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August, 2016 NewsLetter

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To Our Valued Clients and Friends

THOUGHT FOR THE DAY

"You're entitled to your own opinion, but you're not entitled to make up your own facts."

Daniel Patrick Moynihan

MARKET PERFORMANCE

Markets rallied in July in spite of protectionist rhetoric from Mr. Trump, and saber-rattling threats from Hillary to raise a variety of taxes to help out 'hard-working families'. Q2 GDP came in at a paltry 1.2% and Q1 revised down to .8%, signaling recession (see **EXHAUSTED**). S&P Q2 earnings came in OK and Q3 forecasts look encouraging – as long as oil prices hold up (which some analysts are now questioning). FFA portfolios benefitted from the rally in both stocks and bonds, showing nice gains as the S&P and Dow have finally made it back to the old highs set in May, 2015. Central banks around the world have now positioned themselves in a coordinated way to fend off any attempt by short-sellers to crush currencies, European bank bonds, or stock markets. Gold continues strong, reflecting global pessimism about everything in general. We remain cautious as the debate continues over winners and losers in this environment. **YTD: DJI +5.8%; S&P +6.4%; NAS +3.1%; PRISM +6.1% Gold +33.8%; WTI OIL +11.7%; 10 yr TSY=1.45%**

EXHAUSTED

The Republican Convention was a declaration of war, the Democratic Convention a gospel revival (with Michele Obama celebrating the triumph of her black people over white oppression). The reality is weak Q2 GDP at 1.2% is stall speed for the economy, thus explaining why research firm Stifel has forecasted a recession in 3-6 months. As economists, we try to take an impartial view of what's going on politically, connect the data dots, then think about possible solutions to fix problems. Here's what we see: jobs are created by businesses when they spend money to grow. For a variety of reasons, they are not spending, so the economy is stagnant. Instead, businesses are using their cash to (1) buy back their own stock, or (2) using cash and cheap loans to buy out competitors (which actually results in *cutting* jobs). The reasons why businesses are not spending on growth – at least in the US - seem to be centered around government policy issues: **regulation** (Dodd-Frank, EPA, minimum wage); **social policy** (Obamacare, global warming, Common Core/unions); **free trade/outsourcing**; and **corporate taxation**. Central banks like our Fed have stepped in to keep the economy afloat with **monetary** policy (zero interest) while waiting for businesses to start spending again – but they're not, and Fed policy is exhausted. The Dems are blaming it on corporate greed and Republican hard-headedness in Congress; the GOP is blaming it on social engineering and anti-business policies. So now what? Bottom line: the new President must woo business back into *doing business*. Government could help by adopting a coherent energy policy around fossil fuels and coal, and by implementing a massive infrastructure program (which both parties agree needs to be done) to refurbish roads and highways. Whatever we do, it will require compromise. I personally think it would help alleviate the anti-business sentiment to eliminate the ridiculous compensation packages of S&P corporate executives, which is rubbing the noses of ordinary workers in the extravagance and decadence of the superrich. We may even want to consider adopting the European policy of requiring worker representation on corporate boards (no, I'm not a Communist). In any case – something has to give. Who will blink first, we wonder.

APPEASEMENT

Neville Chamberlain was not a bad person. Before negotiating with Adolf Hitler the fate of Western Europe in 1938, he enjoyed a distinguished career as a politician and served as Prime Minister of Great Britain at the time. To appease Hitler's war ambitions, Chamberlain conceded Czechoslovakia to Germany. Then the world watched in horror as Hitler's war machine rolled over Poland, pulling Britain into the war anyway. Chamberlain's problem was that he failed to recognize that he was dealing with a fanatic (mad-man?) and assumed that Hitler would adhere to some standard of civility – not barbaric bloodshed. Chamberlain guessed wrong, and if it hadn't been for a severe Russian winter and a German tactical error, we all might be speaking German now. As we watch **Muslim** fanaticism erupt in sporadic acts of terrorism around the world, it appears Pres. Obama's own attempt at appeasement (**Benghazi**) is making the world a more dangerous place (we remember Obama was raised a **Muslim** as a child in Indonesia among good people, so it's easy to understand Obama's empathy for the **Muslim** people). Nominee Trump has declared himself the '**law and order candidate**', encouraged by former Congressman Newt Gingrich whose blunt remarks following the massacre in Nice, France, began to make sense to a lot of American people ("**Western civilization is at war. We should frankly test every person here who is of a Muslim background, and if they believe in Sharia, they should be deported. Sharia is incompatible with Western civilization.**") Some academic purists have condemned such a policy as a violation of 1st Amendment religious rights, even though Sharia law technically advocates the overthrow of the US government. We used to have the courage to call that treason. Only an intellectual coward – or a traitor – would argue otherwise. Now, thanks to **ISIS** and radical **Muslim** ideology, terrorism has become a wild card in the US Presidential election. Up until now, blue states (Democrats) outnumbered red states (Republicans) in the Electoral College, thus assuring nominee Hillary the Presidency built upon a platform of liberalism, multi-cultural tolerance and generous financial subsidies. What is the only thing powerful enough to overcome the weight of so much political self-interest? **Fear**. Imagine the potential impact of a major terrorist event on American soil in the days leading up to the election, where the American people see innocent American blood shed on the 5 o'clock news, red blood that could turn blue states red – and lead to a Trump victory in November. In any case, investors world-wide have voted with their dollars in stock and bond markets this month, that – when it comes to the economy and business – the US is where you want to be.

