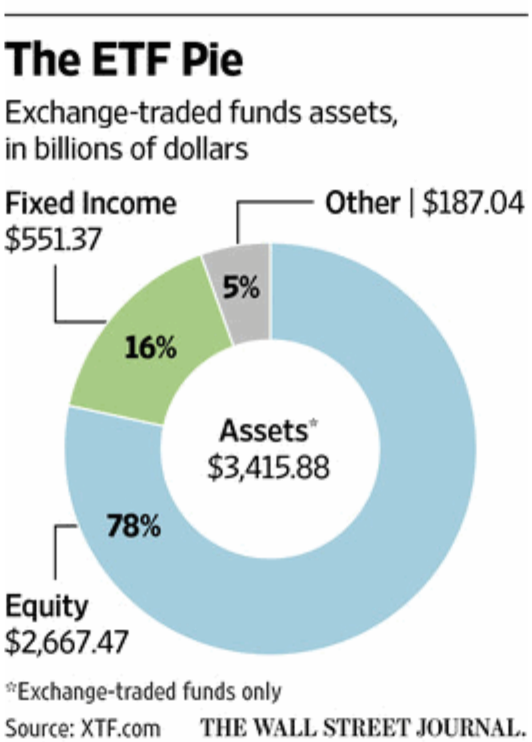
some of them may never come, especially if the federal government succeeds in a new push against state legalization of marijuana), Optimal Capital's Chief Investment Officer Ray Batcha says there are many esoteric strategies that could get more attention should the U.S. **stock market** and debt markets move sideways. These include ETFs offering downside protection with options and swaps.

4. The robots come home to roost. Robo advisers are dead; long live robo advisers. Like "ETF strategists" before them, stand-alone automated investment platforms have ceased to threaten established financial advisers or brokerage firms, despite shining a light on costs and minimums for professional advice. "Distribution is a major choke point for ETF issuers. Even BlackRock has pivoted to model portfolios on the strength of its Aladdin analytics platform," says Matt Hougan, CEO of Informa PLC's Inside ETFs. JPMorgan Chase & Co. revealed its own plans for a digital-wealth offering in December, following Morgan Stanley and Merrill Lynch, while Vanguard's low-cost Personal Advisor Services had $93 billion in discretionary assets and Charles Schwab's Intelligent Portfolios $21 billion through Sept. 30. A November deal between PayPal and microinvesting services Acorns (and its 1.3 million customers) could open up a new front for banks and investment managers.

5. Active management is redefined. Even supporters of actively managed stock funds argue that active vs. passive/indexing can be boiled down to high cost vs. low cost. (And, yes, there is high-cost passive in some areas of the market.) Now, Vanguard is gearing up to blow a hole in the active/passive distinction by introducing low-cost, actively managed ETFs in the first quarter -- index funds with that will home in on areas of the market recently ruled by the smart-beta crowd -- namely momentum, value and minimum **volatility**, among others.

But perhaps the index giant's entry into active equity ETFs -- stock funds that mesh the low cost and tax benefits of ETFs with an active manager -- will jostle the sleepiest region of the ETF market. The niche has just $8.3 billion in assets, according to XTF, across 74 funds.

Mr. Weinberg is a writer in Connecticut. He can be reached at reports@wsj.com.



Document J000000020180108ee1800005

The New York Times

The Upshot
Strong Economies Lift Presidents. Trump Seems an Exception.

By NATE COHN
1,098 words
8 January 2018
09:23 AM
NYTimes.com Feed
NYTFEED
English

The **stock market** has surged. Unemployment is at 4.1 percent. ISIS has largely been vanquished from Iraq and Syria.

But despite it all, Donald J. Trump's approval ratings are mired in the upper 30s. No president has had worse ratings at this stage of his term since modern polling began more than three-quarters of a century ago.

With President Trump starting the new year with a blizzard of tweets and fresh controversy seemingly every day, there are still debates about whether he is as weak as he looks. After all, he managed to win the presidency with terrible favorability ratings a little over a year ago. Analysts have understandably been cautious about assuming that his weak ratings will doom him or his party again.

But it seems clear that Mr. Trump's approval ratings betray significant political weakness.

Setting aside the question of how much credit first-year presidents deserve for a strong economy — they have less influence than you might think — President Trump's ratings should be much better. A 4.1 percent unemployment rate, the lowest in 17 years, is more typically associated with a 60-plus-percent approval rating for a first-term president.

Lyndon Johnson is the only other first-term president in the era of modern polling with an approval rating under 50 percent while the jobless rate was below 5 percent. But this came after he'd already been president about four years (having first finished out John F. Kennedy's term) and as the Vietnam War began to drag down his presidency.

Mr. Trump started in a far worse position than other incoming presidents. His initial approval rating was in the low-to-mid 40s, while most presidents enter with an approval rating over 60 percent. It was fair to speculate that his approval ratings would gradually rise with the benefit of a strong economy. Perhaps he would even benefit from low expectations, as many suspected he did during the presidential campaign.

But by now the economy would have been expected to lift his approval rating into the 50s, based on an analysis of presidential approval and economic data going back to 1950. This is despite the tendency for presidents' approval ratings to decline during their time in office. If the economy were to overcome Mr. Trump's unpopularity and send his approval ratings up, you would think we would have started to see signs of it.

It is certainly possible that the economy — or other good news — will still lift his ratings. But it seems just as likely that Mr. Trump will continue to feel the burden of his time in office. On average, a first-term president's approval rating drops by about a point per quarter after controlling for inflation and unemployment (and controlling for the large bump George W. Bush received after the Sept. 11 attacks).

Mr. Trump still has some of the advantages that helped him win despite low favorability ratings in 2016. He appears to maintain the support of his base and fairly high levels of Republican unity. Indeed, his favorability ratings are still higher than they were in the weeks heading into the 2016 election, when they were in the mid 30s. Many pollsters aren't asking the favorability question anymore, but those that do find it roughly equal to his approval ratings (high 30s).

Moreover, his approval ratings among voters might be higher than among all adults; noncitizens may take a survey but are ineligible to vote, and nonwhite and young voters tend to disapprove of the president but have low turnout rates. National data might not be entirely representative of relatively white battleground states and districts, either.

All of this helps explain why many analysts have been cautious about assessing Mr. Trump's low approval ratings. If his ratings are as good or better today than they were when he won and when Republicans kept control of the Senate and the House, the argument goes, why shouldn't they win again?

These points are worth keeping in mind, especially if Mr. Trump's ratings were to tick back up into the 40s. But the big difference between today and 2016 is simple: Mr. Trump is now the president, and elections tend to be referendums on the party in power. A president's approval rating is typically a very strong predictor of the results of presidential elections and even a helpful one in congressional elections.

Since 1950, no party has held the House through a midterm election when the president's approval rating is less than 40 percent. The Republican Party's considerable structural advantages in the House would at least give them a shot to survive this time, but the growing Democratic advantage on the generic congressional ballot and the G.O.P.'s weak showings in this year's special congressional elections suggest that the president's approval rating is weighing on the party in exactly the way one would expect.

And while Mr. Trump's upset victory in 2016 — defying the pre-election polls that showed Hillary Clinton leading in key battleground states — has given him the sheen of invincibility, his victory was not impressive by most standards.

Fundamental-based models — without taking candidates into account — tended to show that the party out of power was a clear if narrow favorite to win in 2016: The pace of economic growth and President Obama's approval rating were positives for the Democrats, but that wasn't enough for the party to be favored because of the burden of seeking the presidency for a third consecutive term.

Mr. Trump had the added advantage of facing Mrs. Clinton, who was under F.B.I. investigation for most of the campaign and ended with the worst unfavorability ratings of any candidate who won a major party nomination other than Mr. Trump, according to Gallup.

Yet in the end, Mr. Trump lost the popular vote by two percentage points, with 46 percent of the vote. It was the second-worst showing since 1948 for the candidate of the party out of power against a party seeking at least a third straight presidential term (after Michael Dukakis in 1988). It was not necessarily a show of strength.

None of this is to say that Mr. Trump's approval ratings can't or won't rise. But at some point, he'll probably need them to.

President Trump's approval ratings are in the upper 30s. | Manuel Balce Ceneta/Associated Press

Document NYTFEED020180108ee18003pd

THE WALL STREET JOURNAL.
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Investing in Funds & ETFs: A Quarterly Analysis --- Currency Craze: What Now for Bitcoin Funds?

By Rob Curran
1,120 words
8 January 2018
The Wall Street Journal
J
R1
English

After all the tumult and rapid growth in bitcoin markets recently, you might wonder what is going on with the investment funds that own the digital currency.

Turns out there is even more tumult and growth than in bitcoin itself.

There has been a blizzard of cryptocurrency hedge-fund launches. The Securities and Exchange Commission has a pile of bitcoin ETF applications. And like children outside a Fingerlings store, institutional investors are lining up to get into the funds.

The largest is Bitcoin Investment Trust, a de facto exchange-traded fund managed by Grayscale Investments, a unit of Barry Silbert's Digital Currency Group. The fund, which has traded over the counter since 2015, is the only bitcoin investment that people can make in most retirement or brokerage accounts. Thanks to an unusual structure, the fund has seen bigger price swings than bitcoin itself recently. Amid the turbulence, Merrill Lynch has banned its roughly 17,000 advisers from executing client requests to trade it.

"We look forward to speaking with Merrill Lynch and addressing any questions or concerns they have about the Bitcoin Investment Trust," Mr. Silbert said in an email.

Here is a quick update on the wild ride of these bitcoin funds.

What is a bitcoin fund, and how does it operate?

Firms that have filed for bitcoin ETFs, including ProShares, VanEck and others, seek to provide investors with a familiar way to invest in the cryptocurrency. Rather than going to unregulated exchanges such as Coinbase that deal in bitcoin directly, investors buy shares in a fund, leaving the fund managers to purchase bitcoin or bitcoin derivatives.

Those funds are intended to work like traditional stock or commodity ETFs. To date, the SEC hasn't approved any bitcoin ETFs, leaving a few alternatives. Investors can buy secondary shares of the Bitcoin Investment Trust, which trade over the counter and are supposed to track the price of the cryptocurrency. Wealthy, or accredited investors, can buy primary shares of the Bitcoin Investment Trust, which more accurately reflect the price of bitcoin. Wealthy individuals and institutional investors can also buy into specialist hedge funds that trade bitcoin. There also are a handful of bitcoin-tracking funds that trade on overseas exchanges.

What are the pros and cons of buying into a bitcoin fund rather than the digital currency itself?

There certainly are more dangerous ways to gamble on bitcoin, but Bitcoin Investment Trust may be one of the most expensive ways.

The ravenous demand of investors for anything bitcoin-related has resulted in the OTC shares trading at a hefty premium to the fund's bitcoin holdings. The premium, which has sometimes meant that shares of the fund cost double the price of bitcoin, is what led short seller Andrew Left to bet against the price of the fund.

But as Mr. Silbert sees it: "The premium is just evidence that there is a tremendous institutional and retail demand for access to products that enable investors to buy bitcoin."

How have bitcoin's price swings affected Bitcoin Investment Trust?

The fund saw an explosion in trading volumes, assets under management and volatility last year.

When they first raised the concept of a bitcoin ETF a half-decade ago, developers such as the Winklevoss twins, Cameron and Tyler, and their rival, Mr. Silbert, predicted that such funds could one day be as popular as the mighty SPDR Gold Shares ETF. That seemed like a stretch, considering that most fund investors hadn't heard of bitcoin.

But Bitcoin Investment Trust briefly surpassed the gold fund on some recent days by one key measure of popularity -- daily dollar volume.

At roughly $3.21 billion at last count, Bitcoin Investment Trust's assets under management -- counted as holders of the primary, restricted shares -- are far shy of the gold fund's $35 billion. Still, the bitcoin fund started 2017 with roughly $164 million in assets.

The fund's stock chart, meanwhile, looks like it traces the path of a bungee jump. After starting 2017 at around $100 a share, the fund peaked at over $3,400 in early December, dipped to around $1,700 and is now trading around $2,300.

What is the status of the other proposed bitcoin funds?

ETF providers were among those most excited about the launch of bitcoin futures by Cboe Global Markets and CME Group in December. The market Grinches at the SEC had refused the first wave of bitcoin ETF applications from the Winklevoss twins, Mr. Silbert and SolidX, citing the lack of regulation on digital-currency exchanges. So the sense was that the SEC, which has endorsed funds tracking commodities futures in the past, would be more comfortable with a fund tracking futures on these major exchanges.

Almost as soon as the first futures traded on Cboe, the New York Stock Exchange filed for SEC approval for two ETFs based on bitcoin futures -- one long and one short -- to be managed by ProShares. Similarly, Cboe has applied for approval for funds managed by fund families REX, First Trust and GraniteShares.

Critics, including Joe Saluzzi, co-founder of agency brokerage Themis Trading, say that such an ETF would be "a recipe for a disaster." An SEC approval for a futures-based ETF would be viewed as a "housekeeping seal of approval" even though the underlying bitcoin remained unregulated, Mr. Saluzzi says.

How have the futures on bitcoin started out?

Volumes on both Cboe and CME platforms are relatively muted, with trading in the millions of dollars a day compared with the billions of dollars traded on Asian spot bitcoin markets. That's one reason Mr. Silbert says futures-tracking ETFs could be problematic.

"From a practical perspective, the size of the futures market as it exists today is not large enough to accommodate the demand that exists for an ETF," says Mr. Silbert.

What are hedge funds doing?

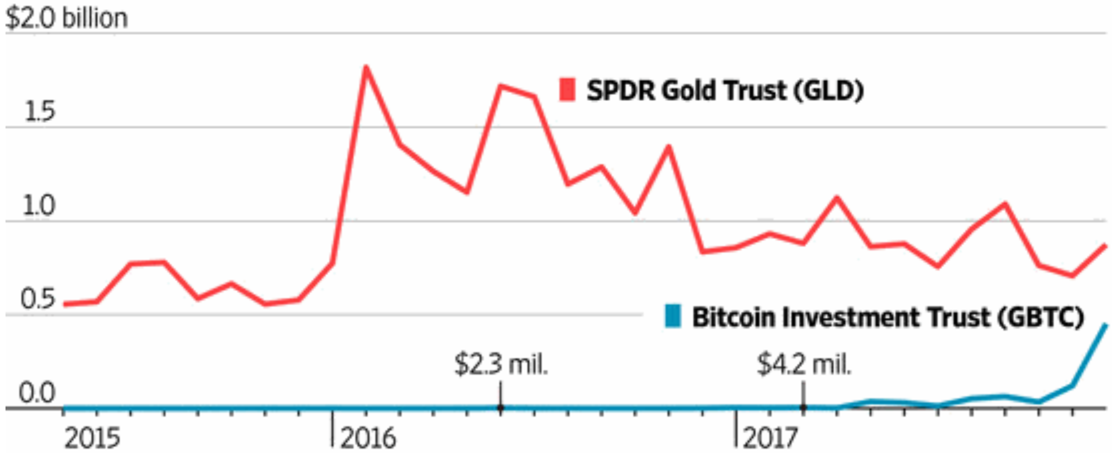
According to Morgan Stanley, hedge funds invested about $2 billion in bitcoin and other cryptocurrencies in 2017. As many as 84 cryptocurrency hedge funds started over the same period. Reports that one of the largest, a bitcoin hedge fund operated by Pantera Capital, was counting its returns in tens of thousands of percentage points hardly hurt their popularity.

Joining the fray is Apex Token Fund, a "fund of funds" that plans to sell investors digital tokens that represent its interest in a group of other crypto funds.

Mr. Curran, a writer in Denton, Texas, is a regular contributor to Dow Jones Newswires and The Wall Street Journal. Email him at rob.curran@dowjones.com.

Out of Nowhere

Dollar volume* of Bitcoin Investment Trust (GBTC), once negligible, has surpassed even mighty SPDR Gold Trust on some days lately. Average monthly volume:



*average of closing prices multiplied by that day's volume

Source: FactSet

THE WALL STREET JOURNAL.

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THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Italy Faces a Reckoning on Debt

By Richard Barley
480 words
8 January 2018
The Wall Street Journal
J
B10
English

[Financial Analysis and Commentary]

Italy, Europe's most indebted large economy, is at a crossroads again. Growth has picked up finally, and the country's bank cleanup is in progress. But the national election due in early March is putting Italy's debt of close to 135% of gross domestic product under the global spotlight again. The irony is the debt burden may finally be about to fall.

Superlow and negative rates engineered by the European Central Bank and a brighter outlook have created the conditions for Europe to heal. This includes Italy. The country's credit rating even received a rare upgrade from Standard & Poor's last year, to triple-B.

Italy's problem of late hasn't been overborrowing, but nonexistent growth. The country has run a primary surplus in nearly every year since the early 1990s, notes Oxford Economics, meaning it hasn't been meaningfully adding to its debt load. But recent surpluses have fallen short of the target, while stagnant growth and low inflation have held back the nominal GDP denominator. Italy's debt burden has remained as heavy as ever.

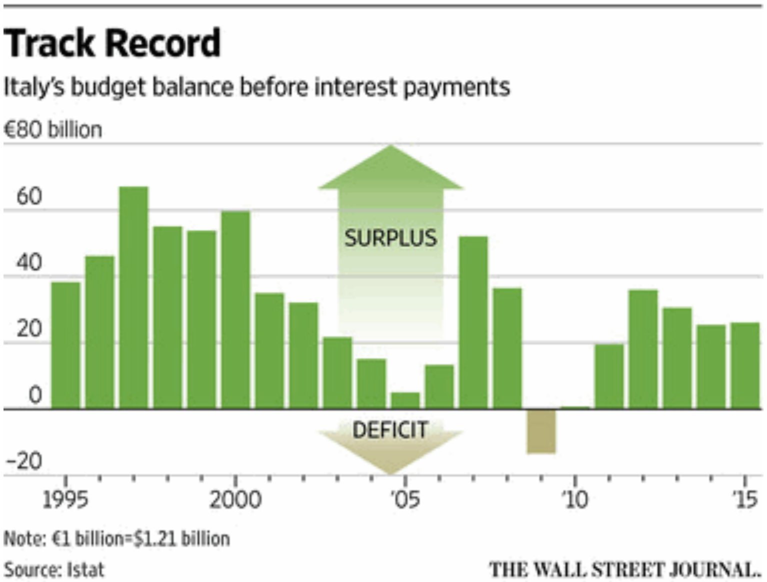
With Italian growth picking up in 2017 to 1.5% on the European Commission's forecast, the debt level has stabilized and appears to be about to fall. The International Monetary Fund thinks it could reach 126% of GDP by 2020.

The ECB's aggressive easing has also bought Italy time and space. In the past three years the yield of newly issued Italian government securities has averaged just 0.64%, according to data from the Italian Treasury. Italian two-year yields are below zero. And the country has taken advantage of bond-market conditions to raise the average maturity of debt to close to seven years.

That means investors shouldn't take fright if Italian bonds prove **volatile** in the coming months. The 10-year Italian yield spread versus Germany has risen to 1.6 percentage points from a December low of 1.3 points, but that isn't an unusual move. In the run-up to the French elections in 2017, which raised fears of an antieuro government in Paris, Italy's spread over Germany topped two points.

The risk is that the election represents either further gridlock or a squandered opportunity. The IMF warns that a higher primary surplus -- north of 3% of GDP -- is still needed to put debt on a clear downward path; higher growth would help, too. That will require political will. But the current consensus is that fractured Italian politics may not deliver a coherent government.

Italy's debt problem is chronic rather than acute. The ECB and current economic conditions offer an opportunity to address it. But it is far from clear that politics will allow Italy to take it.



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THE WALL STREET JOURNAL.
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Investing in Funds & ETFs: A Quarterly Analysis --- Winners' Circle: Growth-Stock Funds Dominated the 2017 Charts --- Eight of the top 10 stock funds had 'growth' in their name

By Suzanne McGee
983 words
8 January 2018
The Wall Street Journal
J
R2
English

Growth, growth, growth.

In 2017, that's all that a mutual-fund manager needed to pursue to reap a healthy return for investors.

The year was "one of the few times that we have seen synchronized global growth, while interest rates remain near their historic lows," says Andrew Peck, manager of Baron Asset Fund, which posted a 26% gain in 2017. Indeed, as John Bilton, a global strategist overseeing multiasset-class solutions for J.P. Morgan Asset & Wealth Management, pointed out in a report, it was "the best period of coordinated, above-trend global growth in almost a decade."

When risk-taking is richly rewarded and investors feel confident that little will rock their world, growth takes the lead. That helps to explain the big gap between large-cap growth funds, which gained 29.6% for the year, and large-cap value funds, which were up a mere 15.9%, according to Lipper data. Gains in big growth stocks pushed **S&P 500 index** funds to a 21.5% gain for the year.

All but two of the top 10 performers in our fourth-quarter Winners' Circle competition, a quarterly contest that identifies the best-performing U.S.-stock fund managers for the preceding 12 months, have the word "growth" in their name. Among the top 10 were two other Baron Asset Management funds -- Baron Fifth Avenue Growth Fund (BFTHX) and Baron Opportunity Fund (BIOPX).

The winner, with a 56.9% gain, was Kinetics Internet Fund (WWWFX), which has as its largest holding a stake in Bitcoin Investment Trust. Even if its managers describe themselves as "benchmark agnostic," it couldn't really be mistaken for anything but a growth fund. After all, any fund that invests more than 12% of its holdings in alternative currencies, while hunting for other disruptive business models to back, may be pursuing a radically different form of growth investing, but it's still chasing growth. (More on the Kinetics fund's win in accompanying article.)

The question, of course, is whether investors should keep betting on growth, or whether it's time to shift toward nearly forgotten "value" stocks, which tend to trade at a lower price relative to their fundamentals. How much of the good news to come -- the heart of any growth stock -- is already captured in market valuations?

According to data from Howard Silverblatt, senior index analyst at S&P Dow Jones Indices, stocks in the **S&P 500** currently trade at about 23.31 times estimated 2017 earnings, or 19.67 times forecast 2018 earnings. That compares with an average of 17.13 since 1936. What's more, he noted, the stocks of a handful of big-name growth companies -- Apple Inc., Microsoft Corp., Amazon.com Inc. Facebook and Google parent Alphabet Inc. -- accounted for about 23.7% of last year's gains in the **S&P 500**, with Apple alone generating 7.44% of the index's returns. Information technology as a sector? Although it accounts for just north of 22.5% of the total **S&P 500** by capitalization, it accounted for 38.1% of its total return.

That's a lot of good news, and many are wondering how much is priced in already.

Some believe that growth and value may wrestle for the limelight in the short term. "Over the last month or so, growth has underperformed value, since the tax-reform package is a short-term catalyst that could drive profits" higher, says Dan Suzuki, senior investment strategist at Bank of America Merrill Lynch in New York. But lower tax rates are a one-time boost to slower-growth stocks, and that could mean value quickly returns to the back seat.

Certainly, the data suggest that growth has an edge. Some of the same classic growth companies in the technology arena that propelled certain funds to the top of the heap in the past 12 months are expected to contribute most to **S&P 500** earnings in the fourth quarter of 2017. Indeed, analysts already are predicting that technology companies will post a 28% year-over-year jump and set a record for corporate profits when they report their results for the fourth quarter of 2017, according to Mr. Silverblatt.

At the same time, there is solid research backing the hackneyed suggestion that it's unwise to put all your financial eggs into a single basket. Fidelity Investments recently published data demonstrating that the longer the time horizon, from one-year periods to three-year and then 10-year rolling periods, the more likely it is that value-investing strategies outperform growth.

Michael Hartnett, chief investment strategist at Bank of America Merrill Lynch, reported similar findings in a study published in the summer of 2016. Looking at the 90-year timespan from 1926 to 2016, he found the average annual price return of value stocks to be 17%, while that of growth was 12.8%.

So is it different this time?

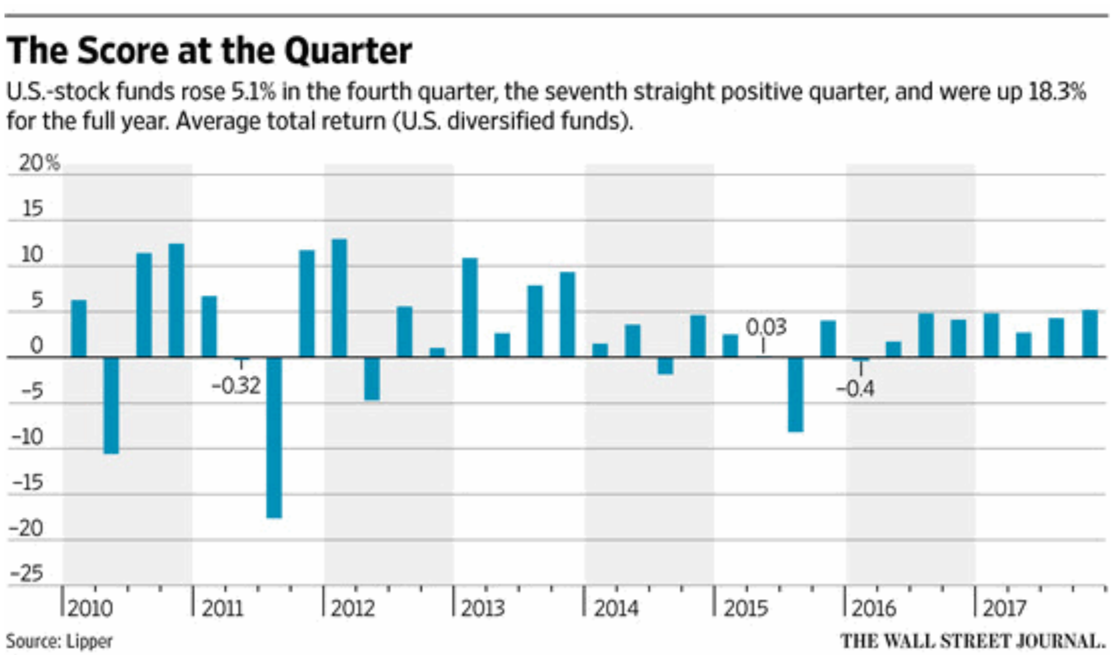
"Over the long term, valuation rules everything," says Mr. Suzuki. "If you have a long time horizon, a strategy of simply buying the cheapest stocks has provided the greatest alpha and return. But it's a terrible short-term indicator."

Some other pundits are saying it's time for fund investors with a long time horizon to begin allocating some of their assets toward value.

"I would slightly overweight value relative to growth, and in our 2018 outlook, that's what we recommend," says John Lynch, chief strategist at LPL Financial.

"It's not about writing off growth; it's about prudence."

Ms. McGee is a writer in New England. She can be reached at reports@wsj.com.



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THE WALL STREET JOURNAL.
U.S. EDITION

Bitcoin Futures Split Big, Little Traders --- Small investors tend to be bullish while large ones are bearish, market data indicate

By Alexander Osipovich
724 words
8 January 2018
The Wall Street Journal
J
B10
English

Small investors are betting that bitcoin's price will rise, while hedge funds and other large traders are betting it will fall.

That is the pattern rapidly emerging after four weeks of trading in the first U.S. bitcoin futures market, launched last month by Cboe Global Markets Inc. Futures are a type of contract that enables traders to wager whether the future price of an underlying asset will rise or fall.

For traders who hold fewer than 25 of Cboe's bitcoin futures contracts -- a category that likely encompasses many retail investors -- **bullish** bets are 3.6 times more common than **bearish** ones, according to the latest Commodity Futures Trading Commission data that cover trading through last Tuesday.

At Cboe, the big players in bitcoin futures tend to be short, betting the future price will be lower.

For instance, among "other reportables" -- large trading firms that don't necessarily manage money for outside investors -- short bets outweighed **bullish** "long" bets by a factor of 2.6 last week.

The CFTC has yet to begin publishing similar data on a competing bitcoin futures contract listed on the Chicago Mercantile Exchange, owned by Cboe's larger rival, CME Group Inc.

The early futures-trading activity seemed to align with the perception of how big and small traders view bitcoin itself.

Frenzied buying by retail investors world-wide helped power bitcoin's extraordinary rally last year. The digital currency surged around 1,330% in 2017 and was trading at $16,764.99 late Friday afternoon, according to CoinDesk.

Many skeptics on Wall Street have called bitcoin a bubble and would be more apt to bet on its decline. In a sign of how more conservative firms are keeping their distance, the CFTC data show near-zero trading in Cboe's bitcoin futures by banks and asset managers.

