MARKET OBSERVATIONS
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Relationships

Observation and analysis over time have revealed important relationships among economic and financial variables and the resultant impacts on investor returns. Realities generally conform to theory; for example, higher economic growth supports higher corporate earnings which support higher stock prices. Unfortunately, outcomes often are less certain as relationships themselves are complex. Changes in variables invite both intended and unintended reactions. Furthermore, reaction times can vary widely. With political and geopolitical changes in the wind, a look at some important relationships can provide perspective and investment implications.

PERSPECTIVE

Income inequality has received much attention. A recent commentary on 2018 data concluded that a further slowing if not an outright recession was ahead as *"people with money (top 10%) do not want to buy and people who want to buy (bottom 90%) do not have the money"*. With 68% of the U.S. economy based on consumption, consumer income and spending relationships are important. As shown in Table I, however, relative relationships by income demographic have not changed meaningfully over the past four years. The highest income decile does not spend all its income while everyone else in aggregate spends all their income and then some. Income and spending have grown for both demographics and real growth for the U.S. economy over these four years was +13%.

Tax policy has received much attention as well, and future tax policy could change depending on 2020 elections. Higher tax rates may raise revenue but they also could impact stock prices. Price/Earnings ("PE") ratios indicate whether stock prices are too high or too low relative to corporate earnings. Higher corporate tax rates could reduce earnings, thereby raising PE ratios. Chart I shows PE ratio levels resulting from a range of tax rate increases. It also shows the corresponding price correction necessary to return PE ratios back to average. While this analysis is informative, other policy and behavior scenarios merit consideration as well.

Consumer sentiment by political party has varied widely as shown in Chart II. There likely are few surprises in recent trends based on continuous commentary across the range of media. While policy uncertainty can be concerning when political power shifts, neither the timing nor the magnitude of policy outcomes is certain. Importantly, the relationship of policy changes to investment outcomes is uncertain as well. No matter the sentiment, consumers across the political spectrum have witnessed quite favorable investment returns during both the Obama administration and the Trump administration to date.

INVESTMENT IMPLICATIONS

Economic and financial variables clearly impact investment returns. Relationships among variables matter, they just are not constant and they can vary widely over time. Achieving financial goals requires a clear understanding of the relationships among goals, time horizons, risk tolerance, and investment opportunities and tradeoffs. At this time of charged political and geopolitical emotions, a disciplined, data-driven investment framework is invaluable. Within such a framework, theories, relationships, data and emotions all can be harnessed and properly deployed.

TABLE I

U.S. INCOME & SPENDING
2018 Vs. 2014

	HOUSEHOLD INCOME	
	Top 10%	**Bottom 90%**
Spending % of After-Tax Income		
2018	**69%**	**101%**
2014	**70%**	**101%**
Growth in After-Tax Income	**15%**	**17%**
Growth in Annual Expenditures	**13%**	**15%**

Source: Bureau of Labor Statistics

CHART I

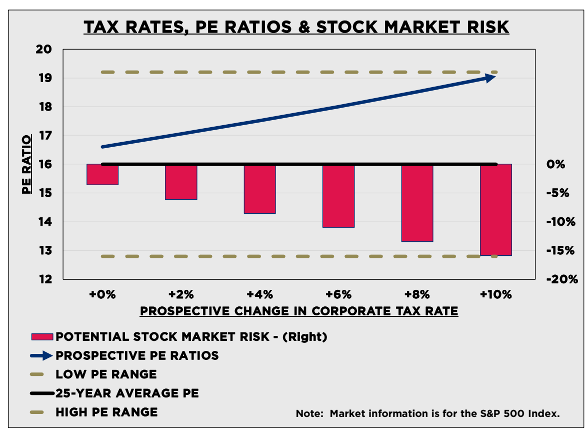

CHART II