Financial Wanderings

A masterful examination of the previous month's financial events, written by Brad Blackburn, CFP ®

(and made even awesomer-ish by Andrea Dickerson)

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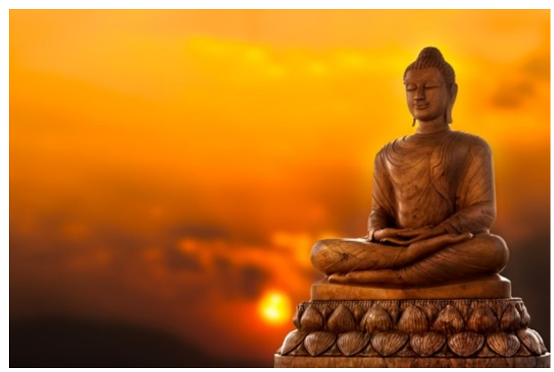
Although the commentary in this newsletter has been thoroughly researched, well-reasoned and contains many impressive multi-syllabled words, please enjoy it responsibly. There are many economic minds that are far smarter than mine—and even they can't agree on even the simplest economic questions. In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

What could the presidential election mean for the markets?

The presidential election is merely days away, and there's a very understandable angst about what it might mean for the markets. Some people think a Trump presidency would ruin the markets, while others worry about a Clinton crash.

As easy as it would be for me to use complex algorithms to analyze the historical impact of elections on the markets, I just don't think it would be very meaningful. We've only had 17 presidents over the last hundred years, which is such a small sample size that I don't think you can draw any conclusions from it.

So, we're left with gut instinct, and my gut instinct is to say: *"Everybody calm down, the markets have gone up under Democratic presidents, and under Republican presidents; it's no big deal, focus on the long-term."*



There's probably a lot of wisdom in that, even this year. But that's not very much fun, and this article would be way too short if that's all I said. So let's dig into this a little more deeply.

As much as I'd like to be perfectly balanced on this topic, the markets are not scared of a Hillary Clinton Presidency. Her supporters and detractors all agree that she is very cozy with Wall Street. She also represents more of the same – and the stock market has nearly tripled under

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Obama and had solid gains under Bill Clinton.

That doesn't' mean the markets will boom under Hillary, but she certainly won't scare the markets.

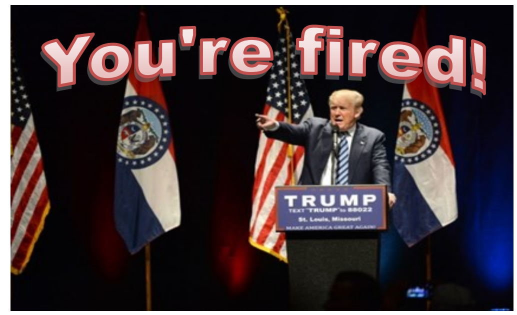
Donald Trump is a different story, and I don't think that's necessarily an insult. The exact thing that could scare the markets – the fact that he's a total wild card – is the same quality his supporters love about him. In fact, I think he's proud of his "wild-card-ness." But even with the uncertainty a President Trump would bring, I don't think the stock market would react in any major way.

However, the bond market is a different story. Donald Trump has taken a couple positions that could really spook the bond market. First, he said that if America got into economic troubles, we could simply renegotiate our US Treasury bonds. In other words, if an investor bought a US Treasury bond for $1,000, they might only get back $900 (or much less).

That's not a strange idea in the business world; it's called a bankruptcy or a default, and it happens all the time. That's especially true when it comes to Trump's businesses.

But US Treasury Bonds are a different kind of beast. In the financial world, the US Treasury Bond is almost sacred because it sets what is called the "risk free rate," which is used in nearly every investment calculation there is. So there's an assumption that is literally built into the financial markets that we are America, and we will always pay back every last cent of our bonds. Donald Trump doesn't seem to appreciate that, and I think that could cause some problems for the bond market.

But the bigger concern for the bond market is about Trump's comments on the Fed. He has called them out repeatedly for being political, and has openly called for Fed Chair Janet Yellen to be removed from her job for keeping rates so low.



