Boenning Morning Comment

This report is prepared for use by Tower Bridge Advisors May 24, 2017

Stocks rose again basically completing the retracement of the losses from last Wednesday when political worries in Washington reached their peak.

Beneath the surface, perhaps a change of attitude is also taking place. Individual investors, long absent from this bull market, are finally moving money from bonds to equities. In particular, they appear to like the outlook for Europe but the movement of funds is broad based and includes incremental additions in the U.S., Europe and emerging markets. We should note that this movement is just starting and could reverse itself with any sudden changes. But it is encouraging to see.

Today, the Fed will release its minutes of the May meeting. At the moment, the market is pricing in an almost 100% chance of another quarter point rate increase in June. While at least one Fed official, after last Wednesday's 2% drop in the market, suggested that a rate increase would be uncertain if volatility increased, the Fed has to stop letting market blips force its hand. If it is on a path to normalization the smartest thing it can do is stay on the path unless economic data, not market action, dictates otherwise. Although Q1 GDP was a bit disappointing, the underlying strength of the economy is the same as it has been despite two rate increases over the previous four months. At the moment, it appears Fed consensus calls for a rate increase in June and at least one more later this year after which the Fed may begin to slowly reduce the size of its balance sheet by not replacing maturing bonds with open market purchases. It could be well into 2018 or even later before the Fed actually sells bonds.

Of course, the Fed constantly has an eye on inflation. That is, after all, its primary mandate. As the unemployment rate creeps lower discussion increases that we are getting to the point where wage pressures will lead to an escalation of wage rates. While the rate of wage increases has been slowly rising, the accent is on the word slowly. For one, workers have gotten used to 2%, plus or minus, wage gains for many years. Against that backdrop, even 2.5% seems like a big deal. Second, while we are close to full employment, except in a few high skill niches, we don't appear to be there yet. Third, companies are very focused on margins and will fight very hard to avoid cost increases at a time when they continue to lack pricing power.

While labor is near full capacity, nothing else is very close. We have more plant space that manufacturers need and more selling space than retailers need. There is also a glut of oil, food and other commodities, at least for now.

Obviously, at some point, if labor shortages actually appear, nothing will stop the upward pressure for wages. Companies, however, will not stand still. Rather, they will invest in equipment to improve labor productivity. On the manufacturing floor, that means robots replacing people. In the convenience store that means ordering kiosks to take your order. The same applies to restaurants. At airports, you now can self-tag your luggage and get your own boarding passes. Movie theatres have kiosks as well. A bank branch today might be a set of ATM machines. This trend is likely to accelerate over the next few years. If department store sales people can check you out with a portable terminal, registers can be eliminated freeing up more selling space. Most of these trends are already in place. They will be accelerated by technology, accented by the movement to mobile platforms. Once we get to driverless cars and trucks, goods can move from A to B without touching human hands!

If all this sounds scary to some, it really isn't any different than what has happened in the past. Technology constantly changes what we do and how we do it. Even garbage collection is increasingly automated. New trucks require one or two fewer collectors. The jobs that are disappearing at the ones that are the most mechanical and require the least intelligence. In a restaurant, for instance, taking orders and collecting payments is easily automated while food preparation is not. In the airline business, you now obtain your own ticket via the Internet and check yourself in. But with all the automated systems, pilots are still needed to fly the plane safely. I can't imagine the time when no one is in the cockpit.

Education has to keep pace with technological change. No need today to learn how to replace a set of spark plugs. Kids today are born into a mobile computer world. They learn how to play games on a smartphone before they know how to make a phone call. They probably text before talking! (I hope I am only kidding!). Their future summer jobs won't be as waiters but as programmers. To get ahead, they need to be 100% comfortable not just with using a pre-programmed computing device, they need to able to customize the device to do what they want to do specifically. When I started to work with computers, we were preparing do-loops in Fortran or Cobol. Really sophisticated programmers were working in raw machine language using binary number systems. A huge computer at the time had capacity for 72,000 bits of data. Today's phones have more than 1,000 times the capacity of an IBM computer than took up a whole room. Today, building an app can be done by assembling parts much the way Lego constructions are formed. You can choose basic layouts, customize them with logos, add a payment block, some encryption, get an IP address and away you go. It may not be quite that simple but I'm not far off.

If I bring all this back to the stock market, the winners today are the ones that will create tomorrow's world. That means the technological building blocks, the creators and operators of our new mobile world and the capital goods companies that support increasing and smarter automation. You might overlay this with companies that fit better with changing life cycles but at the core are those that create both the building blocks and the finished products for a changing world.

Today, Patti LaBelle is 73. Bob Dylan turns 76.

James M. Meyer, CFA 610-260-2220