StraightTalk

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The Most Unloved Bull Market

As this month began, it seemed as if the entire nation was captivated by the confirmation hearings for the open seat on the Supreme Court. To most objective observers, it also seemed that Washington, D.C. was descending down a rabbit hole every bit as bizarre as the one in Lewis Carroll's book, "Alice's Adventures in Wonderland." With that unpleasant process behind us, and the hyper partisan mid-term elections looming, I thought it was time to re-focus on some basic economics. After all, it is the economy, and the earnings of those companies making up the economy that truly matter to investors in the markets – not Senate hearings, negative attack ads, or bloviating speechmakers.

A simple starting point is to recognize this as the most maligned, mistrusted, and unloved bull market of my lifetime, perhaps ever. I could, quite literally, find a negative news headline for every single day since the stock market bottomed on March 9, 2009. More relevant to our discussions of the current secular bull market – which began in March 2013 as the market hit new highs – is to recognize how quickly and completely the recovery occurred, and continues on today.

Without ascribing blame to any one group (there is undeniably plenty of it to go around) it is fair to say that mortgages and real estate values were at the epicenter of the storm in 2008. No one born after World War II began had ever seen the value of their home fall that far, that fast. This provided the news media plenty of web banner space, headlines, and column inches to write about how dire things were, and how long it would be before prices recovered. In 2012, a writer for CNN Money penned a piece titled, "Home Prices May Not Return to Peak Until 2023" which turned out to be too long by more than half of a decade! And when you consider household net worth (home and stock market values combined) – the recovery was complete by 2012. Even more significant to this rest of this newsletter, household net worth now stands 50% higher than the previous peak *before* the 2008 decline, at one hundred trillion dollars. In other words, the relentlessly negative financial news media, as is their undeniable pattern, overshot the mark on the economic fundamentals which always and everywhere drive prices. Had you relied on those headlines for advice on buying or selling a home, or more to the point of this newsletter, for what to do in your investment portfolio - you would have been led astray once again.

Fast forward to today. I will, as attorneys often say, stipulate to the fact that we have a highly controversial 45th President. This makes today's news headlines ever more sensational, not only covering presidential policies but also personal peccadillos. One area that has garnered enormous media coverage is the threat of increased tariffs on our trading partners, and extrapolations of the effects of a "trade war." As many of you are aware, it is my belief that the endgame of this tariff strategy is a more level playing field, not an actual trade war. A world completely without tariffs is unrealistic, but one in which we are no longer subsidizing the world's growth by paying higher tariffs than we in turn charge is the goal. In fact, there are three areas in which the U.S. has been systematically subsidizing global growth, all three of which appear to be changing for the better.

For decades, the United States has, either directly, or indirectly, subsidized global growth. The most obvious direct subsidy was the Marshall

Plan, in which we provided a large amount of direct financial aid to rebuild Western Europe after the carnage of World War II. Ever since then, we have provided never-ending direct aid to a long list of foreign countries. But the even larger subsidy has been indirect, in the form of tariffs and taxes that, intentional or not, advantage other countries.

For the last three decades, the U.S. has held our tariff rates below most of the world. The same goes for our tax rates. And, most spectacularly, during this same time, through poor regulatory structures we hindered our domestic production of energy. Not only did we self-impose drilling and petroleum production limits, in 1975 our Congress actually banned the exporting of natural gas!

This has all changed, and it has profoundly positive effects for our economy.

According to the WTO, before the Trump tariffs were announced, the U.S. charged an average tariff rate of 3.4%. The European Union averaged 5.1%, Mexico 6.9%, China 9.8%, and South Korea 13.7%. In other words, by the U.S. being charged higher tariffs (taxes) than almost every country in the world, we were subsidizing their growth. In effect, we are the richest guy at the dinner table and have been paying more of the nightly dinner check than everyone else for decades. By threatening to boost tariffs on select countries and products, we are attempting to remove the subsidy for much of the world, i.e., splitting the dinner check more evenly. And, because we remain the world's largest economy, the threat of increased economic pain should force other countries to negotiate a more equal trade environment. We have already seen movement in this direction from Mexico, Canada, and the EU, all of which will add meaningfully to our domestic economic rate of growth.

The story is similar regarding taxes. Since 1993, when America raised federal corporate taxes to 35%, we have had the highest business tax rate in the developed world. When you add in state and local taxes, the average business tax rate has been 38.9% for the last two and a half decades. In 1993, the average worldwide tax rate was 6% lower than ours, at 33%. More critically, by last year the worldwide business tax rate had fallen to an average of 23%. In other words, it was cheaper to do business everywhere in the world but the U.S., and by a growing margin over the last 25 years. Unlike the poker game of tariffs and trade negotiations, there is no guesswork on taxes because they have been lowered by law. With corporate tax rates at 21%, the U.S. has simultaneously announced to companies around the world that we are open for business, and also put foreign governments on notice that the competitive global playing field is now level. Corporations around the world are now changing their decision making on where to do business as a direct result of our tax cut.

The third of the three global subsidies that has been thrown on the ash heap of history is our stance on petroleum production and energy policy. Since President Carter's "malaise speech" in July of 1979, our country has done an about-face on energy policy, production, and techniques. Despite predictions of "peak oil" from the early 1970s through the late 1990s, there are more proven oil reserves under our country than at any time in history. Because of horizontal drilling techniques and hydraulic fracturing (fracking for short) these reserves, trapped between layers of shale, are viable and now being tapped. More importantly, we are now the Saudi Arabia of natural gas, with 341 trillion cubic feet of proven reserves. This energy renaissance will have long lasting positive impacts for our country, and devastating economic effects for Iran, Venezuela, and the OPEC nations.

The world is becoming flatter and more economically fair, which means a reshaping of the global establishment is underway. You don't need a slide rule to connect the dots on how this will help propel our economy forward for the foreseeable future. This bull market – fueled by the trifecta of lower tariffs, lower taxes, and energy independence rolls on – even if the headlines say otherwise.

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