

THE SMITHFIELD Forecast

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For Customers & Friends of
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A NOTE FROM THE CHAIRMAN

It is certainly safe to say that 2017 contained many surprises, both politically and economically, for the United States. One hugely unreported phenomenon for 2017 is the lack of volatility in our domestic equity markets. I think that it will be interesting to see if 2018 changes this.

May all of our dear readers have a happy, healthy and prosperous 2018.

— Bob Kopf

LOOKING INTO 2018

With President Trump's major victory on tax reform and Xi Jinping consolidating power in China, the world's two biggest economies appear headed on directly opposite paths as we enter 2018. In the U.S., the push for deregulation and tax reform is freeing business' hands and adding stimulus to an already strong economy that is operating near the record-low unemployment rate. Meanwhile in China, the Party's drive for control is adding regulation and business restrictions – particularly for technology companies and financial services, which have been linchpins of recent growth. Add in rising tension on trade relations between these two highly interdependent and globally-dominant economies, and it looks like 2018 will be an interesting year for economic growth around the world. While the emerging markets and Europe may believe they are independent of these gravitational pulls, we expect the new policy settings in the U.S. and China will be the key variables for the next big thing in global economics.

With tax rates reduced substantially for U.S. businesses and moderately for households, there is little doubt the U.S. economy will run hot in early 2018. The key question is whether this stimulus is setting the stage for trouble in 2019. The bullish case emphasizes increased productivity enhancing investment and job creation. However, over two-thirds of U.S. capital goods purchases are satisfied by imports, and there are few able bodies left to hire. The pessimists see swelling deficits, rising inflation and tightening by the Federal Reserve that could derail the economy. A more introspective

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view simply asks where the beneficiaries of the government's largess will spend their extra dollars. If higher corporate profits primarily go to stock buybacks and dividends, as in the past, there will be little economic impact – and the outlook for equity markets depends on how much one feels is already priced in. Similarly, if tax relief for households goes to pay down debt, as it did post-Lehman, rather than being leveraged up into new home and car sales as in earlier cycles, there won't be much oomph either. Bottom line, the critical question is whether the government has simply refinanced private sector debt at a lower rate, or will deregulation and lower tax rates encourage greater efficiency – even with the same number of workers.

A second question is where the Trump Administration focuses now that it has addressed deregulation, tax reform and even Obamacare by eliminating the individual mandate. Some point to infrastructure, which could provide another dose of stimulus. Others emphasize entitlement reform and deficit reduction to pay for some of the tax relief, which would reduce its stimulative effect. The Administration has started talking tougher on trade – primarily about China – but disagreements about the international aspects of tax reform could raise tension and court cases with Europe as well. Our concern is that while greater business freedom may stimulate purely domestic growth, many U.S. firms are multinationals and greater global uncertainty could delay the anticipated benefits of tax relief.

The greatest international threat may be from a slowdown in China similar to the correction set off by the advent of the corruption campaign in early 2014. Back then, after a year of negotiating with the powers that be in China, Xi Jinping attacked what he saw as the greatest threat to the Party by reining in unbridled - and often highly inefficient - investment fostered by Chinese politicians hankering for promotion. The crackdown stalled China by late 2014, setting off a collapse in commodity prices

that undermined the emerging markets in 2015, and reduced capital goods demand from Europe, weakening growth there as well. A round of substantial devaluations ensued, that lowered global labor costs, exported deflation to the U.S. and helped keep the dollar strong and U.S. interest rates lower for longer than most had anticipated. In Xi's second five-year term, we expect he will address the growing power of technology firms and the runaway excesses in the financial sector. He has already taken "golden shares" in the major tech firms and added Party representatives to their boards, usually as Vice-Chairman. On the financial front, a new super-regulator has been appointed who will oversee the central bank Governor, and the regulators for the banks, stock market and insurance industry. Transactions in the dark corners of China's wealth management are being driven into the light, where they can be monitored, modulated and taxed. It seems clear the Party's focus is on achieving the goal of being a leading power in 2021 – the 100th anniversary of its founding – and is willing to spend some of their current strength in 2018 and 2019 to set up that path.

