Palmetto Wealth Management

@Failing_US_Congress #sad

John M. Gustafson – 31 March 2017

The last couple of weeks have proven once again that in our current political environment, the United States Congress will only take action when there are true, immediate consequences - and only then at the very last minute before the car flies off the cliff. They didn't perceive that to be the case last week regarding healthcare and it was President Trump's miscalculation. My title for this article is merely homage to our Commander in Chief and his combative tweets. Childish insults that sound as if they come from an illiterate 15 year old.

I realize that President Clinton had the same, chaotic fires burning "over there" when being asked about the smoke right behind him. Those other fires, of course, were set by the master of Democratic misdirection (and a personal hero of mine) James Carville. It just seems odd to have the current POTUS doing the same thing himself. I wish he would find a proxy like Carville and at least have a little plausible deniability when things get crazy.

The fact that we have unfiltered access to the thoughts of the President is great - he simply needs to learn to quit while (when) he's ahead and not rise to every trolling statement. The constant chaos may be his strategy to distract while other things are being done, (i.e. Carville / Clinton) but the means do not always justify the ends. It is clearly not a unifying activity... It certainly consolidates "his" base, which needs little encouragement, but pushes everyone else who may be interested in joining the circus out of the tent. It also continues to roil the capital markets while his "real intent" is sorted out in the screaming media.

Looking ahead, the upcoming debt ceiling fight will likely reveal how bifurcated the Republicans remain and even the thought of a US default is going to truly roil the bond markets - a huge detriment to continued growth economically. One failed vote on healthcare, which swung to a loss very late in the process, took the wind out of the market's sails rather quickly last week. Another fight about whether or not Treasuries may be allowed to default - the dangerously ridiculous issue we had in 2011 - will really throw a wrench in things.

America remains the global economic leader, but if we continue to chip away at international confidence in our creditworthiness via ridiculous political fights, the Chinese will be happy to step into the arena in that role. And once that lead is lost, it may never return.

Unfortunately, we remain mired in a political environment where a 65% legislative "win" is still viewed as a 100% "loss." Especially on the far-right, who seemingly believe that the guy they hated and worked against throughout the primaries is now somehow on their team - or at least should be - simply because he isn't a Democrat. Based on President Trump's comments of the past few days they are completely wrong.

The President has proven over and over again that any perceived criticism of him or his policies is absolutely unacceptable and must be attacked, no matter how minor the issue or formerly loyal the speaker. It is a glaring difference between a politician and a businessman who had never been told "no." (at least not for awhile) It seems that somewhere in the middle of the two would be more pleasant and functional. But as we always say, we live and invest in reality-world, not theory-world.

The Democrats have their issues as well, which I think is why the attacks seem so bitter from both sides - the Dems appear completely disorganized, rudderless and seemingly still stunned and offended that they aren't in the White House. They've become a non-factor, which made the first healthcare-vote failure so surprising to the equity markets. (Even though the bill had been amended with so many Congressional bribes it began to resemble the GOP version of the ACA - and would never pass the Senate anyway.)

From an investment perspective, I'm willing to give the Trump Administration their first fumble - in reality it was their first actual attempt at real legislation. (Who knew it could be this difficult?!? :) However, if they blow something like this again, I will likely reverse my entire perspective on the economic positivity that was supposed to arrive and look for more non-action in D.C., a wildly contentious 2018 mid-term cycle beginning early and blossoming into a huge economic distraction with plenty of talk about how terrible things are by both sides. A plague we have been suffering since 2010… Negative talk from on high does matter and may not be completely self-fulfilling, but infects enough minds to slow things down as we've outlined (ad nauseam) in these notes for years.

It was a lesson to the White House that POTUS needs to understand the granular details when he has a pet bill that requires his lobbyist-hand to pass. Nobody has any interest in doing all the heavy lifting simply to bend to his will - especially not in our modern political climate. The incredibly offensive part in my opinion is that the Republicans have been scrambling for a chance to dump the ACA for several years and apparently NOBODY put any though into actual legislation. Trump's team didn't either, clearly - but someone should have at this point with all the complaining and hand-wringing. It was a big pile of political capital tossed into the furnace of D.C. simply because of haste. Speed kills on the road and in Washington.

