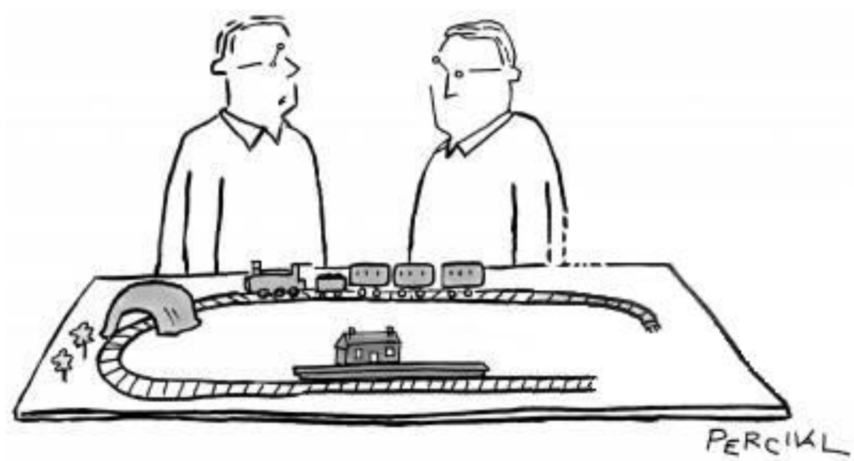
The View from Princeton

Market Commentary* ⬧ *September 2014

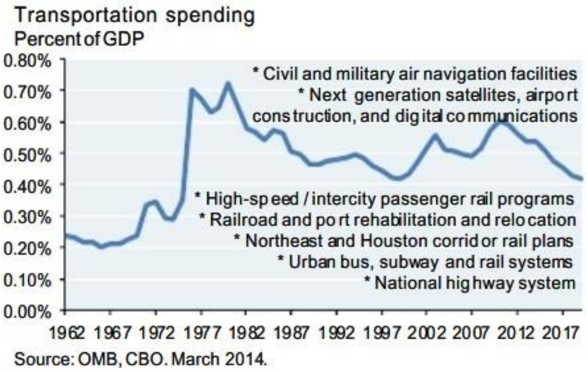
INCOME INEQUALITY:
CATALYST FOR COMPROMISE

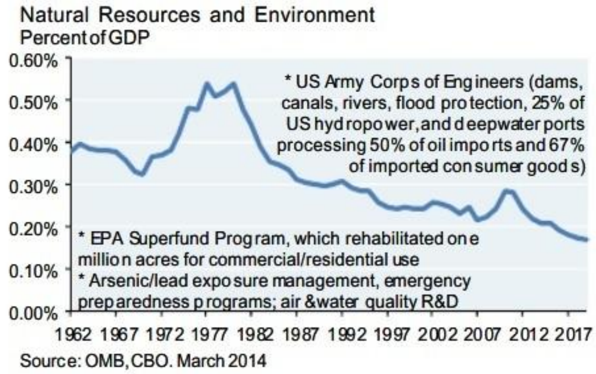


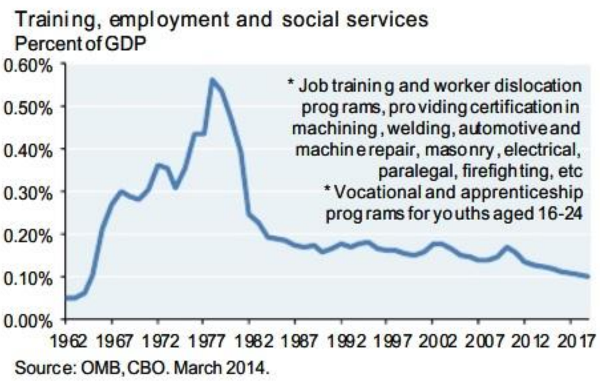
"I've had to put a major infrastructure project on hold."

