COULTER & JUSTUS WEALTH ADVISORS
575 OAK RIDGE TURNPIKE, SUITE 203
OAK RIDGE, TN 37830

865-481-0385 *phone*
865-483-7930 *fax*

WWW.CJWEALTH.COM

October 24, 2016

Dear Valued Client,

Last week, we hosted our quarterly client roundtable, where we discussed the elections and the rise of political populism in America. A copy of the speech transcript is enclosed below for those clients unable to attend. For the purpose of this investment letter, some of the speech has been edited for length and clarity purposes.

The purpose of today's talk is to educate clients on political populism and its influence on the economy and financial markets. The content of this speech, its views and opinions are entirely mine and does not necessarily reflect the views and opinions of our firm or any of its employees or advisors. My goal is to reveal the facts that are sustaining these trends so clients can understand the context in which today's populist movements are happening.

Political populism represents the manifestation of frustration of the citizens of a country whose elected leaders are: 1) failing to do their jobs or 2) doing their jobs in ways that don't reflect the will of its constituents or the American people at large. Sometimes it isn't frustration with an elected leader per se, just frustration with public policy that is not adequately addressing the present-day challenges of society. As we unravel the challenges that are driving the populist movement, the key issues are the role government will play, the cost and who will bear it, and what incentives may be leveraged to produce the desired long-term outcome?

Here in the United States, we will soon select a new President from two candidates that each carry a lot of baggage. This is just my opinion, but Clinton has issues of trust that she must overcome, while Trump has issues of competence that he must overcome. First, let's lay out some facts that each side is using to influence voters.

Beginning on the left, real household income has shown negligent growth over an 18-year period. While real median household income was $56,516, up 5.2% in 2015 over 2014, it is still at the same level it was in 1998. Breaking down real income by quintiles, since 1967, real incomes for the top 5% of earners are up 101% (350k median income), the second quintile is up 83% (202k median

COULTER & JUSTUS WEALTH ADVISORS
575 OAK RIDGE TURNPIKE, SUITE 203
OAK RIDGE, TN 37830

865-481-0385 *phone*
865-483-7930 *fax*

WWW.CJWEALTH.COM

income), while the bottom two quintiles of income (32.6k & 12k) are only up 18.6% & 25%, respectively. These statistics support the populist view that the middle class feels stuck and top earners have disproportionately received income gains from the economy over the past few decades. Clinton is making the appeal that her policies can broaden the base of economic participation and level the playing field via proposals to increase the minimum wage and tax increases for upper income earners (including carried interest).

Whenever income gains reach levels that are vastly disproportionate to the rest of society that it serves, it has two opposing effects. On one hand, the desire for financial independence increases the entrepreneurial drive of innovators, encourages the growth of small business, and revitalizes the American dream. On the other hand, it fosters a sense of economic injustice and antagonizes the struggling classes. A recent example of egregious executive compensation comes from Wells Fargo, which was recently fined $185 million by the Consumer Financial Protections Bureau (CFPB) for opening fake accounts. As a result, over 5,000 employees lost their jobs and just last week, the CEO resigned. Since 2000, Wells Fargo CEO received $23 million in salary, $44 million in bonuses, and $190 million from vesting of stock and exercising of stock options. Another example comes from Mylan, a generic drug maker under scrutiny for increasing prices on its Epi-pen product by 227% over a 4-year period. Mylan settled with the Department of Justice (DOJ) for $465 million, but while under questioning on Capitol Hill, the CEO came under scrutiny for her own salary, which increased by 671% over an 8 year period, taking home nearly $19 million last year and $26 million the year before. These are the headlines that fuel class warfare and gives Clinton a lot of appeal amongst voters who believe it's important to narrow the inequality gap in America today.

I reference executive compensation because I believe most of the abuses in executive compensation are not in the form of salaries or bonuses, but instead, in stock based compensation, which has reached egregious levels and continues unabated. Whenever a company issues stock options or restricted stock that is exercised or granted by employees and/or executives, ownership amongst existing shareholders gets diluted. Companies are able to sidestep dilution by using corporate funds to repurchase their stock, which reduces dilution and allows for the practice to continue without investors penalizing the stock price. This is a disservice to investors and highlights the lack of accountability between the board of directors and company executives as well as the lack of accountability between shareholders and company management. BlackRock and Vanguard Group Inc., which are among the largest shareholders at most big U.S. companies, vote with board recommendations on executive pay over 90% of the time, according to Proxy insight, a shareholder advocacy group. Unfortunately, the growing proliferation of index funds is giving managements a pass on pretty much anything they put up for an annual proxy vote. Part of the reason we prefer active management is their ability to engage managements & put pressure on them to maximize shareholder value.

