

## In 2020, the business bogeyman is not the Fed

With the new year underway, people are asking me what economic signs I'm seeing in my dealings with clients. And, of course, the No. 1 concern for those firms sensitive to interest-rate fluctuations on debt is how much longer the economic expansion can go on, keeping rates low and allowing lenders to pass out cheap money.

But I'll surprise you pessimists: Despite all the end-is-near drum beating about the next recession, I'm seeing a number of positive indicators — and really only one potential pitfall. (Clue: It's not interest rates.)

We're talking about the political climate and its implications on the economy. But let's de-politicize that conversation. For the purposes of making my economic point, I could just call them Tories and Whigs. But the prospect of a tax-friendly president in the near term, coupled with the impeachment circus surrounding the Tory president, is something that Wall Street seems to have chosen to ignore so far, possibly at its own peril.

First consider the other factors that influence the economy: While many other major economies are cooling, we remain in an enviable position. For example, after fracking our way to the top of the pile among energy producers, we're less reliant on energy imports than ever.

Trade war tariffs? They're being largely absorbed by product substitution and cost-price adjustments.

Another big advantage for us: Unlike most advanced economies whose GDPs are driven overwhelmingly by exports — up to 67 percent for countries like Thailand, in the 40s for the EU, Japan, and South Korea — our dependence on exports is very low, about 14 percent, because we have our own domestic market of 330 million qualified buyers.

This fact makes us less exposed to global economic ups and downs or currency fluctuations. And we essentially have full employment, with companies having to



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pay more to retain talent, yet there's still been no sign of the inflation that might spook the Federal Reserve.

We're also seeing some fascinating and teachable moments as companies find new products and services to stay relevant and grow cash flow. We're no exception at SC&H, where we're always trying new products and approaches to allow for tectonic changes in the marketplace, such as in data and AI.

Some of the best examples include companies like those run by Elon Musk. Their innovations just in the past year spanned everything from tunnel boring, renewable energies, and, of course, Tesla autos — solar roof tiles and battery deformation detection, to space travel.

If you consider the blinding speed at which this country is innovating, plus the simple economic indicators I mentioned, then I certainly am not going to assume that rates will go up, valuations will drop, or that capital markets will lose liquidity.

The economy is still growing, but one of the things that could change that is tax policy.

That's why I have my eye on the still-crowded Whigs' primary race. If you look at the tax changes the various candidates are proposing, it would mean anything from a 10 percent increase in taxes proposed by the most moderate candidates to an increase of 50 percent or more.

We will know much more about what to expect after Super Tuesday on March 3 as

we will better understand who might win the nomination.

And if you want to take liquidity out of the pockets of consumers and businesses alike, that's a surefire way to do it, and the effect would hit us much faster than any gradual interest rate tightening.

An extreme case of the markets losing liquidity was the 2008 recession. When loans went bad by the billions, the capital markets froze, and there was quickly no place to get refinanced. The main source of capital was regulated banks, always under the watchful eye of the feds and suddenly reverting to their most strict, CYA debt-to-revenue ratios.

There are a lot more checks and balances in place in the banking industry now, but other things have changed in the capital markets since then, too. Today, internationally, there's so much capital available that is outside the regulated markets that such a liquidity freeze would take a cataclysmic event, and on a global scale.

Those private equity markets are hungry for investments and acquisitions and willing to accept risks that banks can't stomach. You can watch them every day buying sovereign bonds from near-broke nations, or securities offered by shaky, c-rated companies all over the developed world.

So, I'm betting the cost of money will stay low and demand for assets will remain strong, fueled by those unregulated capital markets. But that isn't to say a future federal tax increase wouldn't throw a wrench in the works, since it would be a hit to cash flow and would reduce the supply of money.

We're all fat, dumb, and happy after a decade of low interest rates, which explains investors' obsession with the Fed. But we have our eye on the wrong ball.

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