For emerging markets, this suggests the triple threat of rising U.S. interest rates, a stronger dollar and declining demand for commodities. Having just suffered this fate in 2015, they are likely to be quicker to respond with rate hikes to quell debt demand and devaluations to avoid economic weakness. Europe, which has been riding high on recent economic strength, feels it is immune to the global environment, but may be rudely reminded that one of its core businesses is the export of sophisticated capital goods to Asia and the emerging markets. Moreover, if profits previously taxed in Europe flow toward the U.S., lifting European rates in competition with treasuries, we may see a resurgence of concern about Italian banks and Greek deficits. Japan, Korea and Taiwan are all exposed to the same issues as Europe, with the added worry of increasing demand for defense spending to counter both China and North Korea.

After living through a long period after the Lehman Crisis, during which policymakers were fearful of rocking the boat, the almost universal strength of the global economy has generated more aggressive policy decisions recently around the world. For better or worse, the uncertainty about how these policies will develop and interact should inject more risk into the low-volatility world that has created extraordinary stability in the performance of financial markets. Currently, optimism is running high as the success of the new tax reform bill was, until recently, unexpected. As we move into 2018, investors will begin to evaluate and adjust to the reality of both intended and unintended consequences.

— Michael Drury

SMITHFIELD TRUST COMPANY BOOK REVIEWS

THE LAST CASTLE

By: *Denise Kiernan*

The famous characters of the Gilded Age reappear in Denise Kiernan's *The Last Castle*. Through meticulous research and access to letters and interviews, Kiernan writes the true story of George W. Vanderbilt and the story behind the design and construction of the famous Biltmore House in Asheville, North Carolina.

Kiernan depicts life in the Victorian Era with all its lavish spending, costume balls and competition for the most opulent estates among the Astors, Vanderbilts and other rich and famous tycoons of that period.

The Last Castle focuses on the life of George Vanderbilt and that of his wife, Edith, and daughter, Cornelia. Though tremendously wealthy, the family experienced heartache as well as concerns about finances as they discover the vast sums of money it takes to keep Biltmore afloat.

Kiernan credits Edith Vanderbilt for the courage and financial stewardship that has kept Biltmore in the private control of the family to this day.

A work of nonfiction that reads like fiction and a great read.

— Mark D. Edwards

MISSION: JIMMY STEWART AND THE FIGHT FOR EUROPE

By: *Robert Matzen*

Born in 1908 in Indiana, Pennsylvania, Jim Stewart had a normal childhood with a loving mother and demanding father. His grandfather fought with distinction in the Civil War, and his father, who ran a hardware store in Indiana, served similarly in World War I. The importance of military service was hugely emphasized to Jim by his father.

Stewart went to Mercersburg Academy near his home and then to Princeton, where he was exposed to acting. Ultimately, this led to Hollywood, where he rose to stardom. The book's big surprise for me is Stewart's real life role as a Don Juan. Women loved his wry and self-deprecating demeanor, and he had affairs with nearly all of Hollywood's leading ladies in the 1930s, including but certainly not limited to, Margaret Sullavan, Ginger Rogers, Jean Harlow, Lana Turner, Norma Shearer, Loretta Young, Marlene Dietrich, Olivia de Havilland and Diana Shore.

Becoming restless with his lifestyle and Hollywood itself, Stewart converted his passion for aviation into enlistment with the U.S. Air Force after the start of World War II, with a promotion to First Lieutenant as a flight instructor. Joining the 445th Bombardment Group for deployment in England, Jim looked forward to combat. His Hollywood bosses worked behind the scenes to keep him out of combat missions, and many in the Air Force itself wanted his role to be limited to recruitment. He resisted, and, despite being an older officer, flew many harrowing and dangerous bombing missions over Germany. A natural leader, Stewart left the service at the end of the war as a highly decorated Colonel.

The war was tough on Jim with the loss of many of his men. When he returned home, his family and friends were shocked to see how he had aged. To his credit, he avoided publicity during and after the war about his service.

Upon returning to Hollywood, Jimmy Stewart initially had trouble reestablishing himself as an actor. Then, luckily, he and Director Frank Capra made "It's a Wonderful Life." He settled down, was married to the same woman for over 60 years and had twin girls. He remained a complex, good and quiet person, deeply affected by the war.

