JAMESSON ASSOCIATES

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QUARTERLY NEWSLETTER

Recent Economic Events

The American economy shook off its lethargy in the third quarter, growing faster than it had since mid-2014. Employees may finally be reaping some of the benefits, as job gains have been steady while wages are picking up. Although not a "hard" economic statistic, consumer confidence could be a game changer if optimism replaces pessimism. Oil prices are firming, but the core inflation rate remains under control. President-elect Trump has vowed to kick things into an even higher gear once he takes residence at 1600 Pennsylvania Avenue, but high debt levels, rising interest rates, and a stronger dollar may temper the takeoff.

Real GDP grew by 3.2% in the third quarter. This broke a string of sub-2% numbers going back a year and sub-3% figures for two years. The largest positive contributor was once again the consumer, as personal consumption expenditures totaled 1.9% of the gain. Investment was a small positive of .3%, driven mostly by inventories, while strong exports of soybeans helped the trade picture contribute .9%. Government expenditures rounded out the totals by adding .1%. Early fourth-quarter releases used by the FRB Atlanta to forecast fourth-quarter GDP point to similar growth of 2.9% (and this presumably discounts inordinate demand for tofu).

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Stronger economic growth is having a beneficial impact on the labor market. November job gains totaled 178,000, right on the annual average, and wages were up 2.5% from last year. The Unemployment Rate fell to a new recovery low of 4.6%. Not surprising since new claims for unemployment insurance are close to 40-year lows, and those quitting their jobs are near record highs. Workers are starting to believe that the grass is greener elsewhere. Plus, consumer confidence jumped to the highest level since July 2007. While some of the improvement must be due to the end of the contentious election, folks are recognizing some clearly positive signs.

And speaking of the election, Mr. Trump has proposed both infrastructure spending and tax cuts. This promises to balloon the Federal Deficit and has already led to increases in interest rates as inflation fears have spiked. Higher rates may be an obstacle to an accelerating economy — there is no question that some economic growth has been purchased through debt. Outstanding auto loans have topped $1.1 trillion, and the percentage of these loans that are sub-prime or show negative equity has exploded upward. Higher mortgage interest rates are already slowing refinance activity and may impact home purchases as well. 30-year mortgage rates have increased from their recent low point below 3.5% to almost 4.25%. This boosts the monthly payment on a $200,000 mortgage from less than $900 to over $975.

The jury is still out on inflation. Although OPEC has reached a deal that has boosted oil prices, US production is rising as more rigs are put into service and technology unlocks domestic reserves. An analysis of recent trends suggests that medical and shelter costs are the biggest factors in the current inflation uptick. (Excluding them puts annual core inflation close to zero.) And here, trends point to a reversal. The new Congress and Administration

Recent Economic Events *(continued)*

have promised to fix Obamacare, which may moderate medical cost increases, and rental rates are softening.

Finally, the market has not only boosted interest rates, it has also sent the dollar screaming upward. A stronger dollar is associated with lower exports and more competitive imports, i.e. more downward pressure on prices.

The economy definitely has a better tone today than it did a few months ago. The expected policies of the new Administration promise even more upside. However, the obstacles to a substantially faster pace of growth have not disappeared. The more optimistic attitude of economic players is a welcome change, but it will have to translate into results before we can truly celebrate.

Commentary

One thousand years ago in 1016, King Canute conquered England. He also tried to conquer nature by siting on his throne at the seashore and ordering the tide not to rise. The King got wet.

In 1517, Martin Luther nailed his 95 Theses to the church door in Wittenberg. While not the sole cause, his act helped spark the Reformation, the Counter-Reformation, and the Renaissance in Medieval Europe.

Another half a millennium on, Donald Trump is elected President of the United States. Will he turn out to be a man who tried to command the sea to no avail or a catalyst for real change? Are the secular trends faced by the economy the determining factors in our slow-growth world, or are bad deals and poor government policies to blame? We will be embarking on a real-time experiment to find out.

Republicans will control all the key Federal Government power centers save the Federal Reserve. They will have a relatively free hand in enacting legislation and populating government agencies with officials who will follow their professed path. As Congress and the new President start turning campaign rhetoric into real policies, they will deserve to either reap the rewards of success or shoulder the blame of failure.

Let's look at the facts on three big issues: Can the free market replace Obamacare? Are tax incentives and threats going to bring manufacturing jobs back to America? How much red tape is the right amount?

The case for medical care reform rests on the fact that the current system is grossly inefficient, opaque, and the most expensive in the world. Even an incompetent prosecutor could secure a guilty verdict based on the evidence.

Here are the facts: No human being wants to die; insurance companies collect higher premiums the more medical care costs; doctors are sworn to do no harm. To counter these realities, Republicans have promoted consumer choice. Will Americans, who cannot distinguish between real and fake news, be able to coolly

Commentary *(continued)*

weigh medical options while lying on a hospital gurney? I am skeptical.

On the job front, Mr. Trump managed to save some manufacturing jobs at a Carrier plant in Indiana where Mike Pence is the current Governor. He used state tax credits, threats to apply punitive tariffs to any production that moved, and hints of a defense contract "review" for United Technologies, Carrier's parent. How repeatable and sustainable can this be? Even Sarah Palin thinks it's a bad idea. (Never thought I would be quoting her favorably.)

The real issue is that capitalism ruthlessly drives efficiency. If companies can make more stuff with fewer workers, they will. One-off tax incentives won't change this fact. Robots and artificial intelligence are replacing jobs worldwide, not just in the US. Guess what? China is the world's the biggest purchaser of robots.

