Quarterly Insights October 2016

The Investment Counsel Company's Quarterly Insights is intended to provide our perspective on current economic conditions in order to help those we care about improve as successful investors.

When considering the outlook for interest rates set by the U.S. Federal Reserve, we are reminded of the famous Forrest Gump quote, "Life is like a box of chocolates. You never know what you're going to get." The Fed recently decided again not to raise interest rates at their September meeting, relieving fears of many investors. Historically, the Fed has only raised rates this close to a presidential election twice, in 1980 and 2004. However, the Fed continued to call for higher interest rates before year end, most likely at their December meeting.

In 2017 and beyond, many economists are expecting two to three interest rate hikes per year. From our viewpoint, the weight of the evidence favors a continuation in lack of urgency by the Fed to raising rates too quickly. Chair Yellen has stated that there were no signs of economic overheating, and near term risks to the economic outlook appear roughly balanced. Furthermore, on more than one occasion, she made it clear that increasing interest rates was more about timing than her desire to return rates to historically normal levels. Finally, with The Bank of Japan and The European Central Bank both signaling their intention to continue holding longer-term interest rates near or at zero percent, it makes efforts to continue pushing interest rates higher by our Central Bank even more difficult in globally connected and competitive financial markets.

Many investors ask why there is so much concern about higher interest rates when they will likely remain low compared to historical norms, regardless of the Fed's actions. The reason is that changing interest rates reset price levels for most, if not all capital assets, including, stocks, bonds, real estate and more. They also influence an economy's rate of growth and inflation, and therefore, impact employment levels and the cost of goods and services. As interest rates rise, investors can expect to see banking stocks and other low valued companies move up, while selling pressure increases for utilities and other high dividend paying stocks. Bond performance is also a mixed bag when it comes to interest rate sensitivity. Price movements depend on length of maturity, credit quality, and global geographic region. Real estate prices have typically done well when interest rates are declining. Yet its sensitivity to economic prosperity as well as credit availability tend to make real estate values also vulnerable to changes in rates.

And how might financial markets be affected by our country's next president? To call the 2016 election cycle unorthodox is an oversimplification. The American political system has been dysfunctional for so long that some pundits are forecasting that this election might be a non-event, especially if Congress remains gridlocked, which would checkmate the White House regardless of who takes office. When trying to understand politics today, we find merit with journalist Colin Woodward's explanation. He is the author of the best-selling book, American Nations, whose thesis is that the U.S. two-party system has evolved into 11 rival regional cultures in North America. Each has a different view on the role of government. Among these sub-cultures are the

Pacific Coast region, Western region, Texas region, Mid America, the Deep South, Greater Appalachia, North Easterners, and others. These 11 regions form coalitions at the party level. The group of regions that control the majority coalition set the political agenda which can impact financial markets and the economy. Coalitions and supporting members can change over time, distorting traditional Democrat and Republican comparisons and how these parties function.

Given these ever-changing dynamics, we feel strongly that successful investing should focus beyond near-term uncertainty and unpredictable factors. Incorporating reasonable margins of safety when setting asset allocation policy and portfolio construction strategies allows for sustained success over both shorter challenging environments and longer prosperous periods. Through diligent preparation, The Investment Counsel Company looks forward to meeting the challenges and opportunities during this exciting period.

Sincerely,

Randy Garcia
Chief Executive Officer