

December Economic & Market Outlook

Update on Markets

With Republicans in control of the Presidency, Congress and the Senate, the Trump administration will probably enact:

1. Lower taxes
2. Repatriation of approximately \$2 trillion of overseas U.S. corporate profits
3. Reduced regulations
4. Infrastructure & military spending

The markets are bullish regarding the prospect of fiscal stimulus, pro-business, and pro-growth policies.

Earlier this month I wrote,

“The markets are doing well for the following reasons:

- Many investors, and money managers like the new administration that is pro-growth and pro-business.
- The markets and some stocks are making new highs. Once prices break to new highs, it is normal for prices to continue to make new highs because all the supply, resistance of the previous high has been taken out, making it easier for prices to move higher.
- Money managers that have weak performance this year will have to move into the markets, equities to try and improve their performance. The better performance can help them achieve higher bonuses, and for some to keep their jobs.
- Trend followers and momentum players will continue to jump on the bullish trend.”

The markets continue to follow the same course as described above.

I also wrote, “Once the current rally sees profit taking, we can expect continued volatility in the markets.” We will probably see this at the beginning of the new year.

Also, I have the cable financial news on during market hours, and many guests, investors suggest investors/traders should wait to take profits in 2017 because of the potential tax cuts in 2017.

Trump = Reagan or W Bush

Some commentators, investors and money managers believe that the Trump administration could be similar to the economic and investment prosperity of the Reagan years. Unfortunately there is more in common with the Bush Administration.

Below is a table that lists the background, and some of the key economic metrics and trends of Presidents Ronald Reagan, George W. Bush & President Elect Donald Trump:

PRESIDENT	EXPERIENCE	GDP \$ TRLN	10-YR TSY	CPI	OIL	UNEMPLOY MENT	ECONOMIC TAILWINDS	ECONOMIC HEADWINDS	CYCLE
REAGAN	CALIF 2 TERM GVNR	2.73	10.80%	12.40%	\$40.00	7.60%	1. BABY BOOMERS 2. VOLCKER, REVERSING INFLATION 3. OIL PRICE COLLAPSE 4. LOWER TAXES	1. OIL SUPPLY DISRUPTIONS 2. HIGH INFLATION, INTEREST RATES, INFLATION 3. STRONG DOLLAR 4. U.S. GLOBAL ECONOMIC ENGINE 5 STAGFLATION	1981 RECESSION
BUSH	TEXAS 2 TERM GVNR	9.92	6.60%	2.70%	\$25.50	4.25%	1. SURPLUS 2. LOW OIL PXS, INFLATION 3. LOWER TAXES 4. HOUSING BOOM 5. CHINA BOOM	1. TECH WRECK 2. 911 3. GULF WAR II IRAQ & AFGHNSTN 4. CORP SCANDLS 3. HIGH OIL PRICES, INFLATION 4. FINANCIAL CRISIS 5. CMPTN CHINA, INDIA, RUSSIA, BRAZIL 4. FALL OF COMMUNISM	LATE STAGE OF CYCLE 2001 RECESSION
TRUMP	RE DVLPR TV REALITY STAR, CELEBRITY	18.45	2.57%	1.90%	\$52.74	4.70%	1. LOW INTEREST RATES, INFLATION, OIL PRICES 2. LOW UNEMPLOYMENT 3. LONG ECNMC EXPNSN 4. HEALTHY BANKING INDSTRY	1. DEBT 2. DEFICITS 3. LAW OF LARGE NUMBERS 4. SLOWING GLBL ECNMY 5. MARKETS OVERVALUED 6. STRONG DOLLAR 7. BABY BMRS, MLLNLS 7. LATE IN ECNMC MKT CYCL	LATE STAGE OF ECONOMIC CYCLE, RCVRY FROM GREAT RECESSION

Presidential Qualifications, Businessman versus Politician

President Reagan (California) and Bush (Texas) were both two-term governors of important states. They both had government, political experience. Donald Trump is well known as a real estate developer and celebrity, reality TV star.

There is always a question whether a business person has the right skills to take on what is probably the most difficult job in the world. Several businessmen have tried to run for President unsuccessfully (Ross Perot, Mitt Romney), and a few have run state and local governments (Mitt Romney, Michael Bloomberg) with some success. Donald Trump will be the first President who ran his businesses all of his adult life.