Cutting regulation is hardly a no-cost option. No one likes being regulated, but whenever something goes wrong, the public is up in arms over the lack of government oversight. So, we have changes in regulation; then results (good or bad) pour in, and then we have changes in regulation. Timing condemns us to oscillate between tighter and looser regulation. Let the pendulum swing.

Were I a courtier at the White House next year, I would keep King Donald's throne well away from Healthcare Beach. Nor is the rising tide of automation any more subject to government fiat than is the sea. Regulation will be pulled back, but keep in mind what happens when you invite the fox into the chicken coop.

Market View

My, what a wild ride it's been. The stock market is near or at all-time highs while interest rates have soared. OPEC appears to have reached a deal to boost oil prices, but gold, the classic inflation play, has languished.

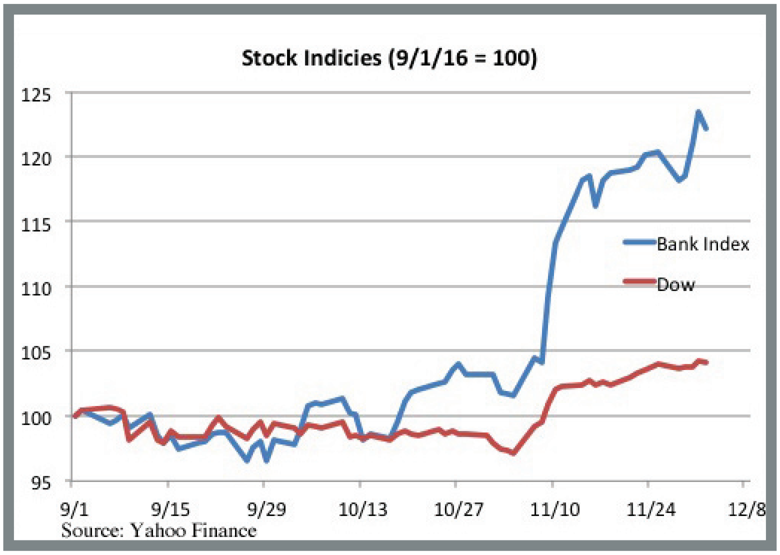
In my Fall newsletter, I said that if government policy were to shift from fiscal austerity and monetary ease to fiscal stimulus and monetary tightness, we could see a profound shift in both inflation and interest rates. I was either prescient or dumb lucky on that call as markets have taken the election of Donald Trump as a signal that the shift is a done deal. I caution that markets, like most human endeavors, almost always over-react to surprise. Some investments will clearly benefit from Mr. Trump's professed initiatives, but it will be important to carefully consider prospects in view of both the uncertainty of the actual policies to be proposed and enacted and just how far the markets have already moved. (Buy the rumor; sell the news?)

Stocks are benefiting from expectations of lower corporate taxes and a looser regulatory regime. The biggest beneficiaries are banks (up 20% from before the election to now vs. 5% for the Dow). They have also caught a tailwind from a sharply steeper yield curve. The Big Four banks have appreciated, but the star performers are regionals and super-regionals. They now sport P/E Ratios at or above 20. Really? Is Utopia at hand?

The ten-year Treasury yield has jumped from about 1.8% on Election Day to nearly 2.5% as I write. This gain adds to the increase from the historic low near 1.3% that we saw in the wake of the Brexit vote. Rates above 2% are probably justified, but I would argue that things have gone much further than the facts support. Intrepid investors can look to the ten-year, but my recommendation is that the best risk/reward trade-off lies in the three to five-year range. Municipal bonds

Market View *(continued)*

have been hit much harder than taxable bonds in the interest rate back-up, but they may fall further if the proposed reduction in income tax rates becomes law next year.



Most commodity prices have had a good run with oil a star recent performer based on expected supply cut-backs by OPEC. While time will tell, there are two big threats to the deal. First, can it be enforced? The historical record reveals chronic cheating on OPEC quotas. Second, what about shale? Drilling rigs operating in the US have been on a multi-month upswing, and US oil production has already increased from its low point. Higher prices are likely to bring even more production. OPEC may temporarily win this battle, but they have lost the war. Use strength to sell oil producers.

Let me end with a quick note on gold. Its price is down $100 since Election Day. If inflation is on the move because of fiscal stimulus, how come gold is falling? One, with better prospects for operating companies, investing in assets that produce no income doesn't make a lot of sense. Two, gold is wildly overpriced versus its historical averages. Long-term comparisons of gold to the Consumer Price Index suggest an equilibrium price of about $625, while compared to a barrel of oil, it should trade at roughly $750. I don't think it is a coincidence that the worst performers since the election included gun manufacturers as well as gold. The irrational fear of gun or gold confiscation evaporated at about 2 AM on November 9th. Perhaps a return to fair value is coming. Finally, a stronger dollar and higher interest rates are associated with gold going down, not up.

The election has upended the status quo, and violent market action has resulted in everyone's crystal ball looking much murkier today. Emotionally driven markets that are barreling down a one-way street call for contrary action. I would selectively sell assets that have appreciated sharply, while adding to positions that have been pummeled. However, I would be wary of municipal bonds unless your potential tax bracket still offers an advantage and would avoid gold because I think the market has this one right.

Editor's Note

I am getting a bit tired of my poultry-centric diet. It started the morning after the election when I wiped the egg off my face and cooked myself an omelet. Then, of course, I was treated to large helpings of crow for a week or two as I met with different clients and friends who reminded me of my political preferences. You might be surprised at how tasty wild game can be. Once enough time had passed to return to normal eating habits, Thanksgiving arrived. Roast turkey followed by turkey sandwiches, turkey noodle soup, etc. have left me in a Tryptophan daze. So if you find my comments in this newsletter a little more flighty than normal, you know why.

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