October 2016

In our July letter we wrote about the "is-ought problem," the tendency to confuse the world we have with the world we wish we had. As we noted then, this problem represents a major danger around election time for investors (and others). The danger is that investors may be so consumed with the *world that ought to be* (i.e., one in which all their candidates win) that they fail to account for the *world that is*. The *world that is* is usually a messy world, with divided governments and unsatisfying compromises. This is the world in which we have to invest, regardless of who is president. We at Confluence are concerned only with the *world that is*; that's the world we have to wrestle with as investors. We'll leave the *world that ought to be* for political theorists and utopians.

It's rare that all or most sides of a political debate agree on *what ought to be* regarding an issue; however, when it occurs, we must sit up and take notice. We have actually seen that happen in this most contentious of political seasons. The issue in question is trade; specifically (for the first time in my memory), both presidential candidates of the two major political parties stand in opposition to a major international trade treaty, the Trans-Pacific Partnership (TPP). Trade pact news is usually buried on page A17 of most newspapers and is rarely the sort of issue that gets the political blood rushing. While most voters are focused on other issues, here is one issue that both candidates seem to agree on, and that gets our attention.

Trade particularly gets our attention because the globalization of trade that has prevailed since the late 1970s has been, in our opinion, one of the major factors in reducing inflation, not just in the U.S., but around the world. We don't have time in this short letter to go into the reasons this is so or why the candidates have come out against the TPP. (Our chief market strategist, Bill O'Grady, has written extensively on this in our Weekly Geopolitical Reports.) Suffice it to say that after blowing in the same direction for about 40 years, the trade winds have shifted. The Brexit vote, wherein the British people voted to separate the United Kingdom from the European Union, is a comparable event and illustrates that this trend is not a U.S.-only phenomenon. If this political trend in opposition to unfettered trade between nations becomes a consensus, then we may be looking at rising inflationary expectations (for the first time in 35 years). Rising inflation would probably pressure interest rates up and stock valuation metrics down.

We don't raise this issue to scare you, but to provide an example of what we look for as we analyze the political theater before us. Agreement between candidates is rare, but when they agree on an issue that affects the portfolios of all investors, we must take notice. There are powerful influences in both government and business that greatly favor the TPP and other trade pacts. It's not at all certain that either candidate could easily unwind the pro-trade consensus. But we want you to know that we are paying close attention to this and possible implications of the political process, even if they're on the back pages.

We appreciate your confidence in us.

Gratefully,

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CEO and Chief Investment Officer

This letter was prepared by Mark Keller of Confluence Investment Management LLC and reflects the current opinion of the author. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change. This information does not constitute a solicitation or an offer to buy or sell any security.