"There is probably more optimism in the retail segment than there is in the institutional segment," said Steven Sanders, an executive vice president at Interactive Brokers Group Inc., an electronic brokerage firm that offers its customers access to bitcoin futures.

Hedge funds and other money managers had placed almost 40% more short bets than long bets last week, according to the CFTC data. That represented a less **bearish** outlook than they had in late December, when such funds had more than four times as many short bets as long bets.

These numbers don't include bets made as part of what the CFTC calls "spreading" strategies, in which a firm is both long and short at the same time.

Shorting bitcoin futures doesn't necessarily mean a trader expects bitcoin to crash. For instance, a cryptocurrency trading firm with significant holdings of bitcoin might go short to hedge those inventories against a price fall.

Going short could also be part of certain sophisticated trading strategies, such as betting that rival cryptocurrencies will outperform bitcoin.

With the CFTC data, "you're not seeing the full picture," said James Koutoulas, chief executive of hedge-fund firm Typhon Capital Management, which trades futures in bitcoin as well as commodities. Typhon has swung back and forth, being long and short bitcoin futures at various times, Mr. Koutoulas said.

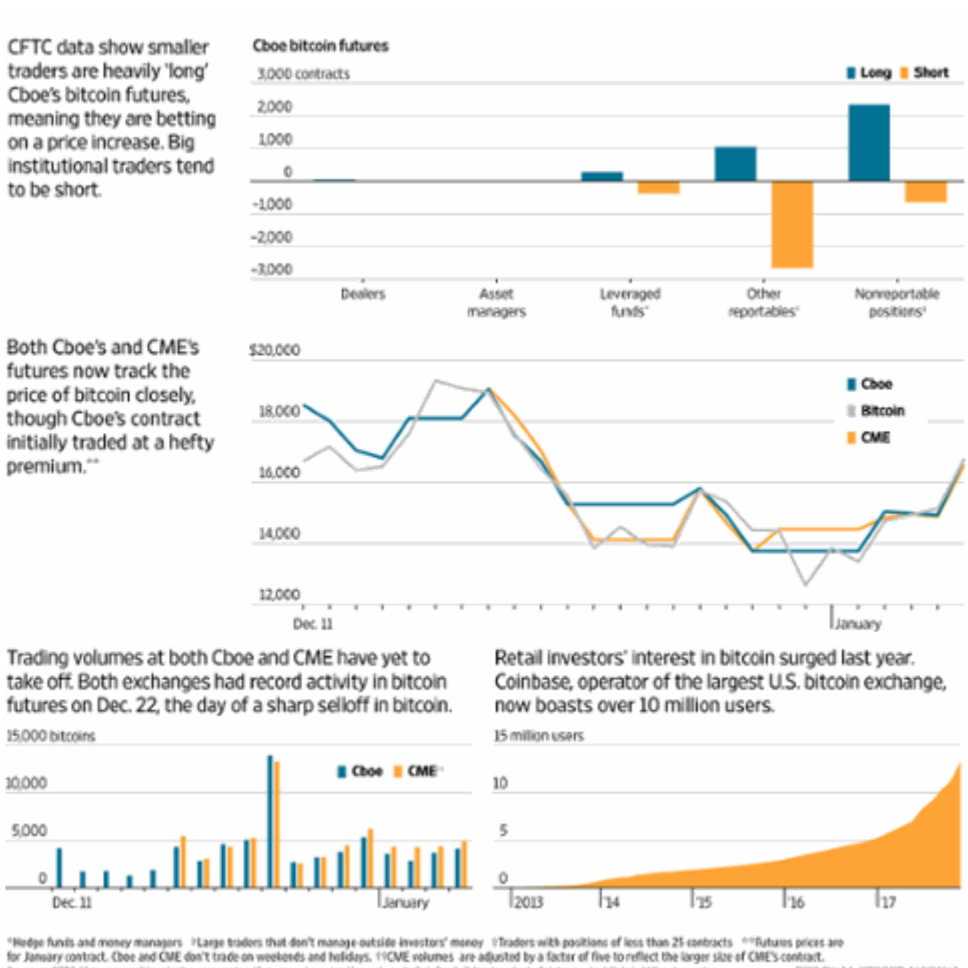
Analysts say Cboe's bitcoin contract is geared more toward small retail investors because CME futures require more cash upfront to trade.

Activity in both Cboe and CME's futures has been muted, especially compared with the booming market for bitcoin itself.

The combined size of the nascent bitcoin-futures markets at the two exchanges was roughly $150 million on Friday, measured in terms of the value of outstanding contracts, while the total value of all bitcoins in existence was around $290 billion, according to coinmarketcap.com.

At both Cboe and CME, the average number of bitcoin contracts traded each day has been below the level set on each exchange's first full day of trading on Dec. 11 and Dec. 18, respectively.

One factor behind the slow volume growth may be the reluctance of many Wall Street banks to touch bitcoin futures. Firms such as JPMorgan Chase & Co. and Bank of America Merrill Lynch haven't offered their clients access to bitcoin futures.



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THE WALL STREET JOURNAL.
U.S. EDITION

Investing in Funds & ETFs: A Quarterly Analysis --- Need to Know: Is the Fund-Flow Indicator Dead? --- Flow stats aren't what they used to be; We can thank ETFs

By Simon Constable
898 words
8 January 2018
The Wall Street Journal
J
R9
English

Smart investors used to be able to identify market tops and bottoms by watching the weekly flows of money into and out of mutual funds.

Then came the stampede into exchange-traded funds, and the crystal ball for predicting market shifts grew cloudy.

Because weekly flow data now measures not just money moving into or out of mutual funds or between stock and bond funds, but also between one type of investment product (stock mutual funds) and another (lower-cost ETFs), the data has lost much of its usefulness for gauging small-investor sentiment toward equities in general.

Strategists still keep close watch on the aggregate weekly flows into or out of U.S. stock-focused mutual funds to get an idea of what individual investors are doing on a macro level. Some 95% of long-term mutual-fund assets (which includes around $10 trillion in stock funds) are owned by retail investors, according to estimates from the Investment Company Institute.

"We've always used fund flows to measure investing styles, bond versus equities; we use it as a sentiment of retail [or individual] investors," says Terry Gardner, senior managing director at CJ Lawrence LLC in New York.

What has changed, however, is experts' confidence in the ability to use the flow data to call a broad market shift.

To understand how that worked in the past requires a bit of reverse psychology. Namely, recognizing that individual investors are often perfectly bad market timers: They have a record of selling low and buying high. Thus, the worst excesses of each tendency tend to be seen at market peaks and troughs.

Back in 2008 and 2009, for example, mutual-fund investors sold heavily as the market fell. The dumping reached its zenith as the market hit bottom, as the accompanying chart shows. Those watching fund flows thus had a pretty good indication that a market shift was under way. Similarly, in the late 1990s, individual investors piled into stock funds as the market peaked, signaling a reversal was imminent.

Assessing the current situation, Mr. Gardner says, "we continue to see outflows from domestic equities and inflows to bond funds; that tells you the retail investor hasn't fully bought into the rally." In other words, small investors haven't yet gone crazy for stocks, as they did in the late 1990s.

That's useful as far as it goes. But whether the traditional fund-flow data will be of any use in calling a market top this time is an open question.

The reason for doubt is that over the past decade, individuals have changed the way they invest. Increasingly they are moving out of actively managed mutual funds and into lower-cost indexed mutual funds and ETFs, says Shelly Antoniewicz, senior director, industry and financial analysis, at ICI. Those shifts are believed to be driven by cost considerations and by financial advisers moving clients into lower-cost products including ETFs, Ms. Antoniewicz says. Thus, flows out of mutual funds may have zero to do with market sentiment and much to do with the long-term trend of small investors moving to ETFs.

Institutions, hedge funds and portfolio managers increasingly use ETFs, too, says Arthur Hogan, chief market strategist at B. Riley FBR in New York. A portfolio manager may want to sell short the SPDR **S&P 500** ETF, which tracks the **S&P 500**, to protect from a drop in the market. Portfolio managers switching investments between sectors also sometimes use ETFs to park money before a final investment choice is made.

Flow data that is made public, meanwhile, doesn't distinguish between money of institutions and small investors.

"Anecdotally we understand that there is a 50-50 split between retail and institutional, but we don't have data on that," she says. "The data is closely held by brokers."

Nevertheless, institutional investors tend to invest differently from individuals, so big institutional moves will skew the data away from what small investors are doing.

In seeking to determine whether fund flows are still a useful market bellwether, one could argue that ETFs were around during the last downturn in 2008 and that market watchers at that time were able to use flow data to spot a market reversal. ETFs then, however, were a smaller part of the retail investing picture.

Meantime, market professionals say it can make sense to use the flow data in conjunction with other indicators when trying to decide whether the market has reached a pinnacle or a trough.

Stephen Wood, chief market strategist at Russell Investments, says it is worth adding sentiment metrics into the analytical mix.

Russell uses proprietary sentiment measures. For the rest of us, the American Association of Individual Investors publishes a regular Sentiment Survey indicating how **bullish** or **bearish** individual investors feel about the market.

If the metric looks very **bullish** and there are major fund flows into stocks, it would support the view that the market was peaking. If the AAII data is **bearish** and investors are dumping stock funds, that's a **bullish** indicator.

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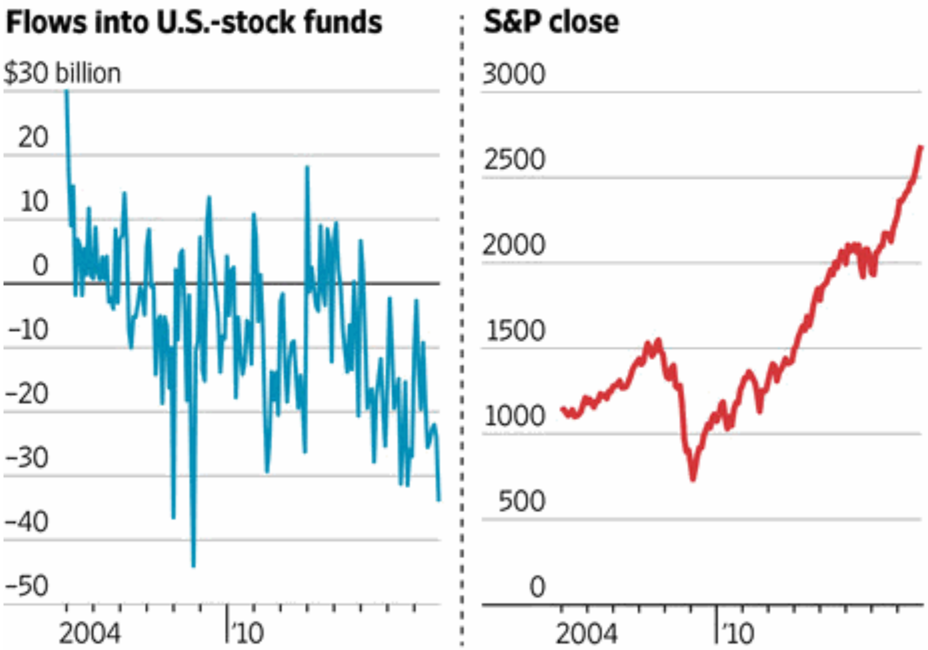
What 2008-09 Taught Us

Fund investors sold heavily as the market dropped in 2008-09, setting up the market for the rally that followed. Net new cash flow into U.S.-stock mutual funds, against the S&P 500's performance



Sources: Investment Company Institute (flows) and Yahoo Finance (S&P)

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THE WALL STREET JOURNAL.
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Investing in Funds & ETFs: A Quarterly Analysis --- Quarterly Monitor: U.S.-Stock Funds Rose 18.3% in 2017, but Investors Kept Swimming in Foreign Waters

By William Power
429 words
8 January 2018
The Wall Street Journal
J
R2
English

When is an 18%-plus gain in the average stock fund not something to boast too much about?

Answer: When the rest of the world has done better.

In 2017, the average diversified U.S.-stock fund registered a total return of 18.3%, according to Thomson Reuters Lipper data. Strong, yes, but international-stock funds rose 26.8%.

"I was afraid investors had abandoned international stocks because they'd underperformed for years," says Brent Schutte, chief investment strategist at Northwestern Mutual Wealth Management, Milwaukee. Instead, investors saw cheaper valuations overseas and piled in. Investors in 2017 pulled a net $38.8 billion from long-term mutual funds and ETFs focused on U.S. stocks, while adding $233.9 billion to international stocks and $379.4 billion to bond funds, based on Investment Company Institute estimates.

Such figures could be a good sign for the stock rally, says Jim McDonald, chief investment strategist for asset manager Northern Trust. "We finally started to see some flows into equities over the last year, but they've still been outweighed by flows into fixed-income funds," he says. "To me, that is one way to measure that investors haven't completely bought this **bull market**." In the 1999 and 2007 rallies, flows were overwhelmingly into stocks.

Bonds also had a positive year, as investors were satisfied with the Fed's pace at raising interest rates. Funds focused on intermediate-maturity, investment-grade debt rose 3.6%.

Mr. Schutte sees commodities as the asset worth sticking with now -- as an inflation hedge. "I think the story for 2018 is that inflation will return."

Replay Needed!

Super Bowl Market

Predictor Falls to 40-11

For the second year in a row, the Super Bowl **stock-market** predictor fumbled in 2017. Before this, the quirky indicator had worked for seven straight years. As popularized by analyst Robert H. Stovall, the Dow tends to rise for the year after an original NFL team wins the game, and to fall otherwise.

Last year's win by New England, which came from the old AFL, incorrectly predicted a 2017 market drop. The predictor nonetheless has worked after 40 of the 51 Super Bowls -- still an All-Pro 78% completion rate.

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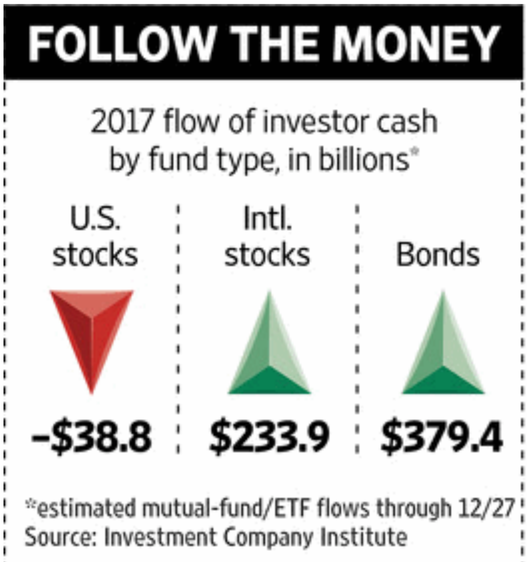

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THE WALL STREET JOURNAL.
U.S. EDITION

Investing in Funds & ETFs: A Quarterly Analysis --- Alternative Investments: Sports and Mutual Funds Can't Seem to Team Up

By Dan Weil
942 words
8 January 2018
The Wall Street Journal
J
R11
English

While millions of Americans count themselves as devoted sports fans, few exchange-traded funds or mutual funds are available for them to invest in their passion. And even those options are only indirectly related to professional sports, with returns that have been mixed.

The irony is that sports analogies are common in investment discussions, and investing and sports have a similar competitive appeal for many people. But the disconnect stems from the fact that most of the revenue generated in professional sports isn't accessible through public securities, analysts say.

"The idea of investing in what you know and love has been around for a long time," says Matt Hougan, chief executive officer of Inside ETFs, which organizes ETF conferences. "But most of what we associate with the economic value of sports -- team ownership and player contracts -- comes in private transactions."

Chris Marangi, a portfolio manager at Gamco Investors Inc. who has researched the sports industry extensively, found only a handful of leagues, teams and regional sports networks that are publicly traded:

-- The New York Knicks basketball team and Rangers hockey team, which are part of Madison Square Garden Co.

-- TV networks that are part of MSG Networks Inc.

-- The Atlanta Braves baseball team, part of Liberty Braves Group.

-- Formula One car racing, part of Liberty Formula One.

-- U.K. soccer team Manchester United.

-- German soccer team Borussia Dortmund.

-- The wrestling franchise World Wrestling Entertainment.

Given this limited universe, it's difficult to put together a diversified mutual fund or ETF with stocks directly related to pro sports.

One of the few indirect options available for individual investors is the ProSports Sponsors ETF (FANZ), which invests in sponsors of pro sports leagues.

FANZ has about 70 predominantly large-cap stocks, with the consumer sector accounting for about 51% of the fund, information technology 15% and financial services 15%. The fund's top holdings, in descending order, are media company 21st Century Fox, sneaker retailer Foot Locker Inc. and athletic-apparel giant Nike Inc. Other companies in the top 10 include liquor company Brown-Forman Corp., Amazon.com Inc., software analytics company New Relic Inc., hot-dog purveyor Nathan's Famous Inc. and hotelier Marriott International Inc. (21st Century Fox and The Wall Street Journal's parent, News Corp, share common ownership.)

Some analysts say the fund is unfocused and sports aren't the main determinant of its performance. Foot Locker and Nike do make sense for someone looking to invest in sports-related companies. "But Amazon, Marriott and Microsoft [the No. 11 holding]: Are they really going to rise and fall with sports?" asks Russel Kinnel, director of mutual-fund research at research firm Morningstar Inc. "No, you could run a similar fund with ballet sponsors." Sports sponsorships represent a small portion of the revenue of most companies in the fund.

"This is a portfolio of great companies making investments in their brands," says Dave Nadig, CEO of research firm ETF.com. "That's a legitimate way of looking at companies, but the fact that it's connected to sports strikes me as a bit irrelevant."

The fund also may be overly diversified. "Diversification is supposed to be good, but for a niche ETF, it could be a bad thing," says Eric Balchunas, an ETF analyst at Bloomberg Intelligence. That's because diversification can make it difficult for a fund to outperform broad market indexes.

"We created the ProSports Sponsors Index because we believe that companies that invest in their brands through partnerships with professional sports leagues will potentially outperform the general market over the long term," says Nick Fullerton, co-founder and president of SportsETFs LLC. The ProSports fund's investments are meant to track the index.

The fund, which had $4.4 million of assets at the beginning of this year, according to Morningstar, has traded fairly closely to the **S&P 500**, which the managers consider its benchmark, since its July 11 inception.

From that date through the end of 2017, FANZ returned 11.63%, compared with 11.16% for the **S&P 500**, according to Morningstar Direct.

If pro sports are inaccessible to fund investors, how about investing in fitness?

A fund focused on health-and-fitness stocks could succeed, analysts say, as the industry is booming, and there are numerous companies tightly focused on it. "That's a legitimate segment of the economy," Mr. Nadig says.

But the offerings here are sparse, too. Motif Investing Inc. offers a basket of mostly fitness stocks titled World of Sports on its online investment platform. The basket includes shares of apparel and footwear makers, equipment makers, fitness facilities and sporting-goods retailers. The fund has about 20 stocks, and the biggest holdings are Nike, apparel and shoe manufacturer VF Corp., Columbia Sportswear Co. and Footlocker.

The basket has underperformed the broad market. From its Dec. 17, 2012, inception through the end of 2017, the fund returned 74.6%, compared with 103.4% for the **S&P 500**, according to Motif.

"This is a reminder that a logical theme-based investment doesn't always perform well," says Todd Rosenbluth, director of ETF and mutual-fund research at research firm CFRA. "A portfolio is driven by the prospects of its holdings and not the concept."

So sports fans may fare better simply watching and playing their games than trying to invest in them.

Mr. Weil is a writer in West Palm Beach, Fla. He can be reached at reports@wsj.com.

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THE WALL STREET JOURNAL.
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Finance Watch

366 words
8 January 2018
The Wall Street Journal
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B9
English

CHINA

Foreign-Exchange

Reserves Rise Again

China's foreign-exchange reserves grew for the 11th straight month in December, hitting the highest level since end of September 2016, official data showed.

The reserves increased by $20.67 billion from the previous month to $3.140 trillion at the end of December, following a gain of $10.06 billion in November, the People's Bank of China said. Economists polled by The Wall Street Journal had expected a rise of $5 billion.

Beijing tightened rules on moving money out of the country in 2017, which helped limit capital outflows. Renewed firmness in the yuan against other currencies, including the U.S. dollar, has also reduced the need for the central bank to burn through reserves to prop up the Chinese currency.

In December, the yuan rose more than 1% against dollar, bringing its gains against the U.S. currency in 2017 to more than 6%.

-- Liyan Qi

NEW YORK FED

Official Weighs In

On Money-Like Assets

A top Federal Reserve Bank of New York staffer said Saturday the U.S. central bank has a role providing "money-like assets" even outside of times of financial stress.

In a speech in Philadelphia before the American Economic Association, New York Fed executive vice president Simon Potter sought to take stock of the central bank's role in providing assets that aren't cash but are effectively seen as a substitute by **financial market** participants.

Mr. Potter said provision of these money-like assets is a Fed job when it is doing emergency lending during times of financial sector crisis. But that may not be the only time for the Fed to be active on that front.

"Central banks are uniquely able to produce money-like assets that are viewed as safe during nonnormal times," Mr. Potter said. "In more normal times, regulation and supervision are the best tools to mitigate risks from the private creation of money-like assets, but there is a role for the central bank to use its balance sheet to smooth fluctuations in the supply and demand for money-like assets."

-- Michael S. Derby

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THE WALL STREET JOURNAL.
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MoneyBeat: Stocks Off to Good Start

By Ben Eisen
287 words
8 January 2018
The Wall Street Journal
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English

The **stock market** had a blowout start to the year. In just four days, the **S&P 500** rose 2.6%, its best week since the end of 2016.

That is a good omen for the rest of 2018.

When the benchmark has been up during its first five sessions, it has been green for that full year three-quarters of the time. In the past 10 years in which the **S&P 500** has gained in the first five days, the index has risen in eight of those years, according to The Wall Street Journal's Market Data Group. Across all the years since the index's creation, it has risen 65% of the time.

With one day to go in this year's first five-session stretch, the **S&P 500** is poised to stay in positive territory. To erase the gains accrued over the first four sessions, it would take a period of **volatility** last seen right after the British voted to leave the European Union in mid-2016.

The rise for stocks at the beginning of the year, which adds to the S&P's 19% rise last year, has pushed all three major indexes to fresh milestones. The **S&P 500** crossed 2700 for the first time, the **Dow Jones Industrial Average** rose past 25000 and the **Nasdaq Composite** topped 7000.

The rapid gains of 2017 left many investors nervous that stocks could be in for a reversal, or at least a period of tempered enthusiasm. While some strategists predict **volatility** will emerge at some point in 2018, there is no sign of it yet.

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THE WALL STREET JOURNAL.
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Inside View: Unicorns Need IPOs

By Andy Kessler
823 words
8 January 2018
The Wall Street Journal
J
A15
English

Get ready for the Unicorn Jailbreak. Tech stocks have taken off this year like a bat out of hell. But several hundred startups valued at over $1 billion, so-called unicorns, are watching with envy. Sure, 57 startups became unicorns in 2017, according to Recode. Their valuations are rising with venture-capital money, but what's the fun in that? Liquidity is where it's at.

This market is dominated by investors suffering from split personality disorder, rotating between risk-on and risk-off modes. Risk off means uncertainty and caution -- and investors avoid risk like they're retiring next week. Today the market is definitely risk on. Heck, the Cboe **Volatility** Index, or "fear gauge," briefly hit an all-time low last week.

It's time for the whole blessing of unicorns -- look it up -- to break out, hit the public markets and trade every day like real companies. Spotify has done a confidential filing for a direct listing on the New York Stock Exchange. It's a great start, but others will need a bigger splash.

I've rarely seen a frothier market. Fed-driven low interest rates mean investors are begging for things to buy. They're chasing mirages like cryptocurrencies and initial coin offerings. Calpers just raised its equity allocation, more as a magic wand to stave off municipalities actually kicking in more dough. But no matter, they need stock. As they say on Wall Street, when the ducks are quacking, feed them.

Where are all the IPOs? One problem is that SoftBank's $93 billion Vision Fund is bagging unicorns like Teddy Roosevelt shooting wild buffalo from his train. It put $4.4 billion into office-space provider WeWork, $2.5 billion into the Indian online retailer Flipkart, and $1 billion into Fanatics, which sells football jerseys. And don't forget the $7 billion it just invested in Uber, shrinking the ride-sharing giant's valuation to $45 billion from $68 billion at the previous round. Only public markets can judge whether these valuations are right. For now, it's shoot and wish.

Some worry about recent initial public offerings. Snap is still below its opening price. Meal-prep company Blue Apron stayed in the oven too long and its stock burned to $4. On the other hand, newly public companies Stitch Fix and Roku are well up over their offering price. Time to make the doughnuts.

There are so many great new companies and, be warned, plenty of duds. How can you tell them apart? Let the market sort it out. Slack is almost the standard for in-company chats. Uber's highly reported problems show up everywhere but its growth rate. Airbnb booked three million guests on New Year's Eve, up from 1,400 in 2009.

Bring the new batch on: Robinhood, Peloton, Dropbox, Xiaomi, Pinterest, Houzz, Compass, GitHub. Even Reddit, valued at $1.8 billion this past summer, should go public. Then there's Leonardo DiCaprio-backed Rubicon Global, which automates trash collection and recycling. IPO Leo! The market could absorb a deal a day.

For all I know, since financials are annoyingly hard to come by, all these companies are in the red. Uber certainly is, losing almost $1.5 billion in the third quarter of 2017. But in a risk-on phase, investors don't care if you're losing money -- for now! Just show what the company will look like in five years.

I hear all the time that companies are not ready or are too nervous to go public. They should get a grip. If a company is afraid to go public -- with all the transparency and responsibility that entails -- it shouldn't be in business. Being public provides cheap capital, compensation to attract talent, and a currency for acquisitions. Ask Facebook. If I were an investment banker, I'd be shaking the trees for deals. If managements and boards of directors don't take companies public in this forgiving market, they're guilty of malfeasance and shirking their fiduciary duty.

The economy needs this. The more companies are publicly traded, the more information quickly gets into the market. This is especially important in innovative industries. And for several years now, venture capitalists have been putting more into startups than they have been taking out in exits. That can't last forever. Capitalism can't perform at its highest potential with large opaque companies.

But if there is a Unicorn Jailbreak, don't buy with your eyes closed. Study management teams and competition. Not many unicorns will turn into the next Facebook or Amazon. Or even be around in a decade. There is no guarantee this ends well. Companies are racing Fed rate increases, the ultimate IPO party pooper. The risk-off time will come soon enough. Until then, party like it's 1999.

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THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
The Mystery Of Risk-Free Greek Bonds

By Richard Barley
302 words
8 January 2018
The Wall Street Journal
J
B10
English

[Financial Analysis and Commentary]

If you thought markets were insane when the yield on European junk bonds fell below that of the **10**-**year Treasury** last year, look away now: The two-year Greek yield has recently fallen below the two-year U.S. yield.

Once again, the comparison is flawed. U.S. and Greek bonds are denominated in different currencies with very different monetary policies. The U.S. two-year Treasury yield, now 1.96%, has been steadily rising as the Federal Reserve has been raising rates. The European Central Bank is still printing money and its key deposit rate is negative.

Markets don't think Greece is less risky than the U.S. The relevant risk-free comparison for Greece's two-year yield of 1.68% is Germany, where it is minus-0.61%. The Greek two-year yield is still above Germany's 30-year yield of 1.25%.

The hunt for yield is still going on, and in the eurozone, Greece is the final frontier. The enormous drop in Greek bond yields might be reason to be cautious. But Greece may finally exit its bailout program in 2018. A convergence between Greek and eurozone yields is a necessary part of that process.

The bigger consideration is the extraordinary monetary-policy gap that has opened up between the U.S. and the eurozone. Although the debate around the ECB is about how and when it removes stimulus, it is still far from raising rates and will be years behind the Fed when it starts doing so. That German two-year yields are negative and more than 2.5 percentage points below U.S. yields is the real oddity for markets.

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THE WALL STREET JOURNAL.
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Trump Courts Economic Mayhem

By Robert B. Zoellick
915 words
8 January 2018
The Wall Street Journal
J
A17
English

President Trump's new National Security Strategy argues that the U.S. must compete in a hostile world. Yet the White House also wants to retreat behind trade barriers. The Trump administration has stacked up a pile of trade cases that will come tumbling down early in 2018. More important than any specific case is the signal of a strategy of economic defeatism.