COULTER & JUSTUS WEALTH ADVISORS
575 OAK RIDGE TURNPIKE, SUITE 203
OAK RIDGE, TN 37830

865-481-0385 *phone*
865-483-7930 *fax*

WWW.**CJWEALTH**.COM

In the absence of having the ability to legislate executive salaries, the current administration has increased regulatory scrutiny of the banking system as well as those that provide investment advice. Before the financial crisis, mortgages were packaged and sold like hotcakes, generating handsome profits for stockholders and bonuses for their executives until debt levels within the banking system reached a tipping point and the system imploded as many investment banks failed and housing prices declined. As a result of Dodd-Frank regulations, proprietary trading activity of regulatory capital has been vastly reduced, which increases the stability of the banking system at the expense of its profitability. Another covert-form of regulation that is hurting the banking system today is the persistency of low interest rates, which hurts the spread between the interest a bank receives from loans and the interest a bank pays to checking/savings account owners. Between regulatory reforms and low interest rates, banks in America today operate more like regulated utility companies.

In another example, the Department of Labor (DOL) has recently announced new regulations for financial advisors like us, which seeks to standardize the bar in regards to how advice is given and products are sold within a fiduciary framework. The intent is to make sure client interests are put first and conflicts of interest are adequately disclosed. Ultimately, this means that commission-oriented investment sales, in the form of public investments, private investments, insurance, or annuities will require disclosure of any conflicts of interest, along with supporting documentation that proves every recommendation was made in the best interests of clients. As a fiduciary firm that is committed to doing what is in our clients' best interest, the passage of this law validates what we have already been doing for a long-time. Competitor firms that are product-focused and dependent upon commissions will have a tougher time adjusting to this new law and their compensation will likely be reduced. This is just another example of how regulations are "tightening the screws" within banking and investment industries.

While Obama has sought to tackle inequality through regulations across banking, healthcare, and the environment, Clinton is expected to address inequality primarily through changes in the tax code. Hillary's proposals on capital gains tax rates in particular, seek to penalize short-term investment and reduce the velocity at which financial transactions occur in what she calls "quarterly capitalism". If this capital gains tax proposal ultimately passes, expect to see the volume of trading be reduced, which could increase financial market volatility.

Another area where we might see changes is in the Affordable Care Act (ACA), which was meant to expand insurance access to Americans that either had pre-existing conditions or that didn't have insurance coverage through their employer. Access came through the form of insurance exchanges, which were meant to drive down insurance costs through competition from private carriers. Unfortunately, there are too many sick people in those exchanges. United Healthcare, the nation's largest insurer, said it would lose about $1 billion on Obamacare policies in 2015 and 2016.

COULTER & JUSTUS WEALTH ADVISORS
575 OAK RIDGE TURNPIKE, SUITE 203
OAK RIDGE, TN 37830

865-481-0385 *phone*
865-483-7930 *fax*

WWW.CJWEALTH.COM

Aetna, the nation's third largest health insurance company, announced earlier this year it would lose $300 million on the plans. Aetna CEO Mark Bertolini said: "Providing affordable, high-quality health care options to consumers is not possible without a balanced risk pool," At least 1.4 million people from 32 states could lose their health insurance under the ACA, as their plans are set to disappear from the program next year and people will have to find new coverage outside the ACA exchanges, according to Bloomberg reports. That means there will be fewer, but more expensive plans, and the same doctors and hospitals people used before may not be included under the ACA. In my mind, the lesson learned here is that political idealism—universal insurance—must intersect with economic reality—who will foot the bill. Since private insurers have a vested interest amongst its stakeholders to run efficient and profitable businesses, there will be limitations to how long the red ink will bleed before prices adjust higher and/or insurers leave unprofitable health exchanges. The fallout of this will mean ACA will face more criticism as people see their premiums increase and their options diminish.

