Market Commentary

"Want of foresight, unwillingness to act when action would be simple and effective, lack of clear thinking, confusion of counsel until the emergency comes, until self-preservation strikes it jarring gong – these are the things which constitute the endless repetition of history."
-Winston Churchill

Before discussing the economic impacts of the recent natural disasters in many parts of the world, beginning with the U.S., we want to highlight our hope for a speedy a recovery as can be expected and that lives will return to normal as quickly as possible. We have heard and read about some people taking advantage of many dire situations which is truly shameful. We also believe that while there are many immoral deeds committed, disasters like hurricanes Harvey, Irma and Maria overwhelmingly bring out the best in people. It is unfortunate that such behaviors aren't learned and practiced in less trying times. One can only hope a new tone of cooperation and positive leadership has been set by those who have taken action to help those most in need.

As investment advisors it is impossible for us to not look at the number of implications that such devastation brings about. As we enter the final quarter of the year, it is inevitable that this summer's storms had a negative impact on third quarter economic activity. Texas and Florida are among the most populous states and the implications are far-reaching and significant. From a consumer standpoint, spending all but came to a halt and is likely still very depressed. People are simply not willing or able to frequent their local stores and markets. From an industrial and commercial standpoint, think about the bottlenecks that have been created from a transportation standpoint. In many cases, flooding has impacted inland waterways and terminals but also much of the local road and highway infrastructure. Utilities have had downed power lines to businesses and individuals, preventing them from going about their activities. While improvements are being made in all aspects of recovery efforts, economic activity is still very much subdued in many parts of Texas and Florida. GDP expectations for the third quarter have inevitably declined.

Yet, the benefit to economic growth will far exceed the shortfalls we are likely to witness near term. Not only does pent up economic activity have to return but rebuilding efforts which had not been anticipated, will be taking place at a frantic pace. We have already seen the benefits of this in many stock prices tied to economic activity. Homebuilding activity will not simply go along at its normal rate; it will have to exceed planned build rates over the next year or so. Car sales, which had been expected to decline to 16 million, not because of the hurricanes but because of the general slowdown, are now back on track to reach over 17 million annualized. Carpets, roof tiles, wallboard, asphalt, wires, cables, power lines, paint will all be purchased and therefore manufactured at elevated levels. All of the service industries that cater to rebuilding efforts will be short on labor. The inevitable improvements to economic growth will be sizeable over the next year. And all of this will be accomplished without much help from either the current administration or the Federal Reserve!

Imagine what GDP growth could be in 2018 if stimulative fiscal policy measures were implemented. President Trump reaching across the aisle to strike a deal with Nancy Pelosi and Chuck Schumer created waves in the Republican party the likes of which hadn't been experienced in decades. Perhaps some of our legislators have learned something from Harvey, Irma and Maria. The deal was struck for the right reasons – to not keep hurricane relief hostage to debt ceiling discussions. There is a time when the right response is not a political one – it is a moral one. Is this bipartisanship a sign of things to come? Politics is in many respects the art of reaching deals that benefit the country as a whole.

Reaching across the aisle will also have to come into play as the president pushes for his tax plan. We are a long way from finalizing changes to the tax code but many areas need to be addressed which could also have a salubrious effect on economic growth, particularly if they include a reduction in the corporate tax rate to a level more competitive with the rest of the world and if the tax on the repatriation of the $2.5 trillion in foreign retained earnings of U.S. corporations is significantly reduced. Such fiscal policy measures have been absent as a benefit to economic activity for too long, leaving monetary policy as the only tool with which to stimulate growth. We are hopeful that tax reform will take place. Should it, economic activity would inevitably increase, providing yet another likely boost in 2018.

This benefit to growth would accrue to the economy even if the Federal Reserve Board continues on its path toward raising the Fed Funds rate and as its balance sheet shrinks, which begins in October with at a modest $10 billion per month and should rise to a more meaningful $50 billion per month in 2018.

As a result, there is a reasonable likelihood that economic growth will be better than expected both in 2018 and in 2019. In 2018, rebuilding will occur. Beyond that, demand, lending and spending could increase providing uplift to the financial sector, basic materials, industrials and many consumer cyclicals, all sectors which incidentally have struggled over the last few years.

In the investment strategies we manage for our clients and fund shareholders, we have had a modest cyclical bias because those are the areas that have been out of favor and have offered a combination of downside protection as well as capital appreciation. It just so happens that they may also benefit strongly from all of the factors we have touched upon.