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November 2016 NewsLetter

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To Our Valued Clients and Friends

THOUGHT FOR THE DAY

"When I see a garden in flower, then I believe in God for a second. But not the rest of the time." **Nobel Laureate Svetlana Alexievich**

MARKET PERFORMANCE

Q3 earnings and revenues came in modestly positive allowing markets to hold modest gains YTD. The World Energy Congress member states tried to reach an accord to curtail oil production in order to support prices at \$50/bbl but it didn't stick. M & A activity continued at a record pace marked by AT&T buying Time Warner. BAC-Merrill head of US equities, Savita Subramanian, gave US markets a chill with a bold forecast: the US will be in a severe recession in 6 months. Goldman Sachs' chief US equity analyst, David Kostin, predicted weak Q3 earnings will keep a lid on stock prices thru year-end. Adding to the confusion were the comments of Brian Wesbury of First Trust Advisors who argued rising inflation will force the Fed to raise interest rates in December (see **READY FOR LIFTOFF**), triggering a major market selloff. The threat of rising rates kept pressure on our income 'cows'. The election results will dominate the news, so we hope your candidate wins ☺. **YTD: DJI +4.1%; S&P +4.0%; NAS +3.6%; PRISM +7.4% Gold +20.1%; WTI OIL +26.1%; 10 yr 1.827%**

WORLD BANK

The **World Bank Group** (WBG) is a coalition of five international organizations that make leveraged loans to developing countries with the goal of *"eliminating extreme poverty and hunger."* Its President, Jim Yong Kim was raised in Iowa and so brings to the bank a US perspective on world economics and the interaction between countries and trade relations. He was awarded an M.D. at Harvard Medical School in 1991, and a PhD in anthropology at Harvard University in 1993. The man is a brilliant humanitarian. While being interviewed this month at the annual meeting of the IMF (International Monetary Fund) and the World Bank, Mr. Kim observed that world economies are doing OK but the disparity between rich and poor in the US needed to be addressed. He also commented that the emerging third-world economies of the world will depend heavily on trade with the US (TPP) and that free trade is the solution to much of the world's economic ills (see **FREE TRADE AIN'T FREE**). The IMF and WBG distribute a budget of \$298 billion/year in loans to a worthy list of poor countries. The US shells out \$35 billion/year in foreign aid to many of the same countries, countries where they can't keep the lights on nor distribute clean water, yet the leaders of these countries continue to stash the money in foreign banks and enjoy lavish life styles. Why is that? I'm sure foreign policy experts have their own reasons why we continue to dole out the money, knowing full well that only a fraction of it ever ends up helping the people who need it. Let's stop giving money to the bad guys, figure out a way for some of the world's legitimate non-profits (the Clinton Foundation ☺) like **Rotary International** to oversee the placement of the money and do some real good, rather than pretending we are helping by enriching bad leaders (see **IF YOU'RE SO SMART**).

CYBER WARFARE

Last month you may have tried to log in to your Twitter or Netflix account but found that you were unable to connect for several hours. They were just two of the major internet sites that got shut down by a massive cyberattack. Even though most sites were able to resolve the problem and get back up running, they were brought down by a second attack later that day. In the digital world that we live in, with so much of what goes on in our lives dependent upon the internet, if an enemy wanted to bring us – or any other western society – to its knees, they could do it by shutting down access to the internet. These cyberattacks have taken on a definite hostile face as if a foreign entity is probing for weaknesses in our cyber defenses, in everything from your social media accounts to the electrical grid and even military installations. The internet itself is a distributed network of 13 backbone servers located in different countries around the world that got its start in 1983, originally started by the US Dept of Defense to share scientific information. A computer scientist by the name of Tim Berners-Lee came up with the idea in 1990 of multiple links to the backbone network which we recognize now as the WorldWideWeb (www). To go to your favorite internet site, you click on an *address* that probably ends in .com or .net. The server at the other end routes the traffic of the multitude of users who are trying to visit the site (envision you're a tourist pulling into the sites parking lot. Once the parking lot is full, you can't get in). These cyberattacks are launched by hackers using a string of commands (a *botnet*) that initiates millions of *visits* to the host server, eventually shutting down the site. The hacking technique is called DDoS – Distributed Denial of Service, and the US military is now concerned enough about the threat it poses to national defense that it is considering setting up a separate Cyber Command fighting force with its own battle plan to conduct attacks on foreign enemies. Verisign (VRSN) is one of the key players in the effort to mitigate cyber attacks. Welcome to the world of cyber-warfare.

ROSH HOSHANA

This month we celebrated Rosh Hashanah, one of the holiest holidays in the Jewish calendar because it *"celebrates the creation of the universe and the birth of Adam and Eve"* and, hence, is the start of their new year. Jews of the Middle Ages calculated the date of creation to be 3761 BCE, or 5777 years since our first parents were placed on earth by G-d. By tradition, each year on this day *"all inhabitants of the world pass before G-d like a flock of sheep and it is decreed in the heavenly court who shall live and who shall die, who shall be impoverished and who shall be enriched, who shall fall and who shall rise."* Prayers are offered that the Almighty will grant us a year of peace, prosperity and blessing. An important part of the tradition is the acceptance that the earth is on a 'Sabbath cycle' when, after 6000 years, the "7th Day" arrives and *"everything that belongs to G-d has to be returned to Him irrevocably,"* what Christians call the 'end of times'. By that calculation, the year 2240 promises to be an event not to be missed.