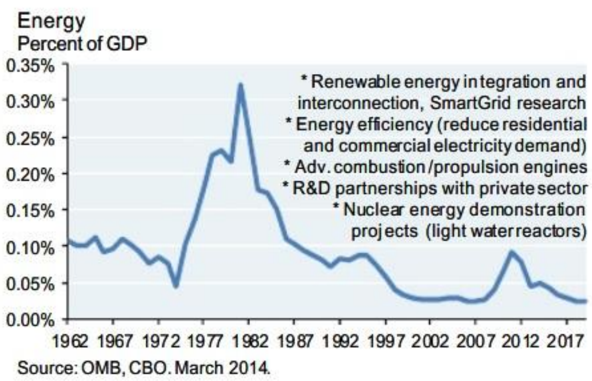
As long-run investors, we are constantly attempting to ferret out major secular technological, structural, and demographic changes in the economy. These growth drivers provide the most fertile ground of investment opportunities. As one reflects on the current state of the US, it is painfully obvious that years of neglect and mismanagement have seriously impaired our structural capabilities and educational foundations. From transportation to scholarship, we have fallen dangerously behind our global competitors. Pent-up demand festers within our national infrastructure.

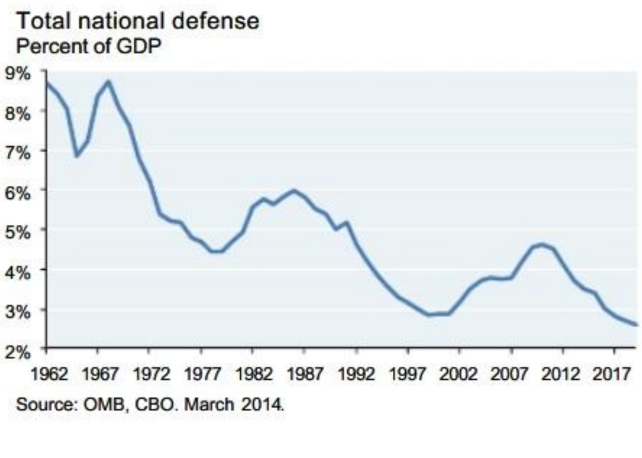
In a recent market letter, Michael Cembalest, Chairman of Market and Investment Strategy at J.P. Morgan Asset Management, presented a set of charts highlighting the historic negative trends in government spending on our infrastructure. This persistent underinvestment has placed serious limitations on the US's economic growth and global competitiveness.



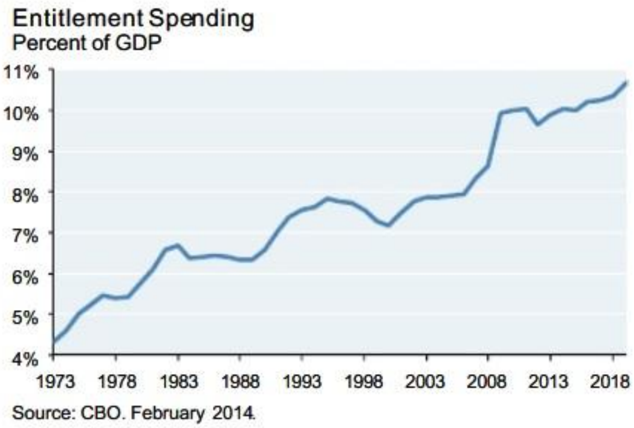








During this period of the dramatic underinvestment, there was a steady rise in government outlays for entitlement programs.

