What's Past is Prologue

John M. Gustafson – 29 December 2016

"The pendulum of the mind alternates between sense and nonsense, not between right and wrong." – Carl Jung

Dr. Jung's quote is a fitting allegory for what has been a very interesting year across all facets of life. Especially since Jung is also the man who created the term "collective unconscious." 2016 not only shined a hot spotlight on the two vastly different "Americas" in terms of politics, investment markets and even general personal philosophy - it has also revealed that there are unconscious similarities of belief as Americans that rise to the surface, especially in times of national elections.

This year almost more than any other in the recent past proves the old saw that, "markets climb the wall of worry." Both sides of the political aisle in our Presidential election felt their opponent would bring nothing but disaster to the economy and our standing in the world. However, the markets continue to grind higher after the surprising result – something you would never realize by any of the political bloviating or even in the business press constantly predicting doom just around the corner.

However you perceive the outcome of the election – either excitement or disappointment – the one thing everyone seems to be able to agree on is that *everything* just changed. That's the real reason, in my mind, for the strong rally we've seen since Donald Trump was elected President. In these notes over the past several years we've called generally subdued feelings, "the malaise" driven mostly by the negative news cycle coming out of Washington's rhetoric, with both sides blaming the other and convincing people that things are terrible – despite the continued improvement of actual economic numbers. As I pointed out multiple times, "slow growth" is not "recession."

With that kind of ongoing narrative, constantly trumpeted on the news, it is almost impossible to change the mentality of investment participants or even regular members of society. Now that a complete outsider is sitting in the big chair and appointing people to jobs in departments that many of them dislike and want to change, whatever you think of what might happen, at this point it's pure speculation. What I hope we see, is a clean sheet of paper for most of the Federal budget and tax code, to truly move things forward without the saddlebags of failed policy and lobbyist detritus of the past.

From where I sit, that is going to be the primary focus when it comes to adjusting allocations and managing portfolios in 2017. If truly new and different policies are proposed and implemented that make financial sense, it could lead to an explosive rally in the markets that we haven't seen for 25 years. However, if the "outsiders" fall victim to the lobbyist vortex in Washington DC and bills are loaded up with non-germane amendments rendering them completely ineffective we will fall back into a familiar rut. (The real problem with the Affordable Care Act – anything it was meant to solve was amended out of the law by pharmaceutical company lobbyists, state insurance boards and other political players.)

Our investment philosophy remains one of a broad, global allocation but there will be some fairly major changes coming as we slide into the new year. For instance, the 30+ year rally in bonds from ever falling interest rates is clearly over. With unemployment as low as it is, and expected to plunge further as disenfranchised workers once again look for a job, this will undoubtedly ignite some wage inflation along with the predicted increase off the bottom last year of oil and other energy prices.

If policy moves in line with President Trump's stated intentions, it should be a boon for the US economy and likely our stock market. We probably won't eliminate emerging markets and other international portions of the portfolio, but we are working on shaving non-US allocations for sure. In a similar sense, because of the previously stated bond / interest rate adjustments on the horizon, will have almost no "fixed" income allocation, but rely more on economically sensitive, floating-rate and convertible issues to give us a "bond" safety net that pays good dividends and interest but can also adjust accordingly as rates and the markets rise.

Outside of crazy US politics, the world did seem to become slightly more dangerous as the year went on. This isn't anything we can allocate portfolios to guard against and the sad fact is, because these "lone wolf" types of attacks have become more common, the investment markets almost don't even react. If something is truly devastating, along the lines of another 9/11, that could put things off the rails and we are vigilant for such things, but again you can only bet on the end of the world once.

The largest economic item that I believe we'll see is significant tax reform. If the corporate tax laws can be corrected to allow companies like Apple, General Electric, Caterpillar et al to repatriate billions (possibly trillions) of their capital, surely most will take advantage. Not for any patriotic reasons, it's not a corporation's job to be patriotic - simply because it is far less hassle to domicile your working capital and financial reserves in the same country in which you are headquartered. There are a lot of lawyers-paid and cash-burned arguing with other countries over their tax policies as well. It seems every few weeks there is another news story about some large corporation fighting the tax collectors in a foreign land. Most corporate boards would likely enjoy the chance to be viewed in a positive light for their financial moves as well.

