

Boenning Morning Comment

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Stocks fell over 1% in the first trading session of the fourth quarter. While the headline story was elevated tensions vis a vis North Korea after a successful hydrogen bomb test, there were other factors that added to the selling pressure. September is a notoriously nervous month for equities. Congress is just getting back to work without a clear path to successfully getting anything accomplished. Tax reform, so far, is a one-page outline. More on that in a moment. Costs related to Hurricane Harvey are escalating and Irma is the next huge storm that threatens the U.S. mainland. Finally, yesterday President Trump said he would end the “Dreamers” program in six months if Congress couldn’t find a solution. That is all Congress needs; more items on its agenda to further detract from Trump’s economic agenda

The President invited the six Republican leaders working on tax reform to a White House meeting yesterday, hopefully to try and get everyone on the same page. As I just noted, so far, all that has been made public is a one-page outline. Sure, more is to come. But every time House and Ways and Means Chair Brady introduces a new revenue raising idea, it gets shot down by opponents. Obviously, any revenue raising idea is going to have its opponents. If Republicans are going to be successful, some of these are going to have to stick. While we all like tax cuts, lower taxes without any offsetting revenues is a long term recipe for disaster, even for those willing to use dynamic scoring aggressively. Thus, in order for any serious tax legislation to pass, Congress, at some point, is going to have to take away the cookie jar and make someone angry. That’s why the devil is always in the details. We can all agree with one-page outlines that say to lower tax rates, make them simple, give most of the breaks to the middle class, etc. But when the details are revealed, suddenly what sounds like peaches and cream more often than not resembles sour milk. That’s why tax reform is never easy. In order for it to happen, everyone in leadership must be on the same page, everyone must be willing to stand strong against every lobbyist and complainer who is out to preserve his own little fiefdom, and the President has to take a strong and firm leadership role. To date, Republicans haven’t shown that unity and the President hasn’t consistently stood united with the rest of the Republican leadership.

But that all pertains to tax reform. The odds of success have been dwindling since inauguration. There are other agenda items this month that have to come first. Number One is Harvey relief. I have little doubt that some form of relief will pass. But once again, the devil is in the details. No one is going to open a blank checkbook. Money that heads to Texas is money that was destined to go somewhere else. And there may be another storm just a week away. As a result, there will be several days of squabbling not as to whether to fund relief, but how much and for what purposes.

After Harvey relief, Congress has to pass a budget. Republicans need a budget in order to pursue reconciliation for tax reform. There have to be spending bills passed. The fiscal year ends at the end of December. Without new spending authorization, non-essential government activity stops. Hopefully, Congress can find a way out, even if it has to pass a temporary extension at prior year levels to give it more time. That could be necessary in any event given that the Senate already has a full agenda including Harvey relief and dozens of appointment requests it must approve.

Next, there is the debt ceiling. There is no logic not to approve it given all it does is help to fund what has already been spent. But recent history says constituencies within Congress, both on the right and on the left, want to attach

unpopular contingencies. Once again, there is a deadline near the end of September and there is no roadmap to easy passage.

Yesterday, the President stuck immigration reform in front of tax reform. There is no mandated deadline for tax reform. Yesterday, President Trump gave Congress a six month issue to solve immigration, at least as it pertains to those who came into this country at a young age and are still here, paying taxes and staying clear of trouble. Again, solving the dreamers problem may sound simply on the surface but to date Democrats and Republicans haven't agreed on how to pronounce tomato.

No wonder equity investors are nervous.

Yet with all that, the economy chugs along. Jobs created in August were a bit below expectations but that may relate to the fact that it is taking longer to fill open jobs. Manufacturing activity is solid and so are retail sales. With yesterday's weak market, bond prices rose, yields fell and the dollar weakened. If you remember that the recipe for good stock markets is strong earnings (check!) low interest rates (check, and getting lower), and a weak dollar (check!) then this correction isn't going to be very long lasting unless earnings start to fall or interest rates and the dollar start to recover.

To be sure, there are crucial items that must be solved quickly. Steps must be taken in just over three weeks to keep the government open and prevent a default on our national debt. To most key economic officials including Congressional leadership and Treasury Secretary Mnuchin, defaulting on the debt, which means being one day late on paying interest and principal, is not an option. One day isn't any different than one week or one year. It is a default. To avoid it, should Congress not raise the debt ceiling in time, key payments, possibly including Social Security, would have to be delayed. If that were to happen, and it is still highly unlikely, everyone, Republicans and Democrats, would be losers. Congress is unpopular enough already. Thus, we may go down to the wire. In fact, given the Congressional track record of recent years, we probably will. As we do, markets may get nervous, replicating what happened the last time this happened. Some members of Congress, notably Senator McCain, have spoken out strongly about trying for more bipartisan cooperation. But so far, leadership in neither party has moved in that direction and that includes the White House.

Thus, while no one has good reason to expect the worse, we will probably spend several weeks bouncing from one crisis to another. Worse, as he did yesterday, it is more than remotely possible that the President will once again create a new crisis of his own making that will further complicate an already complicated picture. There is even the likelihood of another hurricane or two to consider. Yet with all this, the economy is fine and inflation is none existent. Therefore volatility ultimately should give way to the raw facts that our economy is OK, earnings are growing and stocks remain the best game in town. It may be a bumpy ride for a while but it should end up all right in the end.

Today Pippa Middleton is 34. Gov. Chris Christie is 55. Roger Waters of Pink Floyd fame is 74.

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