

THE PARLIMENT PAGES

JANUARY, 2017

ANNUAL PREDICTION TIME -

Based on our feedback, this is THE issue that everyone really looks forward to, probably because of our previous success in predicting the trends for the coming year. Well, before we get into our numerous predictions, it is really incumbent that we examine the results of the recent elections, and the effect they may have on business in general, and specifically our industry.

THE MANIA OF THE TRUMP VICTORY -

I find it quite hilarious that so many got it so wrong. The pollsters, the talking heads, the economists all missed big time. Hillary's victory was a foregone conclusion borne out by the science of polling and the expert "commentary" of the political wags. Well, now they are all backpedaling about as fast as they can, with some still not acknowledging the obvious. I think an equally big surprise was the economic reaction to the Trump victory. Our economic leaders, who we depend on for their great expertise, all predicted a massive stock market sell-off. Not only did that not happen, but the market that has been mired in stagnation for 4 years has gained over 8% in just a month with indications that it could yet go higher.

People who had given up and refused to talk politics before are showing enthusiastic support for the dramatic change in leadership about to happen. You can't help but feel that a large percentage of the population is optimistic and sees a change in direction that has been craved by so many for so long. However, on the other side of the fence, the opposition is just as strong and the thought of a united country is probably a figment of imagination. What will be the outcome of this, yet again, a divided country? Hopefully not!

VOTER DEMOGRAPHICS -

Pages and pages could be written about the breakdown of the demographics that resulted in the Trump victory. However, one thing seems to stand out amongst all of the rest. Please understand the following comment is a generalized comment and does not apply to specific individuals but rather to a demographic cohort.

A major portion of the Trump support came from entrepreneurial business people and the traditional middle income worker. Many of Hillary's supporters were the lower income, state supported individuals who are very dependent on government. I heard a well-known political commentator say the following, "Trump's supporters are the producers in this country and Hillary's are the takers." Again, this is a generalized comment, but it does seem to ring true when the demographics are closely examined.

NOT JUST A PRESIDENTIAL ELECTION -

Republican candidates held onto the Senate and the House giving Trump a clear path for policy execution. Trump also picked up a huge mandate from the local election scene as well. There were over 6,000 state legislative positions up for grabs. The Republican Party dominated many races and now own 32 of the 50 governorships and over 2/3 of the State Legislatures. There are only eleven states that now have complete two-house democratic controlled state legislatures.

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TRUMP IS CONSISTENT WITH HIS CAMPAIGN -

In Presidential campaigns, many things get said for the pure effect of influencing voters. Most of the time, the elected President will back-off those promises and move more towards the middle positions. It has been the move to middle positions that has caused so many problems in this country. These middle positions have failed to establish who we are as a nation and left us with very uninspiring leadership. I felt throughout this entire campaign that we needed to select someone from the fringes to help establish a positive direction. Whether it was the socialism of Bernie Sanders or the bigger than life Trump, we needed to move away from the status-quo.

While we are still only a couple of months into the transition, it is very clear that Trump intends to follow-through on the directions that he set forth in the campaign. His appointments so far are sprinkled heavily with highly successful business people and anti-establishment operatives. He does intend to transform Washington and accordingly has brought in the weapons to make a go of it.

While many of his appointments will alienate the Hillary supporters, Trump has thumbed his nose at those people and has basically said to get on his wagon. This is exactly the attitude that Obama brought to Washington after his first election. While the liberals are calling “foul” now, they totally supported the same approach under our current president.

HAVE THE FUNDAMENTAL ECONOMICS CHANGED?

This, to me, is the biggest unanswered issue. We still have an incredible level of national debt, we still have huge headwinds caused by student loans, aging population demographics, high real unemployment, and an economy that has been anemic for the past 10 years. Not a one of those changed because of the election.

How will Trump succeed with these fundamentals still in place? I think there are a number of approaches that he is considering that will start the ball rolling. First, consumer confidence is skyrocketing. Remember, over 70% of our economy is still comprised of consumer spending. Optimism in that sector will automatically have a positive impact. Next, he is planning a huge infrastructure spending program. While it is really not as big as being reported, it still will be a substantial boost in spending. Trump plans a massive deportation of the undesirable illegal aliens. This deportation will save the government billions and will create job opportunities that were previously taken by this group of people. He will negotiate tougher trade deals and will place huge emphasis on returning and keeping manufacturing on our shores. This will lead to higher wages and ultimately higher prices which is always a boost for the economy.

In some form, much of the Affordable Care Act will move back into the private sector and will hopefully improve the efficiency of medical delivery and most importantly rein in the out-of-control cost escalations that we have seen. Lastly, he appears to have no problem spending government money on hard goods. While previous administrations ran up debt to cover income transfers (a fancy word for welfare), Trump will spend money to get hard goods. Running up the debt is something that really concerned me as I followed his campaign. However, maybe it is time to look a little differently at our debt and deficit.

HOW DOES THE GOVERNMENT FINANCES WORK? -

Again, we could write books about this complex subject. But, here in this newsletter, I want to address one very important aspect of our debt and deficit.

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The US Treasury department is responsible for collecting revenues and paying the Government bills. Government expenditures have exceeded revenues by about 40% since Obama took office. As business people, we can't help but view this as a catastrophe. If we ran our businesses like that, we would be on the doorsteps at the bankruptcy court. However, the Government does not play by the same rules.

