Vol. 10, Issue 7
March 11, 2016

Something to Think About

OAKWORTH CAPITAL BANK

COMMON CENTS

Now that cooler heads have prevailed in the markets, the news, if you want to call it that, has shifted decidedly towards the Presidential campaigns. Although Bernie Sanders has performed better than most people would have dared imagine this time last year, he is poised for a brutal beating on March 15. So much so, he will likely throw in the proverbial towel the next day.

Things on the Republican side are a little different. If Kasich can squeak by in Ohio, he will hang around for a few more states, before eventually saying adios. Rubio? If the polls in Florida are the truth, he will be out of the race by this time next week. Heck, if you can't win your own state, and recent polls have Trump up in the Sunshine State by anywhere from 9-23%, it is hard to imagine Marco thinking he can make up ground elsewhere.

Unless something kind of miraculous happens, as I type, it would seem 'we' are staring a Clinton vs. Trump or Cruz election in November. Sure, tongues have wagged the so-called GOP establishment could pull some kind of stunt at the convention, but that would likely cause more problems than solutions.

So, Trump or Cruz? What do we really know about either? I confess to having listened to The Donald on several occasions, and have found him to be short of substance, likely by design, but wonderfully entertaining. I understand why his bluster his currently resonating with folks. Cruz? In truth, I didn't know much more than the reputation his had fostered in the media: intransigent, ultraconservative, unpopular, and, dare I say, unlikeable.

This week, I figured I owed it to myself to find out where Cruz stands on the issues. Finally, huh? After all, Alabama voted back on Super Tuesday. Well, I suppose better late than never. So, what did I find?

I really, really like the flat tax proposal and the comments in the "stand with Israel" tab. While many of my CPA friends might not like the former, the current tax code is Byzantine and completely inefficient. Cut the maximum corporate tax rate, drastically reduce (or even eliminate) the tax penalty on repatriating profits from overseas entities, slash the long-term capital gains tax rate to 10%, and Cruz might be onto something here.

If that was the economic platform and if he won, the S&P 500 would rally 25+% in 2017….if it gained any traction on Capitol Hill. Increase corporate profitability AND remove one of the bigger impediments to the free flow of capital in the financial system, and watch out for the Benjamins. Paper wealth? Sure, but I will take that over the alternative any day of the week.

Then, there it was, the wall with Mexico.

Bother Donald Trump and Ted Cruz propose building a wall along the border with Mexico. I heard Trump say it will cost $10 billion, and he would have the Mexican government pay for it. Is this realistic?

First, we can debate whether Mexico will pony up until the cows come home. Second, $10 billion? While that might sound like a huge number, and I am not a general contractor, that seems kind of

Inside this issue:

Have a great weekend.

Something to Think About Cont.

low.

For starters, our land border with the Mexicans runs from basically Brownsville, Texas, to Imperial Beach, California. This is a distance of about 1,954 miles, with roughly 230,000 legal crossing routes. So, just how big and long would the wall have to be, taking into account cities, towns, existing crossings, and the like? Oh, the devil is in the details.

Why don't we estimate 1,300 miles, understanding this isn't exact? But how high and wide? Trump says it is going to be huge, or should I say "yuge"? So, a huge wall it is, and let's make it sturdy to boot. How does 30' feet tall and 6' wide sound? To deter folks from tunneling under said wall, we would probably have to sink it 10' into the ground.

6' feet? Yeah, that would probably be enough to keep folks from blowing holes in it with pick-up trucks full of dynamite. However, since the average width of the Great Wall of China is around 15', you know, this might not be enough after all. 30'? Well, I suppose you would want it high enough you couldn't get over it with a standard ladder from Walmart.

What many folks don't realize is the United States started putting up a fence on its southern border back during the Bush Administration. That $10 billion number Trump has thrown about? Well, that is roughly an estimate of putting up around 1,300 miles of fencing at around $7.7 million per mile. While we aren't talking about 4' tall chain link fence, a fence is a fence, and a wall is a wall.

Now, to build our "yuge" wall, we would first need to dig a trench, 10' deep, 6' feet wide, and 1,300 miles long. That would mean moving roughly 411,840,000 cubic feet of sheer mass. That is the equivalent of filling up 11.13 Empire State Buildings with dirt. That might not sound like much, but if you have ever been to New York, the mind boggles.

Then we have to buy the materials, lease the equipment, pay the workers, buy the land from the owners, and I am more than certain the EPA will gum up the works at some point along the way. After that, there would have to be funds for adequate staffing, maintenance, and the like. $10 billion? That is good for starters.

