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President Trump and the Economy

We are amazed, though not completely surprised, by the Trump victory. On the Sunday prior to the election, when we saw that Mrs. Clinton was in Philadelphia both that Friday night with Katy Perry and then would be back again on Election Eve Monday with the President and First Lady, former President Bill Clinton, John Bon Jovi, and Bruce Springsteen, we said to a friend that the Clinton campaign must be deeply worried about losing Pennsylvania. They saw the need to get every vote possible out of core Philadelphia if they hoped to take Pennsylvania. And that no Ohio appearance took place in the days leading up to the election meant they had conceded Ohio. Ditto for Wisconsin.

In the last issue of *The Linneman Letter*, we wrote that you should be wary of pre-election predictions, as they were based on the historic voting behavior of non-die hard Republicans and non-die hard Democrats choosing between two basically likable candidates. We surmised that historical polling methods, which revolved around this group of voters choosing between two highly disliked candidates, were ill-suited to this election. Hence, we were not shocked that the polls were wrong by 400-600 basis points (bps).

It has been very interesting to watch key Republicans, who in many cases (including all living Republican Presidents and Presidential candidates, except Mr. Dole), very publicly refused to support Mr. Trump's candidacy, but are now working with him as the elected President of the United States. As Mr. Romney's post-election reaction demonstrates, it is a very different phone call when the President of the U.S. asks one to serve, versus a loose cannon candidate requesting campaign support. The prestige and power of the U.S. Presidency is immense and should not be underestimated.

Eight years ago, America voted for President Obama for "change we can believe in." That is, they voted on a largely unknown and inexperienced Senator hoping for real change. Unfortunately, what they

got was foretold by his selections of a very "establishment" Vice President Biden and Chief of Staff, Rahm Emmanuel. Thus, the past eight years witnessed the policies one would expect from a Chicago Democrat, tinged with a bit of community activist socialism (President Obama's true heart).

In fact, President Obama, although personally popular, presided over the virtual collapse of the Democratic Party. When he entered office in 2009, there were 60 Democratic Senators; today there are 48. There were 257 Democratic U.S. Representatives; today there are 193 (one-third of which hail from just three states). There were 29 Democratic Governors, and 60% of state legislative bodies were controlled by

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Democrats; today there are 15 and 30%. And now they have lost the White House.

It is now all about the advisors this fundamentally inexperienced President has chosen, whether he will listen to sound advice, and if he is able to build a “compromise consensus.” Such a “compromise consensus” has not existed since early in President Clinton’s second term, with the fleeting exception of immediately after 9/11. The raw truth is that Mr. Trump is not much less prepared for the job than a peanut farmer-turned-Georgia Governor, or the Governors of Arkansas and Texas, or handsome young junior Senators from Massachusetts and Illinois. In fact, almost no one is truly prepared for the job, as it is a pretty impossible job for which to prepare. The real key is how quickly and effectively they learn on the job, and whether they utilize the wisdom of those with topical expertise without falling prey to the agendas and petty jealousies of these experts.

It is ironic that a few days prior to the election, pundits and the media were preparing to attend the funeral of the Republican Party. Many suggested that the defeat would exceed that of Goldwater in 1964, and that the Republican Party might even cease to exist. Yet in a few weeks, the U.S. will have a Republican House, Senate, White House (though President-elect Trump is hardly a Republican by traditional metrics), and an overwhelming majority of state Governors, state legislative bodies, and state Attorney Generals. The Trump victory not only had “coat-tails,” but was sweeping in its breadth. It also underscored the wisdom of the federalist structure created by the Founding Fathers. It is important to remember that the Electoral College was critical to the creation of the U.S., as most colonists feared that without it, the small states would be overwhelmed by voters in Philadelphia, New York, and Boston. Absent this federalist election structure, these colonies would have never joined together to create the U.S. Only a smattering of major urban counties were carried by Mrs. Clinton, with almost all other counties across the country carried by President-elect Trump.

In Figure 1, counties that saw a majority of votes for Trump are red, while those with a majority who supported Clinton are blue. Based on this perspective, one would conclude that of course Donald Trump won overwhelmingly, because just about the entire

country is red. However, when taking the percentage of votes into consideration, the graphic becomes far more balanced between Republican and Democratic votes for President. In Figure 2, the same county data is shaded by the extent of the vote (e.g., 100% Trump is red, 100% Clinton is blue, with all others represented by gradations of purple). It shows the same general pattern, but reveals that it was not an “all or nothing” vote. That is, many in Middle America voted for Ms. Clinton, and many urbanites voted for Mr. Trump.

