Managed Asset Portfolios

"I skate to where the puck is going to be, not where it has been."

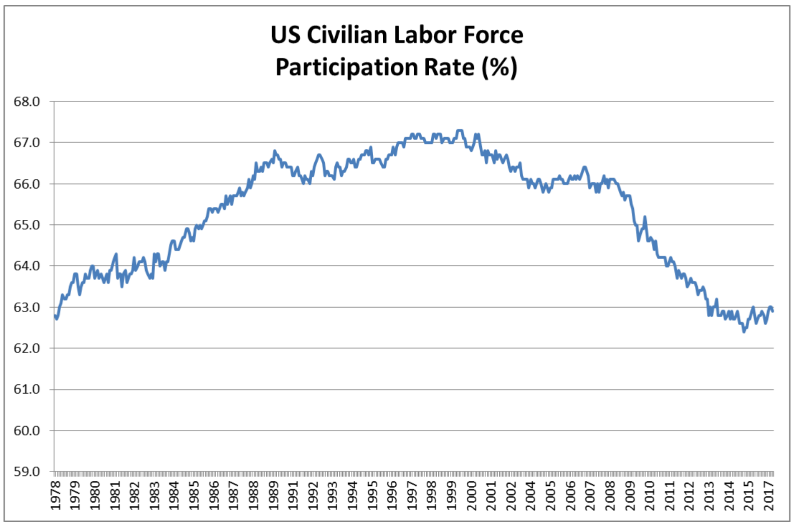
--Wayne Gretzky

The same advice given is appropriate for investors. Don't crowd into where the masses are, but try to figure out what is going to transpire next and position your portfolios accordingly. Spurred by optimism around Donald Trump's presidential win, many investors are hopeful that the U.S. economy will enjoy renewed upward momentum. We believe such optimism is unwarranted, and we are growing increasingly skeptical about the U.S. economy's growth.

For those of you familiar with MAP's history, you know that we have continually cited two structural issues as impediments to meaningful domestic economic growth. The first issue relates to amount debt the U.S. is currently carrying. In the U.S., since 1980, total debt to GDP has continued to climb and now exceeds 350%. Globally, total debt to GDP has risen from 269% in 2007 to 325% today. As intuitive as it may seem, it simply becomes difficult to grow under the current debt load.

The second structural issue we are concerned with stems from the fact that the U.S. has shifted from a high-compensated manufacturing driven economy to low-paid service driven one. In the 1960's, General Motors (GM) was the nation's largest private sector employer. Between wages and benefits and adjusted for inflation, GM paid its workers on average, just under $50 an hour. Today, the largest private sector employer is Wal-Mart, and they are under legislative pressure to increase their wages to $10 an hour.

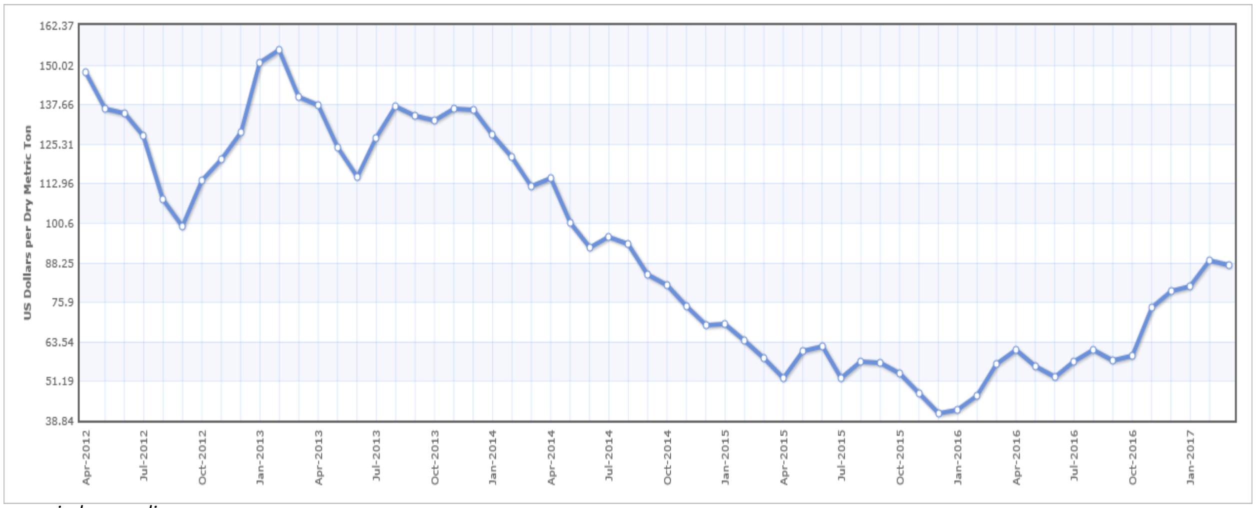
While on the campaign trail, Mr. Trump ran on the platform that he would return U.S. economy to 4%+ growth by bringing manufacturing jobs back home. This task is easier promised than accomplished. Bringing back manufacturing jobs to the U.S. will prove difficult because we are and will never be a source of low cost labor. As unpopular as this concept may now be, we live in a global economy, where companies perpetually seek cheap labor. Evidence of this hunt comes from the fact that companies that once based their production in China are now building plants in countries like Indonesia and Vietnam as these new emerging countries have become the world's new providers of low cost labor. Even with the proposed tariffs and border taxes which are intended to partially offset the cost differential between the U.S.'s and emerging market's labor forces, the wage gap is simply too wide for U.S. manufacturers to bring their production home. Even if manufacturing does return to the U.S., it is unlikely that it will lead to large gains in employment. Over the last decade, approximately 85% of the U.S.' manufacturing job losses was attributable to technology and automation; only 15% was caused by companies moving production offshore.   The rate of adoption of technology and automation is accelerating. Just over the past few weeks, McDonald's and Wendy's both announced that they will be introducing 'self serve' kiosks in many of their restaurants over the next few years; Dominos is currently using a robot to deliver pizza in Australia and Europe; and in October, Uber hired Otto, a driverless truck, to make its first delivery (50,000 cans of Budweiser beer).



