

Financial Wanderings

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A masterful examination of the previous month's financial events, written by Brad Blackburn, CFP®
(and made even awesomer by Andrea Dickerson)



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Although the commentary in this newsletter has been thoroughly researched, well-reasoned and contains many impressive multi-syllabled words, please enjoy it responsibly. There are many economic minds that are far smarter than mine—and even they can't agree on even the simplest economic questions. In other words, please enjoy this newsletter with the full understanding that it may be entirely wrong.



The everything bubble

The US economy is doing well, and the global economy is finally coming along for the ride. But it's not the economy that's the problem. No matter how good the economy is or how much money a business makes, if an investment is too expensive, it's a bad investment – and the stock market is very expensive right now.



There's a measurement called the Buffet Rule, which is named after famed investor Warren Buffet, because it's his favorite gauge of a bubbly stock market. The Buffet Rule compares the total value of our economy (GDP) to the total value of the stock market. The idea is that you should buy into stocks when they are less valuable than the general economy. Unfortunately, that's far from where we are now. According to the Buffet rule, the stock market is 40% overvalued.

There's another popular valuation measurement called "CAPE," which compares corporate earnings to stock prices over a 10-year time period (this is a variation of the P/E ratio which is the most basic valuation measurement we have). According to CAPE, the stock market is also 40% overvalued.

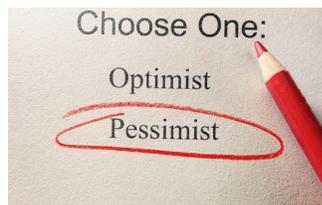
It makes sense when you think about it. In 2017 alone, the S&P 500 is up more than 20%, tech stocks are up more than 30%, Chinese stocks are up 35%, real estate is up, gold is up – and Bitcoin is up more than 1,000%.



That's just not sustainable. The stock market is far ahead of the fundamentals of the economy, which isn't a good omen for the future.

Will tax cuts help the stock market?

The Republican tax bill is almost here. For the stock market, the biggest treat is a corporate tax cut from 35% to 20%. That can't possibly be bad for the stock market, at least over the short-term. But I'm going to try to temper your excitement just a little.



I'm not convinced this bill will change the behavior of the business world in any significant way. Corporations already have plenty of cash and earnings are high. How will giving the business world even more money change their decision-making equation? The best answer to that question is that if taxes are lower in America, businesses will invest more in America.



That argument makes plenty of sense until you realize that Bernie Sanders might be President in 2020. Business investments take time to pay off. The fact that tax rates could go back up in a few years might be enough to keep businesses from changing their plans much. Perhaps more importantly, if the tax cuts lead to the national debt increasing (which is likely), businesses will be even less motivated to invest in America.

Trump's top economic advisor, Gary Cohn, recently learned this as he spoke to the Wall Street Journal's CEO council meeting (a meeting of top CEO's from the business world). The CEO's were asked to raise their hands if they planned to invest more as result of the proposed tax bill. So few CEO's raised their hands that Cohn was left uncomfortably laughing and

asking "why aren't the other hands up?"



There's also the question of whether this is the right time for economic stimulus. We are already at risk for inflation. If the tax cut is successful in stimulating the economy, the economy might overheat. That means higher inflation and higher interest rates – which might be the quickest way to push us into recession. Rather than a tax cut, I'd prefer "tax reform," which means cleaning up the tax code without cutting overall taxes.

Is China evil?

A little more than a year ago, Trump declared that China was "raping our country" and "committing the biggest theft in the history of the world." In my opinion, that wasn't the most constructive approach.



Thankfully, he's completely flip-flopped on that ridiculousness. However, in an odd twist, there actually was some truth in what Trump was saying.

China is playing a different economic game with different rules. They are offering the business world carrots and sticks that our system just can't compete with. In America, we try to keep the government out of the business world

as much as possible and leave it to the free market. However, China's government doesn't apologize for pulling every lever they have. The problem is that we don't like some of those levers here in America.



I don't think China feels they are doing anything wrong. To them, they're being strategic. Unfortunately, we can't be strategic because we are stuck in hopeless, endless gridlock. So, China is a big economic threat to us over the long term. If Trump can somehow get them to play their economic game a little differently, that would be a success. But it's going to be a hard sell.

Will Bitcoin bite the dust?

As the Bitcoin craze has grown into a frenzy, I've shied away from writing about it. That's primarily because I struggle to make sense of it. I'd like to think that's because it doesn't make sense.



However, a lot of smart people believe in it, and it's made a lot of people rich over the last year (at the time I'm writing this, it's up more than 1,000% this year).

Despite its growth, Bitcoin still has many doubters. Jamie Dimon, JP Morgan's star CEO, recently called Bitcoin a "fraud." I wouldn't use that word. I believe in the idea of electronic currencies and think the concept is here to stay. But the rapidly rising price of Bitcoin is based on a pretty weak foundation.



A big problem with Bitcoin is how complex it is. It's relatively easy to wrap your head around a stock. If a business grows, the stock tends to grow. But with Bitcoin, it's not that

easy. How do you determine the proper value of a Bitcoin? It doesn't produce any income, and it holds little inherent value. It's a lot like gold in that way. However, unlike gold, which has been traded for centuries, Bitcoin has no historical precedent to study. For those reasons, anyone who thinks they know the proper value of a Bitcoin is too confident to be trusted.

In addition, many of the most difficult issues around Bitcoin are highly technical. I'm not sure you can understand all the risks without being a high-level computer programmer. There are issues with the amount of energy Bitcoin transactions take; there are issues with the sheer computing power needed, and there are issues with the risk of hackers. I'd like to go into more detail, but you wouldn't understand (and neither do I).

Another worry I have is that a newer, better electronic currency could come out tomorrow and make Bitcoin obsolete. The most vital aspect of Bitcoin isn't Bitcoin itself, it's the infrastructure of Bitcoin, which is called Blockchain. There's not much to stop another electronic currency from using Blockchain in an even better way. In that way, Bitcoin could become a modern version of MySpace.



Another risk for Bitcoin is government regulation. Because of the confidential nature of Bitcoin, it has been a haven for crime and money laundering. The first time a major terrorist attack is funded through Bitcoin, you could see a government crackdown. Bitcoin also weakens the control governments have over currencies. Perhaps that's a good thing, but policymakers aren't usually eager to give up control. The Nobel Prize winning economist Joseph Stiglitz recently said Bitcoin should be "outlawed." Those words should send a chill up the spine of Bitcoin investors.



There has never been anything quite like Bitcoin. Clearly, I wish I would have invested all my clients' money into it years ago. That regret has kept me up at night. But Bitcoin is not an investment, it's speculation. If you've been fortunate enough to ride the rising Bitcoin tide, this might be a good time to get out of the water.

Probably a mountain or a lake

Mission Ridge is often a great place to escape the overcast skies of the Wenatchee Valley during inversions.



Wenatchee is under that sea of clouds



Looking from Mission Ridge, over the Blewitt Pass area, to the Stuart Range



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