



And down the stretch they come!!

John M. Gustafson – 1 October 2016

Using a line that is most closely associated with a Triple Crown race to lead this missive, is probably soft-selling what has felt more like the Mongol Derby – a grueling, 1000 km slog through the Mongolian Steppe. recreating Khan’s 13th century mail system. It - just - keeps - going...

In spite of the ridiculousness and disappointments in big-time, American politics over the last year, the markets have been relatively kind to us. Part of that is simply because we have been in a (slowly but steadily) growing economy where nobody actually believes the good news. The proverbial “wall of worry.” Yes, the growth is anemic, but it’s still growth. The criticism I see / hear lately from the usual hand-wringers is terming it, “almost recessionary.” Well, this isn’t horseshoes, so it still doesn’t count as recession.

The resiliency across the globe has been impressive as well... Brexit isn’t the disaster everyone predicted, oil has rebounded off the lows and remains in a range that seems to allow profitable exploration for most in that business, but not so high that it’s a drag on an economy like ours that runs best on cheap money and cheap gas.

Internationally, Brexit has really only just begun. However, what I’ve read recently appears to be a very smart plan by the new PM. They are basically going to vote that all current EU laws that have applied to Britain over the years immediately become British law. That way, they can carefully take their time to review each and keep it, throw it out or modify it over the next several years. This should make it much simpler for businesses having divisions in the UK, allowing them to continue to work there and remain compliant and also adapt gradually as laws change.

Don’t get me wrong, the economic reality in the US and abroad is nowhere near the nirvana of explosive growth we saw in the 1990’s - which also inflated one of two historic economic bubbles - but it isn’t as dire as many of the politicians espouse. It is somewhat odd in that many

of the candidates running for national office continue to tell Americans how dire it is, why it's the other side's fault and that said candidate is the best option to fix it. Even though most of these folks have been part-and-parcel to the laws, processes of government over the years that landed us here.

In truth, the market perception as to the dangers of our flawed Presidential candidates appears to have subsided slightly in terms of potential economic damage. Primarily because there is now predicted to be little change in Congress. Originally the "fear" was that if Hillary were elected, the Democrats may at least capture the Senate and come close in the House. However, most of the figures I've seen lately show that a change in the Senate is very unlikely and the House is almost impossible. This takes away Clinton's ability to pass anything significant, and likely be unable to successfully nominate a very left-leaning Supreme Court Justice. (A process the GOP completely bungled and gave-away and leverage earlier this year.)

The other hurdle either candidate will have in the House (and Paul Ryan's nightmare) is that the most likely losers appear to be the "moderate" Republicans - thereby shifting the GOP seats even more to the extreme. And they hate Trump as much as they do Clinton, thereby blunting his ability to do anything crazy as well.

In my last notes I mentioned wanting to see the first "debate" before trying to predict the who and why of what's to come, but I'm afraid that circus offered little clarity. I know this has been Facebook fodder for some time, but this election truly is a Hobson's choice between P.T. Barnum and Boss Tweed.

It does remind us of the Wisdom of Winston Churchill, who famously told the House of Commons, "Democracy is the worst form of government... Except for all the others that are tried from time-to-time." The extremes of the main stream media seem to forget that we are electing a President, not the King or Queen. And the current divide in American politics will not "benefit" either candidate once in office. Certainly not in a rubber stamp fashion on any policy outside of necessity. (i.e. Debt ceiling, operational budgets, etc.)

So what are the risks?

A recently prominent issue is Deutsche Bank, which has been rumored to be in a "Lehman" situation over the past week, sparks another contagion. Unlikely in my opinion for a couple of reasons. They are a traditional "bank" and even if their derivative-leverage got out of whack, they would never be levered to the extent that Lehman was and they are also critical enough to

the German economy, that it will likely be contained. (i.e. bailed out) It may hurt that stock, but it shouldn't spread as far and wide as Lehman. The outlier scenario is that it could be blamed on the German financial support of the EU, thereby beginning talk of their potential exit from the Union. That is fairly extreme, but that is the sort of emotional situation that could cause trouble across the globe.

Another issue: Syria can continue to escalate and something truly terrible happens. (mass chemical attack, battlefield nuke from a breakaway Soviet Republic, rash of coordinated terror attacks across the globe from "refugees," etc) This is shaping up to be the proxy war of the current age - think Afghanistan in the early 80's. Not sure of the actual economic implications at this point, but a tinderbox like that certainly can keep the global malaise in place and continue to make things feel bad regardless of actual outcome.

Oil will likely remain volatile and political. As outlined in one of these notes several quarters ago, the Saudi's have blinked and realize they need to change their ways to account for their dramatic revenue drop. They still distrust Iran, but they are having their own economic problems caused by oil remaining low. I expect at least continued talk of supply constraints, but not sure of the actual compliance with any agreement. That said, we should at least remain at current levels and have likely seen the lows last year. That doesn't mean there won't be more bankruptcies of higher-cost producers, but the risk to the large-scale players has likely passed. (the corporations, not necessarily the MENA countries beholden to oil)

China remains a bit of a wildcard. They continue to struggle as a maturing economy, but again their "slowing growth" is still 3x-5x most of the rest of the world's large players. This is the interesting area that may be most disrupted by a Trump win. They have served as his punching bag throughout (even as he continues to enjoy their manufacturing services) and I think that will continue. The bottom line is, they do need the US, far more than we need them - especially now that the rest of developing Asia has become more modernized. Certainly something on the radar.

Finally, back to our politics... The Clinton campaign chose to coast for a couple of weeks (allegedly while Sec. Clinton was suffering from pneumonia) and paid in the polls for their inaction. Trump has proven to be easily provoked and that is the strategy to get him to "punch himself in the face daily" as I heard quoted on some "news" outlet. When left alone, he does seem to stay on message with his current team and talk about what he wants to do, rather than simply throw low blows at his opponent. On the other side of the aisle, their current strategy seems to be to make Trump look unstable and crazy by continuing to poke him as he can't keep quiet and not take the bait.

Back in 2012, I wrote about the GOP's flawed strategy of being completely negative - as the Democrats had attempted in 2004. It was "Bush is dangerous and dumb" in '04 and "Obama is dangerous and un-American" in 2012. Neither strategy came close to working and I posited that it's because people vote *for* someone in an election, not *against* his or her opponent. This may be the first election in history where both are running against the flaws of the other in a race to the bottom, rather than any reasonable push toward the light. I'm not sure yet whether this will bring historic high or historic low turnouts at this point.

Going back to the earlier statements, currently it does seem as though it really doesn't matter from an economic standpoint as neither will have any sort of moral-authority and / or coat-tail advocates on the Hill.

I think the election boils down to this... Both of these candidates are deeply flawed but wasting more time and energy trying to point out the fact that the other is worse, is a waste of time. There are people who will vote for anyone except Hillary, and for the "D.C. outsider" and nothing will change that. The same holds true for staunch Democrats who will not swing the other way no matter the avalanche of accusations. Whomever can pivot to showing what they plan to do (other than just claiming to give away free stuff that everyone knows America can't afford) will have the best chance, (IMO) and at this point it's simply too close to call.

I am happy we performed the major rebalance last month and am comfortable with current allocations. That said, we stand ready to make moves if something completely flies off the rails over the next five weeks. Stay tuned...

Thank you for your business, ping me with questions - here's to a great and interesting remainder of the year. Cheers!

A handwritten signature in black ink, appearing to read "J.M. Gustaf". The signature is fluid and cursive, with the first letters of each word being capitalized and prominent.