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SECOND and THIRD QUARTERS, 2017

MY COMMENTS AND OPINIONS

THE ECONOMY

"The US Economy grew by 3% in the Second Quarter, the best performance in two years. The current recovery has entered its ninth year — long by economic standards — but it is showing some unexpected vigor. The Commerce Department said on Wednesday that the economy had expanded at an annual rate of 3 percent in the second quarter of the year, better than initially estimated, and a substantial acceleration over the first quarter's lackluster 1.2 percent pace. The revised figure is still well below President Trump's goal of 4 percent growth, but it is the economy's best quarterly showing in two years." - *New York Times, Nelson D. Schwartz, August 30, 2017.*

The total effect on the U.S. economy due to this year's natural disasters won't be known for some time. In early October, 2017, estimates as high as $200 Billion have been discussed in the media. On the loss column is the amount of money the insurance industry and government will be distributing to those who have suffered losses. On an information website called **Vox,** I found these statements: **"In 2010, 123.3 million Americans lived in coastal counties, about <u>39 percent of the population</u>. By 2020, another 10 million will be catching sea breezes. A lot of people want to live near the water," said David Samuhel, a senior meteorologist at AccuWeather."**

UNEMPLOYMENT

There are six unemployment measurements used by the U.S. Department of Labor Statistics, U-1 through U-6. **U-1** counts persons unemployed 15 weeks or longer, as a percent of the civilian labor force. In August U-1 was 1.8%. **U-3** is total unemployed, as a percent of the civilian labor force. This is the official government unemployment rate. In August U-3 was 5%. **U-6** is total unemployed, plus all persons marginally attached to the labor force, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all persons marginally attached to the labor force. In August U-6 was 9.7%. The total U.S. workforce at the end of the Second Quarter was about 15,500,000 unemployed or partially employed. **U-2** and **U-5** measure intermediate statistics.

- NOTE: Persons marginally attached to the labor force are those who currently are neither working nor looking for work but indicate that they want and are available for a job and have looked for work sometime in the past 12 months. Discouraged workers, a subset of the marginally attached, have given a job-market related reason for not currently looking for work. Persons employed part time for economic reasons are those who want and are available for full-time work but have had to settle for part-time employment. Updated population controls are introduced annually with the release of January data. *Source: US Department of Labor Statistics*

INFLATION - We usually think of consumer prices when discussing inflation. Most commentators tie price inflation to interest rate increases. One of the primary forces that drive up both interest rates and the cost of living is the amount of money in circulation. Prices of things and services move up and down based on "market forces." If most of the people have very little money, they are unwilling and unable to purchase goods and services. When this occurs, the prices of the goods and services drop to meet market demand. When most of the people have more money than they need for the basics, market forces drive up prices to the level that the market will support. During times of recession, prices drop. During times of inflation, prices rise. Right now we have what could be called a Goldilocks Economy. Our economy is not growing

too fast nor too slow. Prices of most goods and services are somewhat stable. A few notable exceptions to the stable price category are the costs associated with secondary education – colleges and universities. Another is medical care – hospitalization, drugs and professional services. The supply of oil is a determinant of inflation. When there's a surplus of oil, prices stay low or even drop. A shortage, as happened during the 1973 Organization of Petroleum Exporting Countries' oil embargo, can drive prices of oil much higher. Back in the 1970s the term "peak oil" was bandied about. The message was that there would be a point of maximum extraction followed by a time of diminishing returns. Since the early part of the 20th Century various predictions of our 'running out of oil' have been circulated. These forecasts were based on the belief that there was not much more oil to be found and that within a short number of years the supply of crude oil would be spent. Well, not yet as it turns out. Trillions of barrels of oil locked up in shale have been made available through new technologies including a technique called fracturing or fracking, the environmentally controversial method of cracking open fissures in deep layers of rock, has released a great quantity of oil in recent years.

"A 2016 conservative estimate set the total world resources of oil shale equivalent to yield of 6.05 trillion barrels (962 billion cubic meters) of shale oil, with the largest resource deposits in the United States accounting more than 80% of the world total resource. For comparison, at the same time the world's proven oil reserves are estimated to be 1.6976 trillion barrels (269.90 billion cubic meters)." Source: Wikipedia.

Another notable example of inflation is the price increase of common stocks over the past 8 years.

THE STOCK MARKET

Longest Recovery Ever - First Trust Portfolios, L.P.
Brian S. Wesbury, Chief Economist
Robert Stein, Deputy Chief Economist
Date: 10/9/2017

"If the current economic expansion lasts another year and a half, it'll be the longest on record, even surpassing the expansion of the 1990s that ended in early 2001. Notice how we didn't say it'll be the "best" expansion of all-time, just the longest; it's not the best by a long shot. From the recession bottom to the expansion peak, real GDP expanded 39% in the 1980s and 43% in the 1990s. So far, eight years in, this one is only up 19%. That's why we've been calling it the Plow Horse Economy.

"Still, the length of the current expansion is pretty remarkable given how doubtful most were that it would even get started back in 2009, as well as all the predictions since then that it would end in spectacular fashion during the past eight years.

"And we think the odds of going at least another 18 months are very high. Nowhere do we see the kinds of policy shifts or imbalances that could curtail economic growth enough to throw us back in recession.

"In terms of policies, tight monetary policy, a major shift toward protectionism, or large tax hikes could all hurt growth. In the past, tight money has usually been the key factor behind recessions. But, for now, short-term interest rates are about 125 basis points below the yield on the 10-year Treasury, roughly 200 basis points below the growth trend in nominal GDP (real GDP growth plus inflation), and the banking system remains stuffed with excess reserves. Yes, President Trump has talked tough on some trade issues, but has yet to follow through in any major way compared to previous presidents. Meanwhile, geopolitical issues regarding North Korea may limit his ability to antagonize China with the sort of protectionist policies he suggested during the presidential campaign.

