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OAKWORTH CAPITAL BANK

COMMON CENTS

Something to Think About

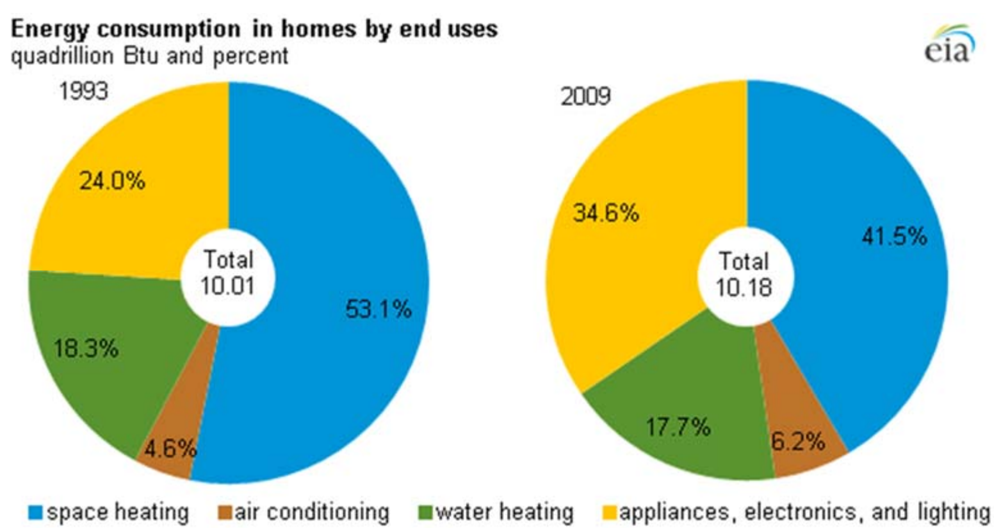
My wife had her office Christmas party last night, and came home with an Amazon Echo Dot she received as a gift from one of her co-workers. I was a little torn on this, as I had planned on getting her one, although largely just for the speaker aspect. So, I decided to proceed forth, and see what I could now buy to make the most of the thing. You know, wall adapters, and things of that sort, to make at least one room of the house a truly 'smart' room.

I will cut to the quick: I will not be making those purchases for the big day. Oh, I might pick some of the necessary accoutrements after December, assuming they go on significant discount, and I mean significant. While really neat technology, I am just not prepared to spend upwards of $40 per electrical outlet, from what I can tell, just so I can order Beth's electronic device to dim the lights. That sort of thing.

You can call me a Luddite all you want. However, it isn't that I don't see desirability of such technology. It is just the estimated, current expense of adapting my house is greater than my perceived benefit. That will certainly change as I age and the cost goes down, both in absolute and relative terms.

Regardless, the Pandora's box is open, and I fully anticipate ALL new homes in the near future will be fully 'smart,' not just the super pricey ones. This will, or should, cut down on per capita energy usage in the United States, maybe. After all, it will be, or is, much easier to turn off all the lights in the house with a simple voice command than it is physically doing it. Trust me, I have no idea how many times I have told my wife I turned off 'all the lights' before climbing into bed, knowing full and darn well I hadn't.

Now, consider the following chart/picture/table from the Energy Information Administration:



What I find particularly interesting is the growth in consumption in the yellow segment of the pie

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(electronics, appliances, and lighting). As you can tell, the number of quadrillion Btu (British Thermal Units) hasn't/didn't changed/change significantly, only about +1.7%. What has changed is how we consume energy. Intuitively, 'we' are far more efficient in heating & cooling our homes, as the number of housing units and central air systems has only grown over time. We must also be better at heating our water, etc. Meanwhile, our population grew about 20% between those years (1993-2009).

So, we are consuming less energy on those areas, in both absolute and relative terms. What happens when we start consuming less on the yellow pie? When we can turn off all the lights and electronics in the house with a simple voice command? If I were an electric utility, I would either be sweating bullets or cozying up to the local Public Service Commission (PSC) more than normal.

I sure as heck wouldn't be advertising energy saving tips like they do on the television, unless that same PSC physically forced me to do so (which they undoubtedly do). Frankly, those ads have baffled me for years: "Consume Less of Our Products!" Now, there is a winning marketing campaign for you.

Strangely enough, I hadn't really intended on this being the topic/purpose of the newsletter; it was simply on my mind, and another reason why I have a hard time being extremely bullish on utility stocks other than in times of severe market distress (and for short periods). More on this later...potentially.

