

October 1, 2016

Greetings,

In my last investment letter, I wrote to expect increased volatility as a result of the “Brexit”. That volatility lasted about two days. I wasn’t all that concerned and once in a while, it is nice to be right. If anything, once earnings season was over in early August, the market had about the quietest 5-6 weeks in years. When was the last time you heard anyone mention the word “Brexit”? At the time of Brexit, the DOW dropped 600 points in one day and the talking heads tried to outdo each other as far as the market impact. Most of them thought that the market’s reaction would continue to be severe, possibly even leading to a 10% global market correction. I don’t think so. I find it astonishing how these people who are consistently wrong with their short term market predictions, continue to attempt to predict what the markets will do in the short term when it is so obvious that they can’t possibly get it right. I am humble enough to acknowledge that it is impossible to predict short term market moves so I don’t bother trying. On occasion, I will raise our cash level in a hot market but that is the extent of it.

Speaking of exercises in futility, the Federal Reserve continues its’ best imitation of The Gang that couldn’t shoot straight. It is a tough call as to whether they are just scared to raise rates because of how they feel the market will react or whether they simply don’t know what they are doing? I will admit, it isn’t the easiest call in the world. On one side of the argument (dovish), the economy is so weak, they are fearful of raising rates too fast as to cause another recession. The other side (hawk) makes an interesting case that zero interest rates are for an emergency situation and even though the economy does stink, it is not an “emergency” situation and the US economy is not in a recession. Close but no cigar. One case that I whole heartedly agree with is that after so many years of zero interest rates, we have reached the point of diminishing returns. Low interest rates have a positive (stimulative) economic effect by allowing consumers (and some businesses, at least the ones that the banks will lend to) to refinance their debt, which puts more money in their pockets to spend. Interest rates have been so low for so long that there is no one left to refinance anymore so it simply isn’t helping the consumer. If anything, banks have less incentive to lend to businesses (and I am the last person to defend the banks, any Wells Fargo customers out there??) since they can’t get much of a return on their loans with the interest rates so low. While it is a positive for the stock market to have historically low rates, for anyone outside of the markets, the benefit is minimal now.

Corporate profits overall continue to be poor. The energy sector is still in a deep recession and that is weighing on earnings in general. Other than the energy sector, earnings were mediocre at best. With Gross Domestic Product growing at 1% (just a smidge over recession levels) to expect stronger earnings is not realistic. The broad market has been doing reasonably well lately despite poor corporate earnings. With stock prices going up and earnings going down, the broad market is a bit pricey. It isn’t a concern to me since most of our holdings are either reasonably priced or cheap. The bond proxies are

the expensive stocks. Third quarter earnings are supposed to be down for the sixth consecutive quarter. Perhaps the slump will be over in the fourth quarter. The economy was supposed to be improving by now so it is difficult to pin point exactly when things will improve. The uncertain political situation isn't helping things that is for sure.

Speaking of the political "situation", I had one of my worst headaches in a long time yesterday afternoon. I wouldn't be surprised if the Presidential election was at least a partial cause. Personally, I truly wish this election were over tomorrow. While I will keep the vast majority of my feelings to myself, I will simply say that I find it sad that these two are the best that this country can find to run the country and leave it at that. As far as the stock market effects, the market likes certainty and predictability. It would be difficult to find anyone more uncertain or unpredictable than Donald Trump. Since the market likes predictability, Hillary Clinton will be the stock market's choice, despite her numerous shortcomings and proposed tax hikes. Please keep in mind that the House of Representatives will almost (I only say almost because the video released last Friday now gives the Democrats a remote possibility of regaining the House as opposed to a zero chance before the video was released) certainly remain in Republican control so all of her proposed tax hikes will be dead on arrival. Hopefully, if she wins, she will be able to work with Congress and accomplish something good as her husband did in the 1990's with a Republican Congress. The Fed is out of ammunition. About the only way out of this lethargic economy will be with some productive fiscal policies.

If you have any questions or anything that you would like to discuss, please either call or email me.