The U.S. is ready to block steel and aluminum imports through a rarely used "national security" rationalization. As an alternative, Commerce Secretary Wilbur Ross had tried negotiating capacity cuts in Chinese production, but Mr. Trump waved him off with a demand for tariffs. Because most of China's metal exports already face U.S. tariffs of more than 80%, Mr. Trump's tactic will likely trigger retaliation from other countries.

Next up are "safeguards" to block imports of solar panels and washing machines. Imposing "safeguards" doesn't even require a claim of unfairness. On top of this, last year (through Sept. 20) the Commerce Department conducted 65 investigations of alleged low-cost or subsidized imports. That figure is a 16-year high, up 50% from the year before.

But these amount to an overture to the big show: likely withdrawal from the North American Free Trade Agreement, the U.S.-Korea Free Trade Agreement or both. The continuing negotiations to "fix" Nafta are doomed. Mexico and Canada would probably agree on eliminating barriers and setting new rules for the digital age. But Mr. Trump's real aim is to dictate market outcomes. The administration wants to start with the goal of eliminating the U.S. trade deficit with Mexico and then manipulate rules to that end. It wants the U.S. to be excused from keeping its side of the Nafta bargain. It wants a five-year sunset clause.

Mr. Trump's National Security Strategy covered every region except North America, our home continent and base for projecting power. The administration gives the bilateral trade deficit with Mexico precedence over areas where our interests align: Asian competition, border security and energy security. Moreover, trade deals cannot change the economic fundamentals that determine the balance. Mexico and Canada cannot agree to managed trade or any deal that lets Washington ignore the rules when it chooses.

The president is trying to placate his political base, which will be enraged if he accepts a deal on "Dreamer" immigrants and fails to build his promised border wall. He relies on the support of economic isolationists who find it easier to blame others than to make America more competitive. Killing Nafta would fit the bill.

Mr. Trump does not know how to use bilateral trade negotiations to create pressure for stronger multilateral rules. The U.S. has historically used bilateral deals not only to eliminate tariffs and trade barriers but also to set higher standards for services, agricultural products, intellectual-property protection and more. Such deals have added environmental and labor protections, while boosting anticorruption and transparency rules.

The U.S. has used trade to expand the circle of like-minded nations. The Trans-Pacific Partnership included six countries with which the U.S. already had a free-trade agreement, and added five more. That offered leverage with China, but Mr. Trump abandoned the deal.

No country wants to do a bilateral deal with Mr. Trump now because he demands managed trade, not fair competition. He wants excuses to raise barriers, not rules to boost trade. That's why Mr. Trump will use his indictment of China's intellectual-property practices to justify more protectionism, not solve the problems. During the president's recent trip to China, when Beijing proposed opening some of its **financial markets** to U.S. companies, the Trump team dismissed this as the old way of doing business. The new way is to block Chinese exports.

Some in Congress, with Mr. Trump's backing, want to establish a new technology-control regime under the rubric of screening foreign investment. But government reviews of "covered transactions" could apply to countless business deals with foreigners -- licensing, joint development, hiring -- far beyond those involving China. The U.S. already has the authority to block investments and regulate the transfer of technology. The Committee on Foreign Investment in the U.S. reviews 200 or so deals a year. Expanding that to many thousands would harm America's competitiveness.

These are all signs of an America in withdrawal, not one confidently pressing the world to adopt new rules of fair competition and technology security. Farmers and ranchers are fretting that the retaliation triggered by a Fortress America trade policy will leave them behind a closed door. Companies that rely on sophisticated supply chains, such as auto makers, will pay a high price.

The U.S. is abandoning the challenge of setting new trade standards, whether for data, e-commerce or transnational services. America once attracted the world's talent, but Mr. Trump's hostility is driving people away. If he pulls the U.S. out of Nafta, even **financial markets** might recognize that his economic isolationism poses a risk to growth.

True competitors honestly assess their weaknesses, adapt and then grow stronger. Those are the qualities that made America great. This will be the year that trade policy could define Trump's fearful America.

Mr. Zoellick is a former World Bank president, U.S. trade representative and deputy secretary of state.

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THE WALL STREET JOURNAL.
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Investing in Funds & ETFs: A Quarterly Analysis --- Sector Strategy: After a Strong Year for Home Builders, Mutual-Fund Managers Look for More --- Even after last year's 27%-plus gain, builder shares draw optimism

By Bailey Mccann
912 words
8 January 2018
The Wall Street Journal
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R10
English

Last year was a great one for home builders. The S&P Homebuilders Select Industry Index was up 27.49% for 2017, compared with 17.74% for the **S&P 500**. Home builders got a boost from demand for new housing as well as a broad market rally, but many investors stayed out of the sector.

It may not be too late to give home builders a second look.

"We see a lot of fundamental support for home builders over the next two to three years," says Wilson Magee, director of real estate and infrastructure securities at Franklin Templeton. Mr. Magee oversees Franklin Templeton's real-estate fund, Franklin Global Real Estate Fund (FGRRX), which has exposure to new and existing homes in the U.S. "There was a significant increase in new-home sales in the most recent data from December, and we still have low housing supply overall."

According to Mr. Magee, demand for new housing is likely to remain strong because it can be hard for home builders to build quickly. "Land availability has been and will remain a challenge for home builders," Mr. Magee says.

Demographic changes are also driving housing demand. While younger Americans have been slower to form independent households than previous generations, that trend is beginning to shift.

"We are about to hit that sweet spot where the youngest millennials are graduating from college and the oldest millennials are starting to think about settling down," says Neil Nabar, portfolio manager for Fidelity Select Construction & Housing Portfolio (FSHOX) at Fidelity Investments. "I expect to see more household formation over the next several years, which is positive for home builders broadly."

In addition to sourcing land, home builders will also have to hire more skilled construction laborers to handle the workload.

Home builders have reported recent difficulty finding skilled laborers to fill empty slots, and Mr. Nabar suggests that may continue. After the financial crisis, many home builders took a more measured approach, which made it harder for home-construction workers to find jobs. And as housing recovered, a skills gap emerged.

"Because we weren't building, many people left the industry," Mr. Nabar says. "We may be in a place where you need to retrain a generation of workers to consider skilled construction as a job opportunity."

Taken together, industry analysts suggest that these supply constraints are likely to keep housing prices and home-builder margins high -- a boon for investors.

The positive trends for home builders have led some formerly short-term investors in this niche market to adopt more long-term strategies. Some, for example, are holding on longer to their shares of Direxion's Daily Homebuilders & Supplies Bull 3X Shares (NAIL), a leveraged ETF that aims to deliver triple the daily returns of the Dow Jones U.S. Select Home Construction Index, says Sylvia Jablonski, managing director, capital markets, and institutional ETF strategist at Direxion.

Because the positions held by the ETF are rebalanced every day, in line with the fund's stated investment goal, the company typically advises investors to consider it a fund to be bought and sold on the same day.

Otherwise, "it can lead to decay or losses," Ms. Jablonski says, due to its history of **volatility**. But that has started to change, she notes. "Interestingly, we have seen investors stay with it because the trend in home builders has been consistent over the past year." NAIL was up 259.59% in 2017.

Ms. Jablonski adds that in her view from a short-term perspective, home builders are still "in liftoff" going into 2018. "As the economy continues to grow there will be demand for housing, and that will create job opportunities and support overall demand," she says.

Rebuild or relocate?

The extreme weather events in California, Florida, Puerto Rico and Texas in 2017 also mean that residents of those states who saw their homes damaged will have to decide whether to rebuild or relocate.

Mark Kiesel, global credit CIO and managing director at Pacific Investment Management Co., says it is too early to tell exactly when the rebuilding effort will start to meaningfully affect home builders, but it is likely to drive growth over the second half of 2018 and into 2019.

In addition, the new tax law will make it more expensive to live in many coastal states including California and New York.

Starting with their tax returns for 2018, residents of high-tax states will be able to deduct only $10,000 of their state and local taxes -- an issue that Mr. Kiesel says could drive migration and new housing starts over the next three to five years.

"When you look at property taxes in some of these states, after the tax bill they become very uncompetitive -- if you can save 10% or more in taxes by moving, that's a meaningful amount for a lot of people," Mr. Kiesel says.

The savings would be most meaningful for high-end homeowners who took the biggest deductions under the old tax rules. "You are likely to see interest in lower-cost states like Texas grow."

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Investing in Funds & ETFs: A Quarterly Analysis --- Index Investing: 'Smart Beta' Keeps Soaking Up Money, but Performance Lags

By Tim Mullaney
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8 January 2018
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The buzz around one of the investment industry's most-watched, most-publicized trends is being called into question.

No, this isn't about bitcoin, but rather smart-beta funds, which new research suggests may not be working as planned.

Designed to bridge the gap between active mutual funds and exchange-traded funds that passively track indexes, smart beta offers the low costs and infrequent trading of an ETF, and ties holdings to both an index like the **S&P 500** and factors such as value or growth in an effort to match or beat the performance of indexes that reflect particular investing styles.

But data from UBS Group AG show that only about 32% to 39% of the 560 smart-beta funds the firm studied beat the performance of the closest capitalization-weighted index over a 10-year period, according to research by David Perlman, ETF strategist at UBS. Factor in the extra risk that ETFs take by indexing themselves to benchmarks other than broad indexes, and smart-beta funds outperform on a risk-adjusted basis only 25% to 32% of the time, Mr. Perlman says.

The numbers got a little better in 2017, "but it's not more than 50% outperforming," Mr. Perlman says. "The biggest headwind has been that value has lagged and a lot of smart beta has a value tilt."

Smart-beta funds attracted $65 billion in new capital for the year through mid-December, according to Morningstar.

Mr. Perlman is right that value funds play an outsize role in smart beta. The fastest-growing fund by far was Vanguard Value ETF (VTV), which reeled in just shy of $5 billion over the past year, bringing its total assets to about $37 billion, according to ETF.com. The largest fund in the category is iShares Russell 1000 Value ETF (IWD), which has more than $41 billion in assets, according to ETF.com.

There are differences in the industry over which funds should be classified as smart beta. ETF.com counts more than 900 smart-beta funds, while Vanguard, which has several of the 10 largest funds on ETF.com's list, doesn't consider any of its existing ETFs to be smart beta, says John Ameriks, head of Vanguard's quantitative equity group.

Those classifications can make a big difference in how to look at performance indicators, says Rob Nestor, head of iShares Smart Beta at New York-based BlackRock Inc.

Beating the market isn't the only reason to use smart beta in a portfolio, Mr. Nestor says, adding that investors also can use smart-beta funds to manage **volatility**, especially when they use more than one fund in tandem. He says 70% to 80% of iShares' 45 smart-beta funds have recently beaten their benchmarks for both absolute and risk-adjusted return. But, like Vanguard, he says its results may differ from the UBS data because BlackRock considers fewer of its funds to be smart beta than outside researchers do.

Those who invest in smart-beta funds need to be patient, says David Nadig, chief executive of ETF.com. Other research shows that smart-beta approaches can take as long as seven years to beat the market even if strategies are well thought out, he says.

"Smart beta works by reducing risk in drawdowns, not by juicing returns in up markets," Mr. Nadig says.

The best approach to smart beta is to use a combination of factors, rather than just one, Mr. Perlman says. Relying on research by UBS quantitative strategist Ronald Sutedja, he says the best approach is to choose investments that equally weight picks made to reflect size of companies, low **volatility**, dividend yield, quality and momentum.

Mr. Sutedja's research found that smart-beta portfolios that chose individual stocks reflecting those five factors would have consistently beaten the **S&P 500**, according to backtesting of returns. The strategy can work with ETFs as well, Mr. Perlman says, though he cautions that it's impossible to project performance as precisely as backtesting can measure what would have happened in the past.

Individual investors should do the same research on funds marketed as smart beta as they would on any other, and should review their results to make sure the fund is doing what it promises, Vanguard's Mr. Ameriks says. That is true whether an investor's goal is to beat the market, to lower **volatility** or simply to gain exposure to a particular factor like value or growth, he says.

"Don't start with what fits the label -- ask what you are trying to do. It's bad news to get involved in an investment based on a category."

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Ripple Steals Some of Bitcoin's Thunder

By Paul Vigna
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In 2017, bitcoin became a household word among investors. This year, it may be Ripple's turn.

XRP, a five-year-old digital currency offered by San Francisco startup Ripple, has soared 1,135% in the past month alone, quickly becoming the second-largest crypto-asset behind bitcoin. The rally included a 32% jump in the first days of 2018.

Such moves have become almost normal in the tumultuous virtual-currency mania of the past year. Ripple, like a bevy of other crypto startups, has benefited from the blind hope many investors are placing in largely unregulated and loosely defined bitcoin-related businesses. What is surprising about Ripple, though, comes from some of the differences that it has with bitcoin, the largest cryptocurrency by market value.

While both focus on electronic payments, bitcoin is governed by a fractious global array of technologists and antiestablishment libertarians. It was created nine years ago to reduce the power of big banks widely blamed for the financial crisis.

XRP, on the other hand, is centralized around a single for-profit company, Ripple, that has courted banks with a promise to reduce their costs. While some banks such as Spain's Banco Santander SA and Bank of America Corp. have signed up for Ripple's international money-transfer services, many large players such as Citigroup Inc. and HSBC Holdings PLC have stayed away and are pursuing their own payment improvements.

Ripple hasn't disclosed how much money the banks are moving over its payments network, which offers software to transfer dollars, yen and euros more quickly and inexpensively. It says it has signed up about 100 banks, but that is a fraction of the 16,600 institutions that use Visa Inc. or the thousands that use the cooperative that runs the international bank messaging service, known as Swift.

Investors have been lining up anyway. XRP's rise in 2017 was 24 times steeper than bitcoin's own ascent. Overall, the company has sold about 38.7 billion tokens, which are called XRP by some and Ripple by others. The market value of those tokens, according to research site coinmarketcap.com: about $118 billion.

"It's amazing what's going on," said Chris Larsen, Ripple's co-founder and chairman. "You've got to be standing in the middle of the road when the luck-truck hits you."

A former online-lending specialist who co-founded Prosper Marketplace Inc., Mr. Larsen owns roughly 5% of the outstanding XRP tokens, according to a person familiar with the company. That stake is now valued at about $15.8 billion at current market prices, up nearly 500-fold from its $32 million value a year ago.

The huge rise shows that "real utility matters," said Ripple Chief Executive Officer Brad Garlinghouse. "Real customers matter."

Despite bitcoin's popularity among investors, its utility as a payments platform has suffered because of network delays and rising transaction costs. And many bankers still distrust bitcoin, with JPMorgan CEO James Dimon last year calling it "a fraud."

Ripple, meanwhile, has become a cash-flow positive, profitable business, according to Mr. Garlinghouse. That is a rarity among crypto startups, though a big part comes from the XRP sales themselves in addition to the fees that Ripple generates by selling software licenses and collecting fees on individual money transfers.

Then there are the 61 billion tokens that Ripple owns and hasn't yet sold. Those have soared to a value of about $185 billion. While the lofty sum could plummet at any time, it is still a staggering amount, greater than the cash hoards of nearly every company in the **S&P 500 stock index**, including Microsoft Corp., which has $138 billion.

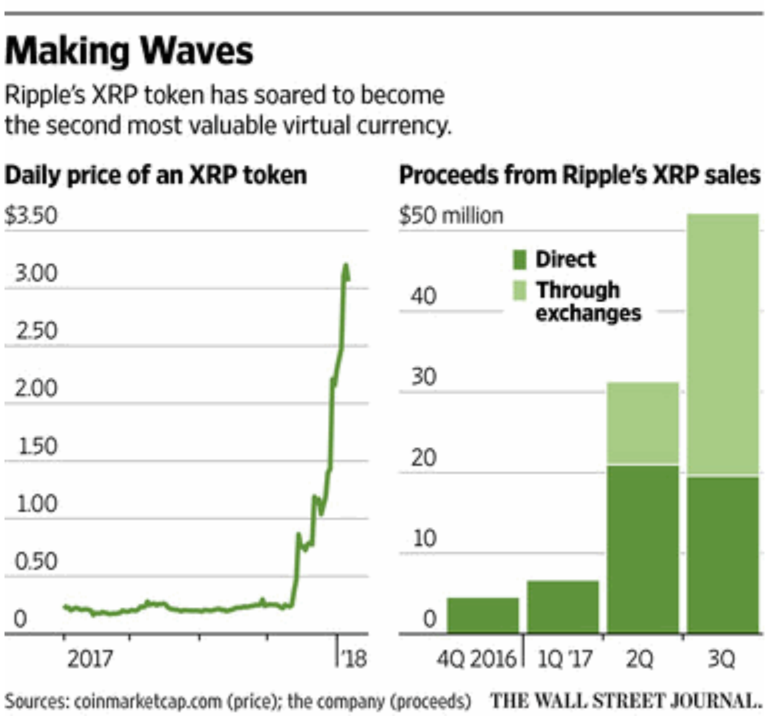
Also, since the XRP held by Ripple isn't easy to trade like a major currency, Ripple couldn't quickly convert major amounts of XRP to dollars without risking a crash in XRP's price, a possibility that has made some investors nervous.

To counter those criticisms, Ripple took 90% of its remaining XRP holdings, about 55 billion tokens, and put them in 55 separate contracts designed to prevent the company from tapping more than 1 billion tokens in any one month.

At the beginning of 2017, Mr. Garlinghouse, a 46-year-old former Yahoo and AOL executive, took over the chief executive spot from Mr. Larsen, who remained chairman. Mr. Larsen says the Topeka, Kan., native impressed him with his blunt assessment of some of Yahoo's past problems.

Mr. Garlinghouse, who joined the company as president and chief operating officer in 2015, has a stake of about 6% in Ripple, said a person familiar with the company.

Despite the surge in XRP's value, Ripple, like all crypto companies, carries big questions. One is whether more banks will adopt it instead of choosing payment projects where they have more control and a greater stake. There are also well-funded startups, including R3 and Digital Asset Holdings, which recently scored a contract from Australian exchange operator ASX Ltd.



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The New York Times

Business/Financial Desk; SECTB
Tech Firms Lead Way As Rally Continues

By THE ASSOCIATED PRESS
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English

After another solid monthly jobs report, technology companies again led the way as U.S. stocks rose for the fourth day in a row to start 2018. They are on their longest new-year winning streak in eight years.

The Labor Department said employers added 148,000 jobs in December. That was a bit less than experts expected, but still underscored the continued health of the economy. Wages grew and factory managers received more new orders than in any month since 2004. Health care and consumer-focused companies also rose, and the weaker dollar gave industrial firms like Boeing and basic materials makers a lift.

Wages and worker productivity are rising at about the same rate, according to Ed Keon, managing director and portfolio manager of QMA, a fund manager owned by Prudential Financial. He said if that trend continues, company profits should stay solid and inflation would not be much of a risk to the economy.

Productivity growth has been weak in recent years, but it jumped 3 percent in the third quarter. Mr. Keon said new technologies might now be helping businesses in a bigger way.

''It's possible that we're on the verge of a new productivity revolution,'' he said.

The **Standard & Poor's 500**-**stockindex** gained 19.16 points, or 0.7 percent, to 2,743.15, and rose 2.6 percent for the week. The **Dow Jonesindustrial average** added 220.74 points, or 0.9 percent, to 25,295.87. The **Nasdaq composite** index rose 58.64 points, or 0.8 percent, to 7,136.56. The Russell 2000 index of smaller-company stocks rose 4.29 point, or 0.3 percent, to 1,560.01.

The last time stocks rose for at least four consecutive days to start a new year was in 2010, when the **S**.**&P**. **500** finished higher for six days in a row. It rose 1.9 percent over that run.

While job growth has slowed with the economy close to full employment, solid economic growth in both the United States and major countries overseas is still supporting more hiring.

Apple gained $1.97, or 1.1 percent, to $175. Alphabet, Google's parent company, picked up $14.53, or 1.3 percent, to $1,110.29. The chip maker Xilinx jumped $3.66, or 5.2 percent, to $74.15. eBay added $1.12, or 2.9 percent, to $39.69.

Consumer-focused and health care companies also stand to benefit from sustained economic growth. Amazon climbed $19.55, or 1.6 percent, to $1,229.14. Netflix advanced $4.36, or 2.1 percent, to $209.99. The used car retailer CarMax edged up $2.79, or 4.1 percent, to $71.04.

Among health care companies, Align Technology, which doubled last year, surged $7.77, or 3.3 percent, to $241.07, and the contact lens and surgical products maker Cooper Companies gained $6.95, or 3.1 percent, to $230.50.

Bond prices fell. The yield on the **10**-**year Treasury** note rose to 2.47 percent from 2.45 percent. The yield on the two-year note rose to 1.96 percent from 1.95 percent.

Facing competition from Amazon, Barnes & Noble fell to its lowest price since 1994 after the bookseller said its sales slumped over the holidays. Barnes & Noble sank 90 cents, or 13.8 percent, to $5.60.

Benchmark U.S. crude lost 57 cents to $61.44 a barrel in New York.

Gold rose 70 cents to $1,322.30 an ounce and silver picked up 2 cents to $17.29 an ounce. Copper slipped 3 cents to $3.23 a pound.

The dollar rose to 113.14 yen from 112.74 yen. The euro slipped to $1.2050 from $1.2072.

CHART: The **S**.**&P**. **500 Index**: Position of the **S**.**&P**. **500 index** at 1-minute intervals on Friday. (Source: Reuters)

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The New York Times

National Desk; SECTA
More Laborers See Pay Gains As Jobs Climb

By NATALIE KITROEFF
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English

The bustling United States economy is beginning to benefit some American workers who have not gotten a taste of the recovery and have been most in need of relief.

That picture was reinforced by a report on Friday from the Labor Department, which showed an increase of 148,000 jobs last month. The figure fell short of economists' expectations, but some of the most impressive job gains in the past year were in blue-collar and service industries that pay a decent salary.

Over all, average hourly earnings were 2.5 percent higher in December compared with the year before, scarcely keeping up with inflation. But other data shows that wages have increased most for the least-educated workers and for people in many industries that are generally low-paying.

''Growth is strong, and the benefits of this growth have been widely shared,'' Jed Kolko, the chief economist for Indeed.com, a job-search site. ''This has been a year in which some of the gaps in the economy that had been growing narrowed a bit.''

Manual-labor positions are the kinds of jobs that President Trump has promised to bring back in droves, so progress could be politically important. Hiring picked up fastest in construction and mining. Manufacturing, which lost jobs in 2016, expanded last year at a respectable clip, part of a global resurgence.

Reflecting the economy's resilience, overall hiring in 2017 was only slightly lower than in 2016 -- and it has risen for 87 consecutive months, a remarkable feat.

The unemployment rate was steady at 4.1 percent, a 17-year low. The numbers point to an economy that still has some room to grow.

In a Twitter post on Wednesday, Mr. Trump cited the unemployment rate as evidence that the economy is ''only getting better!'' When he took office last January, the rate was 4.8 percent.

Most economists say presidents do not generally determine the economy's course, and it is too early to measure the hiring effects of the tax cut signed into law last month. But Mr. Trump's agenda may be having an impact on the economy in other ways. His push to dismantle regulations on businesses seems to have emboldened corporations to start putting more money into machines and plants, the kind of spending that drives broad growth.

A separate survey of manufacturers released on Wednesday suggested that American factories have picked up their orders, production and hiring over the past year.

Democrats offered a less sanguine view of the labor market, asserting that most Americans were still enduring paltry raises and that the Republican tax plan was a boon only to the upper stratum of the country. Among the solutions advocated by Democrats is to increase the minimum wage, as 18 states did on Jan. 1.

''The American economy is unbalanced,'' Representative Joe Crowley of New York, the leader of the House Democratic Caucus, said in a statement. ''Workers struggle to find financial security while special interests, corporations, and the richest among us enjoy lavish tax breaks.''

Wages have been one of the most intensely debated puzzles of the labor market, with incomes growing at a more sluggish rate than the hiring demand would suggest.

There are signs beneath the surface, though, that more widespread wage growth may be around the corner.

The security industry, for example, where pay is below average, showed a 7 percent increase in hourly earnings in November from a year earlier. Workers in clothing stores and food services -- two huge, generally low-paying businesses -- saw wages rise by around 4 percent in that period.

In areas where unemployment has dipped below the national rate, pay has begun to accelerate. Cities where joblessness is 3.5 percent or lower have had an impressive 4 percent year-over-year increase in earnings, said Ian Shepherdson, chief economist of Pantheon Macroeconomics.

In Indianapolis, where unemployment reached 3.1 percent in November, wages for jobs in the private sector rose by nearly 5 percent in the second quarter compared with a year earlier.

''If the unemployment rate everywhere gets to 3.5 percent, then wage growth everywhere will get to 4 percent,'' Mr. Shepherdson said.

That kind of tightening may nudge some employers who have resisted giving raises.

''The wage growth rate kicking in isn't an automatic thing that happens in the economy,'' said Cathy Barrera, chief economist at ZipRecruiter, a job-listing platform. ''It requires employers to feel that friction, that competition for talent, to change what they offer recruits.''

E-commerce companies have begun to raise wages in hot warehouse markets, such as Memphis or the Inland Empire in Southern California, said Bill Ravenscroft, a senior vice president at Adecco Staffing USA. The agency employs around 60,000 workers, hiring more during the holiday season, and places many in distribution centers and warehouses often used by e-commerce giants.

But employers are not taking that approach across the board. Many are vying for pickers, packers and shippers by offering new perks. Logistics companies have begun providing on-site child care, or reimbursing employees who need to put their children in day care while they work.

Some companies are entering workers in raffles every week to win laptops, televisions and tablets, or are bringing food trucks to their warehouses and paying for employees' lunches.

''These types of benefits in the past, you associated them with Silicon Valley, start-up companies,'' Mr. Ravenscroft said. ''They weren't synonymous with your traditional employers.'' Clients are hesitant to offer permanent wage increases, he said, but that could change if the jobless rate continues to dip.

Bob Peterson, the chief executive of Melton Truck Lines, said he had been feeling the job market's heat all year, and that he now had no choice but to raise pay for his 1,600 drivers.

''With unemployment this low, anyone worth their salt has got a job and probably a darn good one,'' Mr. Peterson said. Melton operates in 48 states and has offices in five.

The tight job market has been especially tough on Mr. Peterson, because he requires a drug test for everyone who comes through the door. Many fail, especially after several states legalized marijuana for medical or recreational use.

''There's guys and gals that like to smoke weed, but they can't drive a commercial vehicle because it's prohibited,'' Mr. Peterson said. ''Some people get here and we find out, oops, they have been smoking or injecting.''

Mr. Peterson has not given raises in two years, he said, because when he had asked his clients to increase their rates, they threatened to hire another trucking company. He is planning to increase salaries by 10 percent in 2018. Part of the reason, he said, was that he was seeing hiring pick up in the construction business and in manufacturing, two sectors that he competed with for able bodies.

''No one is having an easy time hiring blue-collar workers today,'' Mr. Peterson said.

Those pressures are bearing down on manufacturing, which added a solid 196,000 jobs last year, and construction, where payrolls increased by 210,000. Mining employers also posted solid gains, bucking a trend of job losses in recent years.

The crash in **oil prices** in 2014 was particularly hard on jobs in the mining sector, which includes support services in oil fields, and had ripple effects on construction and manufacturing, partly because American companies make much of the world's mining equipment. **Oil prices** have begun to climb, and that may be one piece of the expansion in all three sectors, economists said.

The rest of the world is also in the midst of a strong recovery, helping to drive an American uptick in productive blue-collar work.

''The manufacturing upturn story is a global story,'' Mr. Shepherdson said. ''It's happening everywhere. You can't take credit for the recovery in Europe and China.''

CHARTS: The Labor Picture in December (Source: Bureau of Labor Statisics) (A14)

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U.S. News: Powell Privately Voiced Concerns

By Nick Timiraos
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6 January 2018
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Federal Reserve governor Jerome Powell guardedly supported an aggressive expansion of the Fed's controversial bond-buying program in 2012 and expressed reservations behind closed doors about longer-term risks, according to transcripts of central bank policy meetings released by the bank on Friday.

Mr. Powell joined the board in May of that year and has been tapped by President Donald Trump to succeed Fed Chairwoman Janet Yellen next month. Because he voted consistently to support the policies of former Fed Chairman Ben Bernanke and later Ms. Yellen, markets expect he wouldn't deviate significantly from the Fed's current policy path to gradually raise rates.

The materials released Friday reveal for the first time his greater caution in 2012 about aggressively deploying unconventional policy tools compared with Mr. Bernanke and Ms. Yellen. The release of 2,167 pages of transcripts and other materials from eight meetings of the Fed's rate-setting committee provide the first verbatim public record of what individual officials and staffers said during the policy discussions.

