



Capital Drain

Rick's investment opinion newsletter

March, 2017

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Before printing, think about the environment

Hi Readers,

I've been reading the news and trying to figure out what policy changes are coming from Washington, and what effect those might have on the economy and the investment markets. It's anyone's guess, still.

So, this will be short. In my opinion:

Executive Summary:

- The economy continues to do well
- Trump won't get what he wants, which is good
- England's PM May is pushing ahead with Brexit, which is bad
- US stocks seem overvalued compared to other markets

The recovery continues, and many US companies are doing well, but the prices reflect high continued growth expectations. If you're holding shares of any of the conspicuous high-fliers, especially the "hot" new tech IPOs, you might consider selling into this enthusiasm. Better to risk a little less gain rather than a lot more loss.

As most developed and some developing country economies regain health, global diversification funds becomes more attractive. We are likely reaching the phase where a rising tide will lift (almost) all boats.

If you're inclined to pick among individual stocks, be conservative and be in the best of securities: stick to value, to safety, to short maturities (for debt), and call me to chat if you're concerned about anything you're holding.

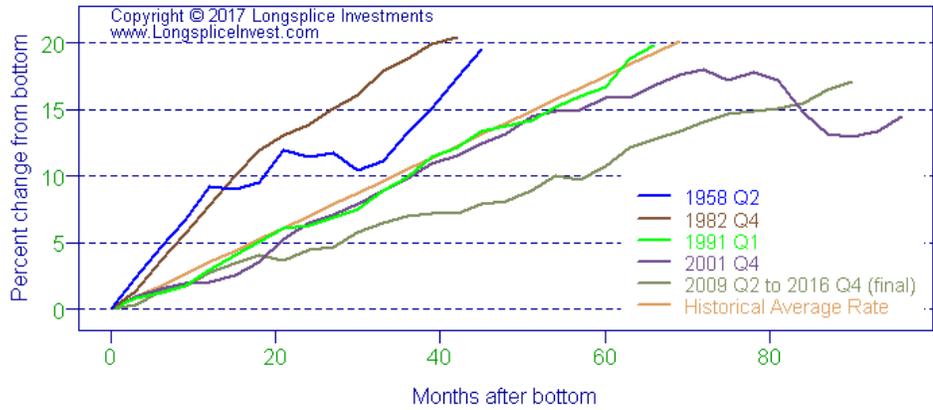
Above all, avoid the investments that are at all-time extreme valuations: junk bonds, developing-country bonds, and headline-grabbing stocks with high P/E ratios.

The Details:

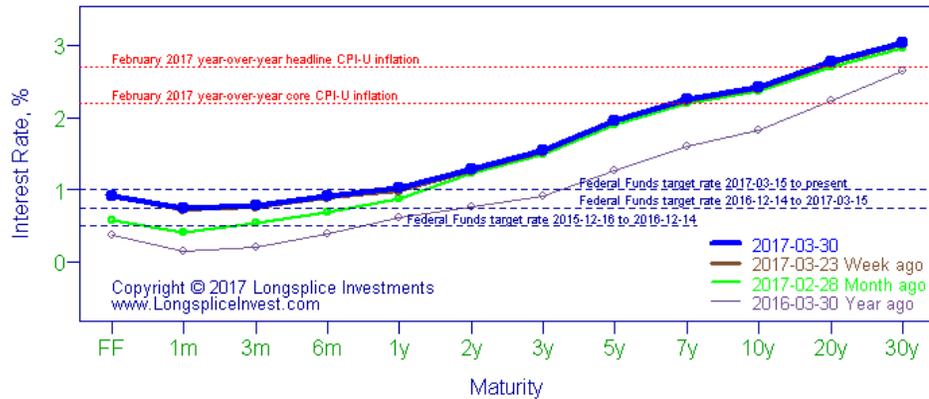
The US economy is continuing the good trend its been on for years.

Interest rates are rising, but they're still very low compared to inflation, and would still have to rise a lot to become a hindrance to growth. That's not good for bond investors. In the country overall, falling unemployment continues to mean more money in more workers' pockets, leading to more consumer demand. The virtuous cycle of the past six years of recovery continues.

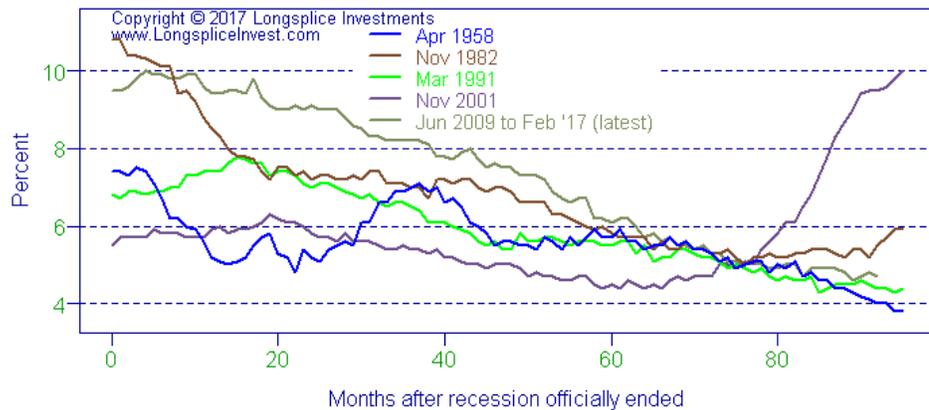
Real GDP in Five Recoveries



US Treasury Yield Curve



Official (U-3) Unemployment in Five Recoveries



Sixty days into the **Trump administration**, we still don't know what substantive changes he'll make. He made a lot of campaign promises, some contradictory, but it's clear he didn't have any plans behind the promises.

