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VIEWS FROM CAMELBACK MOUNTAIN

"Four More Years"

The outcome of the U.S. election will have important ramifications on the U.S. economy, corporate America and many other important factors such as taxes and monetary policy. Many investors were hoping that Mitt Romney would be elected because they believed a Romney Presidency would feature lower taxes and less regulatory burden. We now know that President Obama will be in charge for the next four years and with Democratic victories in the Senate, the Administration feels further empowered to raise taxes on the wealthy and to continue heavy regulatory oversight for many industries. Understandably, this has some investors concerned. Regardless of your political beliefs, the country has made a choice and investors will have to understand that a majority of the American electorate is pleased with the outcome of the election. Our job is to determine how the election will impact our investments and consider any changes that should be made.

On Wednesday, November 7, 2012, our partners met to discuss the impact of the election. Here are a few outcomes that we expect as a consequence of the election.

- Healthcare reform will clearly be enacted and this will impact healthcare businesses directly and all businesses indirectly through their healthcare costs for employees. We have already made significant changes to our healthcare holdings over the last several years and we are now looking for opportunities for niche healthcare companies that may enjoy increased revenue.
- Dodd-Frank regulations impacting banks and other financial services companies will clearly be enacted. While this may be good for the country and certainly 'bad banks' deserve all the regulation they can get, it's unlikely to benefit the traditional banking sector. Although we haven't invested in traditional banks for many years, we are currently evaluating all of our financial services companies to determine whether or not individual positions should be adjusted.
- Taxes on wealthy people and businesses are clearly going up, thus individual clients need to evaluate the impact based on their own tax position. This includes income taxes, capital gain taxes and estate taxes.
- Interest rates are likely to stay at near zero levels for much longer as President Obama is likely to continue to endorse the actions of Federal Reserve Chairman, Ben Bernanke. If Mr. Bernanke elects not to be reappointed in January 2014, it is probable that Vice Chairman, Janet Yellen, would be appointed by President Obama and it is presumed she will continue the current policies. This means that bond rates will likely stay low for the next several years.
- President Obama's re-election means deficits are likely to remain high over the next several years and will add to the potential for inflation. Eventually, this may cause the U.S. dollar to weaken.

The uncertainty surrounding the election has paralyzed much of corporate America. Now that we have closure on the election, whether these businesses are happy with the outcome or not, they will at least have a much clearer direction on how to proceed. There are trillions of dollars in cash sitting on the sidelines in corporate America. Some of these dollars will be deployed as soon as policy direction is known.

The immediate response in the stock market to President Obama's victory has been a sharp decline based on some of the concerns cited above. It is unclear to us at this time how the market will behave over the coming months. Much of the market impact in the near term will be determined by how the President and the Congress deal with the coming fiscal cliff. We expect that either in the lame duck session of Congress or after the first of the year, the new Congress will be able to come up with a compromise to postpone some or perhaps a significant portion of the fiscal cliff. If that happens we would expect the market to improve from the current level. If Washington remains paralyzed, it could drive modest declines in the near term.

Prior to the election, the market had performed well this year despite a whole host of issues ranging from weakness and structural problems in Europe to concerns about China's growth and our fiscal cliff. Corporate earnings have done well and businesses are overall healthy. Stocks remain reasonably priced in our opinion. We look for stocks to perform well after the fiscal cliff is resolved and the impact of the election is absorbed by the markets.

The consumer is alive and well and for the past three months has been driving growth in the U.S. economy. As we approach the Christmas shopping season, we expect the consumer on average to drive a fairly positive holiday season.

All of us here at L. Roy Papp & Associates LLP wish you and your family a happy and healthy Thanksgiving.

Warmest regards,

Harry Papp

Harry Papp
Managing Partner
November 14, 2012