Mr. Powell, a former private-equity executive, is set to become the first non-economist in four decades to lead the Fed. His concerns about expanding the bond-buying program imply greater caution about making big or sudden moves and suggest he may be more attuned to how **financial markets** respond to policy decisions than his predecessors.

The Fed in 2008 launched the first of three rounds of bond purchases aimed at stabilizing markets and lowering long-term interest rates. The untested move drew criticism that the central bank was risking a surge in inflation. In the end, the economy and the labor market strengthened, while inflation stayed under control. Despite his early misgivings, Mr. Powell by 2015 had fully embraced the view that the central bank should be prepared to take aggressive and sustained action to boost growth and fight recessions.

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The Intelligent Investor: Four Things to Watch As 2018 Gets Going

By Jason Zweig
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6 January 2018
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B1
English

Forget Dow 25000. Every year is full of surprises, but there are a few things every investor should expect to see happen in 2018.

With companies moving less in lockstep, professional investors will declare this a "stock pickers' market." Asset managers will proclaim that the impending rise in interest rates means you need bond funds that can hold any kind of debt. After years of smooth increases, even a 5% decline will set off cries of panic. And reported returns will shoot upward as the financial crisis of 2008 is jettisoned from 10-year track records. A look at these trends now should help keep you from overreacting, or acting at all, when they transpire.

Correlations, or the extent to which companies move up or down together, are at their lowest in more than 25 years, according to T. Rowe Price Group Inc.

Whenever stocks rise and fall independently like this, portfolio managers say beating the market becomes easier.

History says otherwise. Most funds run by stock pickers struggle to outperform in years of high and low correlation alike. Such active portfolios charge higher fees than market-matching index funds. And for every stock picker who buys a stock, another is selling; only one of them can be right.

With many professional investors expecting interest rates to climb this year, you should also expect a push to invest in unconstrained bond funds.

Such portfolios can, in theory, generate higher returns by ranging across the entire market -- government and corporate debt, inside and outside the U.S. -- to buy cheap bonds wherever they may be found.

Bear two things in mind. First, a jump in interest rates is probable, not certain. Second, even if rates do rise, unconstrained portfolios are riskier than those targeting only U.S. government or investment-grade debt.

Unconstrained funds invest in less-stable corporations or foreign governments, hoping that these borrowers will get stronger, boosting the value of their debt. That can raise returns when all goes well. Unfortunately, as analysts at AQR Capital Management LLC have shown, it also makes these funds behave more like stocks, weakening their usefulness as protection against a rate increase.

If you want a buffer against rising rates, then hoarding cash and minimizing your holdings of long-term debt will likely be more effective than most unconstrained bond funds.

Meanwhile, for stock investors, the apparent lack of risk may be a risk in itself.

The **S&P 500**, including dividends, has gone up for 14 months in a row, the longest consecutive run since 1928, according to Bank of America Merrill Lynch. And stocks' recent movements up and down have been smoother than in most periods since 1885, according to William Schwert, a finance professor at the University of Rochester.

A 5% or 10% decline in an otherwise placid market is a lot more upsetting than a similar fall in a more-turbulent time. Research by David Le Bris, a finance professor at Toulouse Business School in France, suggests that the pain of a decline depends not merely on its size, but also on its steepness relative to what investors have become used to.

Consider the epic crash of Oct. 28, 1929. That day, the **Dow Jones Industrial Average** fell 13%, or 12.75 times its standard deviation, a measure of how much its returns had recently been varying from their typical level.

Nowadays, says Prof. Le Bris, the market has been so tranquil that it would take only a 5% one-day drop in the Dow to match the same extreme measure of risk from that horrific day in 1929.

So you should brace yourself. In this environment, even slight declines are apt to set off talk of Armageddon, and you will need to focus harder than ever on long-term returns to keep short-term losses from rattling you.

And long-term returns are likely to be distorted this year. In September and October 2008, the depths of the financial crisis, U.S. stocks fell 9.1% and 17%, respectively.

This fall, those apocalyptic months will finally be more than 10 years behind us, and, as a result, the long-term return on stocks will go up like a rocket.

In fact, the **S&P 500**'s 10-year cumulative return would leap from 82% at the end of 2017 to 198% at the end of this coming November, even if stocks go absolutely nowhere for the first 11 months of 2018, says Howard Silverblatt, senior index analyst at S&P Dow Jones Indices.

That would nearly double the average 10-year gain to 12% annually from 6.2%, without even counting dividends.

Stocks will then look much more attractive in the rearview mirror, even though nothing will have changed but the calendar. Don't believe the hype.

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Dow 25000: Industrial Stocks Pump Up Index

By Chris Dieterich
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English

Corrections & Amplifications

AlliedSignal Inc. acquired Honeywell Inc. in 1999 and kept the Honeywell name, becoming Honeywell International Inc. A Dow 25000 article on Friday about the blue-chip **stock index**'s industrial-sector components incorrectly said that Honeywell acquired AlliedSignal. In addition, AlliedSignal's name was incorrectly given as Allied Signal.

(WSJ Jan. 8, 2018)

(END)

It has been a banner stretch for the industrial stocks within the **Dow Jones Industrial Average**.

The five industrial-sector members of the 30-member average -- Boeing Co., Caterpillar Inc., 3M Co., United Technologies Corp. and General Electric Co. -- are responsible for nearly 30% of the Dow's sprint to 25000 from 24000. Boeing and Caterpillar did most of the Dow's heavy lifting, with the pair by themselves adding 263 of the Dow's latest 1,000-point advance.

The trend holds over a longer time frame. Boeing is the priciest stock in the Dow as well as its top performer over the past year, climbing nearly 90%. Caterpillar is up 70% over the same stretch, second most among Dow stocks. Stocks with the highest prices carry more heft in the Dow, unlike almost every other index.

Losses for 3M were offset by gains in United Technologies since the Dow hit 24000 in November. GE, down sharply over the past year, is roughly flat since the Dow's last round number.

The Dow's yearslong rally would be more robust if the average still included Honeywell International Inc., the most recent industrial giant to be jettisoned from the average in the name of modernization. Honeywell's sharp gains are reminiscent of the saying that former Dow constituents tend to outdo their replacements, at least for a time.

Honeywell, which makes everything from muck boots to respirators, was replaced in the Dow in February 2008. Its predecessor, Allied Chemical & Dye, joined the Dow in 1925, and Honeywell acquired Allied Signal Inc. in 1999.

In 2008, Honeywell was the average's smallest component by sales, and the Dow's index committee used Altria Group. Inc.'s split of its international operations as an opportunity to broaden the index to include financial and energy companies. Honeywell and Altria were out, Bank of America Corp. and Chevron Corp. were in.

The Dow index committee, a group that includes editors of The Wall Street Journal, periodically reshuffles holdings to align the benchmark with trends in the broader economy. The most recent update was in 2015.

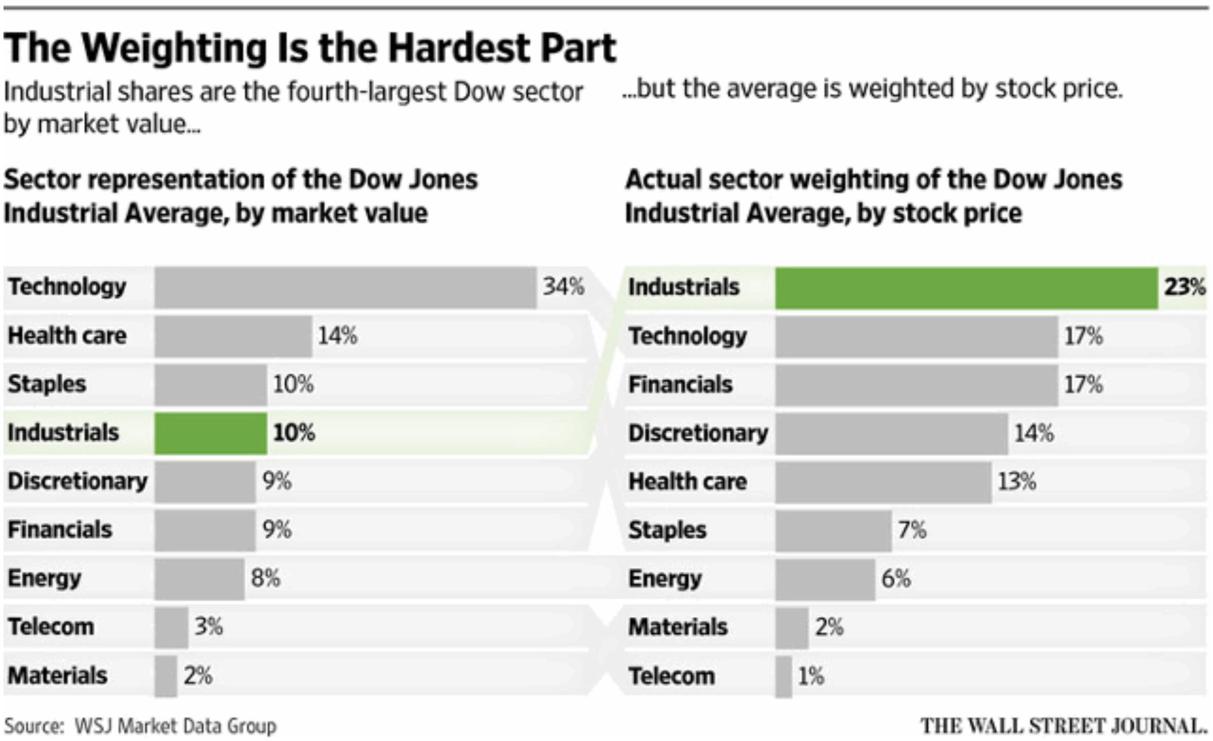
Honeywell has been on a tear since getting the boot, returning 251% to investors, including dividends, according to FactSet. That compares with a roughly 159% return for the Dow and 149% return for the **S&P 500**.

Honeywell's stock gains have also trounced both stocks that replaced it in the Dow over the same period (Bank of America left the Dow in 2013).

Like other industrial conglomerates, Honeywell is facing calls to separate its businesses to help unlock shareholder value.

The company, which appointed new Chief Executive Darius Adamczyk last year, plans to spin off its home and transportation businesses by the end of 2018.

Honeywell's **stock price** has beaten Kraft Foods (now Mondelez International Inc.) since that company joined the Dow in September 2008. It has beaten the performance of Cisco Systems Inc. and Travelers Co. since they joined the Dow in June 2009. It has even beaten Apple Inc. since the technology giant joined the Dow in March 2015.



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THE WALL STREET JOURNAL.
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Dow 25000 -- Streetwise: Economic and Market Indicators Offer Up Contradictory Signals

By James Mackintosh
837 words
5 January 2018
The Wall Street Journal
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A9
English

Corrections & Amplifications

Gregory Peters is a senior bond fund manager at PGIM Fixed Income, part of Prudential Financial Inc. The Streetwise column Friday incorrectly said he was at PGIM Investments, a separate unit of PGIM.

(WSJ Jan. 6, 2018)

(END)

The economic cycle has been turned upside down. Depending where you look, there is strong evidence that the U.S. is in the first stage of recovery, in a long midcycle, or even approaching the final stages before rolling over.

No wonder investors are confused. Deciding where the country stands in the cycle is a vital part of putting money to work, determining whether it is best to be in bonds, stocks or commodities, and which sectors of the **stock market** are likely to perform best.

At the moment, different markets appear to be priced for all parts of the cycle other than recession, while economic indicators, after nine years of growth, point to early cycle again. The blame can be on a mix of eccentric inflation, irregular central banks, and global expansion, and investors have to decide whether there will soon be a return to the usual cycle or if they should rip up the playbook.

The starting place for cycle analysis is the bond market, particularly the slope of the yield curve, the gap between long- and short-dated bonds. Last year's three Federal Reserve rate increases were accompanied by flat long bonds, taking the gap between 10-year and two-year Treasury yields to just half a percentage point, where it last stood as the **stock market** peaked in October 2007. Such a flattening of the yield curve normally suggests the economy is moving into the late cycle, and investors should be taking less risk.

Stock markets sent a different signal. True, large companies beat smaller stocks, which are usually riskier. But the performance was led by high-growth technology companies and by consumer-facing businesses, which usually do best in the early and middle phases of the cycle. There was no sign of a switch to defensive stocks that are able to cope well with the usual late-cycle threats of higher interest rates and weaker growth.

Industrial metals have become a less useful guide to the U.S. economy since the opening up of commodity-hungry China, but the 30% ramp-up in prices last year would usually indicate we are either very early or late in the cycle.

"The cycle is much more diffused and dispersed than we've seen historically," says Gregory Peters, a senior bond fund manager at PGIM Investments, part of Prudential Financial Inc. "It's asynchronous, with minicycles in commodities and energy."

The economic data are confusing, too. Nine years of growth, albeit much weaker than is normal, should place the U.S. at best in an extremely extended midcycle. Instead, the Institute for Supply Management's manufacturing index is surging, with new orders leading the way and no sign of a buildup of unsold inventory. Strong new orders and low inventories presage further growth from restocking and are a sign of being early in the cycle. Economic data haven't just been strong, they also have been soundly beating expectations, giving a further boost to growth stocks.

One explanation for the mixed signals is that bonds are distorted, but it also points to risks ahead. Long-dated bond yields are low partly because investors are convinced that interest rates will be permanently lower and inflation has been defeated. Long-dated bond yields are also being held down by quantitative easing, still under way in Japan and Europe. The Fed has taken baby steps to reverse its bond purchases, but so far the reduction in its balance sheet has been minuscule. Low bond yields in turn make growth stocks more attractive.

If inflation comes back or central banks become more aggressive, rising bond yields and higher rates together could hurt these long-duration stocks and push shareholders toward defensive stocks with more reliable short-run earnings, a late-cycle behavior.

However, the cycle itself could be misleading. The U.S. economy is being lifted by the recovery in the rest of the world. Improved prospects abroad weakened the dollar, which helps explain the strong gains for U.S. stocks. In constant-currency terms and including dividends, the **S&P 500** was beaten by eurozone, Japanese, U.K. and emerging-market stocks last year.

Global growth, together with the falling away of concerns about China's debt pile, helps explain the gains for metals prices, too.

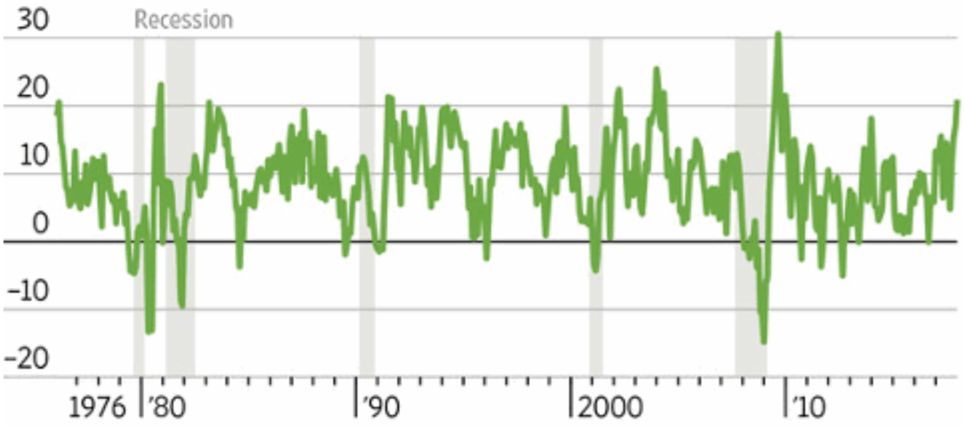
Maybe the U.S. is just a year or so into a new minicycle, likely to be further supported by corporate-tax cuts. If so, this minicycle starts out with the advantage of low inflation but the disadvantages of already-low unemployment, high corporate debt and a Fed set on a tightening path.

There is little reason to think recession is imminent. Whether this is a new minicycle or a mixed-up superlong cycle, any hint of inflation is likely to prompt worries that the cycle is maturing, push up bond yields, and hit tech and other growth stocks.

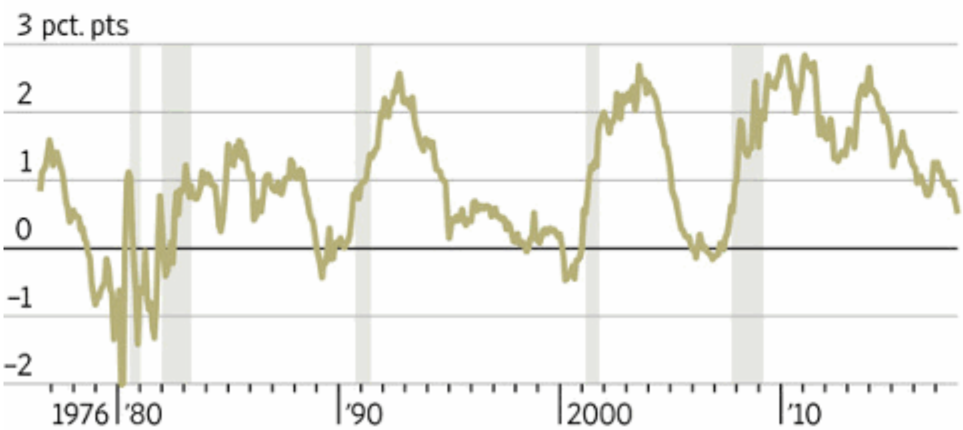
Opposing Measures

Manufacturing is usually only this strong early in the economic cycle, but the flattening bond-yield curve suggests we are late in the cycle.

ISM new orders minus inventories



Gap between 10-year and two-year Treasury yields



Sources: Thomson Reuters Datastream (ISM); Federal Reserve Bank of St. Louis (yields)

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Heard on the Street
Price Bitcoin Like a Commodity

By Nathaniel Taplin
473 words
5 January 2018
The Wall Street Journal
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English

[Financial Analysis and Commentary]

Is a bitcoin worth the $15,000 it commands today, or is it really worth about $3,000? The huge run-up in value since September suggests the lower figure.

Cryptocurrency fans typically fall into two groups. One sees the currencies as ways to buy and sell things; the other views them as investments. For now, the investment crowd is winning out: Bitcoin remains a cumbersome way to purchase most goods, but its value has skyrocketed, nearly quadrupling since mid-September.

If bitcoin is an investment, it most closely resembles gold. Both are stores of value that provide some built-in protection against inflation because there is a finite supply and because extracting new deposits gets more expensive over time, barring big technology changes.

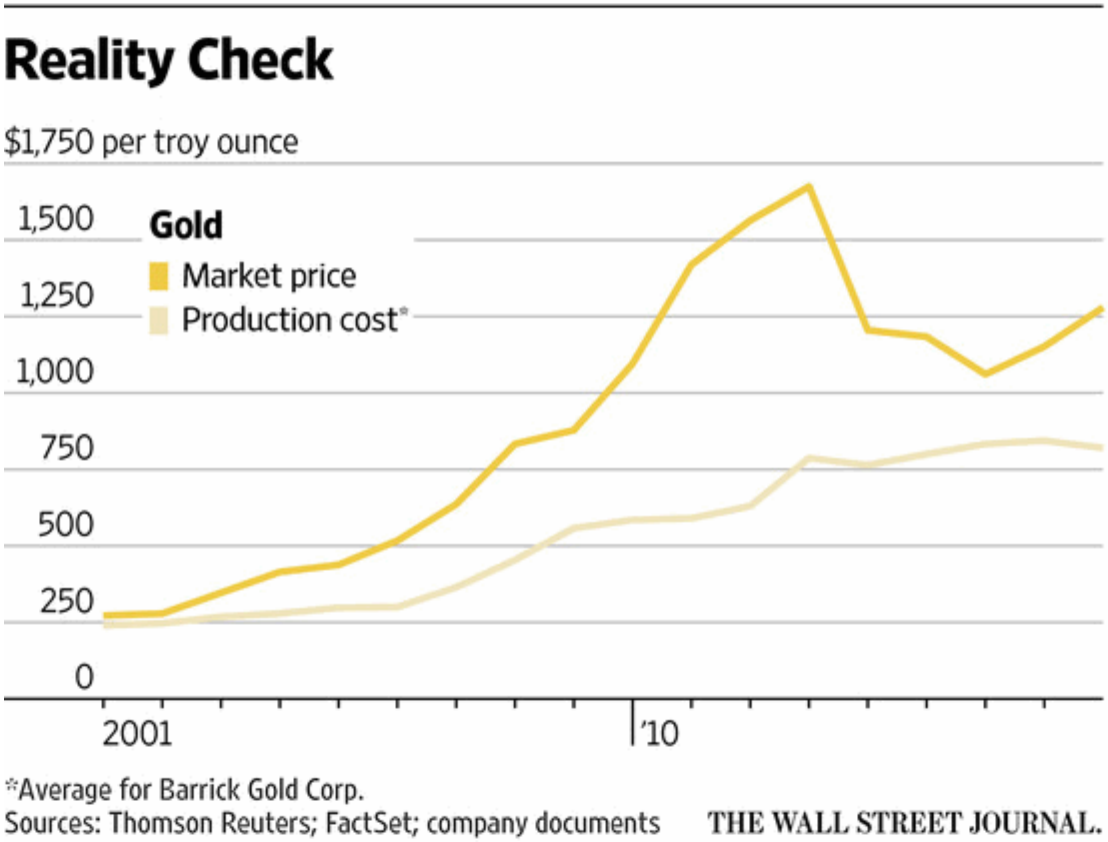
The most important factor in gold prices over the long run is production costs, which act something like a natural price floor when demand dips. Of course, gold prices can also temporarily move much higher when demand is strong but tend to fall back toward the marginal cost of production once worries about inflation or the dollar subside and gold begins to lose its appeal as a hedge.

The last great **bull market** in gold is a classic example: Prices peaked at around $1,900 a troy ounce in 2011 -- more than three times the production cost, at the time for Barrick Gold, the largest listed gold producer. By the end of 2016, gold prices had plummeted to $1,151 a troy ounce, above Barrick's production cost of $844, according to FactSet.

Applying the same analysis to bitcoin suggests its price could face a steep fall if demand dries up. The cost of minting a bitcoin is as low as $3,224 in Louisiana, according to an analysis by the Crescent Electric Supply, one of the largest electrical suppliers in the U.S. The Pelican State had the lowest average residential power costs in the U.S. as of October, according to the Energy Information Administration. Electricity is the biggest cost for bitcoin miners once they fork out for their equipment.

On the demand side, some investors appear to be using bitcoin as a hedge against currency weakness in a manner similar to gold. Deutsche Bank reckons that Japanese retail investors were the main force behind the monstrous bitcoin rally last fall -- also a period of weakness for the yen, which shed about 6% of its value between early September and mid-November. Around 40% of bitcoin trading is yen-denominated, according to Japanese bank Nomura.

If the yen were to rise sharply this year, or even if investors begin concluding bitcoin is overpriced as a hedge relative to gold, bitcoin might have a long way to fall.



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THE WALL STREET JOURNAL.
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Dow 25000: Number of Listed Companies Is Falling --- Analysts debate what role such a drop has played in the nearly nine-year stock rally

By Michael Wursthorn and Gregory Zuckerman
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The Wall Street Journal
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A8
English

As the **Dow Jones Industrial Average** broke through 25000 and other **stock-market** indexes continue rising to new highs, the number of publicly traded U.S. companies keeps shrinking.

That phenomenon has investors and analysts debating what role the decline in number of listed companies has played in the nearly nine-year rally, and more broadly what it means for investing.

Some say it is a simple question of supply and demand: As money pouring into stocks rises as the number of companies and publicly traded shares falls, the remaining listed companies are bound to get a lift. Others say it is more complicated than that, arguing there is little evidence that the shrinking market translates directly into higher share prices.

What is clear is that the number of publicly traded companies has been steadily declining. In 1996, more than 7,400 companies were listed on U.S. stock exchanges. Today, that figure is less than half, according to the Center for Research in Security Prices at the University of Chicago's Booth School of Business.

The number of listed companies peaked during the late 1990s, when hundreds of startups cashed in on the rise of the internet by selling shares to the public. Many of these companies disappeared during the dot-com bust that followed. Small companies are also staying private longer, preferring to raise venture capital or other private money rather than having to abide by more-stringent regulatory requirements of public companies. Merger and acquisition activity continues to shrink the number of public companies too.

Years of robust corporate buybacks, meanwhile, have reduced the number of shares available to investors. Company share buybacks hit a record of $572 billion in 2015, according to S&P Dow Jones Indices.

Some investors believe the dwindling number of publicly traded companies and shares outstanding has helped boost blue-chip indexes, coming as the amount of money flowing into U.S. stocks has risen steadily. Assets under management for U.S. stock mutual funds and index funds are up about six times to more than $10 trillion from 1996 to 2016, according to Credit Suisse.

When demand for stocks rises but the supply of shares available shrinks, that helps push stock prices higher, says David Rosenberg, chief economist and strategist at Canadian investment firm Gluskin Sheff & Associates Inc.

In his view, the reduction in shares outstanding has been equivalent to a 15% boost to earnings since 2009.

Some analysts note that vast majority of the stocks that have disappeared were small or microcap. They wouldn't have had a major influence on the broader blue-chip indexes anyway, since most weight stocks by size rather than equally.

"What it does is make the markets more efficient," said Quincy Krosby, chief market strategist at Prudential Financial, of the shakeout of smaller companies from public exchanges. And while common shares outstanding in the **S&P 500** have shrunk each year since 2010, it been at a rate of only about 1% a year or less, according to Citigroup.

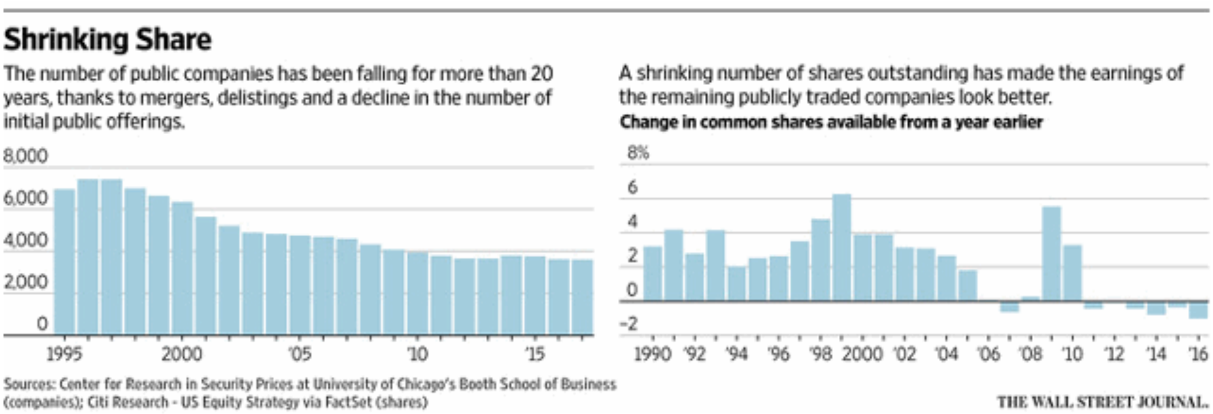
Tobias Levkovich, chief U.S. equity strategist at Citigroup, says companies seeing the greatest share-count reductions haven't outperformed the market, suggesting the share reduction has limited impact. He also said that while the number of shares are down overall, the drop has been less than 1% a year in recent years. That decline has been enough to help offset issuance of stock-option grants that add to the supply of shares, but it hasn't been sufficient to boost the overall market, he said.

Still, the diminishing number of listed companies has affected the market in other ways, some investors say.

The reliance on private capital has made it harder for stock investors to get exposure to younger companies that would have otherwise listed on an exchange more quickly. The average age of a listed company last year was about 18 years old, while in 1996, companies that were public were about 12 years old, according to data compiled by Pantheon Partners.

Amazon, for example, was considered a small-cap stock when it went public in 1997, and has ballooned into a $566.3 billion behemoth, giving early investors a significant fortune. Today, companies like Facebook Inc. wait until they are multibillion-dollar businesses before going public, while others such as Uber Technologies Inc. and Airbnb Inc. have remained private.

Some analysts suggest that large stocks such as Netflix Inc. or Alphabet Inc., Google's parent company, may be benefiting indirectly from the lack of startup companies in the public markets. With fewer opportunities to buy small, high-growth companies in the **stock market**, investors are putting more money in bigger, established companies and passive investment funds.



