



BACK AT THE RANCH

An Afternoon with Dr. Arthur Laffer at the Reagan Ranch

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Under the great old oaks shading the modest Reagan home at Rancho Del Cielo, Dr. Arthur Laffer (of Laffer Curve fame), center stage, found a most appropriate backdrop for his story of economic optimism and growth. Laffer's policy and world view has not been much in demand in recent years, nor has it changed much, but his message is unrepentant and unbowed. Lower taxes are the engine of economic growth. He did however, have plenty to say on the health care bill debacle and Trump's style ("a conservative Bill Maher"—yikes!) but overall his message is one of stronger GDP growth—a return to the 3-4% range and a long runway (believe it or not after their stumble out of the gate) for Republican majorities in the mid-terms and beyond.

- **On President Trump:** In July of 2016, Laffer penned an opinion paper suggesting Trump would win the presidency. His reason? Not an embrace of Trump's personal style, but rather a key metric Laffer relies on: de-trended GDP growth per person. This metric of individual prosperity hit its lowest level in 67 years in 2016. Laffer read that as an electoral desire for change. This is not to say he didn't regret his prediction frequently prior to the election, but the facts that prompted his forecast—the lagging prosperity of the American middle-class family—didn't change throughout the various scandals.
- **On the stumbles of the new Administration:** This is Trump's first run for office. As Art quipped: "He doesn't know any politicians besides those he has bribed." Though his cabinet is filled with accomplished, successful individuals, Laffer expects to see important additions/replacements within the first 18 months. He reminds that George Shultz was not added to Reagan's cabinet until 18 months after Reagan took office. Stay tuned. It takes a few months for each Administration's team to get their sea legs.
- **On economic growth:** Laffer believes Trump could get very little of his agenda passed—say, repatriation and some regulatory relief—and still generate 3.0-3.5% GDP growth. The economic bar has been set so low and the last recovery so anemic, Laffer predicts Trump will

benefit from his uncanny ability, as he says, "to select his predecessors." A low bar is an easy hurdle.

- **Trump on trade:** "He understands the value of imports. After all he has imported two wives" quipped Laffer. Seriously, he is very concerned about the Border Adjustment Tax (as are we) but he is not overly concerned about trade policy given policy orientation of the President's cabinet.
- **The next four years:** Laffer sounded a much more optimistic posture than many economists and commentators. He summed it up like this: The Republicans control the House, Senate and White House. Soon they will have a majority on The Supreme Court. Fed Chairwoman Janet Yellen's term will be up in about nine months. The Fed will look very different in one year (with other terms expiring as well) and will carry the Trump Team's imprimatur. Finally, the mid-term elections look better for the Republicans than the Democrats (not conventional wisdom!) for the following reason: 34 Senate seats are up for re-election—25 are held by Democrats, only 9 by Republicans. Laffer believes that this is the greatest vulnerability Democrats have ever had, a counter to the prevailing narrative. He expects the Republican Senate majority to expand which, in his view, will be good for growth.
- **Trump's favorables are low and sinking:** Another low bar which should be easy to scale.
- **In Summary:** We are in early days. Expectations are low. Corporate earnings are recovering and the market seems to be looking through the Washington drama to an easing regulatory environment, improving economic growth driven by a robust employment picture, some eventual tax relief for corporations and individuals, and consumer and CEO confidence at recent highs. The Conference Board's Consumer Confidence reading of 125.6 versus a survey expectation of 114.0—recently hit a 16-year high.

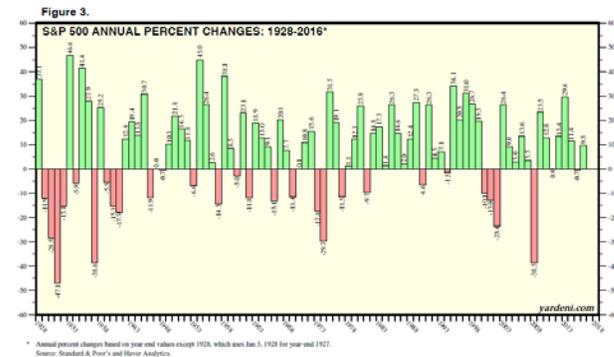
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- **When the Political Muck gets too deep:** Remember the greeting the press gave to President Reagan: a danger to world peace, an amiable dunce, a party outsider, a yahoo, without depth in policy, and no experience in foreign affairs. In short: we've been here before. Stocks will climb this wall of worry as they always do. Watch sentiment and keep your eye on earnings season. The consensus expects to see 9% quarter over quarter growth. We will be watching, too.