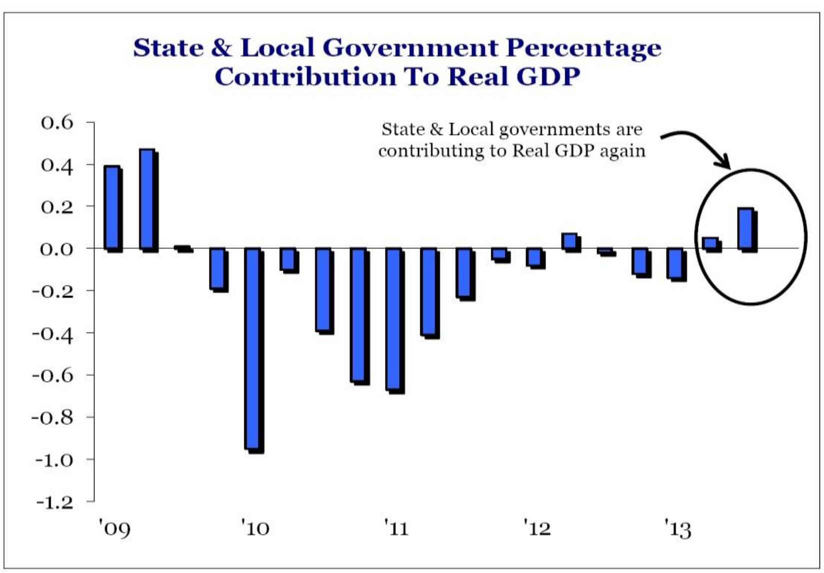


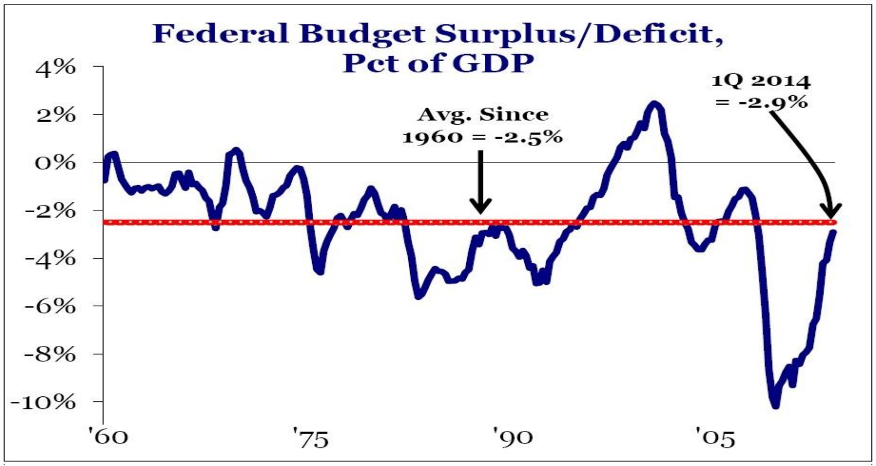
Unless the country is truly fatalistic, a revival in infrastructure spending must be forthcoming. The economic and social implications of this revival will be profound and investment opportunities plentiful and rewarding. The question then is not whether, but when?

In order to ascertain the timing of a pickup in fiscal outlays, three critical prerequisites must be present: societal need, ability to fund, and the political willingness to spend.

Having just undergone a period of tax increases, budget cuts, and sequestration, we are currently in an ideologically charged political environment. Thus, until the health of Federal, state and local budgets have been repaired, there will be a continued inability to fund infrastructure initiatives. There is little political will to enact meaningful fiscal stimulus if sizeable deficits persist.

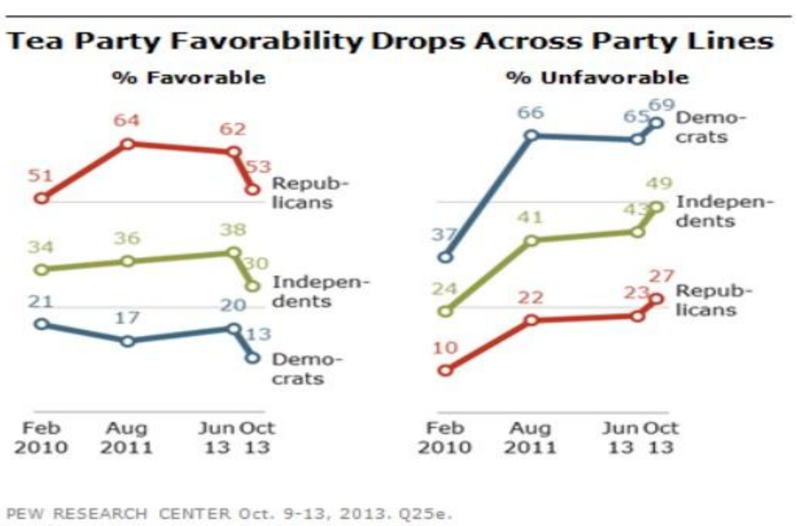
Fortunately, since the Great Recession, the economy has been on the mend. Federal deficits have decreased dramatically and state and local finances are showing encouraging signs of revitalization. The ability to fund and embark on spending programs has improved measurably over the past five years.