Improving access to healthcare, education, raising taxes on income/capital gains, and making private enterprise "toe the line" through regulatory actions are all meant to redistribute wealth, reduce inequality, and create a closer dependency on government. If these measures are collectively successful in their end goal, then what does that mean for capitalism? What does it mean for our free enterprise system? What does it mean for our collective dependency on government? These are all questions worth pondering. For investors, if Clinton is ultimately elected, it will likely be a continuation of the status quo. Assuming political power is divided in Congress, I believe more power rests in the hands of the Federal Reserve than in the office of the President, at least when it comes to the financial markets. For investors, while it's important to be mindful of changes in regulatory policy that may influence the economics of businesses in the private sector, at the end of the day, the process for successful investing and investment philosophy should not change based upon who is in the White House. While divided political powers means passing legislation will be challenging, it also means that ideological policies that are disconnected with economic reality will have a tough time passing, so on some level, political gridlock is mildly bullish for the markets.

On the other side of the aisle, the right is trying to utilize the following arguments below to persuade voters that the economy can do better.

- Economic growth is 2.1% since the recession, the slowest since 1949.
- Second quarter GDP grew by only 1.4%.
- Productivity growth has stalled (down 0.4% year over year)
- Corporate earnings growth has stalled (7 consecutive quarters of S&P earnings declines).

WEALTH ADVISORS

COULTER & JUSTUS WEALTH ADVISORS
575 OAK RIDGE TURNPIKE, SUITE 203
OAK RIDGE, TN 37830

865-481-0385 *phone*
865-483-7930 *fax*

WWW.CJWEALTH.COM

- Manufacturing jobs that are leaving the country. (46k jobs were lost over previous 12 months).
- Industrial production down for 12 consecutive months.
- Multi-national corporations hording $2.5 trillion of cash overseas that won't come home due to the fact the U.S. has one of the highest corporate tax rates in the world.
- Trade deficit with other countries totaled $737 billion in 2015.

As of July 1, the Federal Drug Administration (FDA) had 4,036 generic drug applications awaiting approval and the median time it takes to for the FDA to approve a generic drug is now 47 months, according to the Generic Pharmaceutical Association, or GPhA. In Europe, that process takes 12 months. All these statistics appeal to Trump's base of supporters, who believe the economy is under-achieving its potential primarily due to the over-reach/mismanagement of government, whether that be from tax policy, bad trade deals, or regulations.

Based on information from the Committee for a Responsible Federal Budget, the current tax proposals from Clinton will increase the public-owned federal debt from 77% of GDP to 86% in 10 years. Under Trump's tax plan, the federal debt would increase from 77% of GDP to 105% in 10 years. Another non-partisan think tank called the Penn Wharton Budget Model suggested that Trump's plan would increase GDP by 1.12% compared with current policy, while Clinton's plan would decrease GDP compared with current policy by 0.19%. But by 2027, the end of the 10-year budget window, Trump's plan would decrease GDP by 0.43% and Clinton's plan would increase GDP by 0.4%. No matter which side of the political aisle you are on, sustaining $19.7 trillion dollars in debt is a tax on the economy and unfortunately, the seriousness of fiscal responsibility has largely been left out of the debate amongst these two candidates this Presidential cycle. Perhaps we have taken the debt for granted given how low interest rates are currently, but it's foolish to assume that interest rates will remain this low indefinitely.

Perhaps most striking in the current political debate is how globalization has lost its political support amidst stagnant global growth and continued concerns over income inequality. According to the International Monetary Fund, annual growth in the volume of world trade has averaged just 3% over the 2009-2016 period – half the 6% rate from 1980 to 2008. According to the World Trade Organization (WTO), global trade this year will grow at the slowest pace since 2007. With world trade shifting to a decidedly lower growth trajectory, political resistance to globalization has intensified, with Bernie Sanders making strong arguments against the Trans-Pacific Partnership and Trump making strong arguments against trade deals from Mexico & China.

