



Capital Drain

Rick's investment opinion newsletter

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Before printing, think about the environment

Hi Readers,

Well now, that was quite a surprise. We will spend the next few months learning what the Trump Administration really means to the economy and the markets.

It is far from clear. In my opinion:

Executive Summary:

- Our economy is going well, so we get a good start.
- Trump can't do all he said-- contradictions.
- Republican Congressmen want many things that Trump voters do not.
- Uncertainty requires analysis with an open mind.
- The stock market surge is relief from election uncertainty, and belief that Republicans are better for business.
- Historically, for new Republican president in office stocks rise first, then drop.
- Bond prices will still fall as rates rise.
- Brexit-- we still don't know what it means.

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 confidence in the economy spreads, investing in all-market index 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:

First off, with the election over, let's review where the **economy** really is.

On the positive side: GDP has been growing steadily for quite a while, unemployment by any measure you care to pick is much lower than 7 years ago and improving, real numbers of people working, and the real value of their earnings are all up and rising. Inflation is reasonable and interest rates are very low. That's all a great situation from which to move forward.

On the negative side, the de-industrialization of the US, mostly through labor-intensive industry moving offshore, left many millions of formerly middle-class people in lower-paying service jobs. They feel cheated. They were.

All the academic talk about the beauty of freer trade has some small print: that the government help those hurt by trade to readjust to modern similar-paying jobs. Our trade deals generally had language about helping. Unfortunately, the help didn't help. Instead of specifying the result-- workers made whole, being productive and prosperous again-- the help discussed wasn't always offered, and the help offered wasn't always effective. Often the culprit was that help is expensive. Many millions of workers lost out.

Now we have president-elect Donald Trump.

If there's one thing that's clear about Donald Trump, it's that he's not the status quo.¹

Now, what do we know about his policies?

From his words, not much. He frequently **contradicted** himself, or made promises that no president could possibly keep, misstated the current economy so badly that he could claim a miracle cure simply by embracing reality, and most importantly relied heavily on fuzzy phrases. "Make America Great Again" or "Drain the Swamp" can mean whatever you want them to mean. To his supporters, they meant whatever the supporters wanted to hear. Based on his own interpretation, Trump will certainly declare victory in due time. We'll see if his supporters feel better off.

His cabinet thus far are mostly super-rich white males, and some Generals. To a Blue State observer, it appears that he's **drained the swamp** of anyone with experience in public policy or governance. There are also people with some very strong opinions quite at odds with environmental or worker or small investor or civil rights or retiree

1 Brian Chappatta and John Gittelsohn, "Trump Has Bond Investors Rethinking What's Normal," [BloombergBusinessweek](http://www.bloomberg.com/news/articles/2016-12-15/trump-has-bond-investors-rethinking-what-s-normal), 15 Dec 2016, Bloomberg LP, 15 Dec 2016 <www.bloomberg.com/news/articles/2016-12-15/trump-has-bond-investors-rethinking-what-s-normal>.

protection. OK, we'll just have to see how that works, by which I mean OK, we'll just have to gird on our armor and prepare to fight them for every inch.

His nominal allies will be right there in many of the battles, and in battles all their own. Although he ran as a Republican, most of the **Republicans in Congress** derided him in detail during the primaries and even in the general election. They will probably not easily rubber-stamp some of his ideas, and he will probably not be friendly to some of theirs. I say 'probably' because we can't really know where he'll come down on some of his contradictory positions, or what sort of horse trading they might do. Truly, as citizens and investors, we'll have to watch and see what happens, and be ready to jump to the barricades as necessary.

It is simply not possible mathematically to simultaneously cut taxes, increase spending on infrastructure and the military, and lower the deficit. Of those, you can at most pick two.

It is probably not possible politically to kill Obama-care, because there's nothing to replace it for millions of potentially very upset voters. Likewise Social Security and Medicare. The list goes on.

Less often discussed: Washington D.C. is home to tens of thousands of lobbyists, and many political operators who aren't in office or registered lobbyists, but who will be maneuvering to get Trump's ear and guide him through the treacherous Washington swamp (in ways that suit their own goals.) Which of those will gain influence, and where that will lead...

In addition to the political aspects, there are economic aspects, and those will have investment implications. We don't know yet what those implications will be. It's important to keep an open analytical mind, and not jump to simple-minded conclusions.

Since the election, the US **stock market has been racing upward** (to my surprise, to be honest), at this writing pausing just short of reaching a new record. That is typical after a Republican is elected president, because they're often seen as "good for business." This particular Republican is not typical, but I guess that to a lot of investment managers he's close enough.

Also typical historically is that after a few months the stock markets dive. That's because "Good for business" is pretty vague, and not everyone can get what they want at the same time. Good for billionaires is different from good for small businesses, and different from good for companies that create lots of good jobs. In fact, reality often falls short of the hopes and dreams that can get pumped into optimistic investment forecasts. On the first disappointment, expectations are adjusted downward, and the market falls.

One important economic factor is outside the influence of the president or Congress: **interest rates**. I wrote in detail about that in the previous ([October 2016](#)) newsletter, starting at the top of page 3. Short summary: bonds are likely to be poor investments for individuals for a while.

Democracy is the theory that the common people know what they want, and deserve to get it good and hard.²

– H. L. Mencken

The UK's exit from the European Union, or **Brexit**, is still as uncertain and confusing as it was the morning we learned it had passed. The then-Prime Minister who had campaigned against exiting the EU resigned, and curiously none of the prominent “Leave” campaigners of his party sought to be the new PM. It fell to Theresa May, who had opposed leaving, but she promised she would not thwart the will of the people by watering down the Brexit mandate.

Bear in mind that the “Leave” side didn't have any unified plan for what Leaving would mean, or really any plan at all. In fact, some of the concepts which were most popular with “Leave” voters were fanciful misstatements of the facts of the current economy, or they were “have your cake and eat it too” ideas that the EU would have no incentive to agree to.

May is being true to her word and taking a hard line for a complete exit and re-negotiation of the terms of commerce between the UK and the continent. The UK needs free trade with the continental EU far more than the EU needs anything from the UK. The EU can drive a very hard bargain. Many “Leave” voters are now seeing clearly what they would lose, and re-examining whether leaving is in fact a good idea overall.

My personal theory is that PM May will continue to push for a Brexit that would give all the desired benefits, while the electorate learns bit by bit how much those demands will cost. In the end the public opinion tide may ebb so far that the Brexit idea will be discarded, and the Prime Minister will have the result she originally wanted.



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Please forward this to any and all friends who are interested. Thanks! If you

2 H. L. Mencken, “A Little Book in C Major,” John Lane & Company, New York, 1916.

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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

A collection of fine industrial Boilerplate, but true:

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