

Boenning Morning Comment

This report is prepared for use by Tower Bridge Advisors

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Stocks advanced yesterday after a series of strong earnings reports. While only a small fraction of companies have reported Q2 earnings so far, almost 75% have beaten expectations on both the top and bottom lines. Thus, despite all the troubles in Washington, stocks are moving higher. On the other hand, without any economic tailwinds emanating from Washington due to the inability to move new legislation forward, inflation is non-existent and, therefore, interest rates are falling. So is the dollar as other countries around the world are now growing faster than we are. Perversely, the combination of better than expected earnings, lower than expected interest rates and a weak dollar are the perfect combination for rising stock prices. Hence, stocks go up while the Trump agenda falls apart.

With the failure to pass any bill to repeal and replace Obamacare, Republicans in Congress are being forced to reflect and reassess. What they are finding is the following:

1. Even when allowed to use the reconciliation process that requires only 50 votes in the Senate, getting 95% of Republicans to agree on complex legislation may be impossible. Health care reform has obviously failed. The outlook for future legislation, including tax reform and infrastructure spending, is similarly bleak if Republican leadership takes the same strictly partisan path.
2. Of the multiple proposals to replace Obamacare that surfaced in recent weeks, none appeared to improve healthcare. Thus, Americans polled suggested that, for all its flaws, they preferred Obamacare to any of the Republican alternatives by a resounding 2-to-1 margin. Part of that may relate to the messaging. It's hard to explain something new and complex in such a short period of time. But that is what happens when new bills are introduced one day and scheduled for a vote just a few days later.

There are a lot of good reasons to believe Democrats have no interest in working across the aisle. Certainly, they were in no rush to repeal President Obama's signature piece of legislation. But they should have an interest in tax reform, as long as the benefits are broadly spread out, and they certainly have spoken of infrastructure spending many times in the past.

President Trump's legislative inexperience and the White House's lack of involvement development the Obamacare replacement alternatives didn't help. But now it is on to tax reform. Here, one can expect more involvement. The House Ways and Means package, centered around a border tax on imported goods, hasn't been well received. The White House and Treasury Secretary Mnuchin have promised details shortly. At one point, Secretary Mnuchin said the whole deal would be wrapped up in August. That won't happen obviously. There is still time, but time is running short.

Before Congress can get to tax reform, it must deal with the budget, spending authorization bills and raising the debt ceiling. There are all steps that require some degree of bipartisan agreement. President Obama never did get a budget passed and this Administration may be headed for the same fate. But spending authorizations and raising the debt ceiling are the real deal. If they aren't done by the end of September, the government shuts down. We have lived through many government shutdowns. By itself, a temporary shutdown is no big deal. But it is important for this

administration and this Congress to find a way to work cooperatively if anything is going to happen between now and the 2018 mid-term elections.

Markets, are presuming total failure. Whatever enthusiasm that ensured after President Trump's election victory has been completely reversed. Interest rates are back down to 2.3% on 10-year Treasuries and falling. The dollar is weaker than at any time since the election. Inflation is falling despite all the efforts of central banks around the world to expand. Healthcare reform is dead and we are a long way from any Republican consensus of what tax reform might look like. With a lift from healthcare reform, the odds of a robust tax reform package have dropped dramatically.

As investors, the best course so far this year, has been to totally ignore Washington. That appears to be the best strategy today. I suspect we will have bumpy ride over the next 60 or so days while Congress wrestles with spending authorizations and the debt ceiling. It isn't unlikely that it will employ some form of continuing resolution, meaning everyone can spend at last year's levels, until the details can be hammered out. If ever. Simply said, during Obama's second term, Congress went into almost total gridlock. Despite a completely new cast at the top, it seems increasingly likely that we are in for the exact same thing going forward.

There is only one solution. Neither the Democrats during Obama's second term nor the Republicans today had a sufficient majority that allowed meaningful legislation to pass in a completely partisan fashion. Neither Obama or Trump to date have sought bipartisan solutions. Maybe the chasm between the two parties has gotten so wide and no one knows how to traverse it.

But there is some hope if Trump pivots towards the populist center that got him elected. Leaving healthcare reform to the conservatives in Congress didn't work. If tax reform is going to happen, the White House is going to have to bring centrists from both parties into the conversation. Right now, markets don't believe that will happen. I can't say I believe it either. But that is the path. Straight up partisanship hasn't worked since the Democrats lost their 60-vote bulletproof majority in the Senate. Trump knows how to pivot. The obvious questions are (1) will he and (2) once he does, can he stay on topic for even a short period of time? It's hard to be very optimistic. But with that said, worldwide economies are all growing. They are in synch for the first time in years. With the ECB and the Bank of Japan still pumping money, the outlook for earnings remains bright. Economic events in Washington surrounding spending and the debt ceiling could cause some short term distractions in late summer but the economic backdrop looks a lot better than the political one.

Today Starbucks CEO Howard Schultz is 64. Brian May, lead guitarist of Queen, who wrote Bohemian Rhapsody, turns 70.

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