C&J
WEALTH ADVISORS

COULTER & JUSTUS WEALTH ADVISORS
575 OAK RIDGE TURNPIKE, SUITE 203
OAK RIDGE, TN 37830

865-481-0385 *phone*
865-483-7930 *fax*

WWW.CJWEALTH.COM

Another catalyst for increased tension in global trade is the increased volatility in global currencies as a result of accommodative global monetary policy, which prints money at unprecedented levels for the purpose of devaluing currency and increasing competitiveness of exports. If currency devaluations increase isolationism, then expect inflation down the road and a drag on large-cap multi-national profits. The trade-off is to what degree Americans are willing to accept higher prices in order to tip the scale back into the favor of keeping manufacturing jobs at home. History has taught us from the Smoot-Hawley Tariff Act signed by President Hoover in 1930 that import tariffs negatively influence trade and hurt the economy. Former U.S. Federal Reserve chairman Ben Bernanke put the protectionist legislation into perspective: "Economists still agree that Smoot-Hawley and the ensuing tariff wars were highly counterproductive and contributed to the depth and length of the global depression." The media talks about how Trump cannot be trusted with nuclear weapons, but the more practical worry in my mind is to what extent Trump antagonizes our 2nd and 3rd largest trading partners in China & Mexico if he is elected. Also keep in mind that China is the largest foreign owner of our treasury debt at $1.2 trillion dollars. Globalization isn't perfect, but letting the free market decide what and where to manufacture has merit, in my opinion, versus restricting it for the sake of nationalism, which could sow the seeds of hostility with our trading partners.

Regarding immigration, Mark Zandi, who is the chief economist at Moody's says "no single policy matters more to lift U.S. growth on a sustained basis than immigration reform. It is vitally important to our economic future. If we don't get this right, we won't get 4% growth; we will get 1%. We will get Japan." In context to the retiring baby boom generation, the problem the U.S. will face will be a lack of labor and a lack of labor force growth according to Zandi, which underlies the importance of immigration reform.

In closing, a new Harvard Business School study found that America's dysfunctional political system has emerged as the biggest threat to its economic competitiveness. Lead author of the study, Michael Porter, says: "While a slow recovery is underway, fundamentally weak U.S. economic performance continues and is leaving many Americans behind, the federal government has made no meaningful progress on the critical policy steps to restore U.S. competitiveness in the last decade or more." That failure, the authors write, "reflects an unrealistic and ineffective national discourse on the reality of the challenges facing the U.S. economy and the steps needed to restore shared prosperity."

Despite this unfortunate reality in politics today, it's important to stay positive and keep in perspective the inherent advantages the United States enjoys over the rest of the world. Jaime Dimon, CEO at JP Morgan, in a recent speech at the Economic Club of Washington, offered an upbeat assessment of America, saying:

C&J
WEALTH ADVISORS

COULTER & JUSTUS WEALTH ADVISORS
575 OAK RIDGE TURNPIKE, SUITE 203
OAK RIDGE, TN 37830

865-481-0385 *phone*
865-483-7930 *fax*

WWW.CJWEALTH.COM

"America has the best hand ever dealt of any country on this planet today and ever, and Americans don't fully appreciate what I'm about to say. We have peaceful, wonderful neighbors in Canada and Mexico. We have the biggest military barriers ever built called the Atlantic and the Pacific. We have all the food, water, and energy we will ever need. We have the best military on the planet and we will for as long as we have the best economy. We have the best universities on the planet. We still educate most of the kids who start businesses around the world. We have the rule of law, which is exceptional. If you don't believe me, we can talk about Brazil, Russia, Venezuela, Argentina, China, India. Believe me, it's not quite there. We have a magnificent work ethic. We have innovation from the core of our bones. You can ask anyone in this room…it's not just the Steve Jobs. We have the widest, deepest financial markets the world has ever seen. It's extraordinary. And we have it today."

These are positive words to keep in mind in this less than positive political season. As always, thank you for the trust you place in us.

Sincerely,

Scott Smith, CIMA®

COULTER & JUSTUS WEALTH ADVISORS
575 OAK RIDGE TURNPIKE, SUITE 203
OAK RIDGE, TN 37830

865-481-0385 *phone*
865-483-7930 *fax*

WWW.CJWEALTH.COM

The S&P 500 consists of 500 stocks chosen for market size, liquidity and industry group representation. Each stock's weight in the index is proportionate to its market value. The S&P 500 is one of the most widely used benchmarks of US equity performance. The MSCI World Index is a market capitalization-weighted index designed to provide a broad measure of equity market performance throughout 23 countries in the developed world.

The opinions and forecasts expressed may not actually come to pass. This information is subject to change at any time, based on market and other conditions and should not be construed as a recommendation of any specific security or investment plan. The advisor does not guarantee the accuracy and completeness, nor assume liability for loss that may result from the reliance by any person upon such information or opinions. Past performance does not guarantee future results.

Diversification can be thought of as spreading your investment dollars into various asset classes to add balance to your portfolio. Although it doesn't guarantee a profit, it may be able to reduce the volatility of your portfolio.