
**L. Roy Papp & Associates, LLP**
**Investment Counsel**

**2201 East Camelback Road**
**Suite 227B**
**Phoenix, Arizona 85016**
**(602) 956-0980**
**FAX: (602) 956-7053**


# VIEWS FROM CAMELBACK MOUNTAIN

***"What If We Already Had the Recession?"***

The United States economy has been expanding steadily since we came out of the Great Recession (2008-2009). This expansion has been very weak by historical standards, but it has lasted for a long period of time. Economic expansions typically run four to six years. Expansions lasting more than seven or eight years are not common. This has led many economists and market forecasters to wonder when this economic expansion will run its course and the U.S. economy will experience the next recession.

There is an old adage that economic expansions and bull markets do not die of old age. Recessions are often caused by the Federal Reserve raising interest rates or by economic dislocations such as inventory build-ups. Recessions can also be triggered by troubling levels of inflation, wars, severe natural catastrophes, or an event like September 11, 2001. Our last recession was clearly caused by a bursting of the real estate bubble and the financial crisis.

As the title alludes to, we believe the U.S. economy may have experienced a very mild recession or a rolling recession that moved from one industry to another sometime over the last three to four years. We think the economic expansion has been so anemic and the recession might have been mild enough that no one noticed. This is important for stock market valuations as many market observers opine that the current record rate of profitability for American companies is near or at an all-time high. Market observers go on to suggest that this means that corporate earnings cannot grow very much from the current levels. If on the other hand, we have already experienced the next recession, corporate earnings could grow nicely from current levels over the next several years. If that were to occur, stocks would not look nearly as expensive as some people believe they are today.

We think two important factors have contributed to the weak expansion. The first was the deleveraging that occurred as a consequence of the meltdown at numerous financial institutions. We believe the second factor was the result of the heavy regulatory actions implemented by the previous Administration. We think these two factors in combination caused businesses to slow or stop taking on capital expenditures, especially those for new technology and productivity improvements. The result of this lack of investment was a dramatic slowdown in U.S. productivity over the past several years. We believe that this in turn caused wages for many American workers to stagnate.

If the "next" economic expansion is currently underway, we should see businesses deploying capital for equipment and technology which should stimulate productivity. This in turn should help wages expand and increase consumer spending. Since 70% of the U.S. economy is tied to consumer spending, this phenomenon could help the U.S. economy grow at a faster pace than we have observed over the past eight years.

Many observers believe the U.S. economy is late in the 8th inning of a very long expansion. If we are actually early in the 2nd inning of the next expansion, which followed a very mild recession that no one noticed, the U.S. economy and the financial markets could enjoy several years of continued success.

We hope that this scenario will help give some perspective on the strength that the financial markets around the world, particularly the U.S. stock market, have enjoyed over the last few years. Even under this scenario we observe that the U.S. stock market is still pricey. We remain optimistic about continued growth of corporate earnings, but it does appear that much of that growth potential over the next few years has already been priced into stock valuations at current levels.

While it is too soon to come to any conclusion about the ultimate results of the tax reform proposals currently being debated, we are optimistic that some reforms will be enacted and this should be helpful for corporate earnings and economic growth. We think it is unlikely that estate taxes will be eliminated; we believe there is the potential that the threshold to trigger estate taxes may gradually be increased. We will keep you advised of any tax reform elements that impact investments or tax strategies for investors.

Best regards,

Harry Papp
Managing Partner
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