Geoffrey Lenk 508-428-1645

LENK LADNER
Investment Solutions

John Ladner 508-420-1684

MARKET COMMENTARY August 21, 2016

Dow Jones Industrial Avg.	**17,929.99**	**Standard and Poor's 500**	**2098.86**
2016(YTD) +2.9 %	2nd Qtr. +1.4 %	2016(YTD) +2.7 %	2nd Qtr. +1.9 %

Election Promises Galore –"More, More, More, How Do you Like It?" by Bananarama (1983)

Stranger Than Fiction –As both political parties struggle to reach the Election Day finish line, many voters remain unimpressed with the choice confronting them. Both conventions have been beset by serious fissures. Trump had to contend with the obstinate Republican establishment and the "Cruzites", whereas Hillary has had to deflect the objections of the socialist "Bernie-ites", who threatened an insurrection because of the way the Democrat party treated their leader. This is indeed shaping up as the strangest election cycle in memory. To further muddy the waters, there are two lesser candidates, Gary Johnson of the Libertarian Party and Jill Stein of the Green Party, who just might garner enough votes to alter the outcome of the election.

Where's the Beef? - Neither Hillary nor Donald has provided much insight into their plans to govern. Wouldn't it be refreshing to have one or both describe the top three or five top challenges facing our country and their suggested solutions? If I may be so bold, here are three problems that deserve immediate attention. The first should be obvious to every voter because it has been high on many lists for years – entitlements. As currently constructed, Medicare, Medicaid, and Social Security are financially unsustainable. All three require increasing annual subsidies from the general fund, in other words all contributions and fees going into the funds fail to cover the costs of the benefits provided. How is the shortfall covered? The needed funds are borrowed in the financial markets resulting in an increase in national debt, which is now approaching $20 trillion and which has doubled during President Obama's nearly eight years in office. However, it is imperative for the public to understand remedial actions are needed to sustain these programs. Any cure will involve some pain in the form of more revenues, fewer benefits, or less payment to health care providers.

A second issue ignored for far too long is our convoluted tax code. If ever there was an issue offering psychological benefits and economic relief, it is the revamping of the tax code. An honest attempt at tax simplification will allow construction of a fairer system. Deduction, credits, exemptions, and other exceptions in the code would be curtailed or preferably eliminated. The role of lobbyists in Washington and the vast sums of money they dispense would be curtailed. As one might expect, the major beneficiaries of the current bloated system are large corporations, key industries (e.g., health care, housing, energy, agriculture, etc), and other influential organizations, such as unions and non-profits. There is a sound argument to be made for lowering the corporate tax rates, so our companies are not disadvantaged vis-à-vis their foreign competition. This lowering of the rates would not be a "gift" to them because they would no longer have the advantages they have in the current code. Similar changes would be enacted to simplify the tax regulations applying to wage earners and small businesses. Tax rates would be reduced, but those reductions would be targeted to the working middle-class earning between $50,000 and $200,000. The lower rates would be paid for by eliminating any existing credits and deductions for all taxpayers earning more than $50,000. Note the vast majority of families earning less than $50,000 are currently paying no federal income taxes. Immediate benefits to the economy and to taxpayers are evident. Topping the list is dramatically lower compliance costs. Closely related to that is the possibility of a major reduction in the size and cost of the Internal Revenue Service (i.e., I.R.S.) bureaucracy. Finally there is the psychic benefit provided to all taxpayers in knowing they will no longer waste endless hours trying to successfully navigate the maze of regulations.

The third issue relates closely to harnessing the I.R.S. Government bureaucracies at all levels exert power by proposing, interpreting, and enforcing the laws, rules and regulations under their jurisdiction. Their "raison d'etre" (reason for being) is to maintain and possibly expand their control. Nothing illustrates this more clearly than the egregious actions of I.R.S. Commissioner Koskinen and former I.R.S. official Lois Lerner who inserted political correctness into application of the tax code or at least condoned the practice.

