INVESTMENT OUTLOOK FOURTH QUARTER 2016

Third Quarter Review

		Total Returns	
	Close 9/30/16	3rd Quarter	2016 Year-to-Date
Standard & Poor's 500 Index	2168	+3.85%	+7.84%
Dow Jones Industrial Average	18308	+2.11%	+5.04%
NASDAQ Composite Index	5312	+10.02%	+7.09%
Dow Jones Global (ex U.S.)	218	+6.38%	+3.78%
Barclays Aggregate Bond Index	2036	+.46%	+5.80%

A New Administration

It is difficult to forecast to what extent, if any, the upcoming election results will influence financial markets. If the results are a complete surprise like the Brexit vote in the UK, then our markets could initially be rattled. However, over time, global economic trends and the direction of interest rates should have a greater impact on markets than the election results. European markets, in fact, declined precipitously after the Brexit vote but recovered when investors realized that the outlook for slower growth would also mean lower interest rates for a longer period.

Nonetheless, **the priorities of a new administration in the United States next year are likely to affect the outlook for various industries.** Both Presidential nominees, for example, appear to have very little affection for drug companies. Both nominees have also talked up the need for more infrastructure spending and tax reform. There is even the possibility that passage of an infrastructure bill will be tied to some tax law changes. To start, we take a look at the possible effects of more infrastructure spending.

U.S. Infrastructure Spending . . . Road to Riches?

Civil engineers and town planners divide infrastructure into two categories -- core and non-core projects. "Core" projects include spending on roads, bridges, trains, water and sewer systems, power systems, and educational facilities that are critical for a functioning economy. Comedian John

Oliver simply calls this infrastructure "anything that can be destroyed in an action movie." Core infrastructure is financed with a combination of federal, state and local assistance -- our tax dollars. Roughly $2.5 trillion is spent annually around the globe on core projects. Considerably larger amounts are spent on "non-core" projects which include corporate spending on commercial real estate, mining, manufacturing, oil and gas activity, and so on. These projects are targeted to increase corporate profitability, not to improve the quality of life of citizens.

In the United States, the Federal government spends about $100 billion annually on core infrastructure compared to the $300 billion spent by state and local governments. Last December, Congress approved $300 billion (65% on highways and 15% on transit projects) to be spent on core infrastructure over five years. Candidate Hillary Clinton has proposed an additional $275 billion effort over 5 years. Candidate Donald Trump has talked about double that amount. Clinton's proposal would focus on improving roads and public transit, greater broadband coverage, modernization of airports and airspace systems, as well as water systems. Trump's plan is less specific but purportedly focused on transportation systems as well.

An increase by the Federal government to either candidate's proposed levels would be a fillip to our sluggish economy. Economists have estimated that these proposed plans could bump economic growth by roughly one half of one percent starting in late 2017 and into 2018. There are offsets, however, to such an impact on economic growth for two reasons:

- State and local budgets do not have the flexibility needed to also aggressively accelerate spending on streets, bridges, and mass transit.
- The political argument for a more aggressive infrastructure spending effort, at this point in an economic recovery, is less compelling than it was in 2009 when the $800 billion American Recovery and Reinvestment Act was passed during a deep recession.

A Plus Domestically, But Offset Global Weakness

Unfortunately, what a new administration in the U.S. may giveth the rest of the world may taketh away. Globally, infrastructure spending has been declining as a percent of economic activity in many developed economies since the 2008 crisis. Most public companies that are involved with global infrastructure projects reflect this weakening trend. Caterpillar Tractor, for example, is the poster child of a company with domestic and international reach. Caterpillar is hurting from economic weakness in China and Brazil, a decline in global oil and gas activity, and the negative impact of low commodity prices on mining. A turn in these regions appears to be a few years off.

There are pressing infrastructure improvements needed in other developing regions such as Latin America, India, and Africa. None of the countries in these areas, however, have the money that China has to throw at massive construction projects. There are other sources of funding for core infrastructure projects beyond national governments, but they are not yet well developed. Insurance companies, pension funds, and sovereign wealth funds, possess the capital to invest in projects. However, these projects are difficult to analyze. There are rarely standard terms or uniform legal protections, and difficult regulatory issues as well as bureaucratic hurdles to be dealt with. As a result, spending increases in the U.S. are unlikely to be accompanied by spending increases globally in the next few years.

More Targeted Spending = Investment Opportunities

It would be of more investment interest if a new administration goes out on a limb and targets a particular nationwide project. This would be similar to the government's effort on our highway systems, which were initially targeted in 1916 and again in 1956 by the Federal Aid Highway Act aka the "Eisenhower Act." There are several areas that could be targeted for more breakthrough infrastructure improvements.

- The expansion of a "next generation" wireless network would certainly be considered by a new administration in 2017 as more people use mobile phones for additional tasks and more data and video are distributed over existing networks. An advanced wireless network could provide more internet access to poor economic regions, which is a step toward better education and healthcare access that are ingredients for more income gains. A nationwide effort to accelerate the build out of a charging station network for electric vehicles would also seem feasible. The strong environmental part of the Democratic Party would endorse charging stations, and Republicans could acquiesce if they see the benefit to small business formations. Germany, for example, has a 300 million Eurodollar budget for new charging stations. In the past year they increased the number of charging stations from 9,000 to 14,000.

Either of these possible targeted projects are probably a pipe dream, but certainly a more signature effort for a new administration than fixing potholes. There are many hurdles to a successful ramp up in infrastructure spending in addition to garnering bipartisan support, setting priorities, minimizing the pork, and funding the expenditures. Many infrastructure projects around the world have been financed by so-called public/private partnerships. The U.S. could support private companies on a charging station rollout. Electric car company Tesla, for example, is in the midst of expanding their own network of some 700 charging stations. Other large companies, such as ABB Ltd, ABM Industries, NRG Energy, and General Electric are manufacturing charging stations as well.

A Shift from Monetary Stimulus to Fiscal Stimulus

Most economists think that it is high time for federal spending to take the lead role in supporting economic growth. **The long period of low interest rates has continued to support financial markets -- the gift that keeps on giving -- but has been unable to ignite a faster economic expansion.** This is true throughout developed economies, where more politicians are also hatching infrastructure spending plans. The Brexit vote was a reminder of the inability of polling to accurately forecast voter decisions. The polling numbers for the U.S. elections on the night of November 7 should be viewed with equal skepticism. Post the election we will evaluate the priorities of a new administration into 2017 for the possible effects on markets and industries. In the interim, we expect trends in earnings, interest rates and economic growth to dominate the financial markets.

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