Zevin Asset Management, LLC
PIONEERS IN SOCIALLY RESPONSIBLE INVESTING

INVESTMENT COMMENTARY

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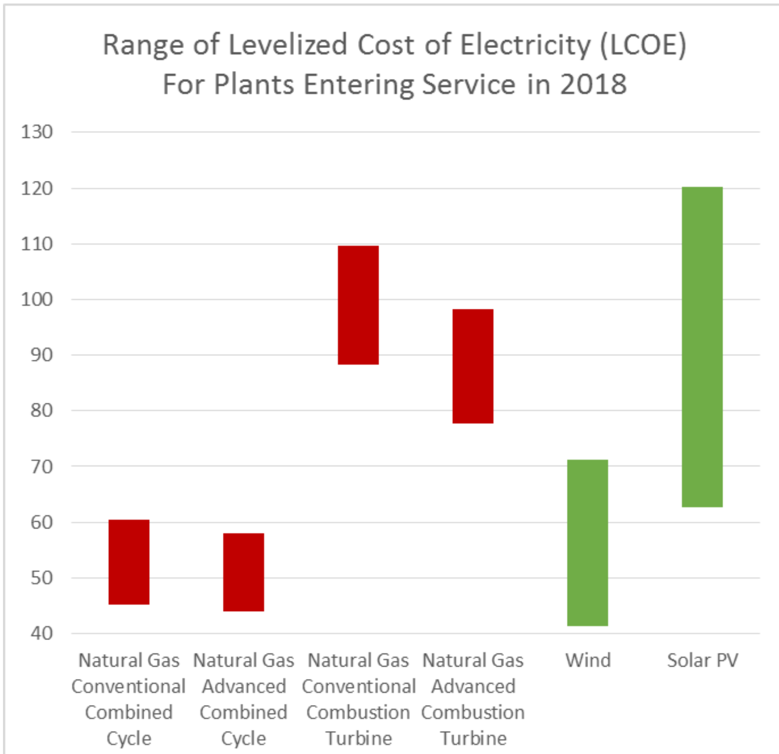
What Will Happen Next?

Seldom if ever has the pending inauguration of a new American President provided such a bewildering and uncertain array of possible consequences. There are as many areas of danger in Trump's threats and promises as there are circles of Hell in Dante's Inferno. For openers, the President-elect has promised to escalate the two most serious threats to the survival of our human species: global warming and a renewed nuclear arms race. As America's social, political, and cultural appeal declines in the rest of the world, and its military interventions continue to fail, there is a strong temptation to build the "killer app" nuclear weapon system that would give the American Century another hundred years of dominance.



The environment is quite a different story. The appointment of climate change deniers and fossil fuel industry champions to various key positions, including the Environmental Protection Agency, nearly guarantees that no further progress will be made at the federal level. Meanwhile, ordinary people and many businesses will continue, along with states and cities, to adopt green energy alternatives because they address the global warming calamity and, in many instances, are already competitive with conventionally generated power.

Changing the Rules

Trade and immigration are high on Trump's list. Regarding immigration, on which American agriculture, upper-middle-class households, and high-tech businesses all depend, Trump has left himself plenty of room to back down—recognizing that there are lots of "terrific" immigrants, as well as the "very bad" ones. Moreover, states and cities have already taken an aggressive position to resist the enforcement of massive deportations of usefully employed immigrants that have already been happening under the Obama administration.