In terms of other major policy in the rumor mill, the Affordable Care Act has to be on top of everyone's radar. However, as simplistic as the talking heads on TV (and the bloviating politicians) like to make it, if you simply throw out the law and claim that you are reverting to the previous regulations, my belief is that none of the insurance companies would change anything. They've spent six or seven years becoming compliant with Obamacare and are not going to simply burn all that money to go back to their old ways unless they are forced to do so.

My hope is that the most politically motivated (not medically nor financially sound) restrictions are removed quickly and special pressure is put on the drug companies to help bring our costs more in line with the rest of the globe. The bottom line is, without doing something about the fact that insurance law is controlled on a state-by-state basis and legal liabilities in America continue to be a problem, I'm not sure what can realistically be done. It is a sector that I will happily avoid next year until there is some clarity on what's to come.

One thing is for sure, there will be no excuses for the GOP; the White House, the House of Representatives, the U.S. Senate and 70% of state governments around the nation are now in Republican hands. If this opportunity is blown and nothing is accomplished the 2018 midterms and especially the 2020 elections (which are currently thought to be well in hand for the GOP) could offer a stunning reversal. As it's always noted, all politics are local, so the thought of all these people working together under one vision doesn't seem entirely possible, but I will at least give them a chance to do the right thing. Remember, we are still in an era where both sides of the political aisle view a 65% win as a 100% loss and compromise is a dirty word.

This may be one characteristic where Trump is more like Bill Clinton than Barack Obama - in terms of the ability to use the bully-pulpit of the Presidency to get people to bend to his will and make actual change. For those on the other side of the aisle, I know things feel bad, but the good news is once actual change occurs if you then grab the helm, the thought of making different changes is much more palatable. I'd like to see a study done on it, but it sure does appear that there has been less actual legislation passed and signed into law over the past decade than during almost any political cycle of the past.

This appears to be the real risk… We've been accustomed to emotional grandstanding and finger-pointing but little actual movement. We may be entering a period where legislation is actually passed and implemented and/or removed as law at a fairly rapid pace. This is sure to cause increased volatility as the implications of such changes are valued. Neither good nor bad, just different than what we've experienced in the recent past and the reality as to what is likely in 2017.

Over the past few days, the financial media has been jumping on the fact that the markets are down slightly and making the analogy that "the Trump rally might be fading." The more likely truth? In a year that the market averages are up nicely, but one that also contained significant volatility (Brexit, elections, terrorism, etc.) that may have caused folks to take profits at one point or another, it’s not at all surprising that tax losses are being harvested this week. As much handwringing as we saw during the elections, I’ve still yet to meet anyone who would prefer to pay more taxes.

Going forward, from a purely American economic perspective, I think the collection of successful business people in the new cabinet bodes very well for our economy – and our investment allocation adjustments will reflect that. The wildcard of course, as we are all more globally integrated year-by-year, is how the strong dollar and political rhetoric from the new administration regarding trade will reverberate around the globe. Will President Trump, a person who is willing to speak his perceived truth with seemingly no concern for the consequences (rather than be a traditional, subtle diplomat) permanently upset existing economic relations with other economic powers? Stay tuned… I’m sure those exact questions are being discussed in Beijing, Mexico City, Mumbai, Ottawa, etc.

President Trump’s political power will surely grow as long as the economy improves – and as we’ve been noting consistently each quarter, the economy has continued to improve for several years, regardless of the public perceptions and media spin. If the policy governor is fully removed from the American economic engine (which does seem to be the point of most of Trump’s economic blather) we truly could see a doubling of economic growth rather quickly.

I for one would love to have a shot at reliving the 1990s – economically speaking. We’ve certainly had quite a long cycle with a lot of noise but not much overall movement and it’s been no fun. I don’t know about making America *great* again but I sure would be up for making it *fun* again.

Thank you for your continued business - please ping me with any questions.

Here’s wishing you all a happy, healthy and prosperous 2017. Cheers!