

the Connection

A Quarterly Review

4th Quarter 2017

BARRIERS OR HURDLES?

Last year, as we expressed to many of you, was very stressful, yet it managed to be our best year as a company thus far. As 2018 begins many people are worried about what it may bring and we would like discuss with you some of the factors that we are considering when planning for the year. As we were sorting through all the different topics we could write about Steve Bradley, Sr. sent us Byron Wien's 2018 thoughts and we would like to address the ones we feel are most important (without politics). We have posted the complete article on our website if you are interested.

The issues that stood out to us were North Korea, Cyber Security, the shift toward Populism, and the increased presence of Artificial Intelligence.

North Korea is not likely to affect your financial holdings. Though the media may portray them as a looming threat it is important to note where they actually stand in the world. North Korea has maintained a highly isolated economy and this will not change. They do not have the power to disrupt the U.S. or the Global economy.

Cyber Security is another threat buzzword, but although real issues exist, there are also many potential solutions. Finding better and more dynamic solutions to this problem is a high priority for technology and financial companies alike. There is no perfect solution, but even though preventing hacks and Cyber Attacks from occurring is impossible, just like with conventional crimes, it is more important to focus on containment and mitigation. We are confident that solutions are being found. An interesting method for ensuring greater security is Sandboxing. Sandboxed programs run independent of the operating system, quarantined so if the program itself is attacked, the other information and programs remain secured. This along with the further pursuit of a litany of other solutions including retinal scans, facial recognition, potentially block chain technology, means that in 2018 our digital world will be made more secure.

The only technological development that was in the headlines more than Bitcoin this year was Artificial Intelligence and there is no doubt that it will impact the world and the economy in 2018 and beyond, but its effects are unlikely to be as large or as rapid as it often seems. The technology though ever expanding is decades away from the robotic butler or hairstylist. For this reason when we hear panicked questions about A.I. taking over jobs, we are generally dismissive. The US job market is oriented around service positions not manufacturing and this means that A.I. and robots pose a very limited threat domestically.

Populism is a theory that gained ground in the US and other developed nations over the past few years and in 2018 more policies may be enacted based on its ideas and these will affect the economy. Populism is generally perceived as the protection of native populations economically against the incoming workforces of immigrants and other outsourced labor sources. Pursuit of these ideas ignore the benefits of a shared global economy and we feel that the U.S. economy will not reach its full potential until this is recognized. The trade imbalances so often cited as negatives by supporters of Populism are as we see them beneficial. The nature of trade is such that when a very wealthy country engages in trade with a very poor country, the balance must be money for labor. The wealthy country has money but no time or desire for labor, and the poor country has time but no money. That is why both engage in trade. Each has something the other does not. It is not economically efficient for the U.S. to make t-shirts. So we pay workers from Mexico or China to make them for us. We get t-shirts and they get money. That looks like an imbalance of trade, because the money does not show up on the balance as an export, but the t-shirts show up as an import. Really, this is a simple purchase. If t-shirts are manufactured in the U.S. then the cost rises dramatically and are no longer affordable for many which causes the t-shirt manufacturer to go out of business. Keep this in mind next time you hear the debates around the trade imbalances with Mexico or China.

The interplay between the effects of A.I. and the globalized economy is very interesting and presents many questions about the economic future that we are working to navigate. As we wrote earlier, A.I. will likely have little effect on the service heavy domestic job market but in foreign countries where the economy is rooted in manufacturing it will cause a dramatic shift. If it becomes less expensive for machines to make our t-shirts, instead of foreign labor, then machines will make our t-shirts. Regardless, Americans will be buying t-shirts at the lowest available price. So yes, the economy will be affected by A.I. and we will account for that both as a potential investment avenue and as a moderate disruptor.

From a wider perspective, the global economy is growing and there are many positive things going on that will continue to be beneficial economically in 2018. The European economy is strengthening, India and China are moving upwards, frontier economies are emerging, Africa and Indonesia are getting better, and the U.S. is strong. The globe is a tiered system. The bottom tiers support the upper tiers. Currently on top are the U.S., Germany, and China. When the lower tiers do well, the top tiers also do well. The U.S. cannot, on its own, support the whole world with our demand, we need other countries to grow alongside us.

If the U.S. hits 3-5% GDP growth, it is because other countries are growing as well. Europe's slow recovery has been a major reason for stagnant GDP growth. With Europe back, although now without the UK, cross trade can resume benefitting both Europe and America.

Corporate tax reform is a positive outcome of 2017, although personal tax reform is still questionable. De-regulation will be an initial positive, and as long as it is carried out slowly and rationally, it can remain positive. Technology companies and other companies with low capital cost and valuable intellectual property will continue to lead. Overtime this will lead to employees being the largest expense for U.S. companies. Wage growth will push our economy forward but it does not necessitate inflation in staples. Wage growth can come without manufactured goods prices rising as global companies find innovative ways, like employing A.I., to keep costs down without sacrificing their employees.

2018 is bound to be an interesting year, as everyone digests all the political and economic changes of the last few years. We think earnings will continue to grow with technology companies leading the way. We recognize that there is likely to be increased volatility, as people continue to question the bull market. We are cautious about the overall pricing of assets but not cautious that those assets have economic value. We will be holding cash aside, as we have for the last two years, and will look for opportunities to deploy that cash into assets when their prices are right. We do think equities will continue to be a good place to be but we also think there will be more price fluctuations than we saw last year. We are looking for opportunities to buy into companies that take advantage of the important themes discussed above while balancing the prices that we should pay for them.

THE ACT OF GIVING

Below is an updated list of some organizations our clients are helping today.

All Local Food Banks

www.sfmfoodbank.org
www.shfb.org
www.foodbankccs.org
www.refb.org

Bloom Marin

www.bloom.org

Maya's Music Therapy

www.mayasmusic.org

Friends of the Urban Forest

www.fuf.net

Guide Dogs for the Blind

www.guidedogs.com

Doctors without Borders

www.doctorswithoutborders.org

The Nature Conservancy

www.nature.org

National Kidney Foundation

www.kidney.org

Guide Dogs of America

www.guidedogsofamerica.com

Golden Gate National Parks Conservancy

www.parkconservancy.org

Fine Arts Museums of San Francisco

www.famsf.org

Canine Companions for Independence

www.cci.org

Alzheimer's Association

www.alz.org

The Foundation for Rotary International

www.therotaryfoundation.org

Wildcare

www.wildcarebayarea.org

Homeward Bound of Marin

www.hbofm.org

Whistlestop

www.whistlestop.org

FINCA

www.finca.org

Sonoma Land Trust

www.sonomalandtrust.org

Friends of the Earth

www.foe.org

The American Friends Service Committee

www.afsc.org

Amnesty International

www.amnestyusa.org

Eastside College Prep

www.eastside.org

Northern Sierra Partnership

www.northsierrapartnership.org

American Bird Conservancy

www.abcbirds.org

The Cornell Lab of Ornithology

www.birds.cornell.edu

Mono Lake Committee

www.monolake.org

California Trout

www.caltrout.org

Tahoe Rim Trail

www.tahoerimtrail.org

Ocean Conservancy

www.oceanconservancy.org

Global Fund for Women

www.globalfundforwomen.org

Marine Applied Research & Exploration

www.maregroup.org



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