

First Quarter 2019

Economic and Market Commentary

Go find your wallet. Don't rush. I can wait. Now that you've found it, take out a one dollar bill. A crisp one if you have it. Did you know that the average dollar bill lasts about 18 months before it's taken out of circulation because it's no longer fit for commerce? Maybe it got dog eared, ripped, written on, limp or just plain dirty. Each year, more than six billion bank notes are turned into the Bureau of Engraving and Printing to be shredded, then burned. This is the same Bureau that prints new money to keep the supply of paper money pretty constant.

Today, our bills are just shy of three inches wide and a little over six inches long. They're made of three parts cotton and one part linen, with red and blue synthetic fibers distributed evenly throughout the paper. Before World War I, these strips were made of silk. It takes 490 notes to weigh a pound. That means a million dollars in one dollar bills would weigh more than a ton. Paper money was first introduced here in the United States back in 1862 as a means of financing the Union's Civil War effort.

So what you have in front of you now is fiat money. Unlike commodity money, it has no intrinsic value. It can't be turned into the government for silver or gold the way it once was. It's only worth something because the government says it is. In the parlance of realtors, let me give you a quick "walk through" around the dollar. The front of the bill, where the portrait appears, is called the obverse. To the left of the portrait is the Federal Reserve District Seal. It identifies which of the twelve Federal Reserve banks issued the currency. To the right of the portrait is the Treasury Department Seal. The Seal presents the Scales of Justice in its center, and below that are thirteen stars representing the original thirteen colonies.

Now, as for the portrait, you guessed it, it's Lawrence Washington's adoring younger half-brother, George. Lawrence was a leading citizen of Virginia, founder of Alexandria and decorated war hero who survived the Battle of Cartagena while serving in the Virginia militia. When he died of tuberculosis, his 20-year-old kid brother George went on to manage his late brother's estate at Mount Vernon until inheriting it himself upon the passing of his sister-in-law, Ann. Years later, George Washington went on to become General of the Continental Army, first president of the United States and father of his country, "First in war, first in peace, first in the hearts of his countrymen." His portrait has adorned American currency since 1869.

Alright, now go ahead and flip the bill over. This side is called the reverse or verso. "The United States of America" spans the top of the bill with a shadowed One in the center of the bill. Above the One are the words, "In God We Trust," which were added to paper money in 1956. (The phrase had originally appeared on coinage in 1864.) On each side of the central One is the Great Seal of the United States. The Great Seal was originally adopted in 1782. Its obverse features our national bird, the bald eagle, under a splendid cluster of 13 stars. The eagle's breast is protected by a heraldic shield comprised of 13 stripes. In its beak, it holds a ribbon which reads, "E Pluribus Unum," Latin for "Out of Many, One." In the eagle's left talon are 13 arrows, and in its right talon are 13 olive branches representing both war and peace.

The reverse of the Great Seal, seen to the left of the central One, features an unfinished pyramid

of 13 steps against a stark landscape. At the base of the pyramid are the Roman numerals MDCCLXXVI (1776), the date of our independence from Britain. Crowning the pyramid is the “Eye of Providence.”

The All-Seeing Eye Of God

For well over 1500 years, the Eye of Providence has appeared throughout the world as a symbol of the eye of God watching over humanity. Sometimes it is depicted in a triangle, at other times it is surrounded by sun bursts or clouds. It can be found in renaissance heraldry, the coats of arms of Belarus and in the Grand Kremlin Palace. Freemasons have used it in their iconography for hundreds of years representing the “Great Architect of the Universe.” It was the artist Pierre Eugene du Simitiere who suggested it be used in the Great Seal of the United States back in 1776.

It’s only appropriate that an artist was so instrumental in the design of our country’s Great Seal. What a country chooses to present on its currency is a portal into what it considers important as a nation. Are they militaristic, compassionate, bold or isolationist? For thousands of years, civilizations’ currencies have served to provide us with insight into who they were, or in the very least, how they wanted to be thought of.

Through the Eye of a Camera

Remember, an eye works like a camera. Its focus is completely dependent on the lens through which it views things. Let me demonstrate my point. Magnifying glasses have been around for at least 2,500 years. They are convex lenses used to enlarge an image. Aristophanes writes about them in the fifth century B.C.E.. They were used to concentrate light, start fires and read letters no matter how small. By the 1200s, they led to the development of the earliest eyeglasses. These marvels of ingenuity enabled people to take in detail that would otherwise be lost to the naked eye. But when in use, people can become fixated by the minute and often lose track of the bigger world around them.

