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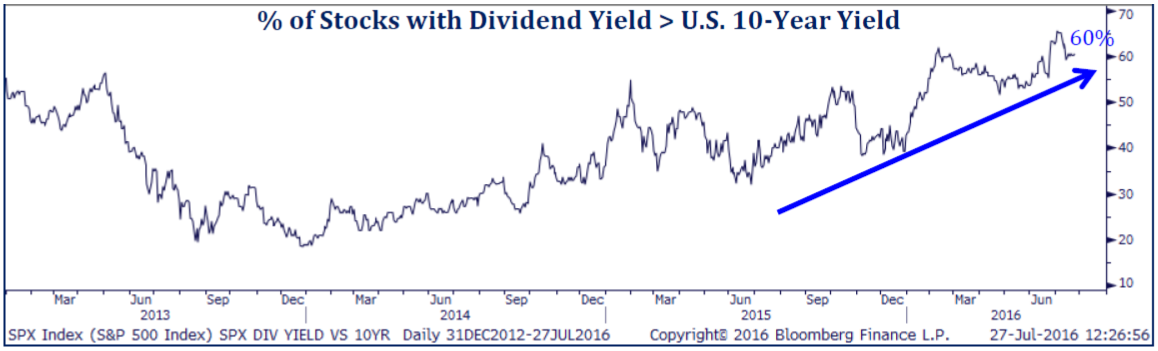
Vice President

New highs for the S&P 500 despite numerous economic and geopolitical negatives. I'd be willing to bet 6 months ago you couldn't have found many experts forecasting new highs if you told them the U.K. would vote to leave the E.U.; Turkey would experience a failed coup; Japan's efforts to kick start its economy were unsuccessful; and on and on. This market wants to go higher, and we will continue to ride this wave until something convinces us to believe otherwise. The S&P traded within a narrow range for two years before the recent breakout. History would suggest this is a very bullish indication for the next six to twelve months. It is true that there have been and will continue to be short term volatility to the downside, but for the foreseeable future these can be used as buying opportunities. For example, no one would deny Brexit was a big deal for the U.K., as well as the economies of the rest of the world. Yet its direct impact on markets lasted only about 3 days. So even if you foresaw such an outcome and positioned yourself accordingly, you only had a very short amount of time to cash in your chips and lock in a profit before the market began to recover.

We believe there are two major reasons the market has been able to shrug off the many negative factors implying lower prices. First, central banks are providing, and have promised to continue to extend, large amounts of excess liquidity that is not being used for productive purposes such as new plant and equipment, but instead is finding its way into financial markets. Large numbers of stock buy-backs and mergers and acquisitions are manifestations of this development. Secondly, investors, particularly those seeking income, are being forced into the stock market due to what many are calling TINA (*There Is No Alternative*). Low to negative interest rates around the globe mean that those seeking income have to find other investments to meet their needs. Researchers at the Bank of England have done a study showing current rates of interest in that country are the lowest since at least 1790 and given that 60% of the stocks in the S&P 500 yield more than a 10 year U.S. Treasury Bond, retirees, pension and endowment funds, and others see more of an opportunity to satisfy their requirements in the stock market, than the fixed-income market.



Source: Strategas Research Partners

As a baby boomer myself, I was a bit shaken by some simple math that shows how much money one needs to provide the income necessary to retire. Let's say you want $50,000 a year (cashflow); what amount do you need to retire today (present value)? The formula is PV = CF ÷ Rate of Interest. When rates are 10% you need $500,000; at 5% you need $1 million; at today's approximately 2% you need $2.5 million. Intuitively, we know this is to be true, but it is striking when seen in black and white.

Too much has already been written about Brexit, but I will share a couple of opinions. The concern that there would be a rush of other countries also trying to exit has so far proven to be overblown. The long-term viability of the European Union is certainly open to question, but it is not imminent. While the uncertainty level is very elevated currently and will likely be a negative for the economy in the short term, I believe the U.K. will not suffer in the long-term once everything is sorted out.

The U.S. election campaign becomes more bizarre by the day. The fighting within the two parties seems to have become more rancorous than between each other. The backroom plotting and conspiracies threaten to make "House of Cards" seem benign by comparison. Although we haven't heard of any murders (so far anyway). It prompts reactions varying between awe and amusement. Unfortunately, it is no laughing matter and the results in November could have meaningful repercussions for world economies and markets. Here in Canada, just as one example, if Mr. Trump were to prevail, the Keystone Pipeline would be back in play, but NAFTA could be cancelled or at least renegotiated. Trump is almost impossible to predict and he wants to be an agent of change; which leads to uncertainty and volatility for markets. As for the Democrats, Bernie Sanders success has pushed the party toward a more socialist agenda, which also is ominous for markets. In the end there should be no clear mandate for either party to pursue, given the likelihood that no one party will control the Presidency and both Houses of Congress. The good news is that possible negative legislation will be stymied, but the infighting and possible gridlock will be another source of uncertainty next year.

On the economic front, China, Japan and the European Union are responsible for 30% of global GDP, and all three are in various stages of slow or slowing growth and fear of deflation. The U.S. continues to carry most of the load, but even there several recent reports that have been less than stellar. For example, GDP was only up 1.2% in the second quarter, after a 0.8% number in the first quarter. The longest reported period of consistent U.S. GDP growth is the 10 years of the 1990's, we are currently in year 8 of this muted recovery, so it is long in the tooth. As an aside, here is a set of fascinating statistics dug up by Oaktree Capital. Current manufacturing employment in the U.S. is 12.3 million workers, down from the 1979 peak of 19.5 million, a decline of 37%. But the current level of manufacturing output is about double the 1979 level and at a record high, which means output per worker has more than tripled. Most job losses have been due to increased productivity not just having been moved off-shore.

Our outlook remains the same, much of the economic and geopolitical news is less than impressive if not alarming, but the market continues to want to go higher. We will be watchful, but we will not fight the tape or the Fed.

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