As far as tax hikes go, recent tax proposals would cut key marginal tax rates, not raise them. In other words, public policy isn't going to be the source of recession anytime soon.

"Meanwhile, home builders haven't overbuilt, consumer financial obligations are still hovering near the lowest share of income since the early 1980s, and bank capital ratios are substantially higher than before the financial crisis. Moreover, market-to-market accounting rules were tamed so that there's less likely to be a sudden drop in monetary velocity. Will there be another recession? Certainly! It's just very unlikely to start any time before spring 2019, which means the current expansion looks set to become the longest on record. And if Congress and the President get their acts together and find a way to pass tax cuts or tax reform (or both!), that should postpone the next recession even further into the future. Just another reason why equity investors have good reason to remain bullish."

This information contains forward-looking statements about various economic trends and strategies. You are cautioned that such forward-looking statements are subject to significant business, economic and competitive uncertainties and actual results could be materially different. There are no guarantees associated with any forecast and the opinions stated here are subject to change at any time and are the opinion of the individual strategist. Data comes from the following sources: Census Bureau, Bureau of Labor Statistics, Bureau of Economic Analysis, the Federal Reserve Board, and Haver Analytics. Data is taken from sources generally believed to be reliable but no guarantee is given to its accuracy.

We're now in the 8th year of this Bull Market. The average Bull Market lasts about 5 years. Does this mean we're overdue for a big sell-off **soon**? I don't think so. A few gyrations are always expected. We haven't yet seen Alan Greenspan's "irrational exuberance," a term he used during the 1990's Dot.Com Bubble. Most markets, stocks, real estate, commodities, collectables, etc. go in a zig-zag pattern with a long-term upward bias. No one can predict the near future of any market. Every five or six years we experience a down market when investors take profits, the news is temporarily bad, or for any number of other reasons. After the market swoons, smelling salts in the form of better economic news, bargain hunting investors, etc., eventually gets the market up off its fainting couch.

Money goes where it's best treated. We usually think of money as currency, such as Dollars, Yen, Euros, etc. But currency is only worth something if it can be turned into purchasing power. The value of money is its purchasing power. At 3% compound inflation, the purchasing power of money shrinks by about half in 25 years. Any time a country undergoes Hyper-Inflation (Germany after World One, Hungary in 1946, Zimbabwe from 2007 -2009), the purchasing power of each unit of currency spirals down until the proverbial 'wheel barrel of paper money is needed to buy a loaf of bread'. Source: Investopedia.

We must have money to function in a modern society. Money is obtained by trading labor for money, by selling things for money, by collecting income from our savings, by receiving dividends from our investments, by collecting insurance proceeds after a loss, by receiving retirement income from our pensions and/or Social Security. In all cases money has value only to the degree it can provide us with needed and wanted goods and services. The many trillions of US Dollars floating around the economies of the world are always looking for a happy home...where taxes are not onerous, where regulations are reasonable and where market forces reward capital investment.

By changing our thinking from "how much" money we have, I suggest thinking about "how much purchasing power" our money has. One of my first classes in financial services was a simple example of a person at three stages of life: 1) Learning; 2) Earning; 3) Yearning. The Yearning person did not make adequate preparation for the future during the Earning phase of life. We were taught to help people save, invest and insure so that they would not be yearning for the good old days once they retired. Fortunately, many of our citizens have been paying attention and have achieved a degree of financial security for themselves and their families. But not enough.

"If the present Congress errs in too much talking, how can it be otherwise in a body to which the people send lawyers, whose trade it is to question everything, yield nothing, talk by the hour?" ***—Thomas Jefferson (1821)***

With apologies to all the diligent members of the Bar, I only want to point out that many of those we send to Congress hold Law Degrees. Fifty Senators and about 167 U.S. Representatives in the 115th Congress are lawyers. Law students are trained to debate effectively. When our nation established the Constitution, the U.S. House of Representatives was to be filled with those who would speak for their neighbors. This was to give communities a voice in the central government. The House is where most bills (laws) begin. After consideration by the House, a bill may be voted on or put aside for future consideration (tabled). The Senate, whose august members are supposed to be the wisest and most thoughtful, deliberate the merits of bills brought to them.

Senators have a longer term of office, 6 years, vs. 2 years for each Representative. If we wonder why "nothing is getting done," it may be because our country is divided on many issues. Unless a bill passes both houses of Congress by an acceptable majority, it will never reach the President's desk for final signature.

This may account for so many Executive Orders signed by Presidents over the past several decades and why many laws have been interpreted "from the Bench," meaning that judges have been creating law by judicial edict, a way to by-pass Congress and the Executive Branch in order to create a new interpretation of an existing law. Only the Supreme Court can make a final determination as to the constitutionality of any law.

How does the political pot-stirring in D.C. affect our investments right now? Congress has a reputation of playing brinksmanship...delaying action until forced by external forces greater than their intransigence. Our recent national election reflects the basic divisions of opinion in America today. As long as the political pot is being stirred on low heat we should not expect any rapid changes. If the heat is turned up and the pot begins to boil over then we might see something not of the norm.

Source material for this letter include quotations from Wikipedia, The New York Times, Vox, an information website, Brian Wesbury, First Trust Portfolios, U.S. Department of Labor Statistics, Investopedia and Thomas Jefferson.