For example, his big promise to end Obama Care died in Congress because the conservative hard core wouldn't support it. It may look like Republicans are in a strong position, controlling the presidency and both houses of Congress. That's deceptive: the Republican party has many factions now: a religious morality wing, a pro-big-business wing, a pro-billionaire wing, and traditional Conservatives. As we saw in the Obama Care fight, those factions have very different interests.

One's opinions can change quickly when faced with the actual results of one's actions.

It turns out Obama Care is pretty popular with actual working people. No one wants to pay the political price for taking it away from millions of voters.

It turns out Mexico is definitely not going to pay for a wall, and a wall that long is expensive.

Some of what's being done by Executive Order is pointless. Companies aren't going to build more coal-burning plants or higher-emission cars, because they know that the clean air regulations that were just eliminated can come back with the very next administration. Many companies have acknowledged the scientific conclusion that anthropogenic climate change is real and a threat and we can reduce the threat. For example, energy giant Exxon Mobil urged President Trump to stick with the Paris Agreement on climate change.¹

Similarly, on trade deals already in effect, it's not clear what the president can do unilaterally. Congress is involved in treaties. There will be pork barrel issues.

Tax reform is potentially even more explosive than health care reform. It turns out giving massive tax breaks to the very rich is easy to spot and extremely unpopular with almost everyone.

So in short, we don't know of any economic variable that the Trump administration can and will change. It's not certain that anyone in the administration really has a clearer view than we do. We just have to see what develops.

The British departure from the EU, or **Brexit**, is not going as its proponents had hoped. It was, at best, an under-planned slogan of an idea, and the devilish details are coming up fast. None the less, Prime Minister May has kept her promise to push the

1 Matt Egan, "Exxon to Trump: Don't ditch Paris climate change deal," [CNN.com](http://money.cnn.com/2017/03/29/investing/exxon-trump-paris-climate-change/), 29 Mar 2017, Cable News Network, A Time Warner Company, 2 Apr 2017
<<http://money.cnn.com/2017/03/29/investing/exxon-trump-paris-climate-change/>>.

exit process forward. She has given the official Article 50 notice to the EU that begins the two-year process of deciding the terms of the split.

Despite pre-referendum predictions to the contrary, financial companies are moving some of their operations and people out of London to EU cities.² Contrary to pre-referendum hopes, the EU is taking a hard line in the negotiations, putting EU citizens and companies first in their priorities.³

Nearly a year has passed since the UK exit referendum passed. It was not clear then what the UK government supporters of the Brexit thought they would gain. It is still not clear. Prime Minister May says only that she'll bargain to get the best possible deal for all the citizens of the UK. Having already said they're leaving, it is hard to imagine what negotiating leverage the UK government has. They have no "or else." It is not credible that if pushed too hard by the EU negotiators, that the UK would be able to say "Well, if you're going to be that way, we'll just stay. Take that!" I don't think this will end at all well for the people of the United Kingdom.

Despite all this uncertainty (which markets famously hate) the **US stock markets** have been charging upward. Likewise the dollar has risen. The US financial markets seem now like the UK electorate seemed a year ago: everyone thought that they'd get the changes they wanted, and no one thought they'd get hurt.

The only concrete Trump policy thus far was weakening the environmental laws, which will benefit only a handful of coal mining companies. Even for them, the Executive Order marks a stay of execution, not a pardon. The pressure on mining (water pollution) and coal (air pollution) will not go away.

What companies will benefit from the next action, whatever it will be? Obviously, we don't know who, and we don't know how much, and we don't know who will be hurt as a consequence.

None of that inspires me with confidence that the stock market gains are justified, or that they'll endure. I'm re-visiting the US stocks I'm holding, as well as other parts of the world that may be good for diversification. I'll let you know what I come up with.



It's time to check the spelling and ship this to you.

If you have any questions, please write or phone. If you want to read more, the company [web site](#) has archived editions of this letter, lots of charts, and links to other interesting sites. There's also a [web log](#) where I discuss the process and progress of starting the mutual fund, along with occasional economic or investing thoughts..

2 Graham Ruddick, "Leading City firms begin to lay groundwork for London jobs exodus," [TheGuardian.com](#), 30 Mar 2017, Guardian News and Media Limited, 2 Apr 2017 <<https://www.theguardian.com/business/2017/mar/30/jp-morgan-dublin-office-building-1000-jobs-city-london>>.

3 Robin Emmott and Alastair Macdonald, "EU offers Brexit trade talks, sets tough transition terms," [Reuters](#), 31 Mar 2017, Reuters News Agency, 2 Apr 2017 <<http://www.reuters.com/article/us-britain-eu-idUSKBN171391>>.

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Take care,

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"Our doubts are traitors,
And make us lose the good that we oft might win,
By fearing to attempt."
--W. Shakespeare



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