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October 2016 NewsLetter

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To Our Valued Clients and Friends

THOUGHT FOR THE DAY

"I can categorically say that partisan politics plays no role in our decisions at the Fed."

Fed Chair Janet Yellen

MARKET PERFORMANCE

The Fed tip-toed past the graveyard by holding rates steady at their September meeting but did strongly suggest they would raise rates before yearend. Interest-sensitive investments like utilities and REITs initially sold off, then regained some lost ground but are still under pressure from a future anticipated rate increase. The Q3 earnings parade starts soon and current projections predict positive YOY comparisons, adding to optimism of positive market performance thru year-end (see **DURABLE GOODS**). OPEC oil ministers reached an historic agreement to limit production (that we don't think will hold) driving the price of oil and stock markets up, even while trouble at Deutsche Bank rattled financial markets. **YTD: DJI +5.1%; S&P +6.1%; NAS +6.1%; PRISM +11.3% Gold +30.1%; WTI OIL +29.5%**

TROUBLE IN RIVER CITY

After 'professor' Harold Hill rolled into town in River City, Iowa, things were never the same. Donald Trump's message of tearing up Washington politics has resonated with Iowa voters where he has now taken the lead in recent polling. It also looks like Gov John Kasich will deliver Ohio to Trump, and no Republican has ever won the White House without winning Ohio. One Ohio business owner who supports Trump said, *"We need somebody who is going to tell the truth in Washington."* Trump has certainly changed the tone of American politics with his blunt talk and abrasive style, which is preferable to the patronizing drivel out of Washington. If Trump is elected president, it's important to remember that Congress is the regulator that keeps Trump under control so that his brash ideas that sound crazy may just be crafted into meaningful legislation. The idea of more of the same in Washington politics gives me indigestion.

EUROPEAN UNION

After WW II, unifying the countries of Europe in some form of coalition was regarded as desirable to moderate the nationalism often at the root of conflict. Over time, treaties and agreements were made, country by country, until in 1992, they decided to formalize their alliance (Maastricht Treaty) and experiment with a unified governing body modeled after the US coalition of states that became known as the European Union (EU). There are currently 28 member countries in the EU, but in June of this year, the British decided to withdraw from the EU. In America, the catalyst for our civil war in 1865 was slavery (see **REPARATIONS**) but the core issue was preservation of the union, the alliance between the states – hence Union soldiers. Britain voting to leave the EU was almost the equivalent of Texas deciding to secede from our union (which they and other states have threatened to do over Obama's heavy-handed policies (see **FAITH AND FREEDOM**)). The late Supreme Court Justice Antonin Scalia stated, *"If there was any constitutional issue resolved by the Civil War, it is that there is no right to secede."* The EU contract *does* allow for its member states to withdraw from their union (Article 50) so the glue that holds them together is not nearly as strong as the blood and guts that holds us together in America. However, the oppressive bureaucracy they have created around the EU is what ultimately triggered Britain's vote to leave. The goals of the EU are represented by the "four freedoms": the free movement of goods, services, people, and money. EU citizens in each country still vote for their own national governments, but every 5 years they vote directly for their representatives to the European Parliament. There is an Executive body called the European Commission which is made up of 28 representatives, one appointed by the government of each member state. The Commission proposes legislation which is amended and voted on by the Parliament. Then, the Council of Ministers (have I lost you?), which consists of one government cabinet member from each country, must approve the amended laws, with their vote weighted by population. Over time, the EU added a president and foreign minister, but the crucial change was adopting the **Charter of Fundamental Rights**, legally binding all member states to EU policy and forcing changes in their own laws. The bureaucracy is based in Brussels and is largely invisible, but the thousands of regulations it imposes on the member states touches every aspect of life, including immigration. Britain felt those policies threatened their sovereignty and so chose to leave the EU.

FAITH AND FREEDOM

President Obama's tactic of imposing his will thru Executive Orders and support of controversial moral issues has resulted in the formation of what is now called the **Faith and Freedom Coalition**, some 45 members of Congress who view the President's heavy-handedness and moral wishy-washiness as fundamentally threatening to American integrity and which has become justification to block legislation at every turn. In their own words: *"We believe that the greatness of America lies not in the federal government but in the character of our people — the simple virtues of faith, hard work, marriage, family, personal responsibility, and helping the least among us. If we lose sight of these values, America will cease to be great."* The basic premise of their cause is represented by this quote from **Alexis de Tocqueville**, the French diplomat, political scientist and historian who wrote about American democracy: *"Freedom regards religion as the companion in all its battles and all its triumphs, as the very cradle of its infancy and the source of all its claims... because religion alone is the safeguard of morality, and morality is the best and surest pledge for the survival of freedom."* With a lame duck President and an obstinate Congress dominated by the Faith and Freedom coalition, there is little chance of any meaningful legislation before year end, especially since the 2017 budget is already in place, but if Hillary is elected president, they will soon get acquainted. The stock market likes political stability (Hillary), so a Trump victory in November means all bets are off.

