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COMMON CENTS

Something to Think About

This week, a client told me my recent newsletters have taken the tone of a frustrated poet. I laughed and told them there was an element of truth to that. After all, the markets seem to be paying attention to only two things at present: 1) the Federal Reserve, and; 2) the Presidential election. How much more insight can any one individual provide over the reams of paper commentators, including yours truly, have already devoted to the subjects? At some point, you start repeating yourself, let alone others, by beating those dead horses.

To that end, many of the columnists and analysts I particularly like have also delved into the arcane, waxed philosophic, and opined on abstracts more than usual. In so many ways, 'we' in the investment/economic industry have become arty worrywarts. Let me attempt to dispel that today:

First, here are my thoughts on the Presidential election:

- After looking at a map of the Electoral College, I don't really see how Hillary Clinton won't win the Presidency. Donald Trump simply has to win: Wisconsin, Ohio, North Carolina, Florida, Georgia, New Hampshire, Arizona, Nevada, and Iowa. He will win some of these states, but he has to win all of them. Three months ago, I would have said there is NO WAY Clinton won't win. Today, again, I don't really see how she won't. Obviously, that isn't the same level of conviction.
- With that said, the actual popular vote is going to be such she won't be able to claim the same type of mandate Barack Obama could in 2008.
- Further, while the Democratic Party rallies behind its candidate far better than the GOP, I would be surprised if Clinton gets the same level of unquestioning support from all Democratic members of Congress that Obama had for pretty much all of his Administration. Basically, just because Hillary says so won't mean it is so.
- Just like you have to play the game regardless of the gambling line, we still have to vote on Tuesday. Even so, from everything I have read from what I would consider legitimate sources, it would appear the GOP will remain control of the House of Representatives.
- As for the Senate, it seems the GOP will lose a seat or three, but it doesn't appear as though the Democrats will end up with a workable majority...if one at all. Given the Democrats will have 23 seats coming up for reelection in 2018, it has to be extremely careful in exercising control in the Senate IF it does end up with even a slight majority. Otherwise, it could flip in a BIG way during the mid-term elections.
- If Trump were to win, he HAS to moderate his behavior in order to get anything done. Right now, he doesn't have the unquestioning, unified support of the GOP, and the Democrats will block him even if he tries to mandate the sun rise in the East. Basically, Trump's room for error doesn't exist; he has to tone it down OR the Congress will impeach him….and in pretty short order too.
- Everything coming out of a Clinton White House will be DOA in a House of Representatives

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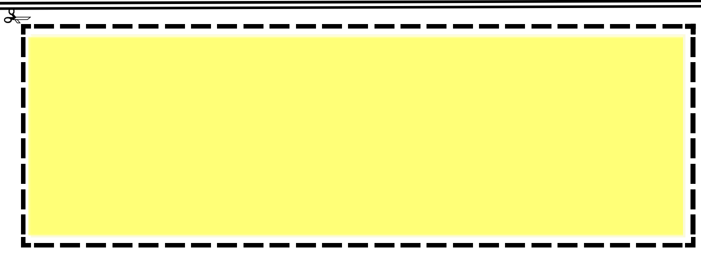

Something to Think About Cont.

with a GOP majority. Period.

- I have played out the various scenarios in my head, and I keep coming back to 'gridlock' in Washington. In fact, the stalemate over the next two years, assuming either Presidential candidate maintains their current positions and posture, will be more pronounced than the last 4 years of the Obama Administration.
- Republicans are scared a Clinton White House will resemble the first two years of the Obama Administration. This will not be the case in 2017. I
    - In January 2009, the Democrats enjoyed a 56-41 advantage in the Senate, with 2 independents (including the Bern) who normally voted with them, and 2 vacancies. At NO point in 2009 could the DNC count on fewer than 58 votes (58%).
    - In the House of Representatives, the Democrats enjoyed a 256-178 advantage in 2009 (59%).
        - Combined, this meant the White House didn't have to do much work on Capitol Hill, let alone try to reach a bipartisan consensus on anything. Shoot, the same could be said of the Democrats in Congress….they didn't have to reach across the aisle on anything, and largely didn't.
    - As previously stated, a Clinton White House will likely not have the same luxury during the first two years. It will HAVE to reach consensuses, etc., or run the risk of being much less successful than the first Clinton White House. Do you think Hillary really wants that?