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THE WALL STREET JOURNAL.
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Dow 25000: Who Needs GE? Not Blue-Chip Indicator

By Ben Eisen
412 words
5 January 2018
The Wall Street Journal
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A9
English

No company is more tied to the **Dow Jones Industrial Average** than General Electric Co. But the Boston-based conglomerate wasn't much help in getting the blue-chip index to its latest milestone.

There isn't a stock that has consistently been in the Dow since its inception, but GE is about as close as it gets. The company was one of the 12 original components of the Dow when it launched in 1896. It was removed in 1898, then added back in 1899 and pulled again in 1901. It has been a permanent resident for more than 110 years.

That is a lot of time for GE's **stock price** to rise and fall. Most recently, it has been falling. The share price is down 39% since the Dow touched 20000, making it by far the worst performer in the 30-**stock index** over that stretch on a percentage basis. The company has been struggling to refocus its sprawling operations and cut costs. Recently, GE halved its dividend.

GE's fall subtracted 81 points from the Dow industrials during its run from 20000 in January 2017 to its close above 25000 for the first time ever Thursday. It could have been even more of a drag if not for the Dow's unique weighting by price. At $18.53, GE's share price is by far the lowest in the index. Its price is just over half of the next lowest-priced component, Pfizer Inc., at $36.79. That means GE has the smallest weight on the index.

It wasn't always that way. GE had a solid stretch during the Dow's rise from 5000 in 1995 to 10000 in 1999. It added 355 points to the index in that span as the company's shares rose 232%. That made it one of the top five performers in the index by points added over that stretch, according to The Wall Street Journal's Market Data Group.

It would take a lot for GE to regain that level of influence on the index. These days, the Dow is ruled by Boeing Co., whose 77% rise from Dow 20000 to 25000 has made it the most expensive stock in the benchmark. Boeing contributed 888 points over that span. Its price, at $296.67, is more than 15 times that of GE.

Electrifying the Dow

General Electric shares haven't always supported the index's rise.

Source: FactSet

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THE WALL STREET JOURNAL.
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U.S. News: Jobless Claims Rise, But Stay at Low Level

By Sarah Chaney
284 words
5 January 2018
The Wall Street Journal
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WASHINGTON -- The number of people in the U.S. filing applications for new unemployment benefits rose last week, but remained at a level consistent with steady job gains.

Initial jobless claims, a proxy for layoffs across the U.S., rose by 3,000 to a seasonally adjusted 250,000 in the week ended Dec. 30, the Labor Department said Thursday.

Claims have remained historically low, showing the overall health of the labor market. Claims numbers have remained below 300,000 a week for nearly three years. The number of claims that workers made for longer than a week declined by 37,000 to 1,914,000 in the week ended Dec. 23, which is reported along with last week's data because continuing claims are released with a one-week lag.

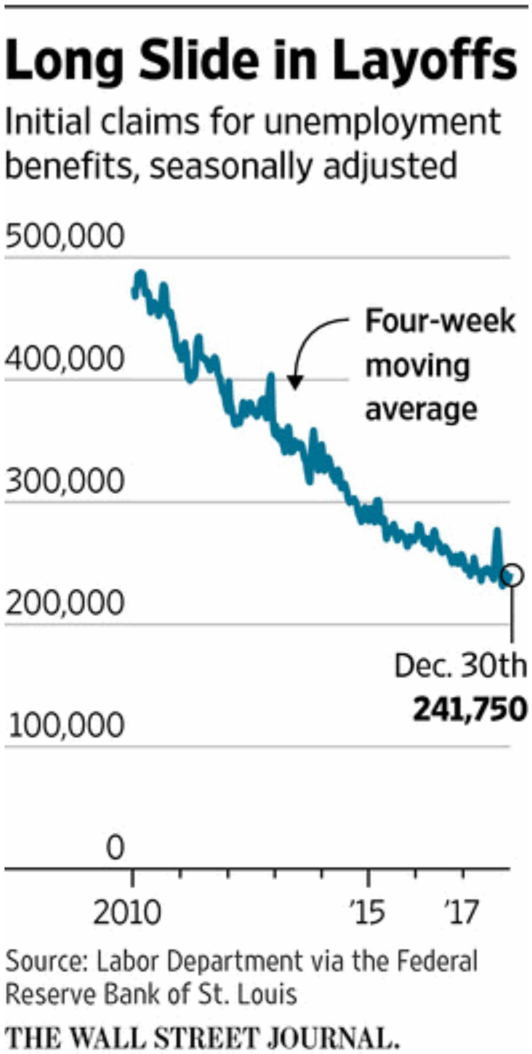
Jobless-claims data can be **volatile**, and seasonal adjustments tend to be especially tricky around holidays; Dec. 25 was Christmas Day.

The four-week moving average, a steadier measure, rose by 3,500 to 241,750 last week.

After spiking in the wake of several late-summer hurricanes, claims have settled down. Still, the effects of Hurricanes Irma and Maria are still being felt in some areas.

The Labor Department on Thursday said that "claims-taking procedures continue to be disrupted in the Virgin Islands. The claims-taking process in Puerto Rico has still not returned to normal."

The Labor Department will release data on December employment figures Friday, and economists surveyed by The Wall Street Journal expect that the unemployment rate held steady at 4.1%, a 17-year low.



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THE WALL STREET JOURNAL.
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Many Investors Bailed Out Early

By Akane Otani and Chris Dieterich
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5 January 2018
The Wall Street Journal
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One of the biggest surprises of the U.S. **stock market**'s relentless rally is how many individual investors have run away from it.

The **Dow Jones Industrial Average** closed above 25000 for the first time on Thursday, punctuating a record-setting period nearly unmatched in U.S. history. Yet throughout the nearly nine-year surge in share prices, small investors have continued to yank money out of funds that own U.S. stocks.

Nearly $1 trillion has been pulled from retail-investor mutual funds that target U.S. stocks since the start of 2012, according to EPFR Global, a fund-tracking firm.

Over that same period, the **S&P 500** soared 116% and, along with the Dow Industrials and **Nasdaq Composite** Index, rose to 191 all-time highs.

Much of those outflows likely made their way back into the **stock market** through lower-cost exchange-traded funds. The EPFR Global figure excludes flows to ETFs and institutional mutual fund shares, and the firm estimates that perhaps as much as 40% of the mutual fund stock outflows were recycled into stocks through ETFs.

Even so, U.S. stock funds in aggregate have suffered outflows in each of the past three years, according to trade group Investment Company Institute, a sign of growing skepticism about the **stock market**'s steep climb.

Nancy Langwiser-Kear, 60, of Wellesley, Mass., said the booming rally has made the **stock market** less attractive. She has been selling U.S. shares.

"This market over the past year has been a mix of hope and fantasy," she said. "There's no reason to be hanging out in stocks at the end of the **bull market**."

The **S&P 500**'s 0.4% rise Thursday put the broader index over the top for its own milestone, making it the greatest **bull market** run by the index in the post-World War II era. The S&P has notched a more than 300% gain since the market surge began in March 2009, surpassing the tech-fueled-rally of the 1990s, according to the research firm Leuthold Group, which excluded dividends from its calculations.

Rather than celebrating this wealth-generating machine, some individual investors have made clear in multiple surveys just how little enthusiasm they have for this market.

For years, analysts have described an "unloved" or even "hated" stock rally, where prices defiantly rise despite one of the weakest U.S. economic recoveries on record, Washington's policy sclerosis and geopolitical flashpoints, from the Greek debt crisis and Brexit to North Korea's nuclear threat.

"It is the most disliked **bull market** of my career," said John Fox, chief investment officer at Fenimore Asset Management. "No one is excited. This is not like 1999 and 2000, where you went to a bar and CNBC was on TV."

Survey data indicate that American stock ownership is retreating.

Sixty-two percent of Americans reported owning equities, on average, between the fall of the dot-com bubble and the onset of the global financial crisis, between 2001 and 2008, according to a Gallup survey from early 2017. That number shrunk to 54% during the current **bull market**, from 2009 to 2017.

Declining stock ownership was consistent across education level, employment status, gender, ethnicity and U.S. region, the Gallup poll found.

This mistrust of stocks has led many individual investors to seek safety in the bond market, despite rock-bottom interest rates and an even longer rally that in many ways looks more stretched than stock valuations.

More than $950 billion has moved into all bond mutual and exchange-traded funds since 2012, ICI said.

The Wall Street Journal polled more than 150 individual investors, of various ages and income levels across the U.S., about why they have avoided stocks.

Together, their responses paint a picture of how America's vaunted stockholding culture has waned -- not during a punishing selloff but amid one of the best periods ever to own shares.

Shawn Goodspeed, 33, said he dipped his toes into investing shortly after college. After taking advice from CNBC, he said he invested small sums in bank stocks in 2007 and 2008 -- and watched his small investment shrink during the ensuing crisis.

"It was a good learning experience," he said. "Now I'll invest only in things I understand."

Surveys show that stock ownership is down among middle-aged investors who still feel the aftershocks of **stock-market** collapses following the dot-com boom and during the financial crisis.

"So when the markets rebounded . . . there was a segment of the population that was very hesitant to get back in," said Steven Wagner, chief executive of advisory firm Omnia Family Wealth in Aventura, Fla.

"People are always shaped by their recent experiences, and much more so by the negative ones," he said.

As baby boomers near retirement age, many are paring back positions in riskier equity funds for more stable holdings such as bonds.

"I'm 10 years from retirement, so I'm being more cautious," said Jeffrey Lee Schantz, a 58-year-old architect in Boston, who has put what he considers to be his nest egg into "very conservative investments," including fixed-income funds.

Many younger Americans, who started accumulating income only after the housing bust and financial crisis, never developed an affinity for stocks.

"I've always been wary of losing my money on a badly timed purchase or sale of a stock, but now I'd rather not risk losing what little money I have on a misreading of the market," said Michelle Morley, a 26-year-old model.

Stocks are less part of the social fabric than during the 1990s bull run.

Discount online brokers such as E-Trade Financial Corp. and what is now TD Ameritrade Holding Corp. sprung up to meet booming demand of day traders who hoped to strike it rich on the next hot stock.

In one of the most extreme expressions of stock mania, doctors and other health professionals quit their jobs to day-trade full-time.

Today, discount brokers are thriving again after a long slump. But this time their business caters to registered investment advisers who trade primarily on behalf the affluent elite.

College students and other millennials, meanwhile, have found other ways to speculate than buying the latest tech stock.

Nate Reutiman, a 20-year-old Boston College student studying marketing and analytics, said he is more interested in cryptocurrencies. Last year, Mr. Reutiman and his roommates discussed contributing $1,000 each to install a mining rig, a system of computers built to find bitcoins, in their dormitory room.

For some Americans, their lack of interest in the **stock market** reflects a lack of disposable income, following a period of stagnant wages and mounting student debt that has more than doubled over the past decade.

"My money is spent servicing student loans," said Marcus Wallace, a 25-year-old waiter in Washington, D.C. Until that debt is reduced, he explained, the great **stock market** bull run will have to go on without him.

Funds and Other

Big Buyers Step Up

U.S. stocks have kept climbing even as many individual investors have stayed away, thanks to robust demand from other types of big buyers.

Institutional investors have been steady participants throughout the rally, ensuring that many individuals could at least partake in the market's big gains through retirement accounts. Many state-owned government funds have tilted toward U.S. stocks, and more recently foreign investors turned from sellers to buyers of the U.S. market.

The most dedicated buyer of U.S. shares has been the companies themselves. Stock buybacks started ramping up in 2009, hitting a record of $572 billion in 2015, according to S&P Dow Jones Indices. With the new tax law cutting the corporate rate to 21% from 35%, analysts expect companies will use at least some of that cash to buy back more of their own shares.

-- Akane Otani and Chris Dieterich

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THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Dow Industrials Have What Investors Want

By Justin Lahart
293 words
5 January 2018
The Wall Street Journal
J
B1
English

[Financial Analysis and Commentary]

Say what you will about the **Dow Jones Industrial Average** passing another round number; it has been the place to put your money.

The Dow reached yet another milestone Thursday, crossing 25000 a bit more than a month after it breached 24000. Numbers with lots of zeros aside, the Dow has done very well lately, with a total return of 27% since the end of 2016, versus 24% for the **S&P 500**. And that has less to do with the quirk of how the Dow is constructed than what is in it.

The Dow is an odd bird, weighted by share prices rather than the **stock-market** values of the companies in it. So moves in Boeing Co. count about eight times as much as moves in Pfizer Inc., even though Pfizer is worth more. Boeing has been the Dow's best performer lately, nearly doubling over the past year, so that matters.

But the median stock in the Dow also has done well, matching the index's overall return of 27% since the end of 2016, while the median stock in the **S&P 500** returned 20%. One reason for that is that companies in the Dow are bigger than most **S&P 500** stocks, and far more exposed to the strong global economy. Another reason is that the Dow is tilted toward growth and growth has been in favor.

These advantages are a function of design. Among the factors considered by the committee that picks stocks for the Dow is whether a company has demonstrated sustained growth. For the moment, at least, the Dow is exactly what investors want.

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The New York Times

COMMON SENSE
National Desk; SECTA
The Dow Hits 25,000: The Party Will End One Day, but When?

By JAMES B. STEWART
1,524 words
5 January 2018
The New York Times
NYTF
Late Edition - Final
1
English

In the midst of a long-running **bull market** that is now reaching momentous proportions, most investors may well have forgotten that just two years ago, during the first five trading days of 2016, the market dropped 6 percent. It was the worst five-day start to a year ever and supposedly a harbinger of bad times.

We know where that ended. Spurred by Donald Trump's election that November, market indexes surged to record levels and went far higher this year. The **Standard & Poor's 500-stockindex** gained 19 percent in 2017, the **Dow Jonesindustrial average** rose 25 percent, and the technology-heavy **Nasdaq composite** leapt 28 percent.

There wasn't a single day last year when the **S.&P. 500** fluctuated more than 2 percent, a level of low **volatility** unseen since the mid-1960s, according to James Stack, a market historian and president of InvesTech Research.

In a rare convergence, investor euphoria spread across the globe. A measure of market performance, the MSCI All Country World Index, gained 22.7 percent last year, closing at a record high. And so far this year, stocks have continued their advance. On Thursday, the Dow broke the 25,000 barrier for the first time, and technology stocks are soaring to new highs. Cryptocurrencies like Bitcoin are adding a whiff of bubblelike mania.

And that may not be such good news for investors.

''If there are any certainties, one will be that this party will eventually come to an end,'' Mr. Stack said. ''A correction would be healthy. The longer we go without one, the greater the risk this will end badly. A lot of people will get hurt. And when it ends, it will end badly, and with high **volatility**.''

That doesn't mean the end is imminent, according to Mr. Stack and other investment managers and market experts I interviewed this week. All of them successfully navigated markets last year, when the greatest risk was being underinvested.

''Everybody thinks the market is overvalued,'' said Jerome L. Dodson, the founder and president of Parnassus Investments. ''So do I. I'm expecting a correction, but I was expecting one after Trump was elected. I was wrong. The market can keep going up even when it's overvalued.''

Mr. Dodson didn't move into cash last year, and his Parnassus Endeavor Fund, where he's the portfolio manager, gained nearly 20 percent last year and is ranked by Morningstar as the No. 1 fund in its category (large-cap growth) over three-, five- and 10-year periods.

''Most seasoned investors realize this market is overvalued and overbought and it's been a long time since a normal correction,'' Mr. Stack said. ''They're nervous.'' Nonetheless, he said he was 82 percent invested in stocks, with 18 percent in cash, only slightly more than usual. He said he had learned from decades of market experience that ''overvaluation isn't what causes bear markets -- it never has and never will.''

In addition, he said, ''there's going to be tremendous political pressure to keep the party going,'' especially since Mr. Trump has so often cited the **bull market** as evidence of the success of his presidency.

So what should investors do?

It's probably no surprise that Burton G. Malkiel, the renowned emeritus professor of economics at Princeton and author of the 1973 classic "A Random Walk Down Wall Street: The Time-Tested Strategy for Successful Investing," recommends that investors "stay the course."

"If the sharp rise in the **stock market** in 2017 has unbalanced your portfolio with a higher proportion of equities than is consistent with your risk tolerance, then you could do some rebalancing by trimming the equities down to the proportion at which you are comfortable," Mr. Malkiel said. "But do not try to time the market. Nobody can consistently time the market, and those who try it usually fail."

Although Mr. Malkiel is a longtime champion of passive, low-cost index investing, a strategy that has worked well since the financial crisis, last year he endorsed an "advanced indexing" approach at the automated investment manager Wealthfront, where he is chief investment adviser. Wealthfront aims to outperform strictly passive investing, and its taxable portfolio returned 20.56 percent last year, which indeed beat its benchmark.

Mr. Dodson is an active manager who focuses on stock selection. "I've never had a good record at market timing," he said. "I look for stocks that are undervalued, but I'm having terrible trouble finding anything that's reasonably priced."

Technology stocks in general "are way overvalued," he said. He has cut back on his fund's large positions in Micron Technologies, Apple and Applied Materials after they notched big gains. With benefit of hindsight, he wouldn't have sold them, "but someone once asked Bernard Baruch how he became so rich," Mr. Dodson said. "'I made my money by selling too soon,'" the famed financier replied.

Still, there are "a few" undervalued opportunities, Mr. Dodson said. He cited the health care sector: The biotech concern Gilead Sciences and the generic-drug maker Perrigo are two of his fund's largest holdings. The toymaker Mattel "is on the bargain table," he said. And even in technology, his fund has a large position in Qualcomm, currently fighting a takeover bid by the rival chip-maker Broadcom.

If so much is indeed overvalued, then this year's market could well reward discerning active managers. "I worry about the index funds," Mr. Dodson said. "They're getting close to 25 percent in technology, given the high valuations and market caps. If there's a reversal, it's going to hit the index funds hard. This may finally be the year that active managers outperform."

Mr. Stack agreed. "Active management isn't about beating the market but about achieving market gains within a defined acceptance of risk," he said. "There are selective opportunities, but you have to dig to find them. None are true bargains anymore."

He recently bought shares in the diversified industrial manufacturer Ingersoll Rand and is moving his portfolio toward more defensive positions in consumer staples, energy and materials. "I'd rather be early with portfolio defenses and leave some profits on the table than go into a **bear market** fully exposed," he said.

Mr. Stack said that in examining bull markets over the past 50 years, he had found that both the technology and energy sectors outperformed in the late stages of a **bull market**. He said investors "should have some portion of their portfolio in the materials sector, notably energy, which had been so out of favor" until mid-2017.

In my outlook column last year, Damien Courvalin, head of energy research for Goldman Sachs's Global Investment Research commodities team, was uncannily accurate in forecasting that **oil prices** would recover in 2017 and stabilize at $55 to $60 per barrel. (West Texas intermediate crude oil futures ended the year at $60.42.) So I asked him what his team was predicting this year.

"From a total-return perspective, it's quite compelling to be invested in commodities," he said -- even though he doesn't see **oil prices** rising much above current levels by year's end. That's because, thanks to the shale oil revolution, producers outside the Organization of the Petroleum Exporting Countries can easily ramp up production when prices are $60 to $65. But commodities investors can still make a profit, he said, by betting on stable to rising prices in the futures market.

Like Mr. Stack, Mr. Courvalin noted that commodities and energy typically do well in the late stages of an economic expansion. Non-energy commodities may do even better, since they have no equivalent to shale and mining companies can't increase production quickly in response to rising prices. In the mining sector, "margins are improving, orders are picking up, and we're seeing new investment," he said.

It may seem a paradox that investors' worries about the coming year are mounting even as the economic outlook seems so bright. "Investors are struggling with this market because the skies are blue," Mr. Stack said. "It's rare when you have an investing climate like this one, where it's all but impossible to find something to worry about, either domestically or globally.''

But that's true in the late stages of most bull markets, he said, meaning investors need to be alert. And while virtually no one can foresee the next catalyst for a correction or **bear market**, even a hint that the Federal Reserve might raise interest rates more than expected would most likely set off seismic tremors.

''Most bull markets die by the sword of the Fed,'' Mr. Stack said.

CHART: Continuing One of the Longest Bull Markets: At over 3,000 days and counting, this **bull market** has been one of the longest on record, as the current eight-year run trails only the boom from 1987 to 2000. (Sources: MacroTrends; Yardeni Research; Thomson Reuters) (A13)

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The New York Times

Business/Financial Desk; SECTB
Dow Jumps Another 1,000 in the Past 5 Weeks

By THE ASSOCIATED PRESS
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5 January 2018
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NYTF
Late Edition - Final
5
English

The **Dow Jonesindustrial average** burst through the 25,000-point mark Thursday, just five weeks after its first close above 24,000.

The Dow broke past 1,000-point barriers in 2017 on its way to a 25 percent gain for the year, as an eight-year rally since the Great Recession continued to confound skeptics.

Strong global economic growth and good prospects for higher company earnings have analysts predicting more gains.

The Dow has made a rapid trip from 24,000 points on November 30, partly on enthusiasm over passage of the Republican-backed tax package, which could boost company profits this year with across-the-board cuts to corporate taxes.

''For a long while in 2017 I would say the biggest driver was excitement and anticipation over tax reform, but at a certain point I think there was a handover to global economic growth really helping to carry the **stock market**,'' said Invesco Chief Global Markets Strategist Kristina Hooper.

Big gains for American blue chip companies have powered the Dow's relentless rise to new heights over the past year, including an 87 percent gain for aerospace giant Boeing, a 70 percent rise for construction equipment maker Caterpillar and a 49 percent increase for Apple.

The Dow has nearly quadrupled in value from its low during the financial crisis in early 2009. But the global economy and spending by people and businesses and governments were much slower to recover than stocks were.

''Instead of fiscal stimulus, we relied on monetary policy stimulus, which inflates asset prices as opposed to the overall economy,'' Hooper said. Stocks have continued to climb as investors saw signs economic growth was finally improving.

Technology companies, which put up some of the biggest gains in the last year, continued to lead the market higher Thursday. Microsoft, JPMorgan Chase and Wells Fargo posted solid gains in late-morning trading. And there was more good economic news Thursday: A report showed private businesses in the United States added 250,000 jobs last month, with smaller businesses adding 94,000. That boosted interest rates and sent banks higher.

The Dow rose 152.45 points, or 0.6 percent, to 25,075.13. The Dow and the other major indexes in the United States all set record highs a day earlier.

The **Standard & Poor's 500**-**stockindex**, a much broader index which professional investors prefer to use as their benchmark for large United States stocks, rose 10.93 points, or 0.4 percent, to 2,723.99. The **Nasdaq composite** added 12.38 points, or 0.2 percent, to 7,077.92.

Bond prices sank, sending yields higher. The yield on the **10**-**year Treasury** note rose to 2.45 percent from 2.44 percent.

President Trump said Thursday that the Dow could reach 30,000, which would take another 20 percent jump. Few on Wall Street expect stocks to climb that much any time soon.

For this year, the more optimistic predictions are for a gain about half that big: Strategists at Credit Suisse, for example, see the **S**.**&P**. **500** ending the year at 3,000, which would amount to a roughly 10 percent gain. At the Wells Fargo Investment Institute, they are expecting just a 2.8 percent gain for the index.

One reason for the more muted expectations is how far stocks have come in recent years. Stock prices have been rising more quickly than earnings. Last year, for example, the **S**.**&P**. **500** jumped 19.4 percent. Earnings per share for the companies in the index, though, rose about 10 percent, according to S&P Global Market Intelligence.

Benchmark United States crude rose 38 cents to $62.01 a barrel in New York.

Gold rose $3.20 to $1,319.40 an ounce.

The dollar rose to 112.74 yen from 112.52 yen. The euro climbed to $1.2072 from $1.2018.

CHART: The **S**.**&P**. **500 Index**: Position of the **S**.**& P**. **500 index** at 1-minute intervals on Thursday. (Source: Reuters)

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The New York Times

Business/Financial Desk; SECT
Dow Closes Above 25,000 as 2-Year Rally Rolls On

By MICHAEL J. de la MERCED
236 words
5 January 2018
The New York Times
NYTF
The New York Times on the Web
English

The **Dow Jonesindustrial average** on Thursday closed above 25,000 points for the first time, setting a record for the 132-year-old index.

The Dow, which broke though the 25,000 barrier shortly after trading opened in the morning, ended the day 152 points higher, at 25, 075.13, a gain of 0.6 percent.

The other major stock indexes also gained. The **Standard & Poor's 500-stockindex**, a much broader index, closed at 2,723.99, a gain of 10.93 points or 0.4 percent. The **Nasdaq composite** rose 12.38 to 7,077.91, a gain of 0.2 percent.

The Dow's climb continues an ascent that began in early 2016. Other major indexes have also reached all-time highs in recent days, including the **Standard & Poor's 500-stockindex** and the **Nasdaq composite**.

Underpinning much of the growth is a belief that corporate America will enjoy economic tailwinds in 2018, including benefits from the recently passed Republican tax overhaul. In the December round of economic projections, the median forecast of Federal Reserve officials was that the United States economy would grow 2.5 percent this year, up from a previous estimate of 2.1 percent.

Follow Michael J. de la Merced on Twitter: @m_delamerced.

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U.S. EDITION

U.S. Reveals Oil Drilling Plan for Nation's Coasts

By Timothy Puko and Lynn Cook
1,125 words
5 January 2018
The Wall Street Journal
J
A1
English

WASHINGTON -- The Trump administration on Thursday proposed opening up nearly all the country's offshore areas for oil and gas drilling, a move that would touch every coastal state, some that have been off limits to drillers for decades.

Under the plan announced by Interior Secretary Ryan Zinke, the government would offer for sale the largest number of oil and gas leases in U.S. history starting late next year.

It would open up 90% of offshore areas for drilling as part of a five-year plan, reversing an Obama-era plan that would have kept only 6% of the same acres available for drilling.

The move, facing fierce opposition from some coastal-state lawmakers and environmental groups, is one of a number of steps the Trump administration is taking to bolster U.S. fossil-fuel production despite a global glut and declining investment. Administration officials say the moves will help U.S. companies, arguing that a rollback of government restrictions could help the country's energy companies grow.

U.S. oil, gas and coal producers have started exporting more fuel abroad. The administration's philosophy is that any government effort to cut regulatory costs can help U.S. energy companies better compete against global rivals.

Last spring, President Donald Trump issued an executive order for the Interior Department to encourage more domestic energy production, leading to Thursday's proposal. The department also proposed recently to reverse drilling-safety rules implemented after the 2010 Deepwater Horizon accident, which killed 11 workers on the drilling rig and spilled more than 200 million gallons of oil into the Gulf of Mexico.

"We're going to become the strongest energy superpower," Mr. Zinke said Thursday. "We certainly have the assets to do that."

As drafted, the plan would be a stark break from years of restrictions on drilling off the coast of most of the contiguous states. The modern environmental movement took hold in part after an offshore oil spill near Santa Barbara, Calif., in the late 1960s. The Obama administration placed more offshore restrictions after the Deepwater Horizon spill. The U.S. government hasn't sold leases for oil drilling off of the Atlantic and Pacific coasts in more than 33 years.

Oil-industry groups and their supporters who want more access to domestic oil lands are cheering the move.

"Expanding access to additional offshore reserves allows the United States to better understand where production potential exists and where capital should be invested," Dan Naatz, senior vice president of government relations and political affairs at the Independent Petroleum Association of America said in a statement. "Today's proposal is exactly the signal industry needs to drive this work forward."

The plan is meeting broad opposition, including from environmental groups and some Republicans. Florida's Sen. Marco Rubio and Gov. Rick Scott both said Thursday they opposed drilling in the waters off of their state. Opponents fear a threat to economic activity, including tourism.

"It's absolutely radical," said Diane Hoskins, climate and energy campaign director at Oceana, an environmental group focused on the world's oceans. "Expanding offshore drilling threatens the livelihood and the coastal economies that rely on a healthy ocean."

Mr. Zinke pledged to work with states and other stakeholders, saying the plan isn't final. The department is planning meetings around the country starting in less than two weeks, with the intent of taking public comments and finalizing the plan by the autumn of 2019. It would be in effect for five years, into 2024.

The administration has said it planned to move quickly, but the type of details, environmental reviews and public comment required to update such a plan makes many skeptical it can meet that timeline. Some experts think it could take more than two years to finish and implement the plan, especially if environmental groups or states file lawsuits. Top officials from several states besides Florida are vowing to stop the plan.