Laffer's work, it should not be forgotten, goes much deeper than the legendary Laffer Curve he drew on a cocktail napkin sparking the Regan tax-cuts and the supply-side economics revolution. After graduating from Yale and earning a doctorate from Stanford University, Laffer taught at the University of Chicago business school—alongside free-market icon, Milton Friedman. (One of the friendliest yet most stimulating debates I've had the privilege to witness was between Laffer and Friedman in San Francisco in 2002.) He was the first chief economist of OMB under President Richard Nixon. Importantly, Art Laffer was a member of President Reagan's Economic Policy Advisory Board from 1981-1989. Laffer also advised Democratic Governor Jerry Brown on his presidential flat tax proposal and Gary Hart (D) on his tax plan, to name just a very few. Far from the partisan he is frequently portrayed as, Laffer famously penned a paper in 1992 announcing his intention to vote for Bill Clinton after the first President Bush's backtrack on "read my lips, no new taxes."

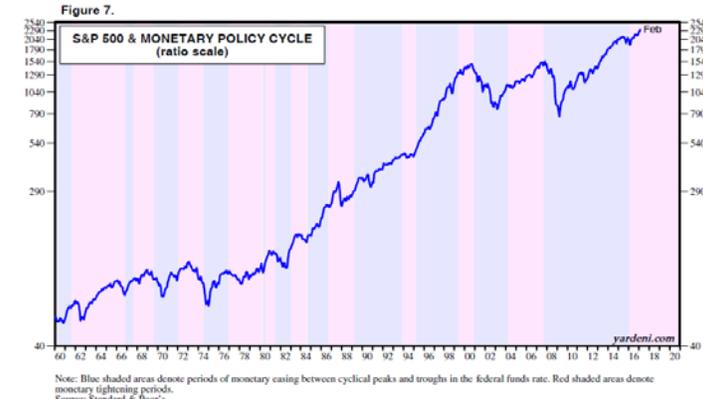
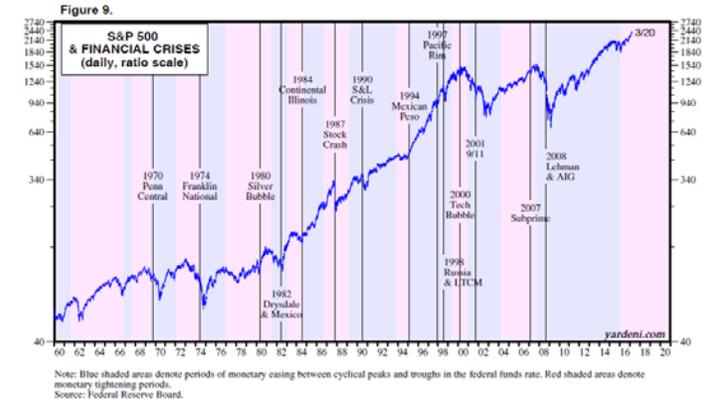
For Arthur Laffer, politics are secondary; the only really important issue, the singular policy that matters—above all else—is sound tax policy.

A Tour of Stock Market Returns Over the Last Century



The current bull market is the second-longest bull market in S&P 500 history. Since the bottom on March 9, 2009, the

index has added more than \$14 Trillion. Still, this appears to be the most unloved bull market in history. Asset flows in equities have been net negative (in both ETFs and Mutual Funds) over the period and bond assets have continued to expand. In 2017, equity flows have increased. Yet, investor euphoria (one of the signs of a market top) has yet to materialize.



Markets have historically rallied and sold off in both periods of monetary easing and tightening. It is all in the pace and magnitude of Fed hikes. With inflation already a concern, we expect a deliberate and market-friendly approach to monetary policy.