



Negative Feedback Loop

John M. Gustafson – 2 July 2017

Sitting in my office and contemplating the upcoming 241st birthday of America, it seems as though the unending stream of nonsense coming from the government couldn't get much worse. However, a thoughtful sermon from the wise Rector of our church returned a little perspective and clarity to our current American situation that I'll attempt to weave throughout this note.

Strictly in terms of the investment markets, after several years of volatile yet flat performance earlier this decade, stocks have seemingly been rising in spite of the constant negative news over the past 12-18 months. The political noise has continued to drown out the fact that the American economy can chug along in positive territory almost no matter what goes on in Washington - as long as the Federal Reserve (who face constant criticism from both sides) continues to function as the adults in the room and counteract the woeful inaction by the elected cabal.

Much to everyone's chagrin currently, the healthcare debate continues to rage with misinformation and propaganda shoved out the door daily by both sides of the aisle. The embarrassing, irrational tweets of the President show little signs of ceasing, despite their immature and cringe-worthy content of late. I'll be surprised if anything comes of this issue in 2017 and healthcare stocks seem to agree - more on that later.

We are clearly in an age that gives everyone almost too much access to information. By that I mean, a person can find a convincing opinion article on whatever side of the argument they may reside, thereby reinforcing his or her own opinion with new "facts." I'm not interested in a journey down the rabbit hole of "fake news" or any other misnomer that may be out there, but this sort of quasi-logical thinking has been around in the investment realm for decades and has only become worse recently.

As I've previously lamented, the easiest character to be as a pundit - whether you discuss politics or investments - is on the bearish / negative side. Even though that has generally been a losing strategy (financially speaking) for quite some time, it is the safest position to take publicly. If you're always cautious to slightly negative, and people listen, all they lose out on is an opportunity, and that's difficult to quantify. (i.e. Nobody runs performance reports outlining how much you lost by not making an investment.) However, if recommendations are made and

followed - proving later to be wrong - the losses are easily quantifiable. I'm not saying everyone should be wildly bullish, but the cheerleaders were popular in the 90's and now we're completely the opposite. (Balance is always the best approach, except in the media apparently.) And as gamblers would say, "Fade the public."

It is not at all dissimilar to what we see and hear coming from our government, at all levels and from both sides of the aisle. Neither side spreads a positive message, (with specific details) but simultaneously can explain why the opposing side is wildly and dangerously incorrect on their current path. It is the easy, unaccountable message to continue to spew with no real alternative course of action. President Trump is clearly the king of jingling shiny (vulgar) keys in front of the breathless media - who all continue to rise to the bait as easily as he. However, the Honorable Senator Schumer is no slouch when it comes to putting on a distracting show with worthless content to disguise his ineffectiveness as well.

This brings me back to the revelation I had from Sunday's Sermon... (you knew I'd get here eventually ;) It was pointed out, while discussing the birth of our Nation and it's sometimes crazy history, that many of the news headlines of the mid-19th century loudly lamented the fact that our government had, for far too long, been populated by "scoundrels and charlatans" interested only in their benefit and not those who elected them to their positions. History doesn't repeat itself, as Mark Twain told us, but it certainly does rhyme.

The American Experiment has been just that for all these years and thinking about it in those terms also reminded me of Congress' almost criminal inaction on multiple occasions in recent years that have truly caused drastic economic disruptions. We've seen this with the debt ceiling, currently with healthcare, dealing with terrorism, etc. Clearly, that modus operandi has almost always been the case (other than possibly during the World Wars of the 20th Century) but it has also been reality that before the clock strikes midnight, the proper actions are taken and things generally fall into place - but *never* prior to 11:58.

The current administration came to D.C. with three big promises to enact - all with fairly large economic and investment implications. The first, is the previously mentioned repeal and replacement of "Obamacare" - hopelessly mired in the bureaucratic nonsense of Congress with little chance of producing anything other than the Right side of the aisle's version of the Left's debacle we're now experiencing. And regardless of your politics, the ACA is a complete disaster and will continue to be an economic drag until it's repaired or replaced.

Some personal perspective... Since beginning Palmetto Wealth Management in 2009, my family has had the same health insurance coverage with zero changes, provided by Medical Mutual of Ohio. Since that time - again, with *zero* changes to our coverage - our premiums have risen 341%! The major flaw in that law is that insurance companies were required to cover everyone, but no limits or other restrictions were placed on how they can allocate or estimate costs, so they simply continue to overestimate potential outlays as if everyone *is* covered, and rake in billions

of dollars from the same folks who were already insured at lower rates. The primary reason for this? The truly sick people who can now purchase coverage, regardless of pre-existing condition generally can't afford the absurd premiums. And the younger, healthier folks, who are now required by law to purchase insurance, can't afford it either, so they simply pay the tax penalty (which is far less) and remain uncovered. All the while, the hospitals of the country, which always provided care to whoever entered their doors, (the lie of "access to healthcare") continue to do so in a still-unreimbursed situation. All of my small-business friends can tell a similar story.

The new GOP version, from what I've been able to read on the House & Senate websites, removes the requirement for coverage, allows those with pre-existing conditions to obtain insurance, but still doesn't address anything to do with the cost of the plans. That is why, despite the uncertainty that would normally concern the markets, insurance company stocks continue to soar. Their current, legislatively mandated gravy train is unlikely to subside, regardless of the name of the law. And if the insurance companies somehow are unable to make money in a given market, they simply leave that particular state. A key issue that never seems to be discussed (IMO) is that insurance has *always* been controlled by state law and until that changes, the Feds have no real options for a viable, long-term solution.