On the plus side, unemployment levels have continued to decline, with April's jobless rate dropping to 4.4%, its lowest level since 2007. Perhaps a more ominous sign of economic vibrancy is the labor force participation rate. This number shows the percentage of Americans actually employed. Keep in mind that in order to be statistically considered as unemployed, one must be jobless and actively seeking employment. The percentage of Americans actually in the workforce today, stands at 62.9%, almost identical to where it was in 1979.

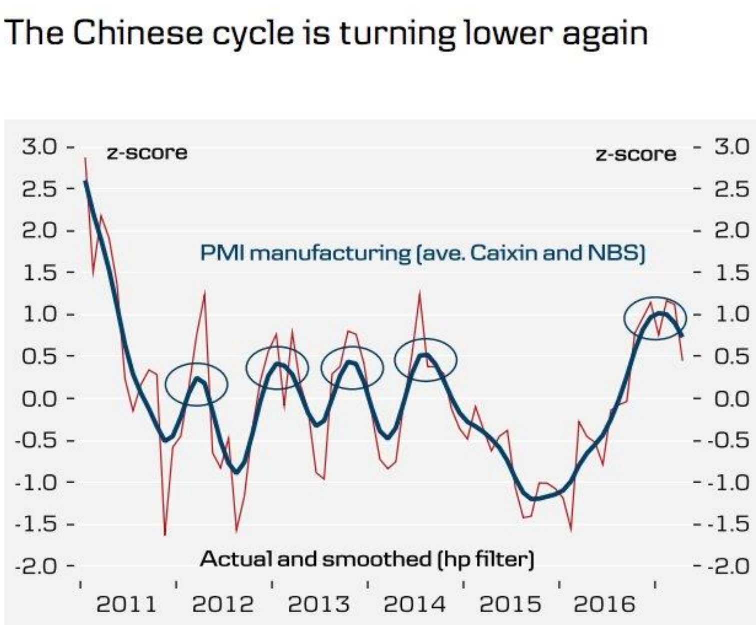
In 1979, Jimmy Carter was in the White House; unemployment, interest rates and inflation were all in the double digits; the informally measured "misery index" (inflation plus unemployment) was soaring. Today, like then, economists and sociologists debate reasons why the level of employment is so low. Some argue that it is merely a reflection of an aging workforce while others argue that it is a byproduct of a discouraged workforce who lost their jobs in the last economic downturn and lack the necessary skills regain employment. While there is probably some truth in each argument, the cause of today's low employment rate is

secondary to the fact that when people are unemployed, they spend less and create a drag on the economy.



www.indexmundi.com

Most recently, several news stories and market actions have heightened our economic concerns. These concerns include sizeable drops in copper, oil and iron ore prices; large declines in April auto sales (down 5% and 7% at GM and Ford, respectively); significantly higher credit card charge offs at Synchrony Financial, Capital One, and Discover; and early signs of slower economic growth in China.