A TIME TO KILL

These sobering words from the book of *Ecclesiastes (the Preacher)* in the Old Testament remind us that evil is always with us and must be dealt with from time to time (see **APPEASEMENT**). After Moses led the children of Israel out of their bondage in Egypt, it fell upon his successor, Joshua, to go in and do the dirty work of occupying the promised land of Canaan, “*a land of giants and men of valor.*” The siege of **Jericho** – the first city to be attacked – was cold and calculating. After encircling the city for a week, when the signal was given, Israel gave a great shout and the city walls ‘*fell down flat*’. The Lord’s instructions were clear – everything in the city must be destroyed: “*And they utterly destroyed all that was in the city, both man and woman, young and old, and ox, and sheep, and ass, with the edge of the sword.*” *But wait!* It seems that a fellow by the name of **Achan** couldn’t resist grabbing some of the goodies he saw laying around during the battle. Jehovah is a jealous God and took a dim view of **Achan’s** disobedience, ordering his execution by fire along with his family, animals, and goods. *Ecclesiastes* reminds us “**to everything, there is a season...a time to kill, and a time to heal; a time to keep silence and a time to speak; a time to love and a time to hate; a time of war, and a time of peace.**” The upcoming presidential election is beginning to show a distinction between a **fighter** and an **appeaser**. Author **Dinesh D’Souza** reminds us in his book **What’s So Great About America** that our war with **Islam** pits our concept of freedom and capitalism against **Islam’s** religious view of virtue – obedience to the will of Allah. The interesting part of Joshua’s story is the way the Lord chose to prepare Joshua and his new generation of fighters (we recall that, because of the hard-heartedness of the original 603,550 fighting men under Moses, they were condemned to die in the wilderness and not inherit the promised land). Before Joshua and his new army were allowed to cross over Jordan, the Lord said to Joshua, “**Sharpen your knives!** Joshua’s young warriors needed to renew the covenant of their fathers – by being *circumcised!* We watched this past election season as a whole generation of Americans embraced a new version of America, rejecting capitalism and traditional American values, thus ignoring the truth that these are at the heart of the American dream and an important element of what makes America great – and strong. It appears it’s time to ‘**sharpen our knives**’ with this new generation (*‘circumcision of the heart’*) and renew the covenant of the Founding Fathers. Easier said than done. It’s impossible for us as investment managers to pretend that these issues – killing and healing, war and peace – don’t impact our investment strategies. They do. Terrorist activity has taken its toll on the airline stocks and so we will sell our holdings of DAL on a rally above \$40.

LADIES NIGHT

As the likelihood of a Hillary Presidency increases each week, we are struck with the feminist story unfolding in global politics. The new Prime Minister of Great Britain is Theresa May, an Oxford scholar (and devout Christian), formerly serving as Home Secretary (crime policy, anti-terrorism, immigration, etc). The office of Prime Minister in Britain is appointed by the monarch, Queen Elizabeth, a person the Queen feels is most likely to command the confidence of the House of Commons. Of course, Angela Merkel (the daughter of a Lutheran pastor) is the current Chancellor of Germany and generally regarded as the most powerful politician in Europe. As the immigration crisis escalates in Europe, it has driven the British to vote to leave the European Union, but emotionally not far behind is France, especially since the tragic events in Nice. Everyone – especially French Pres. Hollande - is determined to keep France in the EU, but elections in France come up next May, and Hollande’s popularity has sunk to a new low, making room for the far-right candidate, Marine Le Pen, who is currently leading in the polls and has vowed a French referendum vote of their own. Add to the list our own Janet Yellen, head of the Fed, and Christine Lagarde at the head of the IMF. We wonder what it will mean to have the world’s most powerful political and financial institutions in the world run by women. I have learned that women are much less inclined to send their sons to war. What will that mean in the fight against terrorism – especially Muslim terrorism? Wouldn’t it be even more interesting if something were to happen to Mr. Putin and another **Catherine the Great** were to rise to power (even though not likely since women are still regarded as second class citizens under Russian communism). Still, 2017 promises to be a year of change dominated by some smart, tough women who couldn’t possibly do any worse governing than the men we have tolerated these many years. **Vive la difference!**

LOOKING AHEAD

This month CNBC voted Utah ‘*America’s top state for business. In many ways, this is the culmination of a decade of hard work by the people and businesses of Utah, developing innovative industries, a skilled workforce and a critical mass of companies big and small that is now rivaling Silicon Valley.*’ No wonder we have our headquarters in Utah. Now that the huffing and puffing regarding Brexit has subsided, we turn our attention back to the flow of large amounts of capital into our US bond and stock markets. After all, who would want to ‘invest’ in a German bond that has a *negative* return (guaranteed loss!) In a world hungry for yield, great US companies yielding 2-3% dividends or government bonds paying 1.6% on the 10 year looks irresistible. So much so, that we think it becomes an attractive nuisance to our Fed, giving them an opening to raise interest rates before year end, even though they chose to leave rates unchanged during their July meeting. If/when they do raise rates, the resulting strengthening of the dollar would likely crush the gold rally and stock prices, and (temporarily) punish hi-yielders like utilities and REIT’s. Nonetheless, while we do not intend to overreact to these gyrations in price as the world economy continues to struggle, we are raising cash anticipating a normal market correction in August to consolidate gains, which also provides us opportunities to buy on weakness.

We value your questions or comments so please don’t hesitate to email or call.

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