It's a very reasonable assumption that a President Trump would want both a different Fed Chairman, and significantly higher interest rates. That could scare the bond market because rising rates hurt the value of bonds.

For that reason, I think the bond market might react more to the election than the stock market. But, either way this works out, I don't think the election itself will cause any major problems in the markets.

An elegant solution

As a general rule, the simplest solutions are often the most powerful. Here's a very simple idea that I stole from the great Dan Carlin (one of the best political thinkers of our time) that I think could have a significantly positive impact: What if you could choose between Donald Trump, Hillary Clinton, or "none of the above?"

If *none of the above* received the most votes, we would simply vote again in a month or so -- without either of those losers on the ticket.

Never again would we be faced with the "lesser of two evils." If our major candidates are so bad that you couldn't dream of putting your name behind any of them – you wouldn't have to.

Higher interest rates could be a good thing

There's an idea in the financial world that low interest rates are perfectly wonderful – just as long as they don't cause high inflation. Since we are nowhere near high inflation in today's world, there's a real argument for the Fed to keep interest rates low indefinitely.

However, the Fed is still actively searching for an opportunity to raise rates. Why is that?

The answer is that inflation isn't the only downside of ultra-low interest rates. Here are five more:

Less spending

The basic idea behind low interest rates is that they encourage spending, investing, and borrowing. But what if it doesn't always work like that?

In the not-too-distant past, a retired couple living off interest from a CD could earn more than 5%. However, in today's world, CD's barely earn 1%. That means millions of people are living off significantly less income – which naturally means they'll spend less money. The same problem impacts people saving for retirement. If you aren't getting much return on your investments, you're going to need to save a lot more money – and every dollar you save is a dollar that could have been spent.

In that way, low rates don't always lead to spending. They can also encourage consumers to spend less and save more – which is exactly the opposite of what the Fed wants.

Be terrified

Super low rates and programs like Quantitative Easing may be an appropriate response to a major crisis. However, at some point it makes sense for policymakers to project a little bit of confidence to the world. Instead, the Fed has been screaming for years that the world should be fearful.

We are nearly 10 years past the financial crisis – and rates are still near all-time lows, and are negative in many places across the globe. That is a bold announcement to the world that all is not okay.

The Fed needs to reload

If the economy slows down and falls into a recession with rates as low as they are now, what could the Fed do? Yet another QE program? Negative interest rates?

Nobody is excited about that. So the Fed needs better ammunition for the next battle. That means rates need to be at least a little bit higher.

Damage to financial institutions

If low interest rates are great for borrowers, what does that mean for lenders?

We recently refinanced our house at the ridiculously low rate of 3.75%. As I was meeting with the mortgage officer, I asked him: *"How is the bank going to feel about this loan in a few years when I'm only paying the bank 3.75%, but the bank*

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has to pay 5% on a CD again?" He chuckled and replied something like: *"Yeah, it'll probably put us out of business."*

If rates ever revert back simply to where they were 10 years ago, banks will be stuck with billions of dollars of loans locked in at historically low rates. Those loans will be a giant albatross on the backs of financial institutions all over the globe. Thank goodness for gigantic government bailouts.

Businesses are paralyzed

Successful businesses are savvy and forward looking. While consumers are feeling pretty confident and have been spending freely, businesses have been incredibly careful with their money in recent years.

A big reason businesses haven't been spending is their fear and uncertainty over the Fed, and low interest rates. Business decisions are based on complex math calculations, and artificially low interest rates impact nearly all the variables in play. That uncertainty makes it incredibly hard to make good business decisions, which has a paralyzing effect on business spending.

In addition, businesses have to worry about how the economy will react when the Fed eventually lets off the gas pedal. For many years, the prospect of rising rates has been a storm cloud in the distance for this economy. Because of those storm clouds, it's really difficult for businesses to justify taking long term risks with their money.

That's a pretty serious problem because we need American businesses to start investing their money. It's the only way "trickle-down economics" has any chance to work.

Probably a mountain or a lake

I took a recent trip into the Enchantments hoping to experience the last gasp of fall colors. Unfortunately, it seems that fall is officially over. However, a fresh coat of snow was a very nice consolation prize.

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