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VIEWS FROM CAMELBACK MOUNTAIN
“Real Problems That Will Eventually Need Real Solutions”

Our country has just endured a presidential election that achieved a new level of hostility and polarization. It involved everything from childish name calling to arguments mainly about irrelevant issues. Today we would like to focus on four important, long-term problems that the election debate overlooked. These are serious problems that need solutions. These problems are unlikely to derail our economy or our society in the short-term, but they will cause serious damage to our country in the long-term if not addressed.

The first item that neither candidate wished to talk about was the deficit and the national debt. We are currently approaching \$20 trillion dollars of accumulated national debt, two thirds of which was accumulated under the last two presidents over the previous sixteen years. It is even more remarkable that we ran up this debt balance while experiencing record low interest rates. It now appears that the Federal Reserve will gradually allow interest rates to rise to their equilibrium level. As this occurs, the service cost on our \$20 trillion dollar mortgage will quickly worsen the deficit. Donald Trump supporters will argue that growth will solve the problem. Directionally, growth will help. Unfortunately, the deficit is so significant and the debt so large that even significant economic growth will not solve this problem. Long-term, our government needs the political resolve to reduce expenditures and raise more revenue. The main driver of the deficit growth is entitlement expenditures, which are exacerbated by our aging population.

The second issue is the growth rate of health care costs, which have now reached approximately 18% of U.S. GDP. There was much discussion, both pro and con about the Affordable Care Act during the election, but no one seems willing to address the rapid increase in health care costs. Again, an aging population that is facing incredibly expensive health challenges, such as Alzheimer's care, makes matters worse. This is one sector where technological improvements do not necessarily equate to lower costs, but instead often drives costs even higher. The Affordable Care Act, with all of its flaws, was about access, not cost control. Other nations are also experiencing rapidly increasing costs, albeit from a lower level.

The third issue is education. Progressives want to allocate more funding for schools while conservatives want charter schools and other methods to bring competition to education in the hope of lowering costs and improving outcomes. In reality, the solution requires both additional resources and structural reforms. This problem is particularly acute in Arizona where funding levels are entirely inadequate and structural reforms have produced mixed results. It is hard to believe that the abundance of knowledge that the U.S. needs to develop may be produced only by the children of wealthy families who are able to provide their children access to superior educational opportunities. All children need to have access to quality education.

Finally, we wish to touch on the environment where almost all reasonable people agree that human beings are having a dramatic impact on the environmental health of our planet. The political debate on this issue was on how effective or not various environmental programs have been. Governments around the world have had a poor track record of developing cost-effective solutions to this serious problem. We believe the solution lies in technology. Arizona State University's President, Michael Crow, has remarked that

while electronic communication and medical technologies have advanced enormously in the past 50 years, humankind's energy strategy, with the exception of nuclear energy and all of its issues, has not changed that much in the last 150,000 years. Our strategy is to cut it down and set it on fire, or dig it or pump it out of the ground and set it on fire. We can surely do better and eventually we will have to.

These are all tough issues and that is why politicians have avoided dealing with them. Long-term, our country as well as the rest of the world, needs to identify and implement successful environmental strategies. We are confident that the United States can lead the world towards solving all of these issues.

Despite tough, long-term issues, we remain optimistic about our country and our prospects. Even with all of our problems, we remain the envy of the world in terms of intellectual freedom, technological development, opportunity for graduate level education and economic vitality. People from many areas of the world are eager to come to the United States because they recognize the opportunities the U.S. offers.

As investors we observe that stocks are hitting record highs, but in our opinion they remain at the upper end of normal valuation ranges. We will continue to experience economic and market cycles and future recessions have not been eliminated. At this point, we do not see significant risks for a near term recession and we believe we are more likely to see a little faster growth, which should help both corporate earnings and wages. If this happens as we expect, the market can grow into the current high valuation levels and continue to appreciate.

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

Best regards,



Harry Papp
Managing Partner
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