My hope is that infrastructure proposals, as well as any tax reform, runs under the guise of measure twice, but cut once. I'd much prefer to have something good, rather than something fast. Although because of the crazy, constant cycle of fundraising, campaigning and elections, the clock is ticking. I don't think anything can be accomplished after Q1 of next year unless there are significant points on the board this year. Everyone will simply shift into self-preservation mode, (the default in Washington) sit on their hands and bloviate on the Sunday morning shows while wagging fingers across the aisle.

The big questions that will be raised with the inability for the Administration to actually deliver any reforms via Congress, rather than broadly vague and easily reversed Executive Orders will be how the Fed reacts. They are clearly in a position to begin to raise rates regularly and manage inflation as the economy grinds higher and labor markets tighten, but once again the inability for Congress & the White House to do their jobs may put Yellen in a similar position to Bernanke during most of his tenure. Keeping the economy moving in spite of the actions (inaction) of our Government, rather than in partnership with them will continue to be their charge. It is partly why rates have remained so low for so long.

In terms of benefitting the economy and the markets broadly - and making Washington look marginally bipartisan - I would love to see an infrastructure bill be passed that puts actual shovels in the dirt. It was the major flaw of the Obama Administration's "stimulus" package. That bill didn't really "stimulate" anything because the money simply paid for services such as police and fire that were already in place with Federal dollars, rather than push any funds into new projects. If we truly want to repair bridges, roads & schools, that will get people into the workforce with a quality job. Things like that are what lead to consumer confidence, more positive earnings projections by companies and removes "the malaise" from the general public's economic outlook. Attitude matters in economics on a broad scale - sometimes more than the actual numbers in the near term. Stay tuned…

Turning our gaze internationally, while the fiddling and smoldering has been going on in Washington, the Brits have officially triggered what could be a messy divorce from the Continent. The reaction so far has been muted - likely because there is no surprise this far beyond the actual vote - with Sterling slowly creeping upward, out of the hole created by the surprising Brexit vote results last June. This process is likely to generate a lot of ugly headlines and volatility but it does seem that the UK is in a good position to negotiate trade deals over the two years the breakup will likely take. We still have our toes in those waters as part of our overall allocations, even after pulling back toward the US a bit recently and it is something front and center on the radar.

Back to the Federal Reserve for a moment... With employment at current levels and economic activity continuing to grow slowly, we are finally at a point where the Fed needs to "normalize" interest rates. Historically speaking, that means Fed Funds at about 3% - 4% (with PRIME approximately 300bps higher) instead of the current 0.75%. The first two increases in December and last month elicited nary a yawn from the bond or stock markets. It is now seen as a vote of confidence in the economy, rather than an impediment to growth. As long as campaign promises move ahead (specifically tax reform and infrastructure projects) I would expect them to move upward two or three more times this year and three or four times over the next two based on their own projections. At that pace, I think there will be little to no harm and it will be like boiling a frog in terms of keeping inflation in check without drastically hampering growth.

However, if the economy stalls because of Government missteps (again) and the Fed has to stop their progression, which will send a message that equities likely won't appreciate. Conversely, if inflation rears up because of a rapidly improving economy, I think the Fed can tamp that fire out with more rapid moves. Those may be perceived as negative in the short term, especially in the bond market and will crush holders of long-term bond funds, but it will lead to greener pastures down the road.

Is there a correction in equities coming? Possibly, but it won't occur because of wild over-valuation. I hear this argument all the time, but broad values are not crazily out of line historically. If the belief blossoms that the economy is on the precipice of extended, higher rates of growth, that will be the emotional fuel to keep things moving. Remember, 2016 was the first real "up" year in 3 - grinding sideways works as well as a drop to bring share prices in line with underlying fundamentals. It merely takes longer to appreciate the results.

And in reality, the broad market averages may not have had a "correction" for quite awhile, but the majority of the underlying industry groups have taken their lumps individually over the past couple of years. It may not be in the headlines, although it is the reality.

To end with a favorite quote from Ben Graham seems appropriate in our current environment, *"The intelligent investor is a realist who sells to optimists and buys from pessimists*." Here's to continued pessimistic headlines and the media constructing our wall of worry!

Thank you as always for your business and please ping me with any questions - wishing us all a great and interesting remainder of the year.

Cheers!