In a statement, the Democratic governors of California, Oregon and Washington pledged to do "whatever it takes" to stop the move.

The final plan will likely be winnowed down, but the industry's top priorities are the eastern Gulf of Mexico, the Atlantic coast from Virginia to Georgia, and Alaska, said Erik Milito of the American Petroleum Institute, a trade association.

Market conditions may impede the administration's efforts, too. The push for more drilling on federal lands -- including lease sales Congress approved last month for the Arctic National Wildlife Refuge -- come at a time when oil companies have made dramatic cutbacks. Energy consultancy Wood Mackenzie's new forecast for 2018 released Thursday predicts another decline in global exploration spending to $37 billion, down by more than 60% from its 2014 peak.

The industry is still recovering from a world-wide glut that has slashed prices since 2014. Technical advances such as fracking caused U.S. output to skyrocket from onshore formations, making producers less interested in drilling in Alaska and offshore, the very types of places new U.S. policy would put up for leasing.

Some big global oil companies -- especially Royal Dutch Shell PLC -- made major bids on drilling areas off Alaska and Nova Scotia over the past decade. But that activity has slowed in recent years. A lease sale in Alaska last month received only $1.2 million from seven bids on less than 1% of the land offered.

Shell scrapped its $7 billion Arctic campaign in 2012 after a disappointing well.

The Trump administration already has offered up more acreage in the Gulf of Mexico that operators aren't leasing, said Imran Khan, a senior analyst with the energy consultancy Wood Mackenzie. Pushing farther into undeveloped areas isn't as simple as having a high enough **oil prices** to justify new exploration, he added.

"The administration is trying to give a signal to the market that it's making things easier," he said. "But in terms of actual investment and getting operators to actually make it work, it will be awhile."

David Demarest, a spokesman for Visit South Walton, a development council that promotes travel to the Florida Panhandle, said fossil-fuel development was a threat to the coastline of Florida, where some of the only white-sand beaches in the U.S. draw millions of tourists each year.

"It's a very real concern for those of us who were here during the Deepwater Horizon spill. That was a long ways away from us, but it still almost got us," Mr. Demarest said, adding that just the threat of oil reaching Florida beaches hurt the state's tourism that summer.

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THE WALL STREET JOURNAL.
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REVIEW & OUTLOOK (Editorial)
Trump and Dow 25000

408 words
5 January 2018
The Wall Street Journal
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A14
English

The **Dow Jones Industrial Average** leapt above 25000 for the first time on Thursday, and naturally the White House sent out a press release taking credit. President Trump's pro-growth policies are partly responsible for the market's extraordinary bull run, but he is still making a mistake to hang his economic credentials on stock prices.

As Mr. Trump likes to say, equity prices have climbed nearly 40% since Election Day in 2016. Investors have stayed **bullish** as growth has increased around the world, inflation has remained contained despite accommodating central bank policy, and the Trump deregulatory and tax agenda has taken shape.

The cut in corporate tax rates will increase earnings, which will flow into equity values in addition to higher wages. The market's run since the tax bill passed may also reflect that many investors doubted it would pass, or that they doubted the final version would have the pro-growth qualities that economist Robert Barro describes nearby. In that sense Dow 25000 is a harbinger of faster growth.

Yet it still makes no sense for a President, especially one in his first year, to tee up stocks as a measure of economic success. As Wall Street legend Ace Greenberg famously put it amid the 1987 market crash, "stocks fluctuate, next question." The current lengthy period without a major correction is highly unusual -- and it won't last. When prices fall after Mr. Trump's many boasts about their rise, the press corps will ask him to explain the correction at every opportunity. Presidents do not want to become **stock-market** analysts.

All the more so because no one knows how the unwinding of the Federal Reserve's unprecedented balance sheet will affect stock and other asset prices. The Fed's bond-buying was explicitly intended to buoy asset prices including stocks, and it did. But will asset prices be under greater pressure as the Fed begins to move in reverse with more dispatch this year? Somehow we don't see Mr. Trump offering an extended financial analysis of the asset-price impact of quantitative easing.

Mr. Trump can certainly tout the benefits of faster economic growth. Those will be manifest in ways that affect all Americans -- more jobs and job mobility, higher wages -- not only those who own stocks or have 401(k)s. Stock prices will take care of themselves.

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THE WALL STREET JOURNAL.
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U.S. News -- Capital Account: Hedge-Fund Titan Puts Away the Punch Bowl

By Greg Ip
826 words
4 January 2018
The Wall Street Journal
J
A2
English

The U.S. economy and **stock market** have just turned in their best performance in years, so it seems like buzzkill to hand the microphone to someone who thinks the path ahead could be much bleaker.

Still, when it's Ray Dalio, founder of hedge-fund manager Bridgewater Associates LP, it's worth listening. That's not so much because of Bridgewater's size and success but because Mr. Dalio looks at the world through a unique prism.

That prism explains how his firm managed to anticipate and profit from the 2008 crisis. While he doesn't see another crisis in the offing, he does see the same underlying stresses: Americans have accumulated far more debt than they have assets and income to support.

Not only will this drag on growth and markets, it will leave the economy acutely vulnerable to higher interest rates. The relevant parallel, he says, is not the early 1930s, when the economy imploded, but the late 1930s when the Federal Reserve tightened monetary policy and extended the Great Depression. Today, the central bank must balance the short-term need for higher interest rates to contain inflation against the long-term need for low rates to work off the debt overhang and sustain high asset prices.

"It becomes more and more difficult to balance those things as time goes on," Mr. Dalio said at his Westport, Conn., office in November. "It may not be a problem in the next year or two, but the risk of not getting it right increases with time."

"We 'finance people' see the world very differently from the way economists do," he writes in his book "Principles," published last fall. The views of finance people tend to be shaped more by trading experience than by formal economics. They assign much more weight to financial factors such as debt, asset prices and cash flow than do economists who emphasize "real economy" factors such as employment and investment. Finance people are wary of how macroeconomic data obscures crucial details of individual companies and households.

One of Mr. Dalio's first big, correct calls was that when the Fed jacked up rates in 1981 to slay inflation, it would trigger a crisis; the next year Mexico's default touched off Latin America's lost decade. Then came a very wrong call: that a depression would follow. Instead, the Fed slashed interest rates and sparked a spectacular recovery.

Such experiences drove Mr. Dalio to comb through economic and financial history in search of "timeless and universal" principles.

As he sees it, since the 1970s, inflation-adjusted interest rates have steadily declined while investors have accepted lower compensation for risks such as bankruptcy, recession and **volatility** (i.e. the "risk premium" has declined). This directly raises asset values and indirectly lifts growth by spurring borrowing. His team estimates this has contributed 3 percentage points a year to stock returns since the 1970s while boosting private and government debt to 325% of gross domestic product.

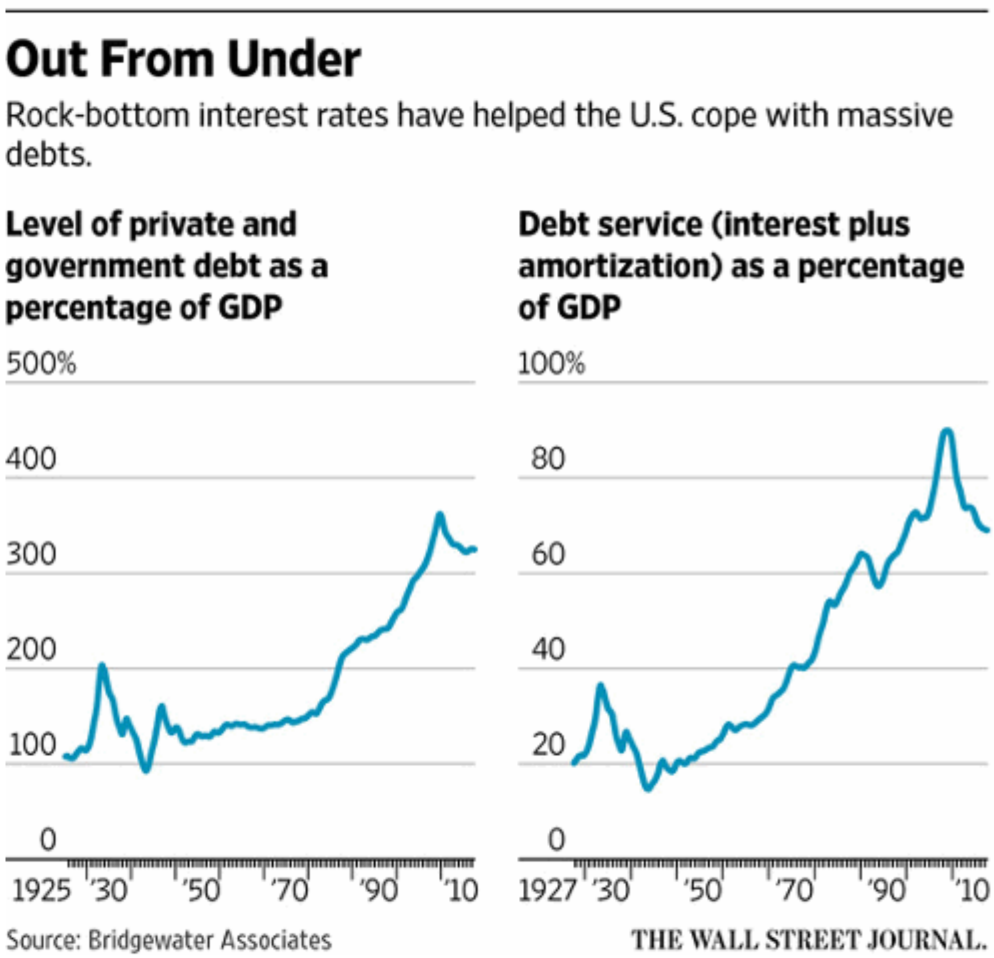
In 2007, Mr. Dalio's team concluded that the cost of servicing Americans' debts was growing faster than their cash flows, creating the conditions for a crisis.

He doesn't blame the Fed for this. In fact, he praises it for understanding exactly what was needed when it burst: By slashing short-term interest rates to zero and buying bonds, it engineered the right combination of economic growth, debt write-offs and low interest rates.

The problem is that with interest rates and risk premia near all-time lows and debt and asset values near all-time highs, there's little fuel to repeat the process. Just as the Fed can't cut rates much, it can't raise them much either, or debt servicing would swamp cash flow and asset prices would sink. Thus Mr. Dalio sees years of low interest rates, and while he thinks stocks are fairly valued, returns to a typical stock-bond portfolio over the next decade will be around zero after inflation and taxes.

When Mr. Dalio speaks, how closely should you listen? Since Bridgewater detailed this thesis in 2016, events haven't exactly followed the script. Last year, the **S&P 500** returned 22% (including dividends); Bridgewater's diversified fund returned about 12%. Mr. Dalio says the promise of less regulation and lower taxes have elevated stock valuations. But that doesn't translate into higher long-term growth or sustained returns, he says.

In fact, his biggest worry is that lower corporate taxes and higher stock prices do nothing for the bottom 60% of households who own almost no assets and whose stagnant wages are the mirror image of expanding profit margins, feeding resentment and political polarization. Says Mr. Dalio: "If we do have an economic downturn, I worry we will be at each other's throats."



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The New York Times

STOCKS & BONDS
Business/Financial Desk; SECTB

Energy and Tech Gains Keep Indexes Rising

By THE ASSOCIATED PRESS
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4 January 2018
The New York Times
NYTF
Late Edition - Final
3
English

Big gains for technology and health care companies helped U.S. stocks set records again Wednesday. Rising crude and heating **oil prices** also sent energy companies higher.

Chipmakers including Nvidia and Advanced Micro Devices made big gains while Intel skidded following news that its processors have a security flaw that could slow down computers. Energy company Scana, which plunged after it canceled a $9 billion nuclear project and started raising rates to cover its costs, jumped after Dominion Energy agreed to buy it for $7.9 billion in stock.

Energy companies jumped for the second day in a row as **oil prices**, already at two-and-a-half-year highs, rose again. One reason is that after a pipeline bombing in Libya last month and ongoing anti-government protests in Iran, investors are concerned that oil supplies will get interrupted.

"Something that's coming back into the market which we've been missing over the last few years is this geopolitical risk premium," said Nick Koutsoftas, portfolio manager at Cohen & Steers. Investors didn't worry that much about those risks in recent years because big stockpiles of oil had built up. Those stockpiles are shrinking now, which has helped **oil prices** but also made them more vulnerable to surprises.

The **Standard & Poor**'**s500 index** rose 17.25 points, or 0.6 percent, to 2,713.06. The **Dow Jonesindustrial average** added 98.67 points, or 0.4 percent, to 24,922.68. The **Nasdaq composite** climbed 58.63 points, or 0.8 percent, to 7,065.53. The Russell 2000 index of smaller-company stocks gained 2.56 points, or 0.2 percent, 1,552.58. All four finished at record highs.

Benchmark U.S. crude added $1.26, or 2.1 percent, to $61.63 a barrel in New York. Brent crude, used to price international oils, picked up $1.27, or 1.8 percent, to $67.84 a barrel in London.

Heating oil and natural gas prices have also climbed as severe cold gripped much of the U.S. Heating oil rose 3 cents to $2.09 a gallon, and it's up 12 cents since Dec. 22. Natural gas slid 5 cents to $3.01 per 1,000 cubic feet, and it's up 34 cents over that time.

In other commodities trading, wholesale gasoline added 3 cents to $1.80 a gallon.

Technology companies rose further. Chipmaker Nvidia gained $13.12, or 6.6 percent, to $212.47. Alphabet, Google's parent company, climbed $18.31, or 1.7 percent, to $1,091.52. IBM added $4.24, or 2.7 percent, to $158.49.

Intel slumped after British technology site The Register reported a security problem that affects Intel's processors, and said fixing the problem could slow down computers that use them. Intel said it's working to patch the problem and the average computer user won't experience a significant slowdown as the flaw is fixed. It also said the problem is not limited to its products.

Its stock lost $1.59, or 3.4 percent, to $45.26 in the highest trading volume in more than four years. Other chipmakers traded higher, but analysts weren't sure the problem could threaten Intel's sales

Dominion Energy agreed to buy Scana in a deal that expands the Richmond, Virginia-based company's business in the Carolinas. Dominion Energy is valuing the deal at about $7.9 billion plus $6.7 billion in debt. Scana soared $8.78, or 22.6 percent, to $47.65 and Dominion dropped $3.09, or 3.8 percent, to $77.19.

Scana traded above $70 a share in June but plunged after Scana and partner Santee Cooper said they were abandoning construction of two nuclear reactors. They blamed the project failure on the bankruptcy of contractor Westinghouse. The end of the project and Scana's rate hikes led to harsh criticism and multiple government investigations, and the heads of both Scana and Santee Cooper both stepped down.

Money transfer company MoneyGram International plunged $1.20, or 9 percent, to $12.11 after U.S. regulators blocked the sale of the company to Ant Financial Services Group. It's not clear why the $1.2 billion deal was rejected by the Committee on Foreign Investment in the United States, which reviews proposed foreign acquisitions of U.S. companies on national security grounds. Ant Financial is linked to Alibaba and its chairman, Jack Ma.

Consumer products company Spectrum Brands said it will try to sell its batteries and appliances businesses. Spectrum, which makes Rayovac and Kwikset, wants to concentrate on its other divisions: hardware and home improvement, global auto care, global pet supplies and home and garden. The stock climbed $9.58, or 8.8 percent, to $118.94.

Bond prices rose after a sharp drop the day before. The yield on the **10**-**year Treasury** note fell to 2.45 percent from 2.46 percent.

Gold inched up $2.40 to $1,318.50 an ounce. Silver added 6 cents to $17.27 an ounce. Copper slipped 2 cents to $3.26 a pound.

The dollar rose to 112.52 yen from 112.27 yen. The euro dipped to $1.2018 from $1.2055.

Germany's DAX added 0.8 percent and so did the French CAC 40. In Britain the FTSE 100 rose 0.3 percent. Hong Kong's Hang Seng index picked up 0.1 percent and South Korea's Kospi added 0.3 percent. Markets in Japan were closed for New Year holidays but reopen on Thursday.

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This is a more complete version of the story than the one that appeared in print.

CHARTS: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Wednesday. (Source: Reuters); Construction Spending: Total construction spending at a seasonally adjusted annual rate. (Source: Commerce Department)

Document NYTF000020180104ee1400053

The New York Times

Business/Financial Desk; SECTB
Fed to Raise Benchmark Rate in 2018, but It Lacks Consensus on Frequency

By BINYAMIN APPELBAUM
978 words
4 January 2018
The New York Times
NYTF
Late Edition - Final
2
English

WASHINGTON -- The Federal Reserve has entered 2018 without a clear plan for raising its benchmark interest rate and with the added uncertainty of an imminent change in its leadership.

An account of the Fed's final meeting of 2017, which the central bank published Wednesday, said officials generally agreed that the Fed should continue to raise its benchmark rate in the new year. But Fed officials expressed a range of views about the frequency of future hikes.

Six of the 16 officials on the Federal Open Market Committee predicted during the December meeting that the Fed would raise rates three times in 2018. But six officials predicted two hikes or fewer and four officials predicted the Fed would raise rates at least four times.

The decision about how often to raise rates will be made under new management. The Fed's chairwoman, Janet L. Yellen, plans to leave the Fed in early February; her nominated successor, the Fed governor Jerome H. Powell, is awaiting a Senate confirmation vote.

Last year was the first since the 2008 financial crisis that the Fed articulated a clear plan for monetary policy and stuck with it. The central bank said it would raise rates three times and did exactly that, with the third hike coming in December.

The decision at that meeting to raise the benchmark rate into a range between 1.25 percent and 1.5 percent reflected the Fed's optimistic expectations for the economy, the account said.

''Participants saw the outlook for economic activity as having remained strong or having strengthened since their previous meeting, in part reflecting a modest boost from the expected passage of the tax legislation,'' said the account, which was released after a standard three-week delay.

Officials saw few serious dangers on the horizon, the account said. Most expected inflation to rebound from a long period of sluggishness and were not overly concerned about rising asset values. The **S**.**&P**. **500 stock index** has climbed 19 percent over the last year.

The Fed also predicted there would be a modest economic boost from the tax cuts President Trump that signed into law at the end of the year. The account said that many officials predicted increases in both consumer and business spending, although they expressed uncertainty about the magnitude.

In the December round of economic projections, the median forecast of Fed officials was that the economy would grow 2.5 percent in 2018, up from a median forecast of 2.1 percent in September. The tax cut was the primary reason for the higher estimate, Ms. Yellen said at a news conference.

The estimate reflected the view of Fed officials that the benefits of the $1.5 trillion tax cut will be attenuated by higher interest rates, as the federal government seeks to borrow more money.

The account also said that some firms were likely to give the windfall to investors or use the money to pay down debts rather than making the types of investments likely to expand the economy.

The internal debate about how quickly to raise rates revolves around the pace of inflation. Last year was the sixth straight year the Fed fell short of its 2 percent inflation target.

"One thing is for certain and that is that inflation has become the most important economic variable steering the Fed's policy," wrote Chris Rupkey, chief financial economist at MUFG.

Some officials have sought to suspend rate hikes until inflation shows greater strength. Charles Evans, president of the Federal Reserve Bank of Chicago, voted against the December rate hike, and said in a post-meeting statement that the Fed needed to demonstrate a commitment to its target.

"I am concerned that too many observers have the impression that our 2 percent objective is a ceiling that we do not wish inflation to breach," Mr. Evans said in the statement.

Most Fed officials, however, expressed confidence that continued growth would increase inflation. That group includes the plurality of officials favoring three rates hikes next year.

It also includes the minority of officials who are concerned that the Fed may not be raising rates fast enough. They noted that the economy is growing more quickly, money remains easy to borrow and the supply of workers is dwindling -- factors that could fuel faster inflation.

One new item on the agenda at the December meeting: Concern about a technical indicator called the yield curve, which compares the interest rates on the different kinds of debt issued by the federal government, which borrows money for periods ranging from one month to 30 years.

In general, investors demand higher interest rates on longer-term loans, to compensate for greater uncertainty, but the difference between short-term rates and long-term rates on federal debt has been compressing. When short-term rates exceed long-term rates, the yield curve is said to be "inverted." Historically, that has often happened before a recession.

Neel Kashkari, the president of the Federal Reserve Bank of Minneapolis, voted against the December rate hike. He said in a post-meeting statement that the flattening of the yield curve indicated the Fed was moving too quickly. "In response to our rate hikes, the yield curve has flattened significantly, potentially signaling an increasing risk of a recession," Mr. Kashkari said.

The minutes said most Fed officials did not share Mr. Kashkari's concerns, judging instead "that the current degree of flatness of the yield curve was not unusual by historical standards," and that further flattening "would not necessarily foreshadow or cause an economic downturn."

Janet L. Yellen, the Federal Reserve chairwoman, speaking at a news conference after the Fed's two-day policy meeting in December. (PHOTOGRAPH BY ERIC THAYER FOR THE NEW YORK TIMES)

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THE WALL STREET JOURNAL.
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Some Venezuela Bondholders Hit Pay Dirt --- Those investors who braved the country's risky debt have been rewarded handsomely

By Julie Wernau
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4 January 2018
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B13
English

Venezuela's bonds have lost about three-quarters of their value, reflecting a dozen missed payments by the government and the state-owned oil company.

But many of their bondholders are still feeling flush.

A number of investors have made their money back and more, thanks to coupon payments topping 13% and large principal payments that typically begin three years before a bond matures.

A recent example includes bonds from state-oil company Petroleos de Venezuela SA, or PdVSA, which matured in November. An investor who purchased that debt at its low of 38.626 cents in February 2016 recovered that initial investment nine months later, according to Bulltick LLC, a Miami-based financial firm that specializes in Latin America.

When PdVSA made the final principal payment in November last year, a few days after it was due, investors who got in at the February low enjoyed a 181% return.

New York hedge fund Greylock Capital Management LLC turned a quick $60 million profit after snatching up bonds in August when prices dropped and correctly guessing PdVSA would find a way to pay investors in November when the bond matured.

A few longer-term investors like T. Rowe Price Group Inc. have also been rewarded. The firm's emerging-markets bond fund has beaten 83% of peers over a three-year period through Jan. 2, according to Morningstar Inc. data, aided in part by holding Venezuelan debt when others were lowering their exposure. Venezuela bonds accounted for 3.6% of T. Rowe Price's emerging-markets bond fund's assets at the end of November, more than two times the country's weighting in the industry benchmark index.

Many emerging-market investors won't get near Venezuela. Some have avoided the country since a collapse in the price of oil, the country's main export, strained the government's finances. Since then, many investors have believed that a Venezuelan default was only a matter of time. On Tuesday, S&P Global Ratings said Venezuela failed to make $35 million in coupon payments on a debt obligation.

But those with a higher risk tolerance have stuck around, and many have been well compensated.

"This has been extremely lucrative for the people who've had the daring to participate in the market," said Gregan Anderson, a macroeconomic strategist at Bulltick. "They've been able to scoop up these bonds at rock-bottom prices and reap huge rewards as the government cut back on virtually every other kind of expense to make those payments."

Total returns for the Venezuela portion of the JP Morgan EMBI Global Diversified, the most widely tracked Venezuelan bond index, doubled over 16 months for investors who got in early 2015, after **oil prices** starting dropping at the end of the previous year.

Even investors who bought the highest-yielding bonds at 100 cents on the dollar would make that initial investment back within 7 1/2 years, before seeing a single principal payment, according to analysts.

These gains stand in contrast to the fallout after many other government defaults, in which bondholders suffered steep losses and then pressed quickly to demand full payment through the courts.

Holders of at least a quarter of any Venezuelan bond can declare a default after a missed payment and demand full payment on the bonds. That would trigger cross-default provisions for other debt, according to bond documents and legal specialists.

But lawyers say such a move could lead to one of the most complicated and contentious default proceedings in history because of so many competing claims on the same assets. That is an outcome bondholders seem eager to avoid.

Instead, many investors may prefer to hold on and hope that the government will continue to make some of its payments. Even though Venezuela and PdVSA have missed 12 bond payments since October, the government has continued to make other bond payments to PdVSA and sovereign debtholders.

"The payments are coming late, but they're coming," said Jay Auslander, a partner at Wilk Auslander, whose practice focuses on judgment enforcement and distressed debt litigation. "It's better to bide your time and wait than to get involved in litigation that could take years."

Major bond-rating firms downgraded the government and PdVSA to default status after they missed several interest payments in late 2017. The South American country has said it wants to restructure its remaining debt, which analysts put as high as $150 billion, compared with international reserves of about $10 billion.

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THE WALL STREET JOURNAL.
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Stocks Can Build Off Strong 2017

By Ben Eisen
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B13
English

Just because stocks had a banner year in 2017 doesn't mean they have to have a bad year in 2018.

The 19% rise in the **S&P 500** last year and the 25% gain in the Dow industrials have fueled expectations for more **volatility** in 2018. For example, Byron Wien, the Blackstone Group LP vice chairman who has been making a widely watched list of year-ahead predictions for more than three decades, said in his newest list Tuesday that he believes there will be a correction of at least 10%.

Given how calm 2017 was, it would be practically unheard of for the market to get any calmer in 2018. That doesn't mean stocks have to end the year lower than where they started. With corporate earnings growing briskly and global economic growth accelerating, many investors see more gains ahead. That includes Mr. Wien, who said he believes stocks will finish the year higher, despite the correction he expects to hit at some point in the next 12 months.

Continued gains have been the case after strong years for stocks more often than not. When the **S&P 500** has risen at least 19% in a year, it has climbed 68% of the time the next year, or 17 out of 25 years, according to The Wall Street Journal's Market Data Group. The average move has been a rise of 8%.

Similarly, when the Dow has finished the year up at least 25%, something it has done 23 times, the following year has offered up an average gain of 9.6%.

It has been up 15 of those years. When the **Nasdaq Composite** has risen at least 28%, like it did last year, it has averaged a gain of 17% the following year, the Market Data Group found.

That isn't to say there won't be more **volatility** along the way. History isn't a perfect guide to the future. But even after the market strength of 2017 -- and perhaps because of it -- it looks a bit early to call time on this **bull market**.

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THE WALL STREET JOURNAL.
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Heard on the Street
Higher Treasury Yields Have a Bright Side for Markets

By Justin Lahart
508 words
3 January 2018
The Wall Street Journal
J
B13
English

[Financial Analysis and Commentary]

There could be serious problems in **financial markets** if long-term interest rates rise in 2018. There could be serious problems if they don't.

Since it became clear that the Republican tax plan was going to become law, Treasury investors have been a bit more nervous -- but just a little. The yield on the **10**-**year Treasury** rose to its highest level since March on concerns that tax cuts could heat the economy up, but fell to end the year at 2.41%, about where it started.

Indeed, after getting head-faked so many times over the past several years, betting on yields going higher can't come easily. While there are good arguments for higher yields, there are good ones for them staying low, too.

The argument for higher yields goes something like this: The U.S. economy already was in good shape and now the tax-cut is going to boost growth. Unemployment will continue to fall, wages will rise and, with an assist from a healthy global economy, inflation will start to pick up. That will push Federal Reserve policy makers to raise rates more than the three times they expect in 2018. Worries about additional Treasury supply hitting the market should take hold as the Fed continues to shrink its balance sheet, and as the government issues more debt as a result of the just-enacted tax cuts.

One reason yields may have fallen at the end of 2017 and a reason they could rise in 2018 involves corpor-ate pension funds. Fund contributions are pretax, points out RBC Capital Markets strategist Michael Cloherty. So companies had an incentive to step up their contributions in 2017, lowering their tax bill when corporate tax rates are higher.

In 2018 they will contribute less and pension funds will buy fewer Treasurys as a result, allowing yields to rise.

Higher long-term rates could be tough on stocks, though. If Treasurys offer better returns, many investors will deem shares less attractive. And, given how richly valued stocks are, any interest-rate-driven selloff could be severe.

But just because interest rates seem likely to go higher doesn't mean they will. Maybe the economy won't have as much oomph as people are forecasting, wage growth and inflation won't really pick up and the Fed won't raise rates by so much. For many investors, that would count as a disappointment, and stocks also would suffer as a result.

Or perhaps things will run a little hotter and the Fed will raise short-term rates but long-term Treasury yields stay around where they are anyway.

That happened in the mid-2000s. It made for a nice environment for stocks, but it also helped intensify the housing and credit-market excesses that precipitated the financial crisis.

