

*The incoming administration faces many known challenges: Democrats will oppose most of Trump's policy efforts/appointments, environmentalists will oppose his energy plan, China/the WTO will fight many of his trade initiatives, Mexico/other countries will protest his immigration policy, Europe/NATO will oppose his foreign policy and fiscally conservative Republicans will likely push back on parts of his tax program/infrastructure investment. Despite all of this, his greatest challenge may be the "Wall". No, not the one he wants to build on the U.S. southern border. The "Wall" I am referencing is a wall made of only three bricks: a tight labor market, rising inflation and the U.S. Federal Reserve.*

## 10-Year History of the U.S. Core Inflation Rate and the U.S. Unemployment Rate



### "Power & Persuasion" vs. "Harsh Reality"

Both "Candidate" and "President-Elect" Trump have overcome great odds through rhetoric and tenacity. Unfortunately, the above "wall" cannot be overcome by either. The U.S. inflation rate is steadily approaching the Federal Reserve's inflation rate targets. At the same time, the unemployment rate has dropped to below 5% which is the point at which employment costs begin to rise causing a chain reaction of cost shifts and higher demand for goods and services. The Federal Reserve not only recently increased the Fed Funds rate in response to this developing situation, but they stated that labor market tightness was approaching pre-financial crisis levels and the Committee's collective forecast indicating that as many as three rate hikes in 2017 were likely. This is all happening prior to Trump's inauguration or policy implementations.

If Trump is successful in getting most of his agenda implemented, it will likely spur a spike in economic activity, but it will likely also motivate the Federal Reserve to become more active in dampening growing inflationary forces which in turn can lead ultimately to a recession. The dynamics of the stock market are very different from those of the "real economy". At present, the stock market appears to only be reflecting the initial catalyst of an improved outlook for economic growth, not the subsequent chain of events that might occur which include higher inflation and a more "hawkish" Fed that could significantly undermine the stock market and interest-rate sensitive economic activity such as construction, capital investment and business expansion.

President Trump needs to implement a successful economic policy, but not one that is so successful as to cause the Federal Reserve to attempt to "take away the punch bowl." While much higher inflation and a restrictive Fed are not good for either the stock market or the economy, the greatest risk might emanate from an overt attempt by President Trump to impinge upon the independence of the Federal Reserve. Many of the great economic collapses throughout history have occurred because of politicians gaining control of monetary policy.

*The final irony is that to keep labor cost-induced inflation from reaching worrisome levels, President Trump may need to find ways to increase immigration, not reduce it, for his goal to be achieved, a more vibrant American economy.*

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