In the end, whatever wall the US builds, if it builds one, will probably disappoint Trump and Cruz supporters. It will likely be more like a really impressive fence and less like the promised "yuge" wall. Sure, it would still be a massive public works program, but so would be improving our bridges, roadways, electrical grid, and educational system.

If we can find $10 billion for some fencing, we should be able to find a lot more for those things. They would have a much larger and more beneficial long-term economic impact, maybe even to the point we wouldn't care about building a wall after all.

To me that is key, the effective, and realistic, use of governmental resources to create future economic opportunity. If we can rise the economic tide, people will be better off even if some are benefit more than others. Consider what General Electric CEO Jeffrey Immelt wrote in his annual letter to shareholders. It is one of the best things I have read in a long time:

> "To sustain this performance [GE's growth], we will have to win in challenging global markets. Some say we are in an "industrial recession," but I don't really know what that means. I learn more from what I

Disclosure

Something to Think About Cont.

> see in individual markets and hear from customers. Commodity prices are down significantly, primarily driven by oversupply. Resource industries and regions are restructuring. The dollar has strengthened, probably for an extended period of time. This puts pressure on American exporters. At the same time, commercial air travel is at a record high. Healthcare demographics and access will demand an increase in global spend. And one-third of the world's population still lacks sufficient access to electricity. The global imperative for enhanced infrastructure investment has not changed. Growth is available, but you have to work at it.
>
> What is unique in this cycle is the difficult relationship between business and government, the worst I have ever seen. Technology, productivity and globalization have been the driving forces during my business career. In business, if you don't lead these changes, you get fired; in politics, if you don't fight them, you can't get elected. As a result, most government policy is anti-growth. In the U.S., we want exports but seem to hate trade and exporters; globally, governments love small businesses but then regulate them to death. And so, we perpetuate a cycle: slow growth, poor job creation, populism, low productivity, higher regulation, poor policy and more slow growth. We now live in a world where the most promising growth policy is "negative interest rates." In the U.S., 2015 was the 10th consecutive year when GDP growth failed to reach 3%, a rate that used to be considered our entitlement."

The math is kind of depressing, really. In the 1970s, real per capita GDP grew at a 2.1% annualized rate. It grew at a 2.4% annual rate during the 1980s, and 2.2% per year (annualized) during the 1990s. Last decade, through 2010, we had 0.7% annual growth in per capita GDP, and it has improved a little this decade to 1.4% thus far. Unfortunately, some of that recent spike in growth appears to have happened because our population is growing at a slower rate. Still, it is better than a sharp stick in the eye.

Now, what is the not so old adage about politics? "It is the economy, stupid." Even so, you can go to any candidate's website and find their take on a menu of issues that would out a Chinese restaurant to shame. It almost comes across like they are throwing as much as they can against the wall to see if something will stick with some subset of voters. Duh, huh? I mean, I think it would be hard for anyone to feel THAT passionately about that many different things.

In my career, I have not listened to, read, conversed with, or watched what I would call a serious investor who paid too much attention to what politicians promise during election campaigns. Building walls with Mexico? Reducing income inequality in the US by making corporations and rich people pay their 'fair share,' whatever that may be? Increasing Social Security benefits while reducing the budget deficit? Creating 'high paying jobs' by tinkering around with tax credits and the like? Reducing healthcare costs by skinning the pharmaceutical companies, which would actually reduce the supply of healthcare and increase the demand for it? Getting rid of the IRS without offering a solution how Washington would collect taxes? The list is almost endless.

Trust me, corporate America isn't waiting on pins & needles for something like accelerated depreciation or a tax credit to build out capacity in the US economy. It isn't creating 'high paying jobs' because of our H-1B visa policies; in fact, the BLS estimates official job openings in the US economy are currently at the second highest monthly rate of ALL TIME. Sure, companies might have an easier finding a unicorn than a worker that meets their specs, but it is what it is. Go back to the last two lines of the first paragraph of the Immelt blurb:

> The global imperative for enhanced infrastructure investment has not changed. <u>Growth is available, but you have to work at it</u>.

Part of that global imperative for enhanced infrastructure investment is a more pragmatic approach to the development of human capital...in other words, training and education to meet the needs of a global, knowledge based economy.

So, three things: 1) infrastructure improvements, and; 2) more stringent development of the US workforce (and not just making sure kids sit through 4 years at some college somewhere, and; 3) a regulatory and tax structure which facilitates the creation of wealth and the free flow of capital through the economy. That is what investors want to hear.

Until such time as we get that, and just that, I will keep on bloviating about how walls on the Mexican border won't solve our problems, and the markets will keep flip flopping around.