April 13, 2017

The JFK Market Rally

Dear Investor:

During the Eisenhower administrations of the 1950's, the US economy generally did quite well. Several sources say it grew by about 37% over the decade. Inflation had been brought down remarkably from very high rates during and after World War II. Some economists attribute this to the tremendous efforts President Eisenhower made to balance the federal budget. Consumerism and credit became a way of life for many American families. A new middle class was born, and they were using credit to live "the good life". Some people thought that poverty had been virtually eliminated, which of course was a great exaggeration.

Although things were generally going very well, there were several periods of recession during that time. There was a recession in 53-54 after the Korean War. There was a fairly sharp downturn starting in the summer of 1957 that carried well into 1958. The market was down over 14% in 1957 and unemployment rose sharply. As a result, the budget slipped back into a deficit in 1959 of over $12 billion, which was a new peacetime record. To give credit where due, the budget deficit on average was smaller during the Eisenhower years than under any other president. When you look at the mess we are in today, it's positively amazing that Ike was able to do this. However, in spite of all the prosperity and good budgets, things slowed down again in April 1960, and unemployment was still elevated. It was against this somewhat gray and dull backdrop that JFK won the election of that time. Kennedy campaigned on the slogan "getting America moving again".

As you likely know, the market is always looking forward and trying to anticipate the future. Wall St. and others had a very positive reaction to JFK's victory. People responded to the relative youth and energy of JFK. They definitely anticipated there would be action and that economic growth and good times were ahead once again. There was talk of a "Kennedy Market" and a "Kennedy Boom". From October of 1960 to the end of JFK's first year in office in December 1961, the market was up around 28%. It looked like the good times were indeed rolling again.

I trust you see why I've included this short history lesson. We talked about the Trump rally the last time, and we see the same thing happened when JFK was elected. There are certain key times when politics play a big role in the markets. That's the situation we find ourselves in today. The market has had a big run since November, but now appears to be stalled. While most of the data show the economy is moving along steadily, the market is looking for bigger things. We know the Trump administration has promised to deliver a pro-growth agenda. We are beginning to sense the realities now of how difficult this could turn out to be. I think the honeymoon may be over. It's too early to know with any certainty what programs or significant changes will make it into law in the coming months. My point here is that what happens in the political arena in the months ahead is likely to have

Lyndon Office Park|7000 East Genesee St. Bldg D| Fayetteville, NY 13066-1139
315-701-5750|Fax 315-701-5751|dkeim@keimassetmanagement.com
www.keimassetmanagement.com

a very big impact on the markets. We also have to look ahead and realize there will be a substantial time lag between possible legislation being passed and actual results showing up in the economy.

It's my opinion that the current recovery was engineered almost entirely by the Fed and I give them most of the credit. There's really not much more they can do right now. You may have noticed that all the talk of negative interest rates and helicopter money has grown silent for now. We are trying to move past the recent era of creating money out of thin air to buy bonds, and that's going to take successful economic policies. The leadership appears to have shifted from the Fed to the administration. The Fed recently raised interest rates a quarter point at their March meeting, and most of the FOMC members are indicating they would like to do two more hikes this year. There's a very different tone coming out of the Fed. They've been very public and straight forward about their desire to push rates higher. There's also talk about when to begin reducing the huge Federal Reserve balance sheet, with several governors favoring starting later this year. This is good news as it would be another very important step on the road of ending the extreme monetary policies that were used in the past years. Naturally, nothing is guaranteed and everything the Fed does is based on the evolving data. If things change from the moderate upwards path we are on, they will respond accordingly.

All the GDP revisions are in for last year, and we did in fact end up below 2% at a 1.6% growth rate. That's not very impressive. The total US GDP is approximately 18.8 trillion dollars without adjusting for inflation. When you have something that big, it takes a lot to move the needle. The fourth quarter ended up decent with a growth rate of 2.1%. Most of the upward revision came from consumer spending. Overall consumer spending rose a solid 3.8% in 2016. People are not putting quite as much money in savings, but the saving rate is still over 5%. Consumer credit has also been rising every month. There's much higher confidence and people are not as worried about borrowing money, particularly for big ticket items like cars and trucks. On that note, there's a good chance that auto sales may have peaked. Some economists believe that the huge pent up demand to replace vehicles from the Great Recession may have run its course. This is not to say that auto sales won't be healthy, but they may settle down into a lower level of annual sales. There was also a lot of spending on health care. The other important news in the GDP reports was the increase in corporate profits. They ended up improving over 9% in 2016. That's a big swing from 2015 when they were down over 3%, primarily due to the issues in the energy industry and also problems in agriculture. In conclusion, when you look at the overall picture, we appear to be on the same slow and somewhat steady upward path that we've been on since 2009. We probably won't know for a year or more if our new administration is successful in their attempt to accelerate the growth of our economy.

I hope you and your family are well since the last time we talked. Please contact me anytime to discuss your portfolio.

Best Regards,

David E. Keim

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www.keimassetmanagement.com