Not only is Donald Trump the first true business person as President, many in his cabinet will come from Wall Street and the business world. Investors certainly like the idea that many in his cabinet that influence the economy will be run by business people.

Those of us who went to business school were taught that the job of every corporate executive is to maximize profits: Profit Maximization = Maximize Revenue – Reduce and Control Expenses.

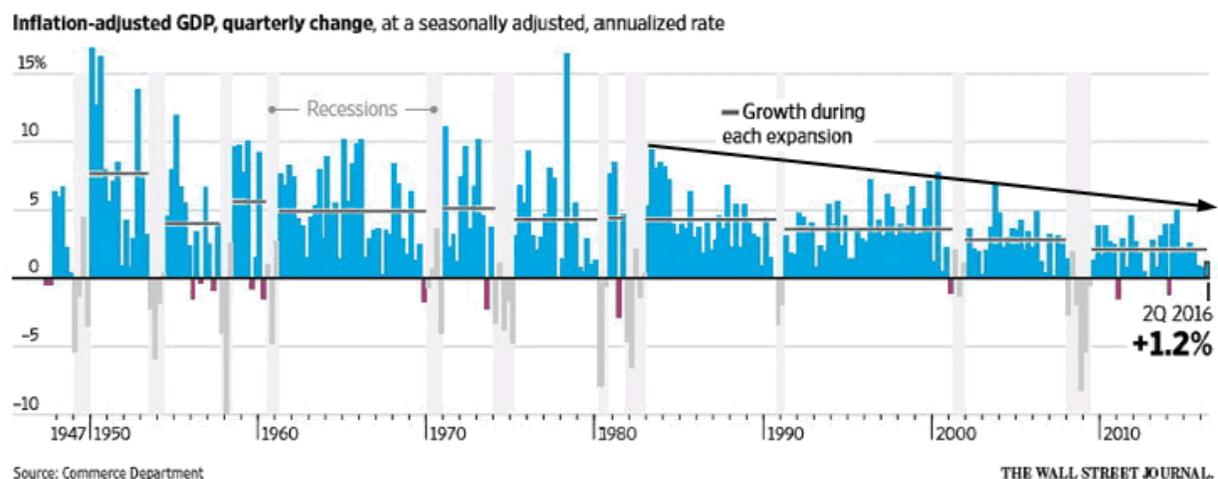
One of the biggest expenses of most businesses is labor. Businesses have reduced headcount by mergers and acquisitions, technology, outsourcing and sending some jobs overseas where labor is plentiful and lower cost.

The new administration has a mandate to create millions of high paying jobs. Will this business oriented administration shift from profit maximization to job creation. They will have to if they want to stay in power.

In a future report I will analyze and write about job creation.

President Reagan

Below is a chart of GDP that goes back to 1947:



The economy was in bad shape when President Reagan took the reins in 1980. The economy was in recession, recovered and went back into recession in 1981 (grey shaded areas in chart reflects recession periods). The major economic events prior to President Reagan's election was Middle East oil supply disruptions during the 1970s. This caused stagflation (a stagnant economy with inflation). As the table on page two shows, inflation and unemployment were high. Oil prices went from around \$5 a barrel to about \$40 in the 1970s.

The economy did recover by 1982, and the markets and economy started a new cycle thanks to:

- Oil prices falling and then collapsing in 1985.
- Inflation finally came down thanks to Fed Chairman Paul Volker who raised rates substantially (a Jimmy Carter Federal Reserve appointment) and falling oil prices
- Lower taxes
- The U.S. was the economic engine of the global economy, and did not have significant competition from its trading partners.

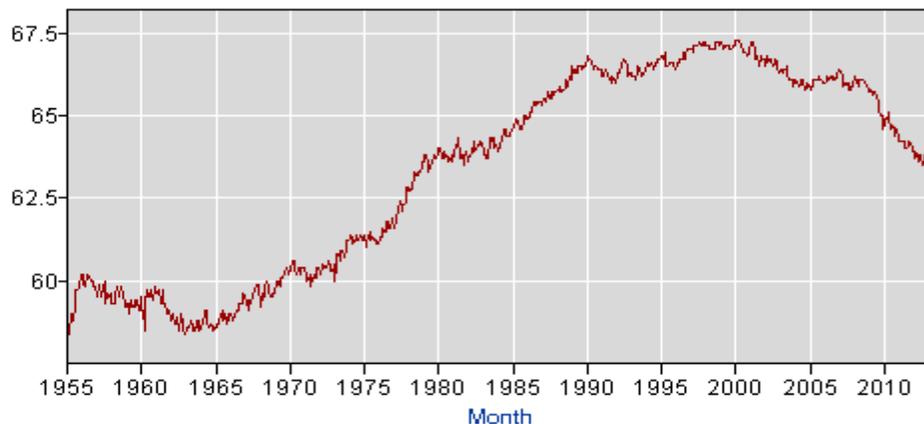
- Not only was the U.S. the global economic engine, it was also relatively small, \$2.7 trillion, making it easier to achieve higher rates of growth. The 1980s were the last time the economy saw double digit growth.