Considering the alternatives, higher long-term rates might be the best investors can hope for.

Moving Up

Yield on 10-year Treasury note

Source: Ryan ALM

THE WALL STREET JOURNAL.

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THE WALL STREET JOURNAL.
U.S. EDITION

Gold Could Shine Even Brighter in 2018 --- Possible spurs to demand include Iran, North Korea and risks to markets' gains

By Amrith Ramkumar
712 words
3 January 2018
The Wall Street Journal
J
B13
English

Some investors are expecting another standout year for gold in 2018, a fresh sign of the anxiety that has accompanied the global **stock-market** rally.

The precious metal had its best year since 2010 last year, boosted by a weakening dollar and political tensions around the world. Now, despite cryptocurrencies such as bitcoin becoming more mainstream and the Federal Reserve projecting three interest-rate increases this year, some analysts expect the haven asset to continue building on last year's 14% gain.

When interest rates rise, gold often struggles to compete against yield-bearing assets such as Treasurys. However, some investors doubt that the Fed will stick to its forecasts and remain wary of market risks ranging from North Korea to Iran. They project that gold will keep climbing after it gained in 11 of the last 12 sessions of 2017. It rose 0.6% more on Tuesday.

"Gold has a chance to be one of the stars of 2018 within the commodity complex," said Mark Lacey, head of global commodities and resource equities at asset-management firm Schroders. He said the firm is overweight gold in its commodities fund. Investors are taking small positions in gold as a hedge going into 2018, he said.

Jitters over a mix of market risks have stoked fear that the gains across many **financial markets** could be upended, buoying demand for gold. Tensions between the U.S. and North Korea have ramped up, with North Korean leader Kim Jong Un ordering missile launches in July, September and November. On Monday, Mr. Kim said Pyongyang had completed its nuclear-weapons program, which could reach any point in the continental U.S.

Concerns have also flared up about Catalonia's push for independence from Spain, protests in Iran and the country's test of a new medium-range ballistic missile in August, and President Donald Trump's granting of U.S. recognition to Jerusalem as the capital of Israel in December.

Doubts about the Trump administration's ability to push its agenda through Congress and a probe of Russian meddling in the 2016 presidential election have also fueled investors' worries.

"We continue to think as a small weight for individual investors that gold can be a good thing to diversify," said Craig Birk, executive vice president of portfolio management at Personal Capital.

Many investors looking at muted inflation figures remain unconvinced the Fed will actually increase rates three more times in 2018, CME Group data show. Roughly 60% of traders tracked by the exchange group expect two or fewer rate increases.

Some investors expect mixed economic data and cautious central-bank policy to continue weighing on the dollar. Because gold is a dollar-denominated commodity, it becomes cheaper for overseas buyers when the U.S. currency grows weaker. The WSJ Dollar Index, which tracks the dollar against a basket of 16 other currencies, fell 7.5% last year, its worst annual performance since 2007.

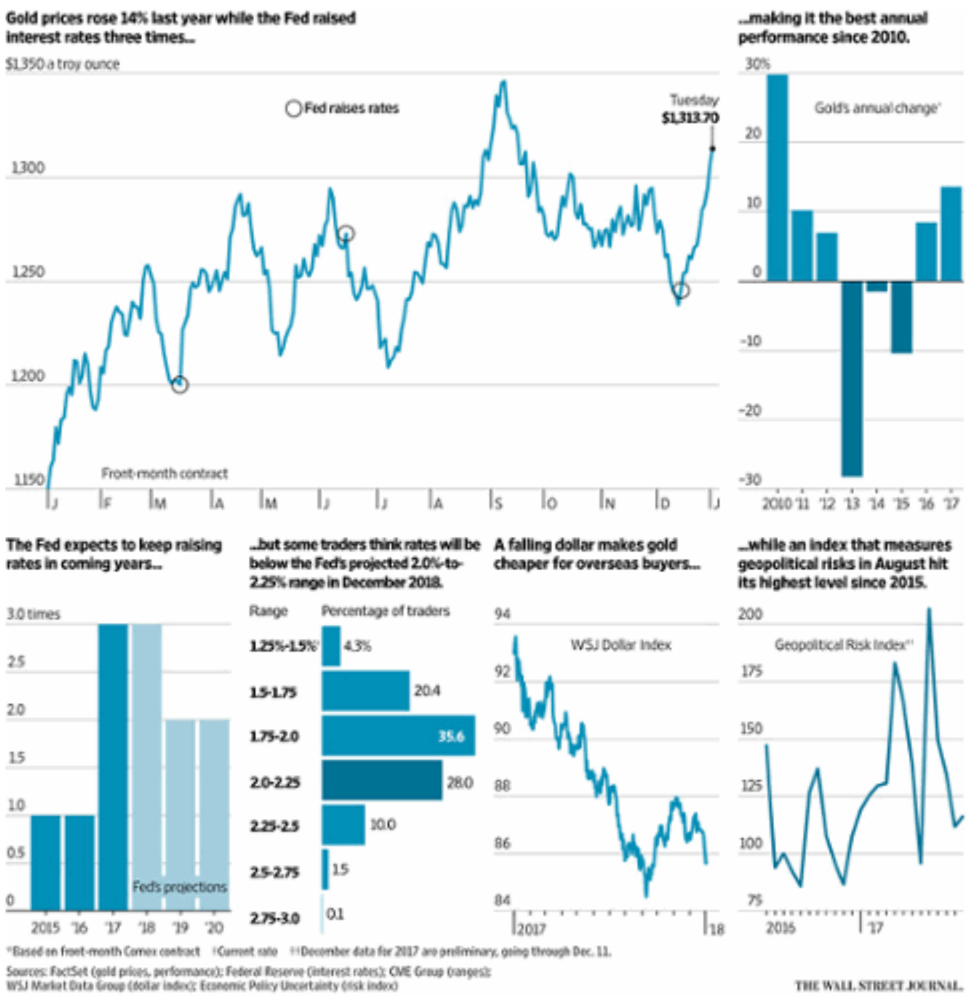
Still, others caution that gold could lose its luster if the U.S. central bank sticks to its projections or even grows more aggressive.

Interest-rate concerns kept gold in a tight trading range late last year. It stayed in a trading band of $34.50 during November, the lowest gap between its high and low in any month since October 2005, according to WSJ Market Data Group.

Fed governor Jerome Powell is set to succeed Chairwoman Janet Yellen in February, and there are also multiple other vacancies on the central bank's board of governors. Some analysts think a combination of changes in membership and economic data could shift the Fed's policy, leading to a swing in gold prices.

Some said gold's banner year in 2017 was a function of its starting point, as the precious metal tumbled in December 2016 following the U.S. presidential election.

"The Fed is a bit of a cipher for the first time in some time," said Tai Wong, head of metals trading at BMO Capital Markets. Mr. Powell is "likely to also move cautiously, but central banks can surprise you," he said.



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THE WALL STREET JOURNAL.
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Billionaire Wagers Millions On Bitcoin

By Rob Copeland
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3 January 2018
The Wall Street Journal
J
A1
English

One of the biggest names in Silicon Valley is placing a moonshot bet on bitcoin.

Founders Fund, the venture-capital firm co-founded by Peter Thiel, has amassed hundreds of millions of dollars of the volatile cryptocurrency, people familiar with the matter said. The bet has been spread across several of the firm's most recent funds, the people said, including one that began investing in mid-2017 and made bitcoin one of its first investments.

Founders and Mr. Thiel, 50 years old, are well-known for early investments in companies like Facebook Inc. that sometimes take years to come to fruition. Yet the bitcoin bet is quickly showing promise. Founders bought around $15 million to $20 million in bitcoin, and it has told investors the firm's haul is now worth hundreds of millions of dollars after the digital currency's ripping rise in the past year.

It isn't clear if Founders has sold any of its holdings. The bet hasn't been previously reported.

Bitcoin vaulted last year from a fringe area of Wall Street interest to the most talked-about asset in the financial world. The currency, essentially a digital form of money with no government or central bank behind it, started 2017 trading around $1,000, then shot to near $20,000 as individual and institutional investors alike ramped up speculating on its rise. From its high in mid-December, the price was chopped almost in half over the rest of the month.

Prices as of late Tuesday afternoon were up 10% to $14,783, after ending 2017 at about $14,000, according to research site CoinDesk. Bitcoin spiked after The Wall Street Journal reported Founders' investment.

Relatively few mainstream investors have bought large sums of bitcoin, scared off by concerns about cybersecurity and liquidity, as well as more mundane fears of investment losses. JPMorgan Chase & Co. Chief Executive James Dimon famously called the digital currency a "fraud," while Bridgewater Associates founder Raymond Dalio said it was a bubble. Even some of those who do own it are cautious about speaking too publicly, lest they draw the attention of hackers.

The late-year price plunge has also spooked some. On Dec. 22, the investor Michael Novogratz said he was delaying launching a crypto-focused hedge fund for outside investors, stating "we didn't like market conditions for new investors."

South Korea announced last week it would crack down on cryptocurrency trading, a potentially ominous sign given that the country at one point accounted for as much as one-fourth of global bitcoin trading activity.

Founders began buying in for its investors before the recent volatility, the people familiar with the matter said.

The billionaire Mr. Thiel is an outspoken libertarian who co-founded digital payments service PayPal Holdings Inc. and made headlines as a prominent booster of President Donald Trump. He serves on the president's technology advisory council. Mr. Thiel previously ran a multibillion-dollar hedge fund focused on global macroeconomic trends and had some success navigating the financial crisis before racking up investment losses by investing in havens and missing out on the rebound.

As a venture capitalist, Mr. Thiel and the Founders fund are among the most successful in Silicon Valley. Founders has more than $3 billion under management and has taken stakes in more than 100 companies, including Facebook, Airbnb Inc., SpaceX and Lyft. More recent investments include the crypto-focused hedge funds Metastable Capital and Polychain Capital, which puts money into blockchain companies.

Mr. Thiel made the decision to buy up bitcoin together with Founders' other investment partners, a person familiar with the matter said. In an October onstage interview at an investment conference in Saudi Arabia, Mr. Thiel described cryptocurrencies as "charismatic."

"While I'm skeptical of most of them, I do think people are a little bit underestimating bitcoin, specifically, because it is like a reserve form of money," Mr. Thiel said. "If bitcoin ends up being the cyber equivalent of gold, it has great potential."

By buying bitcoin outright, as opposed to backing other companies doing business in the sector, Founders would seem to be breaking with its investing tradition, an investor said. But in communications with investors, Founders representatives have sought to cast the investment as a high-risk, high-reward wager similar to its other venture bets, the people familiar with the matter said.

The representatives have told firm backers that a cascade of cash into technology companies has stretched their valuations to historic highs, making stakes in startups as dangerous a risk as ever. They say Bitcoin, on the other hand, could multiply several times over in the coming years.

Thanks to its rise, the bitcoin investment is already estimated as the most valuable in the Founders' most recent, $1.3 billion venture fund.

Founders has also warned investors that bitcoin does share one potentially perilous similarity with more traditional venture-capital investments: The digital currency could be worth nothing, or close to it, in the end.

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THE WALL STREET JOURNAL.
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Year-End Review & Outlook (A Special Report): Markets & Finance --- Global Market Cap Adds Trillions

By Chris Dieterich
578 words
2 January 2018
The Wall Street Journal
J
R2
English

Soaring stock prices across the globe added more than $9 trillion in market value to equity markets in 2017, the biggest one-year swell since the financial crisis.

Almost every major yardstick for global stock prices ended the year with double-digit-percentage gains as improving economic growth and sturdy corporate profits coaxed investors to buy. At the same time, central bankers across the globe mostly kept their economic stimulus measures in place.

These efforts have pinned down borrowing rates and diminished the payout available for relatively safe government bonds, encouraging investors to own stocks even as equity valuations tick higher.

The S&P Global Broad Market Index, which includes most stocks from 48 countries, climbed 22% in 2017, minting $9.6 trillion in market value through Thursday, according to S&P Dow Jones Indices. That surpasses the $8.1 trillion created in 2009, as global markets rebounded from the worst of the financial crisis.

In the U.S., the **S&P 500** ended 2017 up 19%, an advance that added roughly $3.9 trillion to the index's market value through Thursday, according to Thomson Reuters. About one-quarter of the market-value creation came from the five largest U.S. companies by market value: Apple Inc., Alphabet Inc., Amazon.com Inc., Facebook Inc. and Microsoft Corp.

Investors have rallied around the technology and internet giants' rapidly growing businesses and bright prospects, carrying each stock in the group at least 30% higher for the year and adding $1 trillion in market value.

Tech stocks also have played a leading role in lifting Chinese markets. The nation's technology giants Baidu Inc., Alibaba Group Holding Ltd. and Tencent Holdings Ltd. by themselves added $511 billion in market value in 2017. The S&P China Broad Market Index rose 46% for the year.

It was a banner year for emerging-market stocks, with the S&P Emerging Broad Market Index climbing nearly 32% in dollar terms, the best gain since 2009. The emerging-market index added nearly $1.5 trillion in market value in 2017.

Meanwhile, the S&P Developed Ex-U.S. Broad Market Index climbed 23% in dollar terms in 2017, adding $3.9 trillion to its market value, as stock prices boomed across developed markets outside the U.S. The 19-nation eurozone economy was on course in 2017 to expand at the fastest clip in a decade. In Japan, companies' earnings are improving and investors are increasingly encouraged that steps to strengthen corporate governance are taking hold.

Investors have been quick to pile new money into funds that own overseas stocks, which are less expensive than their U.S. counterparts by conventional measures. The price of **S&P 500** stocks compared with earnings over the past year was 22.8 last week, according to FactSet. The price/earnings ratio for the Stoxx Europe 600 was 19.1, while the Nikkei Stock Average was 18.3. Investors added $221 billion into international equity funds in 2017, which by early December was already the biggest one-year haul since at least 2000, according to the Investment Company Institute.

Many analysts say that global equity markets are set up for another solid year in 2018, as lower corporate tax rates in the U.S. boost earnings and modestly increase U.S. economic growth.

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THE WALL STREET JOURNAL.
U.S. EDITION

Year-End Review & Outlook (A Special Report): Markets & Finance --- Shares of U.S. Banks Extend Their Climb

By Rachel Louise Ensign
801 words
2 January 2018
The Wall Street Journal
J
R1
English

Washington extended a helping hand to banks in 2017, pushing stocks in the sector higher for a second year in a row.

President Donald Trump's election in late 2016 prompted a surge in bank stocks on hopes that a tax overhaul and deregulation would help profits. Now, the tax and regulatory changes are finally happening, and they are proving a potent antidote to persistently low long-term interest rates, subdued trading activity and slowing loan growth.

Investors have grown increasingly confident banks' bottom lines will be huge beneficiaries of a lower tax rate. The KBW **Nasdaq** Bank Index rose 16% in 2017. Although shy of the 19% gain for the **S&P 500**, the advance puts the bank index's total increase since the 2016 presidential election at 42%. Nearly all of the 2017 bank gains occurred in the last four months of the year when new tax legislation gained steam.

"Investors were first concerned, and then got enthused over rates, revenues and regulation," said Mike Mayo, a bank analyst at Wells Fargo & Co.

For much of 2017, bank shares struggled to build on their postelection gains. The passage of tax-code changes seemed questionable after health-care legislation efforts failed and stubbornly low long-term interest rates continued to weigh on profits. But investors became more optimistic when tax-overhaul efforts started to seem more likely in the fall.

Banks in the U.S. tend to pay relatively high tax rates, so they are expected to benefit from the planned cut in the corporate rate. Goldman Sachs Group Inc. analysts estimated in December that the measures, which include a 21% corporate tax rate, would boost large bank earnings by about 13% in 2018.

Bank executives said they expect additional benefits from the plan. The tax changes will be "good for the economy, good for job creation and wage growth and all good things will come from that," JPMorgan Chase & Co. Chief Financial Officer Marianne Lake said in December. Many big banks, however, will first have to take a one-time hit to earnings from the changes.

Also boosting banks is the arrival of new Trump administration appointees in Washington. Bankers were eager for an end to the tough regulatory scrutiny of the Obama era, which led to higher compliance costs and major fines.

In recent months, regulators have started to grant banks a number of the changes they have long sought, opening the door to giving more details of annual Federal Reserve stress tests in advance and revising guidelines that limited some kinds of business lending.

Federal Reserve rate increases, which continued in mid-December, also helped profits by enabling banks to earn more on loans.

Bank of America Corp., the second largest in the U.S. by assets, in the third quarter posted its highest quarterly profit in six years. Analysts predict the bank will post annual profit records in 2018 and 2019.

Now, the question is whether bank stocks can sustain gains for a third year in a row and regain the record level they set before the financial crisis.

Since a slight decline in 2015, the KBW Nasdaq Bank Index has rallied to within 12% of its record from February 2007. But challenging trading, lending and interest-rate conditions could stop the index from reclaiming that level in 2018.

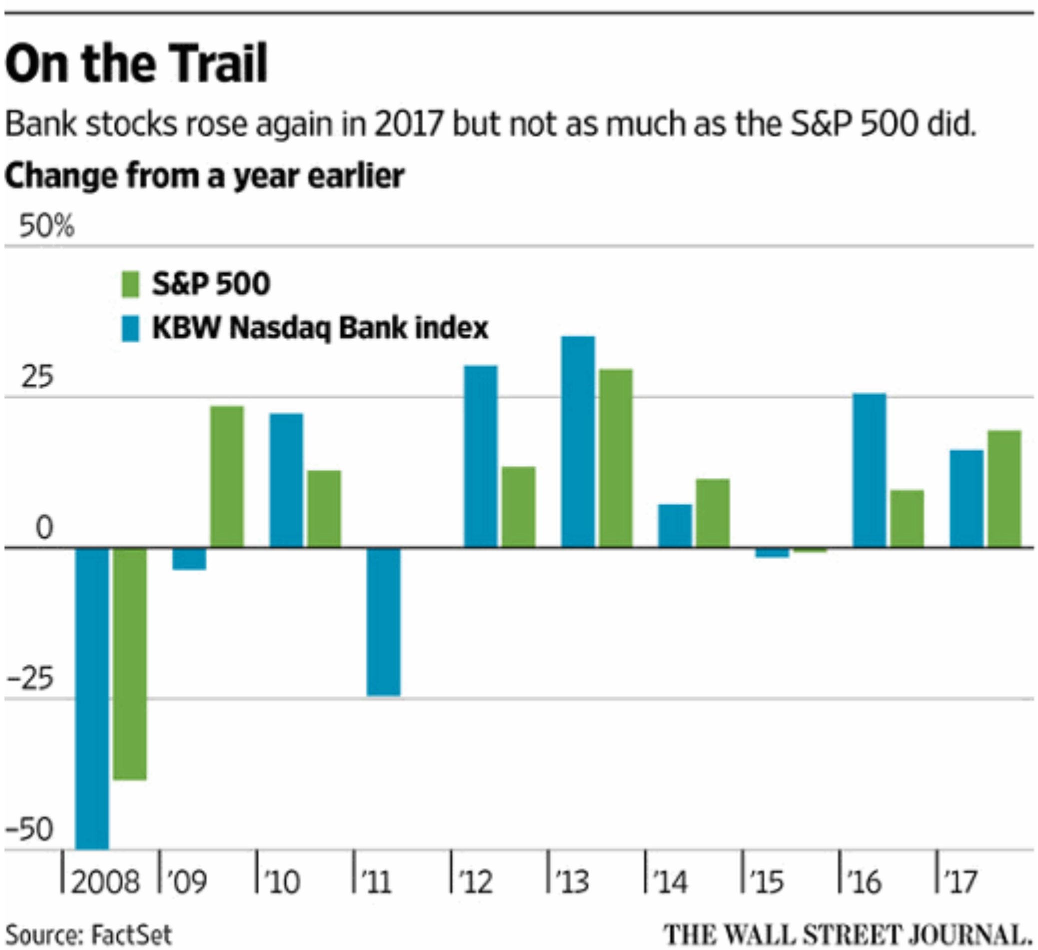
Bank of America, Citigroup Inc. and JPMorgan all have said they expect trading revenue to log a decline in the fourth quarter due to low volatility. Another difficulty is the slowing pace of loan growth. Loans grew 4.1% from a year earlier near the end of December, down from 7.3% before the election, according to the Federal Reserve. Growth for business loans has been particularly weak, despite the stronger economy.

And although banks have benefited from the Fed's tightening, which involves a key short-term interest rate, longer-term rates have remained low, threatening future profits. The difference, or spread, between 10-year and two-year U.S. Treasury debt, a rough proxy for bank profitability, stood at about 0.5 percentage point at the end of December, near its lowest level in a decade.

This "flattening" yield curve will become a bigger issue if banks feel more pressure to pay customers a higher rate on their deposits. If loan balances aren't growing briskly and the interest-rate spread is narrow, it is far tougher for banks to increase lending profits.

Barclays analyst Jason Goldberg projects that lending profit margins will rise in 2018, but not as much as they did in 2017.

The flatter yield curve, he says, "will matter at some point."



Document J000000020180102ee120000v

THE WALL STREET JOURNAL.
U.S. EDITION

Year-End Review & Outlook (A Special Report): Markets & Finance --- U.S. Stocks Wrap Up Strong 2017: Neither geopolitical tensions nor Washington intrigue stopped shares from hitting a string of records last year, but can the momentum continue?

By Ben Eisen
1,594 words
2 January 2018
The Wall Street Journal
J
R1
English

U.S. stocks' headlong advance in 2017 is stoking **bullish** sentiment going into 2018 but has some market watchers questioning how much further the rally can go.

The **S&P 500** surged 19% in 2017, more than triple some Wall Street projections from the start of the year. The **Dow Jones Industrial Average** was up an even larger 25%. Survey data show that individual investors believe the market will deliver more strong gains in the coming year.

A University of Michigan survey in October showed that consumers saw a nearly 65% chance on average that the **stock market** would rise in the next 12 months, the highest share on record. That measure remained near record levels in the following months. Separately, consumers who expected stocks to rise outpaced those who expected stocks to decline by near the most since 2004 in recent months, according to a Conference Board survey.

After eight years of solid returns, investors have become accustomed to buying stocks after even small pullbacks, gaining confidence that the market will rebound and continue its run higher. Corporate profits have been strengthening and the Republican tax overhaul is expected to further boost earnings at many firms.

More broadly, economists say growth across the U.S. and globally is hitting its stride after years of a fits-and-starts recovery.

"If 2017 was the year of optimism, then maybe 2018 could be the year optimism turns into euphoria," said Bank of America Merrill Lynch equity strategist Jill Carey Hall.

Optimism has become widespread among a broad group of market watchers. Nearly two-thirds of investment newsletter writers were **bullish** on stocks in mid-December, nearly a three-decade high, according to a weekly survey conducted by Investors Intelligence.

There are signs investors are putting more cash into the **stock market** as sentiment shifts. TD Ameritrade, the online brokerage, said its clients were net buyers of stocks for the 10th consecutive month in November. Its index measuring investors' exposure to the **stock market** had its biggest ever single-month jump. Meanwhile, a Bank of America Merrill Lynch survey found that a net of nearly half of fund managers had a higher allocation to equities than their benchmarks. That measure is above the long-term average.

"Nothing I see says that we're heading into a recession," said Alex Cabot, 37 years old, a financial adviser in Phoenixville, Pa. Mr. Cabot has used 2017's relatively small pullbacks to buy stocks, which he plans to hold long term.

At the same time, the expansion of **bullish** sentiment is raising concerns among contrarians, who say a red-hot market will exhaust itself in 2018. U.S. stocks already trade at historically high levels; they recently hit 18.53 times their next 12 months' projected earnings, the highest in more than 15 years, according to FactSet.

Historically, investors have rushed into stocks with the most fervor near the end of a **bull market**, ignoring economic and financial metrics that might otherwise urge caution, for example a rise in short-term Treasury yields relative to long-term ones. That signal, known as a flattening yield curve, often indicates a slowing economy.

"When people are not as prepared for the bear, they start putting themselves in vulnerable positions for the bear," said Jim Paulsen, chief investment strategist at Leuthold Group in Minneapolis. "More people get involved in the highflying parts of the **stock market**. People do a lot of other things like borrow money and take down their savings. Corporations start to expand. In other words, players get out over their skis."

To be sure, few measures of sentiment show euphoria among investors. A recent survey of big professional money managers has shown they are **bearish**, with nearly seven in 10 saying stocks are overvalued.

Additionally, margin debt, or the amount that investors borrow against their brokerage accounts, hasn't grown as rapidly as it usually does right before the market peaks, according to money manager Russell Investments.

Because many investors use margin debt to add exposure to the market, it is often seen as a gauge of investor confidence. When it rises at a faster pace than the **stock market**, it can signal investors are growing complacent, but that hasn't happened this time.

That has left investors cautiously optimistic that the gains will keep going, but on guard for a reversal.

"I don't know if we are at the seventh-inning stretch or if we're at the bottom of the ninth, but we are somewhere between those two points," said David Rosenberg, chief economist and strategist at Gluskin Sheff + Associates Inc., a Toronto investment firm.

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Optimism Abounds

Consumers see a high probability that the stock market will rise in 2018, according to a University of Michigan sentiment survey.

Average expected probability of higher stock prices one year out

Source: Gluskin Sheff

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THE WALL STREET JOURNAL.
U.S. EDITION

MoneyBeat: Stocks' Epic Win Streak

By Ben Eisen
230 words
2 January 2018
The Wall Street Journal
J
B10
English

The **S&P 500** climbed 19% in 2017, shrugging off concerns about rising interest rates, political feuding in Washington and the threat of violence with North Korea. Even as investors complained that stocks were trading at high prices relative to expected earnings, they continued to buy. And when stocks dipped, they bought some more.

All in all, the **S&P 500** had positive returns in each month of 2017. It is the first time that has happened since at least 1970, according to The Wall Street Journal's Market Data Group.

The benchmark **stock index** rose in every month of the year except March. It dipped slightly that month, but still provided positive returns when including dividends.

Many investors are bracing for what they say is some long-overdue **volatility** in 2018.

With investors turning more optimistic at a time when stocks are already highly valued relative to history, many say the market could be heading for a reversal, or even a correction, defined as a drop of 10% or more.

Still, when adding in the gains in November and December of 2016, there have been 14 straight months of positive returns for the **S&P 500**.

With such a steady run higher, it is tough not to get used to such smooth sailing.

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THE WALL STREET JOURNAL.
U.S. EDITION

Buffett's Index Bet Pays Off For Charity

By Nicole Friedman
467 words
2 January 2018
The Wall Street Journal
J
B1
English

The real winner of Warren Buffett's 10-year bet against hedge funds is Girls Inc. of Omaha.

Mr. Buffett bet $1 million in 2007 that an index fund would outperform a basket of hedge funds over a decade. The proceeds would go to charity, and Mr. Buffett designated his local Girls Inc. affiliate as the recipient if he won. When the closing bell rang at the New York Stock Exchange on Friday, the famed investor locked in his victory.

Mr. Buffett, the chairman of Berkshire Hathaway Inc., has said throughout this year that he is confident he would win. From the start of the bet through the end of 2016, Mr. Buffett's **S&P 500 index** fund returned 7.1% compounded annually. The competing basket of funds of hedge funds selected by asset manager Protege Partners returned an average of 2.2%.

And because of a twist in the bet's history, Girls Inc. of Omaha is likely to get much more than $1 million.

Mr. Buffett and Protege Partners originally put about $320,000 each into bonds that would appreciate to $1 million over the course of their wager. But the bonds appreciated much faster than expected as interest rates fell so the two sides agreed to go for a bigger prize. In late 2012, they agreed to buy 11,200 shares of Berkshire B shares, which cost $89.70 at the end of 2012. They have climbed 121% since then.

After Friday, the last day of trading in 2017, those 11,200 shares were valued at $2.22 million.

"I guarantee you it will be put to good use" by Girls Inc., Mr. Buffett said in a December interview.

Following Mr. Buffett's investing advice, Girls Inc. of Omaha plans to invest the donation passively and use the investment proceeds to cover the continuing expenses for a new project: transitional housing for 16 young women who are aging out of foster care, said Executive Director Roberta Wilhelm.

The organization bought a property in 2016 and will renovate it next year, with a goal of welcoming the first residents in 2019, she said.

"That's a really life-changing gift for the girls, and it's certainly a big change for our agency as well," Ms. Wilhelm said.

The Omaha, Neb., affiliate provides after-school and summer programs for girls ages 5 to 18. Its annual budget is about $2.8 million, she said.

