



September 14, 2017

Dow: 22,203

Harvey

This is not the six-foot rabbit that was the imaginary and mischievous friend of James Stewart in the movie of the same name. This was the evil Harvey. This is the Category 4 hurricane that hit Texas. It was not enough to scare all native Texans to head for higher ground, but Harvey brought his evil twin with him: rain. Rain did its job by dumping water, lots and lots of water, on Texas. Forty inches in 48 hours in some places. In a hurricane, it is not the wind that usually does the most damage, it is the water and the flooding.

Investors, always on the alert for an opportunity, immediately looked for stocks that would benefit from the carnage. It brings to mind the story of the broken window. Back in the mid-nineteenth century, economists were lamenting the fate of a merchant who had a broken window. Most agreed that the broken window would add to economic growth because the glass maker and the window installer would benefit from additional business. But Frederic Bastiat, a noted economist of that time, disagreed. He postulated that there were the “seen” and the “unseen” effects of the broken window. The seen effects were obvious. However, the unseen effects were more hidden. The merchant would lose some business while the window was being repaired. He would also have to pay for the window, leaving him less personal income for his family's needs. He would also have less income to increase his inventory, resulting in less revenue for the economy. His final analysis indicated that the overall economy would have lower output.

Multiply that scenario many thousand-fold for Harvey and now Irma. Houses will be rebuilt, helping the construction industry and increasing lumber and cement sales. Carpeting will need to be purchased, as will furniture and appliances. In many businesses, inventories will have to be replenished. There are many other seen economic benefits that will arise from these massive natural catastrophes. It is the unseen effects on the economy that are more difficult to discern. Business will be lost while companies rebuild and refurbish. Some businesses will not even reopen. Loss of jobs and loss of personal income are perhaps the biggest negatives to the economy. These are longer-term negatives as money spent rebuilding is money lost to the rest of the economy. Ultimately Harvey and Irma were truly disasters for the economy. Some analysts project a one percent reduction to the overall economic growth for the year.

Speaking of growth, the Labor Department just released its August jobs report. Let the spin begin.

- 156,000 new private sector jobs created in August. Under 200,000 for the fourth month of the last six.
- 4.4% Unemployment rate (not counting the discouraged and underemployed.) Normally 5% would indicate full employment.

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- 62.9% Employee participation rate. Still near the all time lows set in the late 1970.
- 0.01% Wage growth for August. Not a good number.
- Inflation is still below the Fed's target of 2%.

All in all, not a good report. The markets saw it as a positive as it increased the odds the Fed will not raise rates at its September meeting. Stable rates reduce fixed income risk and justify higher stock valuations. It appears that the only thing that can stop this market is North Korea.

In the oil patch, the initial expected reaction to Harvey hitting Texas was that the price of oil would go up. However, most oil produced in Texas is drilled in west Texas, away from the hurricane. Oklahoma is still drilling, the Bakken oil fields are still drilling, and Canada is still drilling, as are Alaska and the Middle East. As there is no shortage of oil, and the price of oil dropped a buck, but the price of gas at the pump went up. That was because most of the refineries are in east Texas and had flood damage and even a fire. Expect gas at the pump to remain high until the existing refineries get back onstream.

Congress had better get their act together on a tax reform bill as expectations are increasing. The President surprised many by negotiating with the Democrats to increase the Treasury's debt ceiling. Could Trump become a Democrat before his first term ends? Let's hope everyone can just start working better together and improve our convoluted tax code.

You have to love the American spirit. Whenever disaster hits, Americans are there to pitch in and help. Millions of dollars have been donated to help the victims of hurricane Harvey. The President even donated one million dollars. Cynics may say that he can afford it, but a million dollars is a million dollars, and it sets a good example. J.J. Watt, All-Pro linebacker for the Houston Texans, started a charity with a modest goal of one million dollars. Before he could say "blitz," it had raised over 28 million dollars. There are always stories of kids breaking open their piggy banks and sending in their quarters and dimes; the American spirit lives on.

Now we have Irma. Can Americans possibly dig any deeper to help the people of Florida? I predict that somehow, they will.

Random Thought for September 2017: The parable known as the broken glass fallacy seeks to show how opportunity costs as well as the law of unintended consequences affect economic activity.

-Frederic Bastiat

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