It took almost 2,000 years for a Dutchman named Hans Lippershey to develop the idea of inserting a convex lens at one end of a tube and a concave lens at the other end of the tube to form the first telescope. When applying for his patent, Lippershey wrote, “We can now view things far away as though they were nearby.” Certainly this was true, but very often it was at the expense of missing that which is right underneath our noses.

Let Me Bring It Home

The Fourth Quarter 2018 was one of the worst quarters equity markets had suffered in the last 100 years. Stocks were way over sold, doom and gloom was everywhere. But, you see, unlike milk or yogurt, bull markets don’t have an expiration date; the hard data did not justify the sell off. Markets were reacting to emotion. In other words, the equity markets were viewed through the glass half empty lens, and taps were being played for the economy and the end of the bull market.

So here we are, three months later, and we just experienced the best quarter broad-based U.S. equity markets have had in the last 10 years. So did things really change that dramatically? The answer is no, definitely not. There is still no graceful exit from Brexit. No trade agreement with China. Washington continues to operate in a state of gridlock and subpoenas are about to go flying out of Congress like bats out of a cave on a warm summer's night. Couple this with about 20+ Democratic Presidential contenders starting to vie for separation from the pack and you have to ask yourself, what changed?

What happened this past quarter is we changed lenses, for the time being, to the glass half full set of optics and focused on our....

- Lowest unemployment in the past 50 years
- A pronounced change in tone from the Federal Reserve Board signaling a stable interest rate environment as long as the data justifies one
- Low inflation
- Relatively low energy costs
- Continued corporate profitability and
- Technological advances taking hold in every facet of our daily lives

Alright, I agree, autonomous cars picking us up at the airport is probably a decade away, but do you know that right now there are companies in San Francisco using artificial intelligence to program 3-D printers to produce robots that make eyeglasses?

Ponder This

The question begs to be asked: If we're worried about a recession and equity markets don't cause economic recessions, what does? A resounding amount of the time it comes down to either poor monetary policy or poor fiscal policy. On the monetary side, it usually means tightening money too quickly by raising interest rates and bank reserve requirements to the point where people and small businesses can't buy homes, expand their businesses, hire new people, buy new cars, etc. On the public side, towns, counties and states can't fix infrastructure (because the cost of the money to do so is too high—think bond interest rates), build roads and bridges or educate our kids by investing in public schools.

The flip side of making money too tight is keeping it too loose, a perfect example of the “punch bowl analogy.” People and governments borrow more than they can hope to pay back without devaluing their currency. Think bubbles and inflation. Although your wages may be going up during these times, you're losing purchasing power.

On To Fiscal Folly

Fiscal folly can rear its head in a number of ways, most often when revenues don't keep pace

with expenditures. Think of running up your credit cards to support an unsustainable lifestyle, just hoping the bank will continue to raise your credit limit. (As a country, we now have more than 20 trillion dollars of national debt separate from underfunded Social Security and Medicare systems.)

The flip side of fiscal folly is trying to raise your revenues to keep up with expenses in an unhealthy way by taxing your citizenry to death . (Think of robbing a bank.) Now there is also the Scrooge approach: Stop investing in your citizenry, cut back on health care, cut back on access to education and the arts along with access to shared national assets such as parks and monuments. Obviously, these are all equally unattractive options. These cutbacks, not equity markets, are the root causes of recessions.

Conclusion

Some analysts are in the camp that put us in the late stages of a long bull market, while others say there's a lot of gas left in the tank and cite statistics such as....

- Even though unemployment is at a 50-year low, the percentage of the U.S. population currently employed is at about 60%. In past economic expansions, it reached close to 65%.
- Currently, the U.S. is spending approximately 17% of GDP on fixed assets like machinery, homes and factories. During many past economic expansions, that percentage was close to 25%, indicating significant room to grow.
- The largest American generation since the baby boomers, the “millennials” (those born from 1981 to 1996), are poised to boost their spending as they enter into their prime earning years of 26 to 50.

Personally, I've said it before and I will stand by my previously stated position that, barring a black swan event, we're in a range bound market. I believe it to be roughly bracketed by the pre-Christmas 2018 S&P lows and by last summer's highs.

Is it impossible to make money in a range bound market? Definitely not. You need to be willing to harvest gains as you approach the upper reaches of the range and be prepared to thoughtfully re-deploy the capital in market sectors that represent good valuation, seeking best-of-breed companies with little or extremely well financed debt.

As educated investors, the smartest thing we can remember to do is change our lenses; that's what reading and distance glasses are for. You'll go blind trying to see things through a crystal ball. As always, I'll look forward to our periodic review. Until then, with very...

Best Regards,

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Enclosures