Ms. Wilhelm said she has followed Mr. Buffett's bet with "anticipation and hopefulness" for the past decade.

"Of course I had full confidence that he would win, but I thought, '10 years, it's so long. Who knows?'" she said.

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THE WALL STREET JOURNAL.
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Heard on the Street
The Secret Ingredient in China's Cure for Debt Addiction

By Nathaniel Taplin
456 words
2 January 2018
The Wall Street Journal
J
B11
English

[Financial Analysis and Commentary]

In the dark winter of late 2015, Beijing's reputation for economic management was in tatters thanks to a colossal **stock-market** crash, currency devaluation, and predictions of financial Armageddon.

Two years later, its reputation looks to have been restored: Chinese markets and the economy have rebounded, and, most impressively, the nation's enormous corporate debt has fallen as a percentage of gross domestic product for the first time since 2011.

Markets have read this as a triumph of domestic policy making, and regulators do deserve credit for tough measures to curb excess capacity and limit borrowing.

But there's another, less optimistic explanation as well: China's debt-to-GDP ratio tends to rise when exports are weak and fall when they rebound strongly, as they have over the past year. That means that China's success or failure in heading off a debt crisis in the years ahead may depend as much on global growth as on domestic policy.

The debt-exports relationship makes sense intuitively. Beijing's obsession with growth targets means it tends to pump up investment, and debt, when external demand weakens, most obviously with its gargantuan stimulus in 2009. It also holds up empirically. Year-over-year changes in China's debt ratio have had a strong negative correlation with a moving average of export growth since the early part of the last decade, even excluding the stimulus-laden period right after the financial crisis.

Exports have become less important to Chinese growth over the past 10 years, but they still make a big difference. From the first quarter of 2016 to the third quarter of 2017, roughly the period of deleveraging, net exports moved from a drag of 0.8 percentage point on growth to a boost of 0.2 percentage point, a net change of about a percentage point on an annual basis.

As a result, overall growth rose to 6.8% from 6.7%. Excluding net exports, growth would have slowed by nearly a percentage point instead, making the drive to contain debt more painful.

The open question is whether this time is really different. President Xi Jinping's administration has de-emphasized official growth targets, but that is easy when the world economy is booming and the housing market is still in the early stages of a slowdown.

Sometime in late 2018 or early 2019 it seems likely that this happy confluence of circumstances will reach a denouement. When that happens, investors will learn whether Mr. Xi's administration is really committed to a different sort of growth model -- or not.

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U.S. EDITION

Aging Population Supports Bonds

By Daniel Kruger
1,003 words
2 January 2018
The Wall Street Journal
J
B1
English

The latest pillar supporting the U.S. Treasury market: everyday investors.

Ordinary investors are a growing force keeping longer-term bond yields low, even as the Federal Reserve has raised interest rates. They are helping cap borrowing costs for individuals, corporations and state and local governments, while boosting the appeal of riskier assets such as stocks, which have climbed to record after record in recent months.

John Nederhiser exemplifies the current crop of bond buyers. While professional money managers fret about interest-rate increases, growing budget deficits and inflation, the 58-year-old accountant in Gresham, Ore., said such concerns won't deter him from continuing to add to his fixed-income holdings.

"Pretty much what I'm going to do is stay the course," he said.

An aging population means investors like Mr. Nederhiser are likely to remain a factor, as people typically increase bondholdings as they approach retirement. The population of U.S. residents age 65 or older has grown more than 40% since 2000 to 49.2 million in 2016, according to the Census Bureau, which could signal steady demand for the debt. The median age for investors with fixed-income holdings ranging from mutual funds to individual bonds is 53, according to the Investment Company Institute's annual mutual-fund shareholder survey, up from 49 in 2007.

After a decade of bond yields holding near their lowest levels in modern U.S. financial history, many professional investment managers entered the year skittish about the potential for losses should demand for bonds decline. Interest-rate increases from the Federal Reserve, plans for tax cuts and generally strong economic data had some analysts talking about the possibility of a selloff sending the yield on the benchmark Treasury 10-year note, which rises when **bond prices** fall, to 3%.

Instead, the 10-year yield has defied forecasts, ending 2017 on Friday at 2.409% from 2.446% at the close of the prior year. While analysts say factors keeping **bond prices** from falling include persistent demand for Treasurys from foreign investors -- whose own bond yields have been driven near record lows thanks to easy-money policies from central banks -- government data suggest that individuals such as Mr. Nederhiser have been playing an increasingly crucial role in stabilizing prices in the U.S. bond market.

Treasury Department data on the $1.87 trillion of new government notes and bonds sold at auction last year through Nov. 30 show U.S. investment funds -- mutual funds and similar vehicles that typically represent individual investors -- have bought a record $917 billion, or 49% of the debt, excluding Fed purchases. The percentage has been steadily rising from 20% in 2010, and the figure significantly exceeds the $316 billion bought by foreign investors through November. Net flows into funds that invest in U.S. government bonds and other taxable debt surged in 2017, exceeding $16 billion for 10 straight months through October, according to data from EPFR Global.

Conversations with more than a dozen individuals and financial planners suggest many of those retail investors are more willing than professionals to stick with bonds, even if yields climb further.

Some older investors have lived through periods where inflation climbed above 10% and where it cratered below zero, while watching plunges in technology stocks and home prices dent their accumulated wealth.

For some, that has led to a pragmatic appreciation of bonds' steady income and relative stability.

"You really can't predict what happens with markets and interest rates," said David Folts, a 59-year-old occupational therapist from Girard, Ohio, who invests in a low-cost bond fund. "My approach is my approach, and it's not changing."

The sanguinity of ordinary bondholders contrasts with 2017 statements from some more famous investors such as Bill Gross and Jeff Gundlach, both dubbed "the Bond King" at various times. Mr. Gross and Mr. Gundlach each created a stir last year by intimating a broad selloff might be approaching.

While the pros fretted, Arun Koparkar dismissed speculation about an increase in yields and kept his cool.

"We've been hearing about this for 10 years and it hasn't happened," said Mr. Koparkar, 66, a retired consultant in the biotech and pharmaceutical industries. He and his wife, Sunita, 59, who works in research and development in biotech, plan to continue investing in bond mutual funds and exchange-traded funds. "I have not changed my strategy," he said.

Much of the support individual investors are giving to the Treasury market is a result of their investments in diversified bond funds, not an insatiable hunger for government debt. That is because government debt now makes up more than one-third of the Bloomberg Barclays U.S. Aggregate bond index, a popular reference point that guides how many portfolio managers assemble their holdings.

The amount of Treasurys in the index has risen from roughly one-quarter in 2007, before the financial crisis led to an explosion in government borrowing and a slowdown in issuance from corporate and mortgage borrowers. The proportion of Treasurys may rise further as the Fed pares back its $4.2 trillion in holdings of government and mortgage debt, which indexes don't count since the Fed's portfolio sits outside of the open market.

It remains to be seen if retail investors will hang on to bonds should yields start to skyrocket. During the 2013 "taper tantrum," which followed then-Fed Chairman Ben Bernanke's statement that the central bank was preparing to stop its bond purchases. Bond funds suffered net outflows for eight consecutive months afterward, while the yield on the 10-year note almost doubled to around 3%.

Mr. Nederhiser, who principally invests in low-fee bond funds, remembers the taper tantrum. Back then, as **10-year Treasury** yields soared, Mr. Nederhiser began shifting some of the gains from his stock portfolio into bonds.

"I saw it as the ultimate rebalancing opportunity," he said.

Close to Home

Individuals buying through funds are playing a bigger role in the U.S. Treasury market.

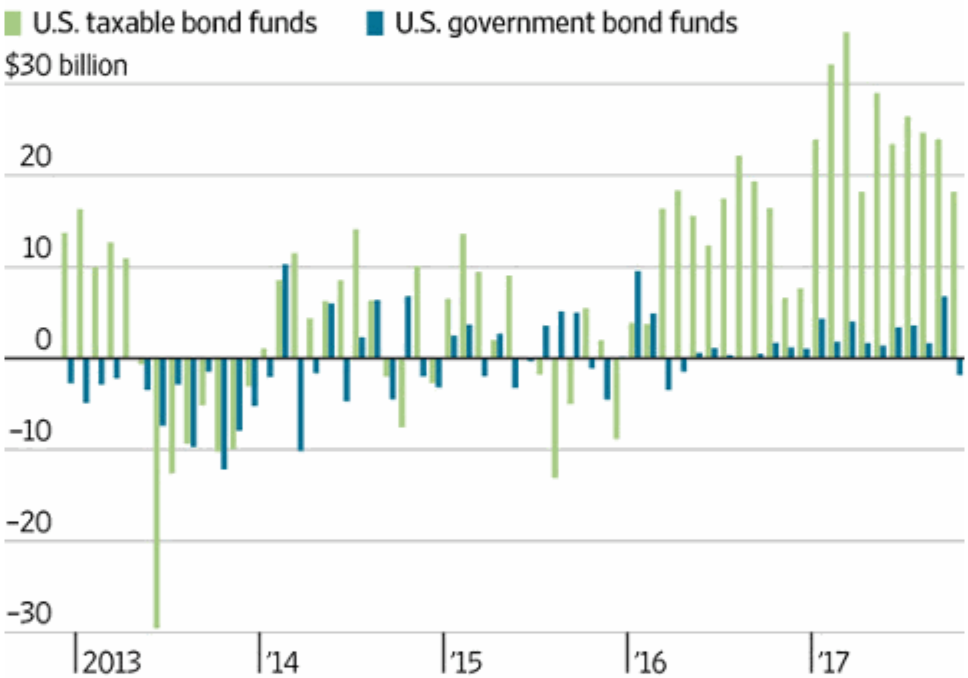
Purchases at Treasury auctions

Note: 2017 data through Nov. 30
Source: U.S. Treasury
THE WALL STREET JOURNAL.

In Demand

Investors have poured money into U.S. bond funds, helping keep bond yields low.

Net flows into U.S.-domiciled funds



Note: Data are through October.
Source: EPFR Global

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THE WALL STREET JOURNAL.
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Heard on the Street
Overheard

165 words
2 January 2018
The Wall Street Journal
J
B11
English

[Financial Analysis and Commentary]

Only one thing is growing faster than the value of cryptocurrencies like bitcoin: the number of people who say they are bitcoin experts.

There is Chris Murphy, a former Facebook executive "on a mission to bring blockchain to the masses," according to an email pitching his expertise to reporters.

Then there's Dominic Marella, who is "available to talk about the potential for bitcoin futures to become a millennial's safe haven from geopolitical **volatility**."

Of course, a real expert needs to live their mission, not just study it.

David Mondrus, also available for interviews, says in his biography that he and his wife were the first couple to get married on the blockchain.

In such a sea of expertise, it's hard to stand out from the crowd.

Perhaps David Drake has the right idea: The subject of his emailed pitch to media outlets reads, "True Crypto source not a phony."

Document J000000020180102ee1200012

The New York Times

U.S.; Politics
The Trump Effect: Business, Anticipating Less Regulation, Loosens Purse Strings

By BINYAMIN APPELBAUM and JIM TANKERSLEY
2,050 words
1 January 2018
05:25 PM
NYTimes.com Feed
NYTFEED
English

WASHINGTON — A wave of optimism has swept over American business leaders, and it is beginning to translate into the sort of investment in new plants, equipment and factory upgrades that bolsters economic growth, spurs job creation — and may finally raise wages significantly.

While business leaders are eager for the tax cuts that take effect this year, the newfound confidence was initially inspired by the Trump administration's regulatory pullback, not so much because deregulation is saving companies money but because the administration has instilled a faith in business executives that new regulations are not coming.

"It's an overall sense that you're not going to face any new regulatory fights," said Granger MacDonald, a home builder in Kerrville, Tex. "We're not spending more, which is the main thing. We're not seeing any savings, but we're not seeing any increases."

The applause from top executives has been largely reserved for the administration's economic policy agenda. Many chief executives have been publicly critical of President Trump's approach to social and cultural issues, including his response to a white nationalist march over the summer in Charlottesville, Va., that turned deadly and his decision to withdraw from the Paris climate accord. Two of the business advisory councils that Mr. Trump assembled in the nascent days of his presidency disbanded after executives grew concerned about his public remarks on the violence in Charlottesville.

There is little historical evidence tying regulation levels to growth. Regulatory proponents say, in fact, that those rules can have positive economic effects in the long run, saving companies from violations that could cost them both financially and reputationally. Cost-benefit analyses generally do not look just at the impact of a regulation on a particular business's bottom line in the coming months, but at the broader impact on consumers, the environment, public health and other factors that can show up over years or decades.

But in the administration and across the business community, there is a perception that years of increased environmental, financial and other regulatory oversight by the Obama administration dampened investment and job creation — and that Mr. Trump's more hands-off approach has unleashed the "animal spirits" of companies that had hoarded cash after the recession of 2008.

Some businesses will essentially be able to get away with shortcuts that they could not have under a continuation of Obama-era policies. The coal industry, for instance, will not have to worry about a regulation, overturned by Congress and Mr. Trump, that would have protected streams from mining runoff.

Brett Hartl, the government affairs director at the Center for Biological Diversity, said the Trump administration might avoid big-splash regulatory rollbacks this year and instead would make it harder for federal agencies to block business expansion.

"It's not going to be sexy things like 'We're killing the Clean Power Plan,'" Mr. Hartl said, referring to the Obama-era rule aimed at curbing greenhouse gas emissions from coal-fired power plants. "But you can make it systematically harder for an agency to do the right thing."

Only a handful of the federal government's reams of rules have actually been killed or slated for elimination since Mr. Trump took office. But the president has declared that rolling back regulations will be a defining theme of his presidency. On his 11th day in office, Mr. Trump signed an executive order "on reducing regulation and controlling regulatory costs," including the stipulation that any new regulation must be offset by two regulations rolled back.

That intention and its rhetorical and regulatory follow-ons have executives at large and small companies celebrating. And with tax cuts coming and a generally improving economic outlook, both domestically and internationally, economists are revising growth forecasts upward for last year and this year.

Even before it became clear that Republicans would pass a major tax cut, capital spending had risen significantly, climbing at an annualized rate of 6.2 percent during the first three quarters of last year. Surveys of planned spending also show increases.

Mr. Trump bragged in a news conference last month that he has rolled back 22 regulations for every new one — 67 deregulatory actions, versus three new regulations. Often in conjunction with the Republican Congress, his administration has canceled several rules approved at the end of the President Barack Obama's term, including a regulation on limiting mining debris in streams, a requirement that broadband providers obtain permission from customers to collect and use online information, and a ban on plastic bottles in national parks.

Administration officials said last month that, since January 2017, federal agencies have delayed, withdrawn or made inactive nearly 1,600 planned regulatory actions. Further rollbacks will affect financial services as well as energy and labor rules, among others.

And Mr. Trump has appointed outspoken critics of regulation to lead several federal agencies, including the Environmental Protection Agency and the Consumer Financial Protection Bureau.

The evidence is weak that regulation actually reduces economic activity or that deregulation stimulates it. But business executives are largely convinced that the cost of complying with rules diverts money that could be invested elsewhere. And economists see a plausible connection between Mr. Trump's determination to prune the federal rule book and the willingness of businesses to crank open their vaults. Measures of business confidence have climbed to record heights during Mr. Trump's first year.

"The notion that deregulation unleashes growth is virtually impossible to find in the data," said Jared Bernstein, a senior fellow at the Center on Budget and Policy Priorities who served as the chief economic adviser to Vice President Joseph R. Biden Jr. "What does matter is this idea that confidence matters. If their expectations about the future are positive, then it does make a difference."

Businesses acknowledge that the most important reason for their increased optimism is the simple fact that the domestic economy continues to expand, with few clouds on the horizon.

Better yet, the world's major economies all are growing for the first time since the financial crisis. Confidence among European manufacturers hit a high in more than a decade, according to European Commission data that goes back to 1985, even without tax cuts or less regulation.

In Japan, now in the middle of its longest period of growth since the early 1990s, the central bank said corporate investment was exceeding its expectations, and it raised its forecast.

"The fundamental backdrop here is that this is a global synchronized expansion lifting everyone's spirits, from Tokyo to New York," said Mark Zandi, chief economist at Moody's Analytics in West Chester, Pa. "The entire global economy is on one page for the first time in over a decade. We're all moving in sync and that has everyone feeling good, not just here but across the globe."

The low unemployment in the United States may also be prompting increased spending, just as it did in the 1990s, as corporations invest in technology to make workers more productive, or replace them entirely. Wendy'sis adding self-service kiosks at 1,000 restaurants.

But business executives say the Trump administration deserves credit. Mr. MacDonald said home builders have benefited from the killing of regulations written by the Obama administration, including a rule that broadened the definition of wetlands, which could have restricted home building in certain areas. The National Labor Relations Board also reversed a decision that made builders more responsible for the working conditions of their contractors' employees.

In some industries, the administration's actions will allow companies to engage in activities they might not have been able to otherwise; electric utilities, for example, might be able to invest in upgrading power plants that run on fossil fuels, thanks to a promised rollback of Mr. Obama's Clean Power Plan to fight climate change.

The Business Roundtable, a corporate lobbying group in Washington, reported last month that “regulatory costs” were no longer the top concern of American executives, for the first time in six years. Mr. Zandi said that regulation was still the top concern in Moody’s survey of business confidence, but that it was rapidly losing ground to concerns about the availability of labor.

The National Association of Manufacturers’ fourth-quarter member survey found that fewer than half of manufacturers cited an “unfavorable business climate” — including regulations and taxes — as a challenge to their business, down from nearly three-quarters a year ago.

Some industries have seen particularly clear changes in fortune. The Trump administration has reversed a number of environmental protections that would have imposed significant costs on energy companies. Mr. Trump’s appointees to the Federal Communications Commissionvoted last month to repeal so-called net neutrality rules, which treated internet services as a regulated industry, like power lines, and prohibited broadband providers from charging for faster internet service or from blocking or slowing some websites.

That decision helped prompt Comcast to announce that it would invest more than $50 billion in infrastructure over the next five years.

The banking industry, in particular, has been buoyed by a relaxed approach to financial regulation as the Trump administration moves to ease many of the postcrisis rules put in place to prevent another financial meltdown. The Treasury Department has issued a series of reports calling for sweeping changes to rules required under the 2010 Dodd-Frank law, and a council set up to designate firms that pose risks to the financial system is in the process of removing those companies from heightened federal oversight.

Mr. Trump has also installed individuals who have publicly questioned the need for many of the postcrisis rules in major policy roles, including at the Federal Reserve and the Consumer Financial Protection Bureau. Bank stocks have been on a winning streak and ended 2017 up more than 15 percent, according to the KBW **Nasdaq** Bank Index.

“There has been some regulatory fixes for a lot of industries, and they would tell you that matters a lot,” said Jamie Dimon, the chairman of JPMorgan Chase, who also leads the Business Roundtable. “It’s just hard to do a direct correlation. It doesn’t mean it isn’t real.”

The confidence is translating to industries that have not, as of yet, seen any obvious benefit or policy changes.

“We have spent the past dozen years or longer operating in environments that have had an increasing regulatory burden,” said Michael S. Burke, the chairman and chief executive of Aecom, a Los Angeles-based multinational consulting firm that specializes in infrastructure projects. “That burden has slowed down economic growth, it’s slowed down investment in infrastructure. And what we’ve seen over the last year is a big deregulatory environment.”

Mr. Burke said he expected the actions to speed future projects for his company, though he declined to offer details, citing competitive risks.

The White House sees its efforts as having their intended effect. Mr. Trump boasted about his deregulatory efforts last month at an event where he stood in front of a small mountain of printouts representing the nation’s regulatory burden and ceremonially cut a large piece of “red tape.”

The chairman of the White House Council of Economic Advisers, Kevin Hassett, said in an interview that the administration’s freeze on new regulations, in particular, appeared to have buoyed confidence. Though he cautioned that it could take years of research to pin down the magnitude of the effects, he said deregulation was “the most plausible story” to explain why economic growth in 2017 had outstripped most forecasts.

“Our view is, the ‘no new regulations’ piece has to be more powerful than we thought,” he said.

Follow on Twitter: Binyamin Appelbaum at @BCAppelbaum and Jim Tankersley at @jimtankersley.

Lisa Friedman contributed reporting.

* Tax Cuts Buoy Republicans, but They’re Swimming Against an Undertow

* White House Boasts of Its Savings in Regulatory Rollback

* The Deep Industry Ties of Trump’s Deregulation Teams

* Counseled by Industry, Not Staff, E.P.A. Chief Is Off to a Blazing Start

President Trump said last month at a news conference that he had rolled back 22 regulations for every new one. | Doug Mills/The New York Times

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The New York Times

Business/Financial Desk; SECTB
New Tax Law Offers Carrot to Gig Workers, but It May Have Costs

By NOAM SCHEIBER; Jesse Drucker contributed reporting.
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The new tax law is likely to accelerate a hotly disputed trend in the American economy by rewarding workers who sever formal relationships with their employers and become contractors.

Management consultants may soon strike out on their own, and stockbrokers may hang out their own shingle.

More cable repairmen and delivery drivers, some of whom find work through gig economy apps like Uber, may also be lured into contracting arrangements.

That's because a provision in the tax law allows sole proprietors -- along with owners of partnerships or other so-called pass-through entities -- to deduct 20 percent of their revenue from their taxable income.

The tax savings, which could be around $15,000 per year for many affluent couples, may prove enticing to workers. ''If you're above the median but not at the very, very top, one would think you'd be thinking it through,'' said David Kamin, a professor of tax law at New York University.

The provision may also turn out to be a boon for employers who are trying to reduce their payroll costs. Workers hired as contractors, who tend to be cheaper, may be less likely to complain about their status under the new tax law.

''Firms currently have a lot of incentives to turn workers into independent contractors,'' said Lawrence Katz, a labor economist at Harvard. ''This reinforces the current trends.''

But it could lead to an erosion of the protections that have long been a cornerstone of full-time work.

Formal employment, after all, provides more than just income. Unlike independent contractors, employees have access to unemployment insurance if they lose their jobs and workers' compensation if they are injured at work. They are protected by workplace anti-discrimination laws and have a federally backed right to form a union.

Those protections do not generally apply to contractors. Nor do minimum-wage and overtime laws.

''What you're losing is the safety nets for those workers,'' said Catherine Ruckelshaus of the National Employment Law Project, an advocacy group.

Traditional full-time jobs also insulate workers against the peaks and troughs in the demand for their services. Consider, for instance, the erratic income of retail or fulfillment-center workers hired in the fall and let go after the holidays.

And because companies have internal pay scales, the lowest-paid employees tend to make more than they would on the open market.

''It used to be that companies like G.M. or the local bank or factory directly employed the janitor, the clerical worker,'' Professor Katz said, noting that their pay would rise along with other employees' when the company was doing well.

Unwinding employment relationships eliminates these benefits, increasing the **volatility** of workers' incomes and magnifying pay disparities and inequality.

It's difficult to say how many workers would choose to become contractors as a result of the new provision, which for couples frequently begins to phase out at a taxable income above $315,000. Mr. Kamin said joint filers who make close to $315,000 and could transform most of these earnings into business income would find it most compelling to make the change. (It could be more compelling still if one spouse's employer offered the couple health insurance, which many employers provide even though they aren't required to.)

On the other hand, many individuals fail to avail themselves of existing tax deductions, like the one that freelancers can take for their expenses, said Jamil Poonja of Stride Health, which helps self-employed workers buy health insurance. That may reflect the lack of access among lower-earning workers to sophisticated tax advice.

The tax benefit could also be offset in some cases by the need for contractors to pay both the employer and employee portion of the federal payroll tax.

Many employers are already pushing the boundaries of who they treat as employees and who they treat as independent contractors.

In theory, it is the nature of the job, and not the employer's whim, that is supposed to determine the worker's job status.

If a company exerts sufficient control over workers by setting their schedules or how much they charge customers, and if workers largely depend on the company for their livelihood, the law typically considers those workers to be employees.

True contractors are supposed to retain control over most aspects of their job and can typically generate income through entrepreneurial skill, and not just by working longer hours.

In practice, however, many companies classify workers who are clearly employees as contractors, because they are usually much cheaper to use. And many labor advocates say the new tax deduction will encourage more employers to go that route by giving them an additional carrot to dangle in front of workers.

''The risk presented by this provision is that employers can go to workers and say, 'You know what, your taxes will go down, let me classify you as an independent contractor,''' said Seth Harris, a deputy labor secretary under President Barack Obama.

Anything that makes workers more likely to accept such an arrangement makes it harder to root out violations of the law. That is because the agencies responsible for policing misclassification -- the Labor Department, the Internal Revenue Service, state labor and tax authorities -- lack the resources to identify more than a fraction of the violations on their own.

''Your chances of finding a worker that's been misclassified if that worker has not complained are worse than your chances of finding a leprechaun riding a unicorn,'' Mr. Harris said.

David Weil, the administrator of the Labor Department's Wage and Hour Division under Mr. Obama, believes the change will add fuel to a trend that has been several decades in the making.

During that time, as Mr. Weil documented in a book on the subject, ''The Fissured Workplace,'' employers have steadily pushed more work outside their organizations, paring the number of people they employ and engaging a rising number of contractors, temporary workers and freelancers.

The tax law will accelerate the shift, he said, because employers who are already keen to reorganize in this way will recognize that even fewer workers are likely to object as a result of the tax benefits.

The effect of the deduction could be especially big in industries where misclassification is already rampant.

Many small-time construction contractors hire full-time workers who should be classified as employees but are kept on as freelancers or paid under the table, said Kyle Makarios, political director for the United Brotherhood of Carpenters and Joiners of America.

Mr. Makarios said the pass-through provision would encourage even more building contractors to misclassify workers, allowing them to reduce their labor costs and underbid contractors who play by the rules.

The practice by ride-hailing companies like Uber and Lyft of classifying drivers as independent contractors has long been criticized by labor advocates and plaintiffs' lawyers. They argue that the companies control crucial features of the working relationship and hold most of the economic power.

Neil Bradley, senior vice president and chief policy officer at the U.S. Chamber of Commerce, said that gig-economy companies classify workers as contractors when it suits the needs of their business and that he did not expect that to change. He also said he did not expect firms with traditional business models to follow suit as a result of the new provision.

''I think the decision is going to be driven by the considerations'' that lawyers cite, such as the amount of control a company exercises, he said, ''not by this tax bill.''

But Mr. Weil was less sanguine.

''These kinds of approaches to making it easier to slide into independent contractor status reflect unequal bargaining power,'' he said. ''When you add to that an additional financial incentive, you're just unwinding the whole system.''

Follow on twitter: @noamscheiber

The tax bill lets independent contractors like Uber drivers claim a 20 percent deduction. But it may hurt workers such as janitors, if employers remove them from payrolls. (PHOTOGRAPHS BY SAM HODGSON FOR THE NEW YORK TIMES; LUCY NICHOLSON/REUTERS) (B3)

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The New York Times

Business Day
Start of a New Year of Trading, and Jobs Report From December

By THE NEW YORK TIMES
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31 December 2017
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English

Here's what to expect in the week ahead:

MARKETS

Trading Takes a One-Day Rest

The question for **financial markets** in 2018 is whether they can continue to chalk up big gains. Most markets around the world will be closed on Monday, as traders get an extra day of rest. Across much of the United States, 2018 will begin with a continuation of unusually cold temperatures, according to the National Weather Service. Zach Wichter

SMALL BUSINESS

Marijuana Becomes Legal in California

On Monday, recreational marijuana will become legal in California, the eighth state to legalize the drug. But because marijuana still does not have legal standing with the federal government, it can be difficult for marijuana start-ups to get funding from banks, or generally to conduct business as usual. Zach Wichter

ECONOMY

Release of Minutes of Fed's December Meeting

The Federal Reserve was full of optimism at the end of 2017. The Fed raised its benchmark interest rate at its final meeting of the year and issued a revised economic forecast predicting faster growth in 2018, citing the effects of a major federal tax cut. The Fed also said it did not anticipate raising interest rates more quickly in response to faster growth. The question is why the Fed is willing to let the good times roll. The minutes of the December meeting, which the Fed is scheduled to release on Wednesday, may provide some answers. Binyamin Appelbaum

December Jobs Numbers Coming Out

The Bureau of Labor Statistics is likely to report another month of strong job gains on Friday, when it releases December's data. It is too early to notice the effect of the new tax law, but economists expect that the unemployment rate will hold steady at 4.1 percent. Natalie Kitroeff

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