In the in 1980s a 10% growth rate would generate about \$300 billion in additional GDP. Today a 10% growth rate would be about \$1.8 Trillion about half the size of the economy in 1980. A 5% growth rate would be about \$1 trillion. This would be very difficult to do this late in the cycle, and on a sustained basis.

- One of the most important trends of the 1980s were the continued entrance of baby boomers and women into the labor force.

The chart below shows labor participation growing in the 1970s and 1980s and currently.

Series title: (Seas) Labor Force Participation Rate
Labor force status: Civilian labor force participation rate
Type of data: Percent or rate
Age: 16 years and over



What was a tailwind for the 1970s and 1980s has now become a headwind when labor participation falls as baby boomers retire, and the economy has a difficult time creating high paying jobs. With baby boomers leaving the work force, will the participation rate fall to the levels of the 1950s, and 1960s?

- Baby boomers started families helping fuel growth and consumer businesses. The chart below shows how consumer companies, stocks did the best in the 1980s.

Biggest Gainers of the '80s*

By total percent price gain from
12/31/1979 to 12/29/1989

COMPANY NAME (SYMBOL)	% GAIN
1. Circuit City Strs-Carmax Grp (CC)	8,252
2. Limited Inc (LTD)	6,100
3. Hasbro Inc (HAS)	5,582
4. Home Depot Inc (HD)	4,997
5. Wal Mart Stores Inc (WMT)	4,032

* Only companies included in the S&P 500

President Bush

President Bush took over as one of the longest economic expansions, and best stock markets was close to ending. The economy was about three times bigger, \$10 trillion, than when Reagan took over. Inflation, oil prices and interest rates were all relatively low. Employment was considered at full employment (unemployment below 5%).

The strength of the economy and the markets were due to the technology revolution that started in the 1990s, but ended in the early 2000s with the bursting of the technology bubble.

The economy went into recession in 2001. Overall, the 2000s were a difficult decade for the country and economy. Some of the difficulties included:

- The bursting of the technology bubble
- 911
The conflicts with the Middle East got worse in the 2000s.
- Wars with Iraq and Afghanistan
- Corporate Scandals (Enron, Worldcom, Martha Stewart)
- The bursting of the housing bubble
- The global financial crisis and the Great Recession

There were two big investment themes in the 2000s:

1. Real estate and financials. After the bursting of the technology bubble, investors put money into real estate. Real estate related stocks and the financials that financed the real estate boom did well.

2. China's economic boom. Oil, gold, copper and most commodities did very well during the 2000s. China became a global manufacturing and export force buying up global commodities to build new cities and infrastructure. China is now trying to transition from a global manufacturing, export driven economy to a consumer economy, similar to the U.S. and Japan.

Unfortunately both trends have reversed and have had negative economic global consequences.

Trump

As Trump takes over, the economy is basically in good shape. Interest rates, oil, and inflation are basically low (they are all starting to rise and could present problems for the economy and markets). The economy has been expanding since 2009, and is one of the longest expansions on record.

Another positive for the economy, a healthier banking, and financial system that is safer.

There are certainly problems facing the economy:

- A stronger dollar, will cause goods and services to be more expensive overseas, and cause currency losses
- Slowing global economy
- Too much debt in the EU, China, Japan, and the U.S.
- We are in the late phase of this economic cycle. Can Trump make this the longest economic cycle in economic history? This list suggests it will be very difficult.
- Law of large numbers, it's hard to move the needle on an \$18 trillion economy
- This economic and market cycle is aging, and future comparisons will be harder to beat.
- If we have a financial crisis or enter a recession, interest rates are still too low to lower to stimulate an economy in trouble. Lowering interest rates is the most important monetary tool our economy has.
- Geopolitical risks from the Middle East and North Africa, Europe, China, North Korea, Venezuela and Israel.
- Our workforce does not have the right training and education for the new jobs of today.
- In the 1980s, baby boomers emerged as a dominant economic and investment trend. In the 2000s, housing, financials and China were the major economic and market trends. There are no major economic trends that could create added growth to our economy today.