Trade is less clear with respect to the constraints on the new President's behavior. Presidents have unusual authority to slap punitive tariffs or bans on imports. The principal obstacle to doing this is the havoc it would play with American companies and American jobs. Many things "made in America" are made with components which are manufactured outside the U.S. And more than half of all the goods

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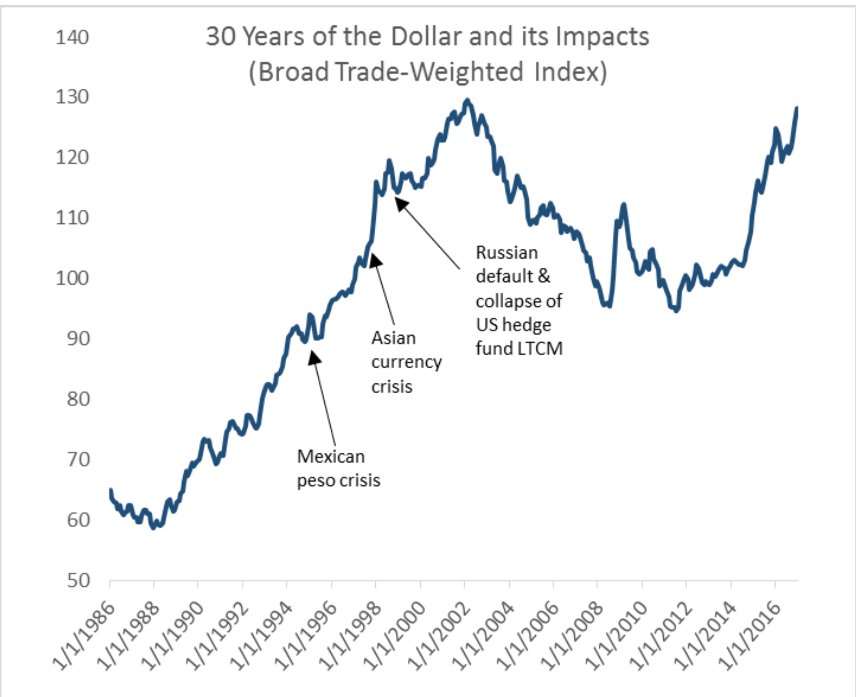
America imports from China are actually made in China entirely by American companies or by their partnerships with Chinese counterparts. Sudden punitive tariffs or embargoes would leave American workers, consumers, and businesses howling in anger.

In the short run, disruptions of trade between America and other countries would have substantial negative economic effects in both the United States and its trade partners. If the disruptions continued, the long-run impact would likely be worst for the U.S. and its immediate neighbors, while other countries, most notably China, could end up accelerating their growing shares of world trade and international investment. An anti-trade policy that effectively leaves China to the Chinese and America to the Americans would only accelerate the rates at which the U.S. is declining and China advancing. It is also quite possible that continued strength in the dollar versus other currencies could cause severe economic problems in emerging markets and elsewhere, as happened in the late 1990s and several times in the 1980s.



The Affordable Care Act, or Obamacare, has been the obsessively hated demon of the Tea Party and most of the Republican Party since it was first proposed. But early signals, including Trump's comments after his initial and only meeting with President Obama, and statements from numerous Republicans, suggest that outright repeal is now correctly perceived as a low probability event. Obamacare has generally preserved the uniquely expensive American way of providing healthcare, with government-protected monopolies and subsidies for drug- and medical device–makers. It appears that the new Congress will "repeal" most of the Affordable Care Act but with a delayed effective date, by which time a new system will have to be in place. Given the overwhelming evidence on what has and has not worked here and elsewhere, as well as the current sensitivity of public opinion to the arrogantly utilized monopoly pricing power of drug companies, it is conceivable that the new Republican healthcare plan could be an improvement.

The other target at which Republicans love to throw darts is the Dodd-Frank Act, which set out to reform the U.S. financial industry and restrict predatory behavior toward borrowers, depositors, and investors. However, the final product incorporates many of the problems it was intended to solve, particularly the complex and obscure accounting standards that have enabled banks and insurance companies to outsmart regulators and investors. Most of the problems of the financial crisis in 2008 had to do with the impenetrably confusing complexity of new financial instruments that seemed to be designed for the sole purpose of facilitating fraud. There is considerable sentiment among ranking

Republicans on the relevant Congressional committees, along with many other conservative thinkers, to replace this complexity with a single and simple measure of risk. An equally simple proposal from the same quarters would impose a steep progressive tax on the total assets of financial institutions, encouraging them to voluntarily split themselves up and discouraging others from growing too large, hence potentially ending the "too big to fail" blackmail under which banks grow and profit only to be bailed out by taxpayers when they ultimately fail. All the same, protection for ordinary consumers from financial services fraud is likely to be severely reduced.