FREE TRADE AIN'T FREE

Economists and politicians continue to argue the benefits of free trade as a win-win for the US and her trading partners, but is it? Free trade may allow the poor of third-world countries to sell their goods abroad, but it also has the effect of exporting their poverty to the rest of us by lowering the standard of living of the developed countries that they sell to when *they* lose jobs. A number of auto manufacturers (including Ford and GM) have located auto assembly plants in Mexico where wages and benefits are a fraction of what they are in the US, so high-paying union auto assembly jobs are lost in Detroit - ruining their economy, but car buyers everywhere get great deals on great cars, and shareholders in the auto companies make money from dividends and stock price appreciation. It's all a matter of '*whose ox gets gored*'. If Mr. Trump is elected president, he has vowed to place an import tax on Chinese goods in an effort to protect American jobs. He might consider giving auto manufacturers a tax incentive to stay in the US and rebuild our auto industry, rather than building a wall. Hillary, on the other hand, is more inclined to open borders and encourage trade as a way of building economic relationships that, in turn, build social relationships and mutual self-interest, as opposed to killing each other.

IF YOU'RE SO SMART...

It distresses me that our politicians and scholars and journalists continue to avoid saying what's really going on in Syria – and Iraq – and Turkey – and San Bernardino. Oddly enough, Putin gets it and has acted accordingly. The war in Syria is just another manifestation of the religious war between *Shia* (Persian) and *Sunni* (Arab) Muslims that has been fought for over a thousand years, sometimes hot, sometimes cold, but always there. We have written about the Muslim feud before (like the Hatfields and the McCoys), fighting over who is the rightful successor to the prophet Muhammed. Once and for all, dear readers, LISTEN UP! Most Muslims thruout the world (an estimated 1.6 billion) are *sunni* Muslim and are generally characterized as common, poor, and uneducated (except for the Saudis who are *sunni*, with their great wealth and political power). Conversely, *shia* Muslim are more modern, sophisticated, educated and cunning (as represented by Persian Iran). Now let's connect the dots. Over the centuries, we have watched a series of brutal dictators take over Muslim countries and quash the religious fighting by making themselves more feared than your religious enemy (Tito in Yugoslavia, Saddam Hussein in Iraq, Gadhafi in Libya). Take away the brutal dictator and the religious blood feud takes over, spiraling the country into chaos – and giving rise to extremists like ISIS. Turning our attention to Syria, Assad is a brutal dictator and happens to be *shia*, oppressively ruling over a population of *sunni* Arabs who are now in rebellion against Assad in civil war. To complicate matters, ISIS (who are radicalized *sunni*) has now moved in to Syria, taking advantage of the chaos for their own political ends. Now you tell me, whose side should the US be on (15 of the 19 9/11 skyjackers were Saudi *sunni*, and the US has just passed a law allowing US victims of the 9/11 tragedy to sue the Saudis for being complicit)? Because of Putin's own Muslim problems in Russia and Chechnya, he has chosen to back the *shia* coalition and support Assad, because *shia* forces are fighting ISIS in Syria. And of course *shia* soldiers are fighting alongside US soldiers in Iraq trying to dislodge ISIS in Mosul. So, if you're so smart, you tell me what to do in Syria. Are you willing to take sides in their Muslim religious war – *shia* or *sunni* – a war within a war? An estimated 400,000 civilians have lost their lives in the war, with more dying every day. Should the US jump into the snake pit of this centuries-old religious war and possibly end up in a confrontation with Russia? Or does Putin have it right – destroy ISIS and accept Assad as the lesser of the evils? Buy **LMT**, **LLL**.

READY FOR LIFTOFF

The Fed has held interest rates near zero for 8 years, hoping that making money cheap would induce people to borrow. We have learned that the banks have been doing plenty of lending, but there is so much cheap money sloshing around, it has allowed the banks to accumulate \$2.2 trillion in excess reserves. In an effort to keep the inflationary forces of so much cheap money from getting out of control, the Fed pays *the banks 1/4% on those reserves* to keep the money at the Fed – risk free to the banks. Some financial 'experts' argue this does not give the banks a disincentive to lend, that it's just internal mechanics to control the flow of money between banks (the Fed Funds Rate) and also control the rate of inflation. Sorry! It still looks like risk-free profits to me. The current thinking is that the Fed will raise interest rates this December by another ¼ point or so because the core inflation target they set of 2% is now being met: core CPI is + 2.3% YOY; average hourly earnings are +2.6%; medical care +4.9%; housing + 3.4% (the average *new home price* is now \$353,600!). The last time the Fed raised rates (December, 2015), the market dived to 1800 losing 10% of its value. We have every reason to expect the same reaction this January if the Fed raises rates this December. Speculation is already starting about the impact of a new president in the White House on Fed policy. If Hillary is elected president, I'm betting she will have a quiet chat with Fed Chair Yellen, convincing her to hold off on a rate increase in December lest Hillary's inauguration be spoiled by a massive market sell-off in January. For the sake of stability, we expect whoever is president to retain Janet Yellen until the end of her term, Feb. 2018.

LOOKING AHEAD

Gold bugs (ZeroHedge, 13D, Mobius) continue to interpret economic data as forecasting ultimate financial destruction while ignoring the fact that gold prices are most correlated to interest rates. If the Fed raises rates, gold prices will fall (they have already fallen 10% this month on the prospect the Fed will raise in December). We acknowledge all the reasons to worry but find it odd that these opinionaters seem to act as if they, alone, are smart enough to know what to do, especially since the people who are managing the trillions of investment money (Blackrock \$5 trillion, Vanguard \$3.3 TT, State Street \$2.3 TT, Fidelity \$2.1 TT) have a different opinion and remain optimistic. We recommend clients hedge modestly by using the bullion gold ETF **GLD** in case the Fed goes political for a while.

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