China, housing, and baby boomer trends are all reversing.

- See my article, the New Normal Update. [Click here](#) to read the article. The article explains why the U.S. has and will probably continue to have a slow growth economy.

Why Trump and W Bush Are Similar Versus Reagan

There are a few similarities that Trump and Reagan have:

- Both were celebrities from the entertainment industry,
- Both had the same slogan – Make America Great Again
- The belief in supply side economics, otherwise known as trickle-down economics. Tax cuts will stimulate the economy, creating more growth and more tax revenue for government coffers.

I will write more about Reagan, Bush tax cuts and the mixed economic results they had in an upcoming article.

- All three are known for delegating their authority to their trusted advisors and staff.

There are more similarities with W Bush and Trump:

- The fall of communism in 1989 created a much more competitive global economy. China, India, Russia, Brazil, Eastern Europe, and other emerging economies. Countries that have lower costs, lower debt, are younger, have less regulations, and are much hungrier.
- Both took over in the late stages of an economic and market cycle. The market was very overvalued in 2000, and is overvalued now.
- Our economy is much bigger and more complicated than the economy President Reagan presided over (\$2.3 trillion). Our \$18 trillion economy makes it hard to move the GDP needle with more global competition.

Our economy is very different than the 1980 economy, even though it was a tough economy that had high unemployment, inflation and interest rates with a double dip recession the first few years of the '80s.

- More geopolitical hotspots.
 - The Middle East is much more dangerous, volatile and uncertain. Protecting Israel, our strongest ally in the Middle East, from its hostile Arab and Muslim neighbors has always been a challenge.

- Russia and its military incursions in Georgia, Crimea, Ukraine and Syria, and its meddling in the 2016 elections.
- North Korea was a headache for Bush and will probably be one for Trump.
- The European Union has had one crisis after another: Grexit, Brexit, slow growth, a weak banking system, massive refugee migrations from the Middle East and Africa, terrorist attacks
- China's economic and military challenges to the West.
- A divided country, red versus blue. 24 hour cable news, social media, right and left media outlets has spotlighted the differences. As a business model, it has made cable networks, radio syndications, blogs and their personalities a lot of money, especially on the right.
- Baby Boomers leaving the workforce started during the Bush years and the trend will continue. Their spending habits are down and changing. They won't pay taxes as they did during their working years, and they are applying for Social Security and Medicare. This large group will be a headwind for our economy.
- Cyber-attacks on government agencies, institutions and corporations.

The Reagan years were more innocent, and less complicated, especially before 911.

Summary

- Investors, analysts that are comparing Trump to Reagan are seeing the world through rose colored glasses, and need to look at economic and market history.
- The success, and prosperity of the Reagan years has more to do with baby boomers and women entering the work force and their family formations. Also helping the economy was the taming of inflation by Fed Chair Volker, and the crash in oil prices. Lower taxes did help, but it was not the whole story.
- The fall of the USSR/communism, and 911 were the defining events that shaped the years after Reagan. The new communism is Islamic extremism and its terrorists.
- Currently the U.S. and the world is more similar to the W Bush years versus the Reagan years.

Below are some of the similarities between Bush and Trump

- The world is more complicated, dangerous, competitive, and more uncertain than the Reagan years.
- Bush took over in the late stages of an economic and market cycle, so will Trump.

- Our economy is much bigger and complex than the Reagan years
- The main problems that Bush, Obama, and Trump face come from outside our borders. There are many geopolitical concerns Mr. Trump will have to deal with: Russia, China, the Middle East, Israel and Africa, North Korea, and a tenuous European Union, Islamic extremists and terrorists.

Will Trump and his administration be up for the challenges? Investors need to adjust their portfolios to the sobering realities listed above. This is especially true as the markets have become even more overvalued since Trump's election.

I'm not saying we will have two wars and a financial crisis like the Bush years (although it's possible we do have a war, and a financial crisis is always possible), but we won't have the growth and job creation that the Reagan years had.