You should enjoy the book. The descriptions of the bombing missions are especially compelling.

— Bob Kopf

SMITHFIELD TRUST COMPANY BOOK REVIEWS (Cont.)

AMERICAN ULYSSES: A LIFE OF ULYSSES S. GRANT

By: Ronald C. White

Probably no President in our history has experienced such tremendous vacillations in how he is regarded as Ulysses S. Grant. At the end of the nineteenth century Grant was held in high esteem by the general public, being regarded as a great general and successful president. By the end of the next century Grant was viewed by the populace as an overrated general, drunkard and the leader of a scandal-ridden administration.

An accomplished biographer, Ronald White sets the record straight in a well-researched volume about the life of our 18th President. While the author does not gloss over Grant's mistakes, he concludes that Grant is, in essence, an underrated public figure. White has high praise for Grant as a military strategist, and he documents persuasively Grant's enlightened treatment of both African-American citizens after the Civil War and Native Americans. No less than the black abolitionist Frederick Douglass called Grant the greatest friend of the "Negro and Indian" in America. Although Grant did, according to the author, have problems with alcohol before the Civil War, he believes that Grant's reputation as a heavy drinker was clearly exaggerated by his political opponents. (Ron Chernow, another biographer I like, also has a new book about Grant, and I am told that he has a different take on this issue.)

The author should be commended for his finding and examination of letters between Grant and his wife, Julia, with whom Grant had a wonderful marriage. The letters reveal much about the man, his policies and concerns in a fundamentally positive manner.

The end of the book describes Grant's race to finish his memoirs before his life is ended by cancer. He desperately wants the proceeds from the sale of the memoirs to create a sufficient fund to care for Julia after his death. Grant succeeds. Grant's memoirs are considered to be the best of that genre by any president. I read them many years ago, and I agree with that assessment.

Ronald White has written an eminently readable biography which restores needed luster to the reputation of our arguably most underappreciated president.

— Bob Kopf

WE'LL ALWAYS HAVE CASABLANCA

By: *Noah Isenberg*

Casablanca is my favorite movie, and it is rightfully called “Hollywood’s most beloved film.”

Released in 1942 just two weeks after the City of Casablanca surrendered to American troops led by General Patton, the movie, starring Humphrey Bogart, Ingrid Bergman and a splendid supporting cast, was an instant hit, became a cult classic and clearly retains its appeal after the passage of 75 years.

Noah Isenberg’s detailed exploration of how *Casablanca* was made shows that some of its success was accidental and some was generated by pure brilliance. Isenberg does “run off the rails” a bit when he assigns too much importance to the movie, even asserting that the lessons from its story should have influenced our conduct of the war in Iraq. The end of the book also unravels somewhat by referencing every theatrical offshoot, parody and revival of *Casablanca* in the last few decades. More focus on the biographies of Bogart and Bergman would have been preferable for me.

I saw, once again, *Casablanca* recently with my wife and daughter. We all loved it. If you are a fan of the movie, see it again before reading this book.

— Bob Kopf

THE IMMORTAL IRISHMAN: THE IRISH REVOLUTIONARY WHO BECAME AN AMERICAN HERO

By: *Timothy Egan*

Thomas Francis Meagher (pronounced “Mar”) is easily the most fascinating historical personage of whom I had no knowledge before reading this book.

Born in 1823 to a wealthy Irish family, Meagher refused to accept the British rule of Ireland. A great orator, Meagher defied his father and led a failed rebellion against the British crown. He was then banished to a Tasmanian prison colony for life. Escaping, he landed in the streets of New York City, keeping his dream of leading an armed insurrection of Irishmen to free Ireland. Incredibly, he then led an Irish brigade in the American Civil War. His heroism (and that of his men) gained him considerable notoriety, won the respect of President Abraham Lincoln and led to his appointment as a general. With these exploits behind him Meagher moved to Montana, being designated as its territorial governor. At this juncture Meagher’s tale becomes even more bizarre.

In strongly recommending the book, I can tell you that an added bonus in reading it is that Timothy Egan’s prose is superb.

— Bob Kopf