It is highly offensive when pundits say “Hispanics, women, blacks and college educated males did not vote for Mr. Trump.” This is simply not true. While the majority of these groups did not vote for Trump, millions of good and honorable people in these categories went into voting booths, thought about their choice, and voted for Mr. Trump because they honestly believed it was the best course for their nation. Whether we agree with them or not is irrelevant. Their votes deserve respect, not criticism. Like each of us, they voted as citizens, not as racial or gender cut-outs. They are neither “idiots” nor “deplorables.” They were fellow U.S. citizens exercising their right to vote. An estimated 42% of women voters, 29% of Latino voters, and 8% of African American voters cast their ballots for Mr. Trump. Had these millions of people not done so, he would not have been elected. It trivializes the integrity of these individuals to say “women, blacks, and Hispanics did not vote for Trump.” They did, just as millions of non-college educated white

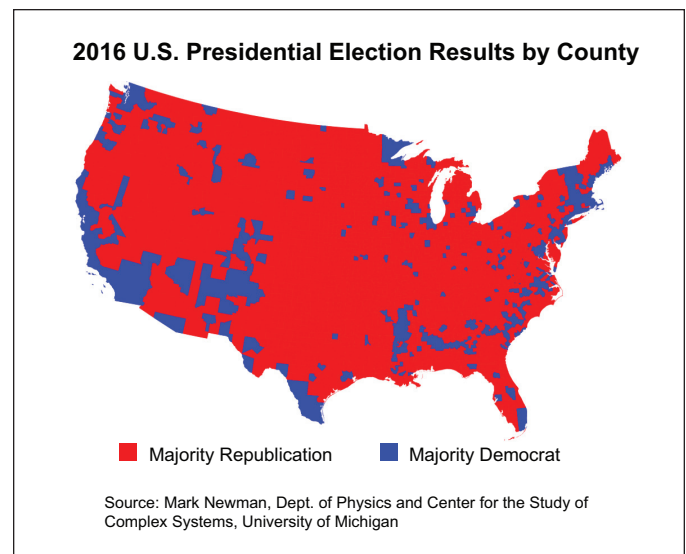


figure 1

males honorably voted for Ms. Clinton because they felt she was the best choice for their country.

The Republicans are now in charge, with a President who is neither a traditional Republican, nor policy savvy. It will be a roller coaster ride. Only time will tell whether Mr. Trump will select and listen to good advisors, and whether he can build an “effective compromise consensus.” To date, he has selected people with high quality resumes, though to the dismay of those who voted against him, these people have massively different policy positions. But this is the familiar losers’ lament amplified by a very liberal media. President-elect Trump is clearly a master salesman and has a proven background in negotiating, though in a very different context.

In terms of economic policies, the primary focus of the Republican Congress will be the repudiation of key elements of Obamacare. They will almost certainly work with President-elect Trump to halt the vast regulatory overreach of the past 16 years, particularly in healthcare, finance and banking, labor relations, and energy/environment. President Trump and Congress will not undertake major tax reform, in spite of the desperate need for systematic reform after 30 years of neglect and “special case” changes. While there may be no decrease in the highest personal tax rate, notable reductions in other personal tax rates will occur, and there will be a modest reduction in capital gains taxation. We anticipate that the estate tax will be effectively

lowered primarily by raising the minimum exemption level. Corporate tax rates will be slashed, and cash held abroad will be allowed to be brought home with only modest taxation.

President-elect Trump will push for a review of all trade agreements and tariffs, but such agreements take years to negotiate and change. Expect minor changes and tariff tweaks accompanied by pronouncements of “radical changes.” In terms of immigration policy, we hope that our borders remain open. We hope that a man who has had two immigrant wives understands the importance of immigrants to the vitality of the U.S. Again, we expect more rhetoric than action in this arena, though entry from the Middle East will unfortunately be made more difficult.

The U.S. will not strategically default on its debt, as Congress will block such behavior. However, federal spending (except for infrastructure) and regulation will be reined in by a President and key economic advisors who have never collected a government paycheck, but have experienced the bite of excessive regulations and paid taxes. The lack of traditional funding support of his candidacy importantly means that no President in our lifetime has entered the White House with less need to pay back “special interests.” This alone is a reason for hope for productive change. And needless to say, the tax treatment for real estate will not be worsened. We doubt that a wall will be built and paid for by Mexico, though the President will tout concessions (real or imagined) which he will successfully negotiate with Mexico that “pay for” greatly increased border controls.