At this point, the Senate and House are too far apart and nothing will likely come out of committee in a completed format. The critical year will be 2018 - as we all know, every member of Congress is only truly concerned with getting reelected - and the critical ("midnight") date for the Affordable Care Act is January 1, 2019. That is when folks like me, who have non-ACA health plans grandfathered-in, will be required to drop them and enroll in the ACA. That is the sort of 11th hour crisis that should motivate Congress into action. One Caveat - the election year always has a chance to blow logic right out of the water. We'll see...

I wish the current members of Congress (and all future Congressmen really) would consider the founding quote that is the motto of this firm. E. F. Schumacher wrote in his economics book, ("Small is Beautiful - Economics as if People Mattered" - 1973) "Any intelligent fool can make things bigger and more complex... It takes a touch of genius - and a lot of courage - to move in the opposite direction." Our lawmakers continue to insist on building Rube Goldberg machines, muddled by special interests and lobbyists, rather than simply figuring out a way to solve a problem. Whatever you think of Trump, at least his stated *intention* is to try and simplify Federal red tape - unfortunately to this point; it doesn't appear to be happening in healthcare.

The second two pieces of the Administration's agenda that I do think will get handled in some fashion this year are tax reform and infrastructure projects - both great economic levers. I'm not sure that too much will change on the individual side - I'm guessing that there will be quite a reduction for corporate taxes. Another reason the U.S. markets continue to grind higher with anticipation... Companies continue to invest, merge and overall have positive plans for the future - a tax cut will throw gasoline on that fire.

Infrastructure projects are the one thing that both sides of the aisle seem to realize that we need. (and what I believe should have been tackled first before burning every ounce of political capital flailing about with healthcare) There are too many bridges and roads out of spec and potentially dangerously so, and every Congressman would love to sprinkle piles of federal dollars into their districts going into the election next year. That is something I believe will be accomplished before the holiday recess at the end of 2017. (Unless the President continues to punch himself in the face via Twitter enough to become perceived as truly toxic and unsupportable by those up for reelections next year.)

The wild unpredictability of the current administration would normally be unsettling to the markets. However, even though the President continues to cause chaos, the Republican-controlled Congress and Senate can't seem to agree even with their own party on anything. It's just business as usual in the corporate world with no disruptive legislation making its way through the snake's belly of Washington D.C. - a pattern that seems unlikely to change.

In terms of bubbles and wild over valuations, questions that always seem to come up in conversation; this market exhibits very little "bubbly" characteristics. Yes, the averages are nominally at record levels, but we were near these levels roughly 17 years ago. At that point, most of the valuation driven indices were being pushed higher by 15 to 20 companies, even if it was an index that tracks 500 or 1000 stocks. Currently, the gains are much more broadly based.

Back at the turn of the millennium, the aggregate earnings for the S&P 500 were barely half of what they are currently - while we continue to inch into record index-territory, the U.S. stock market may be fairly valued, but it can't possibly be seen as wildly overvalued by those numbers. And as much of the clown show as we have going on in our government, the rest of the world still seems to have plenty of their own troubles on hand to allow the United States to continue to serve as a safe haven. Something that can't be discounted...

For further perspective on the current market averages, when the "tech bubble" burst in early 2000, those companies made up almost 35% of the value of the S&P500, whereas now they are only 22%. A little high, but not grossly so... When Oil / Energy was at the peak a couple of years ago, that group was over 30% and is now less than 10%. And finally, prior to the 2008 credit crisis and recession, Banks / Financials were over the Mendoza Line of 30% and now sit at roughly 14% of the mix. All, well-within historical norms.

Looking ahead, it seems that there remains little value in anything other than short and/or adjustable rate bonds, (which is how we have that slice allocated) some good value in Emerging Markets and broad opportunities from small to large cap here in America. Tech may be a little flat in the near future - as indicated by their high-current-weight in the averages - but the rest of the U.S. continues to move higher, despite the political noise.

Finally, to wrap this big mess up with a pretty bow, I'd like to recommend a great article I read over the weekend in *The Wall Street Journal* titled, "America, Meet America." It went into great

detail regarding a lot of political problems I've written about here for years that affect our lives and our economy. Everyone lives in a self-imposed bubble and we need to start doing something to cross-pollinate once again.

Much of it has a good deal to do with the hyper-segregation of the media and one's ability to only read or hear agreeable opinions, but it also has a lot to do with a subject that may be on it's way to being repaired - the process by which Congressional districts are set. There has been so much gerrymandering over the past couple of decades by both parties that it's almost impossible to unseat an extremist on either side and it's simply not healthy.

Congress isn't Parliament and isn't set up to function that way. SCOTUS will hear a case along those lines this fall - fingers crossed. It could be the tipping point to at least begin to move back toward civility and two-sided discussions in politics and general society. No more screaming, safe-spaces, free-speech that's only free if it agrees with me, etc. Something worth watching, for sure...

It is said we are in the "new normal" - and maybe it's just because I'm older, but I'd like to return to a time when things were a bit more balanced. (Although, based on my recitation of 175 year old headlines, perhaps that never truly existed except in our collective conscious.) In the meantime, we will continue to monitor the political shenanigans and position our investments accordingly.

Thank you as always for your business and please e-mail or call me with any questions - wishing us all a great and interesting remainder of the year. Happy Birthday, America!

Cheers!

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