It is also at least possible, based on Trump's rhetoric and the Republican platform, that anti-trust policy could be brought back from the dead. American corporations and their international counterparts have been on a merger binge for nearly fifty years, resulting in the growth of oligopoly and monopoly pricing power in almost every industry, from airlines to drug stores to pharmaceuticals to broadcasting. If a change in policy goes beyond helping his friends and punishing his enemies, this could be a very positive feature of Trump's administration.

Broad economic policy is likely to be more active and supportive of growth since one party now controls the White House, Congress and, don't forget, the Supreme Court. Much of the stimulus, in the form of renewed tax cuts for the highest income earners, will be morally and socially repugnant and will have very limited positive impact on the broad economy. But there is a long history of support among conservatives for various tax arrangements that benefit the working poor, such as earned income tax credits and negative income taxes that are likely to appear in the final Republican tax package. Moreover, increased infrastructure spending is a likely component of increased fiscal stimulus and a consequence of one-party rule in Washington. This is both beneficial to lower income workers and an effective economic stimulus in the present, as well as a source of stronger growth in the future.

An increase in the federal minimum wage will almost certainly remain, as it has been, on hold. But this is yet another area where recent progress has come primarily from states and cities, which are likely to continue reflecting widespread voter concern about the huge contrast in the incomes of rich and poor Americans.

War is Hell

We have not yet journeyed through all nine circles of Dante's Hell, including the assaults on civil rights of every kind; however, not to try your patience further, we can conclude with war, which in the words of General Sherman, is hell itself. As in the mid-1930s, much of the world is already engulfed in active warfare. And, also as in the 1930s, many aggressions and atrocities have met little countervailing force—from the American-backed assault by Saudi Arabia on Yemen, to Russia's seizures of portions of Georgia and Ukraine, to the free-for-all incursions in the Syrian civil war by many countries including the U.S. and Russia. Trump's and Putin's mutual admiration is a wild card in the escalation of violence in Ukraine and beyond. If Putin perceives Trump as naïve and inexperienced, that might encourage further bloodshed. If he sees him as irrational and impulsive, that might be a deterrent to any provocation. If he sees him as someone who is willing to respect Russia, that might put at least a temporary end to Russian territorial aggression. Given that we simply do not know the answers to these questions, the risk of continued expansion of wars and invasions has to be considered high.

What about stocks and bonds?

Barring some intervening calamity, of which there are several plausible varieties, we are likely to see more fiscal stimulus (higher spending and lower taxes), infrastructure investment, possible moves to widen access to higher education and other steps likely to add momentum to an economy that is well into either a long (but slow) recovery or the late stages of a post-recession rebound. Since unemployment is already low and wages are already rising, economic growth is likely to be modestly higher this year than in the recent past, with inflation likely to get back up to the Federal Reserve Bank's two percent target, but not much higher. Corporate pricing power and profit margins are likely to remain under pressure from government actions, rising labor costs, and excess capacity.

With interest rates still lower than stock dividend yields and bond prices likely to fall as interest rates rise slowly in future years, stocks remain the investment of choice, albeit with increased risks due to higher valuations. In these circumstances, it seems wise to keep the majority of stock investments in the U.S., though to a lesser extent than we have been. Investments in the U.S. remain safer than almost anywhere else, even if it is riskier than it has been in the recent past. But given the increased chance of an economic/financial market setback that is centered in the U.S. with much less impact in other parts of the world, it also seems prudent to decrease somewhat our present holdings of U.S. stocks, particularly in health care companies, and to add to holdings in Europe, Japan, and to a lesser extent emerging markets.

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Chairman

Robert Zevin is the chairman of Zevin Asset Management and has been a leader in socially responsible investing since he started the first investment advisory firm specializing in such work in 1967.