We expect that Federal Reserve appointees will take on a very different hue than the group-think unorthodoxy which has prevailed the past 9 years. We hope they will be appointees who understand that artificially low rates do not stimulate the economy, but rather, distort capital flows, redistribute income, and reduce growth, as has been so vividly demonstrated for over 26 years in Japan and the last nine years in the U.S. and Europe. Long rates have risen by nearly 70 bps since the election, and contrary to Fed fears, the economy has done just fine. This is because rates closer to market rates better allocate capital.

A serious challenge facing the new President is that he is 70 years old and highly unpopular. These facts will encourage a Democratic minority, (especially the

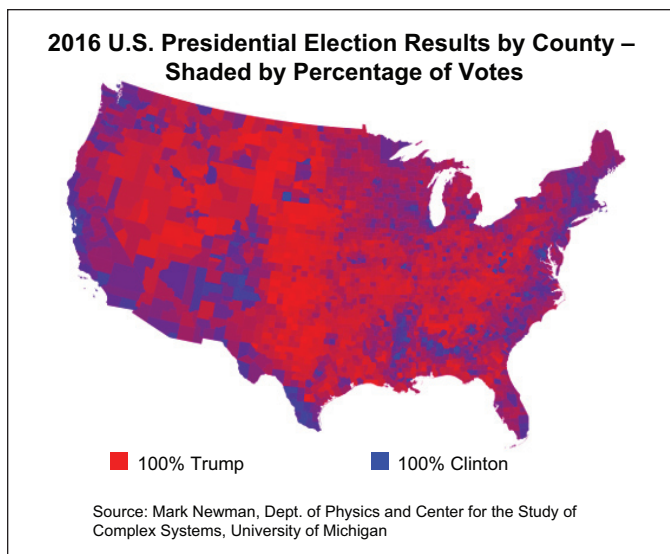


figure 2

Warren-wing) to dig in as they regroup and reform, in an effort to make him a one-term President. And do not write off the Democrats, as political parties have displayed an amazing ability to reform. While this was a devastating defeat of historic proportions, remember that just four years after the disastrous Goldwater defeat in 1964 (when Republicans responded to a close defeat in 1960 by moving too far right), the Republicans retook the White House with the improbable election of President Richard Nixon. The question is whether the Democrats repeat the McGovern mistake of 1972, when they moved too far left after a close defeat in 1968. In the meantime, we doubt that the coastal elites and university professors who said they would “move to Canada if Trump is elected” will do so, but if they do, go long on Toronto real estate.

In short, it is time for all of us: winners, losers and interested observers, to afford President-elect Trump the respect and dignity the office deserves. It is time for us to admit that disagreement does not mean that those who disagree are evil, corrupt, or sub-human. All any of us have are opinions which are the result of our experiences and environment, and none of us has a monopoly on truth. It is time for political leaders of all stripes to understand that it is the job of advisors not to compromise, while it is the job of politicians to arrange compromise among honestly contrasting views. If they are unwilling to compromise, they should not be politicians. A politician who is unwilling to compromise is as useless as a judge who declares all defendants guilty (or innocent). Legislators are paid compromisers. If they are unwilling to compromise, they should resign.

About Dr. Peter Linneman

Dr. Linneman, who holds both Masters and Doctorate degrees in economics from the University of Chicago, is the Principal of Linneman Associates. For over 30 years he has provided strategic and financial advice to leading corporations. Through Linneman Associates, he provides strategic and M&A analysis, market studies, and feasibility analysis to a number of leading U.S. and international companies. In addition, he serves as an advisor to and a board member of several public and private firms.

Dr. Linneman is the author of the leading real estate finance textbook, *Real Estate Finance and Investments: Risks and Opportunities*, now in its fourth edition. His teaching and research focuses on real estate and investment strategies, mergers and acquisitions, and international markets. He has published over 100 articles during his career. He is widely recognized as one of the leading strategic thinkers in the real estate industry, and was named among the top 30 “Most Influential People in Real Estate” by Commercial Property Executive in 2013.

He also served as the Albert Sussman Professor of Real Estate, Finance, and Business and Public Policy at the Wharton School of Business at the University of Pennsylvania until his retirement in 2011. A member of Wharton’s faculty since 1979, he served as the founding chairman of Wharton’s Real Estate Department and the Director of Wharton’s Zell-Lurie Real Estate Center for 13 years. He is the founding co-editor of *The Wharton Real Estate Review*.

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