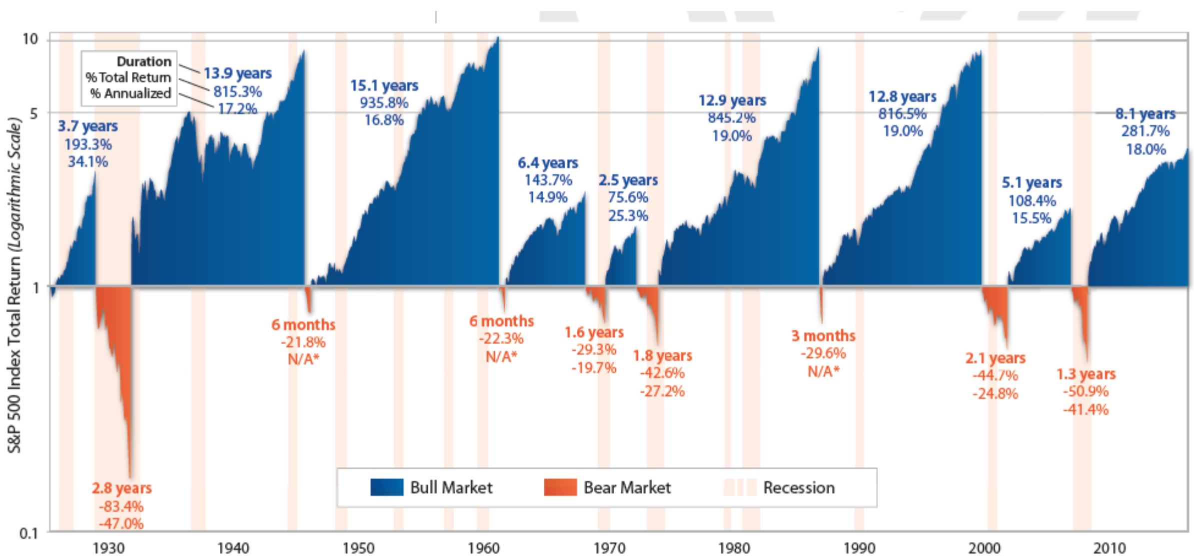


Source: Macrobond Financial, Markit, Danske Bank

We are not predicting another 2008 style economic crisis. However, we do believe that economic headwinds are building at a time when many investors are anticipating improving tailwinds and this incongruence will cause turbulence in the stock and bond markets. This turbulence has the potential of being exacerbated by the trend of indexing. Indexing is indiscriminate between good and bad stocks, expensive and cheap ones. Passive strategies are great when stocks are rising, but are quickly doubted when upward market trends reverse. Given where we are in economic and stock market cycles, we believe, now is the time to be highly selective rather than passively indexing a portfolio.

We are the first to concur that less regulation and lower taxes are generally positive for the economy. How much the administration and Congress will be able to accomplish on this front remains to be seen. Many on Wall Street compare President Trump's proposals to former President Regan's initiatives. There is however one major difference between the two administrations; its debt. The national debt stood at approximately $1 trillion in 1980; today it is at $20 trillion. President Regan had the wiggle room to increase borrowing while he increased defense spending and reduced taxes. We do not believe that President Trump has the same flexibility.

As for valuations, the S&P 500 today, carries the second highest valuation in history (second only to the dot-com bubble induced bull market of the 1990's). Additionally, this current bull market is the second best (both in terms of duration and performance) in history.



Source: First Trust Advisors L.P., Morningstar. Returns from 1926 - 3/31/17. *The S&P 500 Index is an unmanaged index of 500 stocks used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index. Index returns do not reflect any fees, expenses, or sales charges. This chart is for illustrative purposes only and not indicative of any actual investment. These returns were the result of certain market factors and events which may not be repeated in the future. Past performance is no guarantee of future results.*

Given the lack of attractiveness of other asset classes, we continue to believe that stocks "remain the best house in a bad neighborhood." We believe our portfolios are well positioned for the structural economic impediments we outlined above. We remain overweight consumer staples (e.g. foods, beverages, tobacco) and other sectors that do not need a strong economy to perform well, while underweight those sectors that typically rely on a robust economy (industrials, financials, materials, etc.). We believe Gretsky would be proud; in hockey terms that we are skating to where the puck is going.

May 11, 2017
The Investment Team of Managed Asset Portfolios
Michael Dzialo, Karen Culver, Peter Swan, John Dalton and Zachary Fellows

The information contained herein represents our views as of the date above and does not represent a recommendation by us to buy or sell any security or securities mentioned. Past performance is no guarantee of future results.