Scotty C. George
Chief Investment Strategist

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An Untenable Transition

As the US markets surge into the New Year, fresh off the US post-election rally, we regrettably see reason for both optimism and pessimism. For certain, even the buoyancy of building wealth in the final few weeks of the year has done little to quell the insecurities of those who feel alienated from the facts that substantiated their good fortune.

Yes, the data *are* better, and the contagion of buying stocks that we saw in the last two months was emblematic of that fact. The question going forward is whether this is a fact-based pattern of sustainable economics, or a cause by itself to withdraw from the process and make a careful reassessment of what conditions led to the rally, or which might underpin it for months hence.

We are dismissive of this particular rally anyway because the markets have been confirming a strong upside bias ever since the post-recession boom began in 2009. However, our concerns became even more focused when we looked at the underlying fragility of the global data, while the rules of the game seem not to apply equally to everyone on the playing field.

As such, we think we are witnessing a sub-level of defensiveness and *flight to quality* into more traditional sectors of conservative investing, such as Utilities, Consumer Staples, and Tangible Assets (real estate, metals, etc.)

The financial riot into stocks that began last November caused the Federal Reserve to pump the brakes by raising interest rates and threatening to do so repeatedly in 2017 to steady what they believe is, or is yet to be, overdone enthusiasm and far-reaching plans for domestic capital expenditures. In its December "leaked commentary" it was revealed that the Fed's officials were rife with references to *"economic market risk", "caution",* and *"deceleration in consumer spending",* as well as static expenditures for new job creation. In other words, go slowly and do no harm to this very cautious, nascent recovery.

In their view, a history of wage deceleration and earnings gap issues between the ultra-rich and the not-so-wealthy figures to cause more corroboration of deflationary pressures than inflationary ones. Thus, in their minds, the recovery really hasn't matured at all and looks more to be an opportunity for those flush with cash than a reason to go all out fighting the promise of unbridled GDP.

Although there are those who argue that economic activity is vindicated and has been responding dependably in the last few years, we still see many signs of gaps in the way in which the recovery affects different segments of the economy. Most retailers last year, for example, are admitting that despite seasonal adjustments, they had been relying more upon *price reductions* during the year than price (and margin) *expansions*, citing their customer's tenuous job and earnings status. Further, even though the unemployment rate has been going down in the US, there is an even stronger suggestion that unemployment in certain regions is higher than the national averages, worse specifically in areas of poverty that continue to suffer from manufacturing declines and inexpensive overseas competition . This conversation was, after all, one of the central theses upon which the outcome of our recently concluded election was premised.

We would suggest that price-pressure and price-consciousness will continue to reverberate for several more quarters at least, until the political and fiscal debate is ironed out. Energy prices have recently spiked, and many consumers can cite anecdotal examples of cost increases in their daily lives. As a result, our research is looking for muted corporate earnings acceleration patterns in the next few quarters.

We have also stated that we believe the Fed overplayed its hand even in attempting to prime the spending pump as far back as the mid-2000's. Indeed, the markets may have rallied for the last decade because there were no alternatives in which to invest while rates were so low, but the economy failed during that same period of time to reproduce the fundamental underpinnings of a traditionally strong market base. It is for this reason almost entirely, that we enter the new year with a skepticism about the stock market's ability to maintain upside linearity in a decidedly uncertain parabolic world.

Markets

It used to be thought, perhaps 30-40 years ago, that *globalism* was the panacea for what ailed a failing regional economy. Selling into other markets, for profit, was a lot better than going into bankruptcy in one's own neighborhood. It wasn't unheard of to be envious of one's rivals and other leaders of entrepreneurship. In fact, Wall Street made a fortune out of peddling product development in *country-specific funds* as the solution for uncovering new opportunities for capital gains. Identifying those demarcations that revealed the basics that made for unique competition amongst nations was at the core of solving our capital gain diminution problems.

However, the conversation today seems to have turned on a dime...now suggesting that what made us cooperate and conjoin for progress has become the roller-coaster ride that has precipitated the cause of all our negative imbalances, the cause of our displeasure and personal misfortune. The current conversation lays bare the present conundrum that domestic and other global hangers-on must convert to our way of thinking, of doing things. *Does the march to success of one nation really preclude the possibility of other nations participating......or encourage it?*

While the developed nations appear more cordial and willing to dissect the issue, it is a more strident underbelly of conflicted and aspiring nation-states which hold grudgingly to the notion that the world's economic fabric is unfair, disconnected, and something to be feared, not embraced.

Fundamentally, it cannot be refuted that growth is driven by demand, that earnings are the successful execution of management of expenses. Yet, there are still those who aspire to earnings at any cost, to the exclusion of social and moral responsibilities of building a better planet. This misplacement of our value system is intolerable, and indefensible.

This past quarter was a manifestation of those basest elements, we believe. In the aftermath of the election, those market forces that rallied for national pride and exclusionary practices.... profit at any cost..... won big. The result is going to create a rift, politically and economically between the notion of globalism as savior of the underserved versus a hardening in defense of jingoistic politics and standards of evaluation. Any misappropriation of resources...natural or otherwise (water, food, energy, technology, real estate) by countries or individuals for nefarious reasons is an affront to the principles of socially responsible capitalism, and should be disavowed.

The essence of truly great, sustainably responsible profit-making is not *how* or *when*, but *why.* In a broader sense, we in the financial community are at a crossroads at which we run the risk of leaving behind the least fortunate; the truly hungry and impoverished; those without access to replenishable resources like energy, housing, education, and personal security.

Households got wealthier during the 4th quarter. But at what cost? The debate between....and potential cooperation amongst.... political science, ethics, economics, and national pride will become the question of our generation in our analysis as we embark upon our quantitative review of opportunities for the next several quarters.

It is too early to tell whether the trajectories of both stock prices and alchemic earnings accretions can keep pace as synchronistic allies. Somehow, somewhere, the bills for our indiscretions are going to have to be paid. Ranting about those things that divide us does not make us seem as one. If, by some stroke of political genius, the world economy *does* coalesce even while being harangued by *federalism* and *populism* it could prove to be the single greatest economic super-nova since the Great Depression. But it won't take us long to know that outcome, because traders are smart, savvy people who seem to know the score before others even recognize the similes.

Conclusion

Do you remember the year 2000....all the hoopla over Y2K, the changeover in the millennium? Do you remember the anxiety everyone felt about the mystery and majesty of how a new technology would turn over and transform into the next generation? Would the shift work, or not? Recall our innocence in a pre-9/11 world, a more introspective time full of hope and potential? I ask because the world seems now to be juxtaposing a sense of anxiety about technology with human deviousness that fills some of us with a sense of foreboding and fear.

The long political season just-passed was about answering the questions of why, in a world accelerating marvelously at such an historic pace, so many feel a lust for a bygone era, a time when they felt more connected to persons and events that surrounded them.

And that sense of ill-at-ease has become the new measure for quality of life discussions, stock market analysis, morality, and other factors which might sustain economic and social opportunity and prosperity.

Thus, we are fastening our seatbelts and preparing for a whole lot of turbulence.....

Suggested Balanced Account Asset Allocation, Q1, 2017

Equities:	**52%**
Fixed Income:	**15%**
Cash:	**33%**

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