DURABLE GOODS

In spite of all the hand wringing about a weak economy, dumpy GDP, and weak S&P earnings, the latest Durable Goods report for August was mildly 'positive' (-0.4% instead of -1.5% forecast). In this latest report, core capital goods rose +.6% (core orders are viewed as a proxy for business investment) for the third month in a row, which could signal businesses anticipating a more favorable business climate under the next president. It should be clear by now that the big-business community hates this President and his policies (is that too strong a word?) Their reaction has been to stop spending on growing their businesses for the last 8 years and have used their profits instead to reward shareholders by buying back stock. Common parlor chatter is that small businesses are mostly responsible for new job creation, which is true statistically, but the reality is big Fortune 500 companies are the *meaningful* job creators, that is, a job at a wage that can support a family in a middle-class life style. That's why, in our opinion, an unemployment rate of 4.9% may look like full employment, but families are still struggling to pay their bills. We have a simple idea on how to solve this problem and create better paying jobs – give businesses an incentive to grow, to build factories, and to create jobs. The US has the highest corporate tax rate in the world (35%) which gives big businesses an incentive to grow offshore (Ireland) and hoard the profits offshore (estimated **\$2.1 trillion**) to avoid this onerous tax. What if we were able to induce businesses to bring that money home and have it invested here? We recognize that incentives require compromise, so here's our idea. Many states have attracted new businesses to their state by granting tax concessions in direct proportion to the jobs they create (*quid pro quo*). What if we were to employ the same strategy as the states by giving corporations a tax credit in direct proportion to the new jobs they create (the ideal solution would be to reduce the corporate tax to 15% but the likes of Senator Elizabeth Warren would have a hissy-fit if we tried)? In addition, most of us find offensive the extravagant compensation packages paid to corporate executives, so I would also require a dramatic cut in executive compensation as part of the deal (that would make Ms. Warren happy). What do you think? Let us know.

REPARATIONS

You know you have a race problem when it shows up in the NFL. Add to that calls from blacks leaders for financial compensation for our past sins as a nation – reparations – and you've got trouble on your hands. Let's see. Where should we start. Slavery has been part of civilization since history began – *might makes right*. Whether it be warring tribes of cavemen, Persians capturing the tribes of Israel, Tutsis killing and enslaving Hutus in Africa, it's pretty much all the same. Even Sir Thomas More in his famous book *Utopia*, recommended that the ideal household have two slaves, and slaves were an accepted part of Greek society in Plato's *Republic*. American colonizers took advantage of a thriving European slave trade by bringing in the first slaves to Jamestown in 1619 to till the fertile lands of the Americas. Of course, when they got here, the Indians (Native Americans) already had a culture of slavery, not to mention the Spanish gold miners who had enslaved Indians since 1565 to work in their gold and silver mines thruout the American west. Mormon pioneers in Utah had to deal with their moral opposition to slavery while interacting with the local *Utes*, who accepted slavery of captured *Piute* children as an inherent right. Consider this story lifted from the diary of pioneer Dan Jones: *Ute Chief Arapeen brought some of his newly-captured slaves to the Provo River where Dan Jones was camped with a few others. Since the Mormons were responsible for outlawing the slave trade with the Spaniards, Chief Arapeen argued that Jones and his companions should buy the children from him since they could no longer sell them to the Spaniards. Jones instead lectured Arapeen on his evil ways which provoked the Chief. Grabbing one of the slave children by the heels, he dashed its brains out on the rocks. He then tossed the bloody little corpse at Jones' feet who stared at the body in disbelief. Arapeen angrily shouted at Jones, "You have no heart or you would have bought the child and saved his life."* It's easy to forget that America stands alone in the history of the world to make it a matter of national principle to eliminate slavery (13th Amendment) and that we sacrificed the life of one of the world's greatest white leaders to the cause in our Civil War, not to mention the 359, 528 mostly white Union Soldiers who gave their lives so that black men could be free. Too bad that a few would choose to focus on what remains to be done, rather than what has been accomplished, and disrespect the rest of us – and the dead - in the process. Fortunately, wiser black voices (Kobe Bryant, LeBron James, Michael J) are using their wealth and celebrity to help people – black and white - build businesses and revitalize communities across America. That's something to cheer about.

LOOKING AHEAD

October is earnings month for Q3 and profits are expected to be flat from Q2 but an improvement YOY. Since rising profits drive stock prices, forecasters are reasonably optimistic that we could finish the year up from here. However, October has a reputation for sharp market corrections, sort of like hurricane season. Troubles at Deutsche Bank – Germany's largest bank – threatened to trigger a major market selloff reminiscent of 2008, but past actions by our Fed to protect our banks from systemic risk by padding their capital has reassured markets – for now. October is normally the time for budget battles, but the bipartisan budget agreement reached last fall dictated discretionary spending and balanced investment limits for 2017. The presidential elections continue to dominate the news, even as the polls show the race almost a dead heat (who would have thought!), so for now, we stay the course.

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

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