When you add it all up, I see a steady dose of, gridlock, in Washington unless something extraordinary happens on Tuesday. That is the odds on probable outcome, and I believe the economy can deal with it.

As for the Federal Reserve:

- If the overnight lending target was already at 1.00%, we wouldn't be concerned with the Fed. Why? Because it wouldn't be in a huge hurry to do anything.
- After a few cocktails, I imagine most voting members of the FOMC would admit they are more concerned with a potential European financial crisis than anything emanating from the US. With the overnight rate as low as it is, it wants to have a few bullets in the chamber for when, not if, that happens.
    - We can debate this logic until Doomsday, but I submit the fact remains: the Fed is really a policy making body, and it doesn't have a lot of room, if any, to make policy right now.
- I strongly suspect the Fed would like to take the overnight lending target rate to 1.00% and be done with it for a long time. IF such tightening of credit, if you want to call 0.50% in rate increases a significant tightening of credit, is enough to drive the US into a recession, well, it was headed in that direction on its own.
- With that said, I also strongly suspect IF the Fed keeps up another 4 years of this cat & mouse nonsense, "we" will

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have serious discussions about how "we" conduct monetary policy in the US moving forward.

As I read and reread what I have thus far written, my mind wanders to Yogi Berra's (in)famous quote: "it's like déjà vu all over again."

But what about the markets?

- By most measures, the stock market is pretty fully valued...it certainly isn't cheap, and could really only be considered thus by comparison with the bond markets. Therein lies the rub. Where to invest your money when: 1) cash doesn't pay anything, and; 2) fixed income looks even more expensive than stocks. As I have written here in the past: "in the land of the blind, the one-eyed man is king. Right now, stocks have one eye."
- The 3Q 2016 earnings season has been pretty unremarkable in absolute terms. Corporate earnings appear to be growing at a 1-2% YOY clip, which would have been cause for concern during much of my career. Not so much these days, particularly when earnings have been headed in the opposite direction for the most of the last 2 years, if not all. Don't get me wrong; they haven't completely fallen apart. Let me give you an analogy of what they have done.
    - Long years ago, a restaurant chain named Howard Johnson's used to be pretty famous for its fried clam strips. Occasionally, they would have an "all you can eat" promotion of the things. During one of these, my father ate plate after plate after plate, much to the mortification of my mother. However, the old man noticed something about each returning plate from the kitchen: they were smaller than the previous one. That, my friends, has been the status of earnings over the last 2 years: fewer fried clam strips on each additional plate at Hojo's. Now, that ain't no frustrated poet….that's a ***rehd***-nehck.
- Unfortunately, there isn't anything in the crystal ball to suggest a sudden spike in earnings either. The only thing that could cause that to happen would be a sharp decline in the value of the dollar, which would help out the currency translation effect of US multinational corporations. The likelihood of that type of decline, to positively significantly impact earnings over the next 4 quarters, appears remote.
- In summation, it is hard to forecast double-digit positive returns over the next 12 months. It is also difficult to predict the same type of negative results based on current data. If you pressed me, I would tell you to expect 5% over the next year, with a decent amount of volatility. Basically, if you loved 2015 and 2016, right now, it looks like you should love 2017. Of course, things can and will change. Perhaps Russia will invade someone else or something. You just never know.

Okay, so what about the economy?

- The economy created 161K net new jobs in October, which many would argue is a lagging indicator. While this might be true over an extended time frame, it also means things shouldn't fall apart between now and year-end.
- 3Q 2016 GDP was a reasonable 2.9%, but YOY, the economy is growing at a 1.5% clip.
- Leading Economic Indicators have been positive 6 of the 9 months (through September) in 2016, very much in keeping with 2015, and not suggestive of impending doom.
- M2 (money supply) has grown 6.5% thus far this year. Again, this is not suggestive of impending economic doom.
- In truth, it is hard to find any meaningful economic release which would cause you to lose sleep at night. Certainly, you could find a report, do some mental gymnastics, and extrapolate out the worst case scenario. However, you can always do that.
- In summation, everything currently points to continued mediocrity in the US economy.

Well, there you have it, some pretty dull and predictable, well, predications. So, if I have seemed a little frustrated, shoot if all commentators have seemed a little frustrated, now you know the reason(s) why. For all the question marks out there, the actual data is pretty dern dull.