

Nicollet



INVESTMENT MANAGEMENT, INC.

October 4, 2017

The stock market in the 3rd quarter continued to move higher as worldwide economic growth strengthened. U.S. growth (as measured by real Gross Domestic Product) grew 2.9% in the 2nd quarter, coming close to the 3% growth figure that has eluded the U.S. economy since the Great Recession. If the U.S. economy is able to achieve and sustain 3% growth, it is widely held that many of the structural issues with employment, budget deficits, and business investment will be relieved. This is the “grow our way out of our problems” thesis, and it has some validity. In our opinion, so long as the U.S. economy grows around 3%, the stock markets should continue to be in good shape.

The escalation of North Korea’s saber rattling was largely brushed off by the markets. Consensus seems to be that North Korea has no interest in true engagement, but has learned over time that brinksmanship is the sure way to concessions. It’s likely that the harder stance being taken by the U.S. will succeed as the interests of China and Russia are now at stake and neither benefits from the North Korean posture. North Korea is unlikely to pursue a “go it alone” policy, as it is unwinnable.

There has been a lot of talk about the impact of three devastating hurricanes on the economy. Hurricanes Harvey, Irma, and Maria caused significant property damage, with estimates of the losses from each ranging from \$30 Billion to \$55 Billion. Rebuilding will be a source of significant economic activity in the coming months. However, the activity is short-term and not a contributor to structural economic improvement.

The economic “broken window fallacy” best describes the impact of these storms. A shop keeper’s window is broken (the story is told that his son breaks it or it is vandalized). To fix it, he hires a repair man. The repair man orders the new glass and the glazing compound, and repairs the window. He is paid by the shop keeper, and pays the glass company for the materials.

The repair man and the glass company both see their revenues increase as a result of the broken window. Reported economic activity increases by the cost of the repair. Seemingly a win/win as economic activity that would otherwise have not occurred is generated by the broken window.

Does this argue for periodically breaking things to spur growth? The answer (of course) is no. What this analysis misses is the effect of the broken window on the shop keeper. The money he had to spend fixing the window is money no longer available to him for other purchases. The economic activity created by the broken window is offset by the reduction in activity from those having to pay for it.

We will likely see a step up in economic activity from the recent hurricanes. However, the market knows this type of activity is not sustainable and will focus instead the underlying growth, or excluding the “hurricane effect”.

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Looking forward, probably the most important piece of news will be the proposed tax cuts. The administration has proposed cuts that will affect almost every American. The net result of the cuts would be an increase in disposable income and economic activity. Whether Congress is capable of passing anything meaningful is an open question and quite honestly, in my opinion, unlikely. For now the proposal is on the table and the market will view the potential for a tax cut as a positive. We will be monitoring the progress closely.

Where does that leave us? Better core economic growth coupled with short-term support from rebuilding should keep the macro picture in good shape. After eight consecutive quarters of stock market advances, we would like to see a pull back to provide us an opportunity to buy at better prices. Nonetheless, we still do not see stocks as significantly overpriced in the current environment and hope a tax cut is passed to further strengthen the underlying economy.

We hope you all have a wonderful autumn!

A handwritten signature in black ink, appearing to read 'Mark Hoonsbeen', with a stylized, flowing script.

Mark Hoonsbeen