StraightTalk

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ALFRED L. STRATFORD, III

Chartered Retirement Planning Counselor (CRPC®)

Senior Vice President, Investments

Where Do We Go From Here?

As we all collectively turn our attention from election results and turkey dinners to the rapidly approaching holiday season, many of us are asking, "Where do we go from here?" For some, that question is about the course of our nation's culture, for others the question is more focused on healing a deeply divided electorate, while for many of us, that question has to do with the economy, jobs, and the stock market. Economists coined a phrase decades ago called the Wealth Effect, which is at the forefront of this issue. It simply means that when the value of stock portfolios rise due to escalating stock prices, investors feel more comfortable and secure about their wealth, which causes them to spend more. This, of course, translates into activity across our economy, as the dollars that are spent are taxed, spent again, taxed again, etc., in what is known as the multiplier effect. While I am not suggesting that all of us rushing out to spend our hard earned money is the cure for our divided national dialogue, our coarsening culture, or our standing on the world stage – I am suggesting that a robust economy, job market, and stock market will make almost all of us in this country feel better. We have not had a synchronicity of these three factors in almost two decades, and many of us have either never felt the powerful effects of this phenomena, or have forgotten how good it felt years ago. Yes, there have been good jobs reports during the Obama and Bush presidencies, and yes, the stock market and economy have grown under both of those Presidents. However, the last secular bull market we had was from 1982-1999, and during that period of time, real wealth multiplied by 5-6 times, the stock market was up 1,000%, our economy was transformed, and the unemployment rate dropped below 5% for the first time ever - something my Economics professors said could never happen. The secular bull market before that was unleashed by President Eisenhower, one in which productivity, earnings, and employment soared in the post-war manufacturing boom. These secular bull cycles do have a pattern, and the only question is the duration of the expansion, and the growth in earnings.

Before answering that question though, we must wade through all of the negative predictions that surround any changing of administrations, made much more severe by the particulars surrounding this changeover. This brings to mind the old expression that history does not repeat itself, but it often rhymes. Thomas Jefferson, himself not without controversy at the time of his own election, said years later of Andrew Jackson's bid for the Presidency, "He is one of the most unfit men I know for such a place. He has had very little respect for laws or constitutions…he is a dangerous man." The prevailing fear at the time was that Jackson, a hero in the War of 1812, would subvert the American republic just as Caesar did in Rome. History shows that Andrew Jackson turned out to be the most determined defender of the Constitution in its first 70 years.

Similar things were said about Theodore Roosevelt when he was added to the ticket as William McKinley's Vice president at the turn of the last century. At that time, the head of the Republican party said, "Don't any of you realize that there's only one life between that madman and the presidency?" However, after McKinley's assassination, Teddy Roosevelt turned out to be quite the statesman, starting the progressive "Square Deal," busting up oil and railroad monopolies, creating the National Park system, and beginning construction of the Panama Canal. History reveals our President known as The Rough Rider as anything but a madman.

More recently, a television and movie actor was excoriated as a dangerous extremist while at the same time mocked as a lightweight. Tip O'Neill, the powerful Speaker of the House, called Ronald Reagan "the most ignorant man who had ever occupied the White House." Fears about Reagan ranged from his interest in developing a Strategic Defense Initiative to combat the "evil empire" of the Soviet Union, to his coziness with the wealthy and the tax cuts he would ultimately propose for that group. Instead of bringing in America's darkest days, however, the 40th President ended the cold war with the Soviet Union and spurred domestic economic growth not seen since the World War II recovery. During his two terms, inflation came down from over 12% to 4%, taxes were cut while tax receipts increased 8% per year, the unemployment rate fell from 7.5% to 5%, and the economy grew at over 7% per year. *Read those numbers again, folks.* Many historians rank Reagan's presidency as the most consequential since FDR, yet at the time of his inauguration, most were betting on his abject failure.

So, where do we go from here? There is no shortage of commentary today on President Elect Trump, most of which is focused on his personal and professional shortcomings. Much of what is reported is somewhat justified, based on things he actually said, many of which are downright cringe-worthy. However, using history as a guide, the future may actually turn out brighter than the doomsday crowd is currently predicting. I suspect that President Trump will be significantly more moderate and restrained than Candidate Trump. Specifically, I suspect there will not be a Muslim ban, but there will be a ban on additional government regulations in the near term. I don't think we will build a wall on the Mexican border, but I do think we will build new bridges, roads, and airports. I doubt that 12 million illegal immigrants will actually be deported, but I bet that an amount of people almost as significant will soon be employed on large-scale infrastructure projects lasting at least the next four years. I'm betting that dozens of Hollywood celebrities don't pack up and leave the country as they promised, but that dozens of President Obama's executive orders will be sent packing. My inner economist refuses to believe that the President Elect will slap a tariff on international goods, but I fully expect a tax deal on repatriation of international profits.

In short, I believe that a lot of the election rhetoric was just that, rhetoric. Do I think the next President of the most powerful nation in history needs help on foreign affairs? Yes, immediately. Does that make an international disaster a foregone conclusion? No. But after a mistaken veer into Middle East nation-building by the Bush administration, and a foreign policy from the Obama administration that seemed cohesive only in the goal of a smaller America on the world stage – perhaps a middle ground between those two ideologies can be found. Do I think that Trump will try to add some juice to the weakest economic recovery since WWII using a combination of tax cuts, infrastructure spending, and reduced regulation for businesses? Yes. Do I think that the incoming President will contribute to the continued coarsening of our national dialogue on Twitter? Also yes. But a vibrant economy, with full employment, and strong corporate earnings all leading to record gains in the stock market could make many people overlook the personal shortcomings of the 45th President.

Long-time readers will by now have noticed that in the last 10 years, these newsletters have focused more on politics and the Federal Reserve than the newsletters in the prior ten years. It just may be that the least "presidential" incoming President may knock the prevailing dialogue back to the economy, companies and their earnings. Speaking of which, the consensus earnings for the S&P 500 for next year is a record amount a bit above $130. In other words, the "profits recession" that was caused, at least in part, by oil dropping from $107 to $26 over nineteen months appears to be in full recovery. Each quarter this year, earnings have improved, and they appear poised to continue improving into 2017. As this accelerates over the next couple of years, the market will become earnings driven rather than interest rate driven, and lowering taxes on corporations only adds fuel to the earnings fire.

There are other signs that point towards an optimistic outlook as well. A recent Bank of America study showed investment manager's cash holdings to be at their highest level in fifteen years. Fund managers do not typically hold high levels of cash as an investment, as it is a drag on performance; instead it is dry powder to be invested at the soonest opportunity. Legendary hedge fund manager Stan Druckenmiller dumped his huge gold position after the election, going all in on the equity market. Yahoo finance posted an article showing that the OECD expects our nation's GDP to double by 2018. The Wall Street Journal reported that consumers spent $5.27 billion online on Thanksgiving and Black Friday, up 18% from last year. And Capital Research and Management just published that $57 trillion is needed in global infrastructure spending by 2030; think road, power, water, telecom, and railroad spending. So, "where do we go from here?" I think the answer is up!

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