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The Quarterly Commentary of Jurika, Mills & Keifer LLC

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Politics & Investing:

In a recent interview, Warren Buffet cautioned investors that it can be a big mistake to mix politics with investment decisions. We tend to agree.

As we have written in the past, events and markets frequently turn out differently from common expectations. A year ago, if we had predicted that Britain would vote to leave the European Union and that Donald Trump would win the presidency, most market strategists would have predicted economic turmoil, market mayhem, and advised you to sell everything, and hide in your basement. Instead, the global economy is showing surprising strength and global stock markets are reaching new high levels.

Summary:

- It is generally a mistake to mix politics and investing. Events and markets tend to defy conventional wisdom.
- Politics and other factors can impact investment conditions, for better or worse but, over time, economies tend to grow and markets tend to appreciate regardless of who is in charge.
- Things are currently better than the politicians say they are, but not as good as the stock market may want to believe.
- Valuation levels for stocks and bonds are high overall, which makes them more vulnerable to unpleasant surprises. We don't foresee a major correction without a recession and we don't see a recession yet.
- With stocks and bonds expensive, we remain cautious but continue to balance investments targeted at areas of long-term growth with a core of defensive and alternative strategies, and a foundational base of bonds and cash.

Economies tend to be far more resilient than they appear on television, reflecting the collective desires of billions of people around the world to improve their lives and move forward. Economies have an inexorable tendency to grow, through various political regimes, and despite occasional setbacks. Progress is a powerful force. Over the span of years, markets reflect this. Despite wars, recessions, political and economic cycles, stock markets tend to appreciate in value.

Whereas most TV news cycles are measured in hours and days, and political cycles are measured in two to four year periods, most investors investment time horizons are measured in decades. Over time, the global economy and stock market are like the "house" in gambling. The "house" inevitably wins and it is smarter to bet with it, than against it.

Having said that, politics, like weather, can influence near-term investment conditions and outcomes. Regardless of the weather, life tends to go on. People drive in rain and snow, but it's much easier when conditions are favorable, roads are clear and the sun is shining.

Sentiment – consumer, business and investor – can also influence near-term investment conditions, and there is the inevitable tug-of-war between perception and reality. This is only exacerbated by heightened media coverage and political posturing.

Currently, this tug-of war creates an interesting set of contradictions and tensions. Things are better than the politicians say they are, but not as good as investors may want to believe.

Despite Donald Trump's dire admonitions about

"Things are better than the politicians say they are, but not as good as investors want to believe."

how bad things are, presumably so he can claim credit for fixing them, the global economy is fine and getting better. Growth is lackluster and there is room for improvement, especially in certain parts of the economy and country, but overall, things are reasonably good. The US economy is growing above 2%, unemployment is under 5%. The Federal Reserve has started to raise interest rates in response to this economic improvement. Fears of deflation have given way to fears of inflation. Overseas, economic conditions in Europe and Asia are also improving despite numerous predictions to the contrary.

Conversely, investors may want to believe that Trump and the Republicans are going to be more effective and positive for the economy than they are likely to be, counting their Trump chickens before they hatch. After the election, global stock markets rose on the prospect that a unified Republican party would focus on sensible approaches to tax reform, regulatory reform and infrastructure spending.

So far, they are off to a questionable, if not troubling start. For all the talk of easy and quick solutions to complex problems, we have seen a circus of self-inflicted wounds and conflicting ideologies. One of the signature issues of their campaign, the repeal and replacement of "Obamacare," failed, at least in its first iteration, reflecting a lack of unified vision and purpose within the Republican party. It was an unloved and deeply flawed piece of legislation that did nothing to actually improve access to affordable healthcare. It turns out, healthcare is complicated.

Our main takeaway is that much of this dysfunction takes focus and effort away from improving the important things that can be improved and for which there is likely to be bipartisan support.

A second takeaway is that some of the policy that has been put in motion seems more geared towards shaping perceptions rather than improving reality. They are solving problems that don't need to be solved, chasing monsters that don't really exist and proposing laws and policies that actually work against growth and progress.

For example, a $25 billion wall along the Mexican border may have high symbolic value and make people feel more secure, but will do nothing to stem the loss of manufacturing and service jobs to robots and software, nothing to train those displaced workers with new skills to make them competitive, and nothing to make the U.S. less vulnerable to radical Islamic or other terrorism.

Stricter immigration laws may also make people feel safer, but will also lead to shortages of skilled and unskilled labor, which in turn leads to slower growth, higher wage costs and higher prices.

Relaxing regulation of the coal industry may sound supportive of coal miners but will not likely create new demand for coal, which is more expensive and much less clean than natural gas or even solar energy.

Finally, protectionist measures such as border adjustment taxes and tariffs are likely to do more harm than good; hindering global trade, driving up prices for imported goods, provoking retaliation from trading partners and ***slowing***, rather than stimulating economic growth.

Meanwhile, listening to politicians, you would barely know that we have a "winning" technology industry that leads the world and is one of the largest drivers of our economic growth. You would barely know that we lead the world in bioscience, medical research, nanotechnology, robotics and clean energy. You would hardly know that the world is still round.

And meanwhile, initiatives that actually can make a significant positive difference for the economy like tax reform and infrastructure spending are sitting on the back burner and losing momentum.

Fortunately, individuals and businesses tend to be much more grounded and forward-looking than politicians. There is wisdom in the crowd as well as a natural desire to disrupt the status quo and find better ways to get things done. Regardless of who is in the White House and who controls Congress, the pace of innovation will only increase, generating new industries, reshaping existing industries, creating new groups of haves and have-nots. It would be far better for our political leadership to be ahead of the curve on this than behind it.

Investment Outlook:

Despite all the political dysfunction, global stock markets continued their run and enjoyed a strong first quarter, buoyed by improving economic growth around the world. The overall U.S. stock market as measured by the S&P 500 index rose 6% and Global stocks, rose about 7%. Emerging markets were particularly strong, up 11.5% for the quarter. There were also some notable reversals of fortune from the fourth quarter of last year: Technology and healthcare both had strong returns. Conversely, Energy, which was a star performer last year, was down over 6% in the first quarter.

Where the market goes next is anyone's guess. Valuation levels are full and the market is overdue for a correction. But, valuation levels are rarely a good predictor of near-term market direction. Expensive markets can easily get more expensive before they get cheap.

Valuation levels are, however useful at predicting expected returns going forward. As valuation levels increase, prospective returns are diminished. High valuation levels also make markets much more vulnerable to unpleasant surprises when they inevitably occur.

The "house" may inevitably win, but there are times when the odds are more in your favor and it makes sense to invest more aggressively and times, like now, when the odds are less in your favor and it makes sense to be more defensive.

For this reason, we are taking a few steps to mitigate some of the risk in our portfolios. We are not calling for an imminent correction, but do not find the overall stock market particularly compelling. We do continue to like technology, biotechnology and healthcare, and developing economy consumer markets as areas of long-term emphasis in client portfolios.

As always, we continue to invest for the long-term and with a global focus: balancing investments targeted towards areas of long-term growth and innovation with more defensive strategies to mitigate volatility and risk.

We thank you for your ongoing interest and welcome your questions and comments.

Jurika, Mills & Keifer, LLC
April, 2017

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Our firm is built on a core set of values and investment principles that have been central to our identity and success for over 30 years.

Our objective is to preserve and build the purchasing power of our clients' capital over time through forward-looking investment management and smart financial planning and counsel.

Our offices are in San Francisco, California. We welcome your inquiries.

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