The average business person takes out a loan to support a deficit. That loan carries an interest rate and the terms for the repayment of the principal. What you borrow costs money and has to be paid back. For the US government, it is a totally different game. To cover the deficit, the Federal Reserve Bank (Fed) steps in. They loan money to the Treasury by creating "new money" (aka Quantitative Easing). They charge the Treasury interest. But, get this - the Fed is a non-profit so at the end of the year, they return virtually all of the interest that they collected from the Treasury and others (such as individual, institutional, and international investors) back to the Treasury for a net gain to the Treasury. When the notes that the Treasury owes become due, the Fed simply renews them. So, the net effect is that this borrowing that is caused by the deficits never has to be paid back and costs the Treasury nothing in interest. What a deal.

This system only works when the dollar is the preferred worldwide currency and the currency of choice for exchange. With everyone else's currency in the toilet, this system is facing no threat and therefore there is no reason not to run up more debt as long as that debt is focused on growing the economy.

If that is the case, why did we object so strongly when Obama did it? The reason is quite simple. The debt Obama ran up did not grow the economy. The money went to increased government assistance programs and the growth of governmental bureaucracies. Hopefully, Trump will use this deficit spending to grow the economy. Debt for growth is good debt. Remember, it is not the amount of debt but rather the amount of debt in relation to the size of the economy.

POLITICAL PREDICTIONS -

While we share the high level of optimism, we also have a certain amount of skepticism. The changes that Trump wants to make are truly transformational. It will take extreme patience on the American public to give him the time and support to make these changes. We tend to be an impatient populace and it remains to be seen whether or not Trump is actually able to implement his agenda. Will the press ever give him a break and will the Republican politicians quit being politicians and instead pitch in to support the change that is needed?

OVERALL ECONOMIC PREDICTIONS -

Right now, we are still operating on a level of irrational exuberance. Since the election, over \$97 billion has poured into the stock market. To put this in perspective, the total for all of 2015 was just \$61 billion. We need to be realistic and expect that the stock market will retrench and the positive emotional high will subside until such time as results start appearing. If this optimism holds, positive results are seen quickly, and the consumer gets back to spending. There is good likelihood that we will see the first appreciative economic growth that we have had in the past decade. We are hoping that we get within range of that magical 4% growth rate but would think anything north of 3% in 2017 would be a remarkable turnaround.

OUR INDUSTRY PREDICTIONS -

Last year we forecasted that single-family housing starts would be around 800,000 and multi-family somewhere in the 400,000 range.

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Final numbers are not yet in, but the preliminary indications are that is almost exactly what will happen. So, once again, our record of good housing predictions is intact.

We do not see a dramatic change in 2017 and predict that single family will probably come in around 900,000 starts and multi-family will remain about the same, or possibly decrease a bit.

HEADWINDS -

As previously mentioned, Trump's election did not cause all of housing's headwinds to suddenly disappear. On top of those, we have another that is starting to rear its ugly head. For the first time in 8 years, the Fed raised interest rates. They have messed around with the discount rate a couple of times and have threatened to raise interest. However, this time it actually happened. They also are predicting that there will be 3 similar rate increases in 2017.

When all is said and done, we do not believe this will have a significant impact. First, saying and doing are two different things. The Fed has proven that in the past. Second, even with increases, the rates are still incredibly low. And lastly, raising interest rates can result in both positive as well as negative effects. The low rates we have been experiencing have severely punished savers, many of whom counted on their savings to fund their retirement spending. As rates go up, hopefully savings yields will also rise and we could see some additional consumer spending as a result.

There still should be some pent-up demand out there. Even at 800,000 starts, we are still considerably lower than history. For decades, new home construction amounted to about 5% of the economy and employed more than a million people. Today, housing represents 3% of our economy and employs about 500,000. This is happening at a time when our population has increased by tens of millions.

All in all, the country's optimism and pent-up demand versus the headwinds should result in a growth of about 10% in the number of units produced. However, as you will read next, costs are increasing and will likely add another few percent to our actual sales numbers.

PRODUCT PRICING AND AVAILABILITY -

This will unquestionably be a year of price increases and product shortages. We started to see signs of this within the past couple of months. For example, our domestic steel supplier actually ran out of #5 rebar, one of the most common inventory items of all. Fortunately, we had anticipated this and had ample inventory to get through this crisis. However, many users were caught short and lost business accordingly.

Manufacturers still have not expanded enough to meet demand. Demand is also increasing worldwide and many of our previous overseas suppliers are not able to handle the export demand. However, more critical is the price of raw materials. Across the board, all raw materials are rising at a fairly substantial rate. These increases will obviously impact future pricing.

Trump has been very bullish on protectionism. If he goes through with this, and every indication is he will, we can expect countervailing duties or ant-dumping suits on a large number of products that are imported. This will put additional production strains on American manufacturers and will undoubtedly factor into pricing.

We are already seeing significant product delays. One of our major products has moved from the historic 3-month lead time to 6 months. This is especially critical at the dealer level as builders cannot tolerate those types of delays in products. As you purchase, insure that your suppliers are geared up to carry enough inventory to deal with these delays.