What I had really wanted to discuss today was what I wrote about for my Montgomery Advertiser article: "when will the Trump rally end?" As you might imagine, I have had a few people ask me that. So, instead of reinventing the wheel, and since I like what I wrote for the newspaper, let me simply copy & paste here:

> Not surprisingly, I have had a lot of people ask me when the 'Trump rally' in the stock market is going to end. Obviously, I can't look into the future with crystal clarity, and the Securities and Exchange Commission would probably throw me under the prison if I could. However, the odds are it ends on December 31st, or, at least, that is the safest prediction.
>
> There are two primary reasons for this: 1) pension plans, foundations, endowments, and other big pots of money often rebalance in January. Through December 15, the S&P 500 has returned a little over 13% this calendar year. As a result, all those big portfolios are likely 'overweight' equities relative to other asset classes. This means portfolio managers will likely sell stocks in January to get back to the 'target' allocation.
>
> This is NOT set in stone or a fait accompli. After all, those funds could decide to add to their weighting to stocks in January, and you can throw everything I just wrote out the window. However, after a surprisingly strong 2016 in the markets, the low hanging fruit is a rebalancing back to the target weights, as opposed to increasing them.
>
> The second reason is arguably the biggest: investors currently believe the Trump Administration and Republican Congress could, or will, reduce the capital gains tax rate moving forward. As a result, investors have a strong incentive to delay selling stock positions with significant unrealized capital gains. Unless they absolutely, positively have to have the money in three days, what is the harm in waiting until the first week in January to get out of or reduce a holding in XYZ stock?
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> I will save you the mental gymnastics: there isn't any harm in waiting, and it is the most prudent course of action. Even a relatively slight reduction of, say, 5% can mean significant savings.
>
> When you add these two reasons together, you can come to a reasonable hypothesis: there is no reason for the stock rally to fall apart, just because, before the end of the year. However, there is a possibility, a good one even, the direction of money flows in the markets will reverse course during the first two weeks of 2017.
>
> That is a fancy way of saying if I had to bet you a beer, I would bet for the rally to continue through the end of 2016, and then sell off in January. Once the dust settles, we will probably be a little ahead of where we

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were at the end of November. Then it is up to the Administration and Congress to follow through on some of their promises.

IF the Republicans don't tackle the tax code and regulations the way they have promised, I won't hold out much hope of a double digit return in stocks in 2017. In fact, I will go so far as to say it won't happen, period, and we could even slip into negative territory. However, if they do hold up their end of the bargain, if you will, 2017 could be a much better year for stock portfolios than anyone would have thought possible in September 2016, much better.

If this sounds like there is little room for error, it is because there isn't. There are less than two weeks remaining in 2016, so enjoy the rally. However, don't bet on it continuing unless The Donald delivers in 2017, and pretty quickly too.

Now, the kneejerk reaction would/could be: "well, Norris, if they do reduce the capital gains tax rate, won't that put selling pressure on the market throughout the entire year?" That is a great question, and I can only answer with the following: "yes, but the market will only fall IF those sellers of XYZ do NOT reinvest the proceeds in other stocks." In other words, if I sell XYZ for $100 and reinvest in ABC at $100, it should basically be a wash as far as the markets are concerned. XYZ will go DOWN and ABC will go UP a commensurate, or near commensurate, amount. It is nothing more than dollars in <u>and</u> dollars out. If more dollars go INTO the stock market, it should go up in aggregate. If they go out, it should fall. If there is no discernible change in net flows, it should stay roughly the same.

But, didn't you say the potential for a cut in capital gains taxes would put selling pressure on stocks during the first two weeks of January, and that would be a bad thing?

Yes, but only temporarily until investors see what, if anything, the Administration/Congress does in the first 100 Days. If it is as advertised, I imagine the vast majority of the proceeds of said sales will go back into the markets, creating something of a wash by the end of February...if not slightly sooner. After all, IF 'they' meaningfully cut the corporate tax rate, investors will want to capture the potential for higher earnings per share. It could be best case scenario, for individual investors, to sell at relatively high valuations and then buy a few weeks later at much lower ones, thanks to a change in the tax code.

It will be interesting to see exactly what happens, but what I have outlined is what I believe to be the probable case scenario. What is the old chart from probability & statistics? One standard deviation from the mean represents a 68.2% probability? That might seem a tad higher than my conviction, but fair enough….I will go with it.

In the end, 2017 proves to be a fascinating year...either good or bad for the markets. We will know which by the end of February. With that said, the one sure promise I will make TODAY is I will NOT have made my entire house a 'smart' home by that time.

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