More broadly, there are the added expenses to businesses, big and small, as they attempt to cope with the abundance of regulations imposed by all levels of government. There are the explicit costs stemming from fees and penalties, but they are dwarfed by the implicit costs required to assure compliance. Staff must be hired to clarify applicable rules and regulations; develop compliance procedures; assure staff compliance; and communicate with all pertinent agencies. Not surprisingly, the greatest burden falls on smaller businesses and particularly start-ups. A strong case can be made that the over-emphasis on a regulatory approach is strangling small business and has been a major reason the U.S. economy has faltered so badly over the last decade. Neither major candidate has provided any innovative solutions to address these three national challenges nor have they made any serious effort to spell out their own economic priorities.

Economy Stuck in Neutral – The economy has been in this extended period of sub-par growth going all the way back to the bursting of the tech bubble back in 2000. Recall this period coincides with the Presidencies of George W. Bush and Barack Obama. Democrats have continually pointed to the financial collapse in 2008-09 at the end of Bush's Presidency as the cause of this protracted period of economic malaise. Republicans, on the other hand, suggest President Obama and his administration have had nearly eight years to propose and promote policies and programs to revive this moribund economy. Even a moderately informed voter knows why the prolonged economic slump has remained such an intractable problem. It is Washington gridlock and it is a primary source of the voter frustration and anger evident this year.

How disappointing has economic growth been? Very. Over the past four quarters, the annualized growth rate has only averaged about 1½%, and the highest rate achieved was a skimpy two percent. Defenders of the current policies point to the protracted decline in the unemployment rate to its current level below five percent as evidence of the success of existing policies. They fail to acknowledge much of the decline is due to the continuous flow of baby boomers leaving the workforce – an average of more than 10 million a month. This continuing flood of boomers will exacerbate the already stressed financial condition of the Social Security and Medicare systems. The only agency within the government to even attempt to address the root cause of this extended economic malaise has been the Federal Reserve Bank (i.e., the FED). They devised and unleashed the greatest program of "easy money" in the history of this country. As a result of the various programs devised by the FED, short-term interest rates have fallen to near zero and have remained there for more than five years. Early on their programs had some salutary effects, as these low rates encouraged home buying activity; mortgage refinancing; and renewed automobile sales. As time has passed, the benefits have waned. There has been a dark side to these low rates, and it is the denial of a fair return to savers seeking a safe, fixed return.

New Ideas? – The outlook for the remainder of the year will to large extent be determined by the competing visions of the Presidential candidates. Although Hillary has a lead in the polls now, the three scheduled debates are critical for both candidates because they are burdened with such high negatives. Given the current lofty valuation levels, stock investors are leaning toward Hillary by preferring the devil they know rather than the unpredictable Donald. Nevertheless, many voters will be willing to change their vote depending on the outcome of the debates. Still lurking in the background is the Federal Reserve and its seemingly unanswerable question, "When should we raise interest rates?" The FED knows it needs to be done, yet they are fearful they may cause a vulnerable economy to tumble into a recession. These factors increase the odds both the stock and bond markets will drift until it is known who the next President will be.

Where to Invest Now – Slim pickins. With stock market averages at all-time highs, investors are targeting fairly valued companies because there are so few undervalued ones. This shift is particularly evident in the high dividend realm. Electric utilities, consumer non-durables (e.g., food and soaps) , and REITs are sectors that have seen their price/earnings ratios soar to levels far above their historic norms while at the same time their dividend yields have fallen to levels far below their historic averages. A market segment which seems to offer the best risk/reward opportunity is the moderate growth segment. With reasonable revenue and earnings growth prospects as well as moderate dividends, many of these companies appear fairly valued. On the other hand, many stocks have done quite well over the past few years so it is wise to remember the gains can disappear quickly if a meaningful market correction occurs. Realizing some of those profits now may help to fill the income void caused by low interest rates. Fixed income markets remain a challenge and have little to offer at this time. - JML