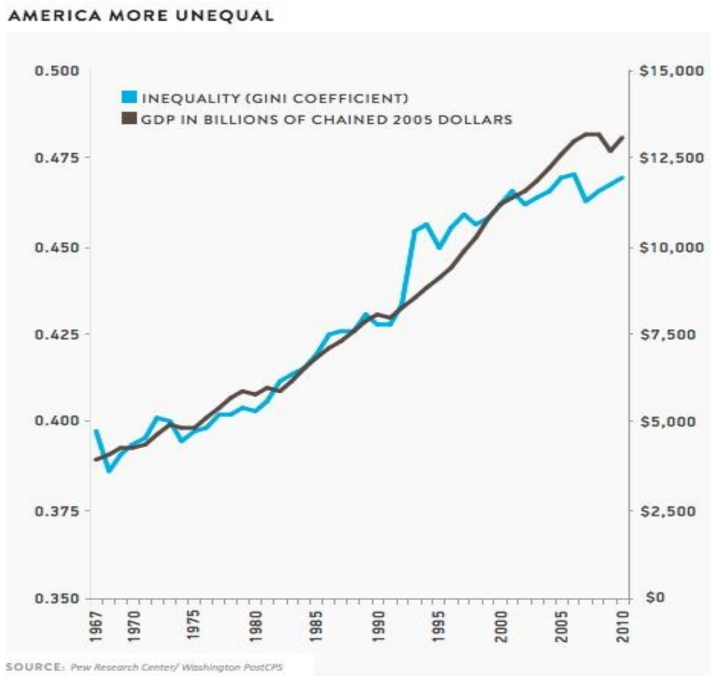


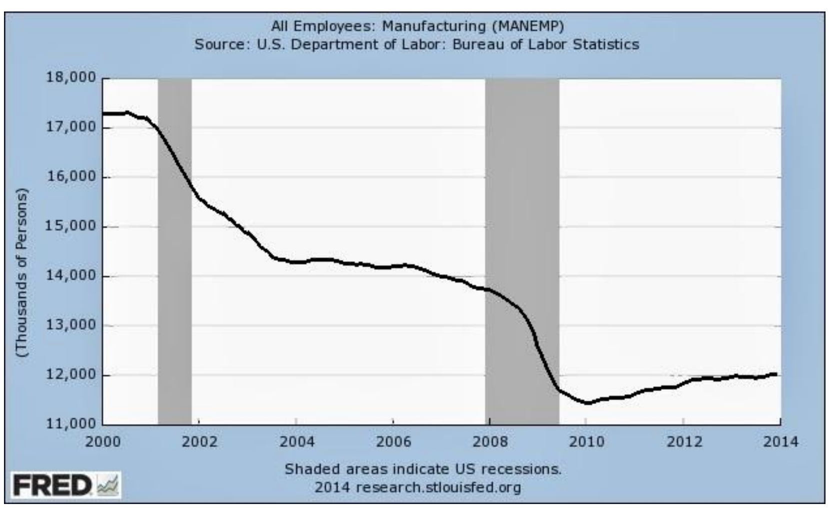
On the willingness to expend tax payer's money, there is little evidence that most politicians have lost much of their passion when it comes to providing for the voters back home. In spite of the enacted fiscal restraints, earmarks and amendments have abounded as most of the representatives in Washington jockeyed for their piece of the spending pie. The best example was the aid for the victims of Superstorm Sandy. The original relief legislation was put forth during the frugal period of budget sequestration. Initially, it allotted \$30 billion for businesses and households from North Carolina to Maine. After refinement, this rose to \$60 billion to include fisheries in Alaska and the Kennedy Space Center in Florida. Bowing to public pressure, the final assistance was cut back to \$50 billion. Watch what "parsimonious" politicians expend, not what they espouse.

Even though it has become increasingly apparent that the US is in need of massive infrastructure expansion and repair, the fiscally conservative Tea Party seems yet to be convinced. As we look at the ebbs and flows of their recent popularity, at both the Federal and local levels, it appears that their influence is beginning to wane. If the ebb continues through the 2014 and 2016 elections, the timing of economic stimulus from increased infrastructure spending could be approaching sooner than most forecasters anticipate.



While at first consideration implausible, one catalyst for improving the political sentiment on fiscal spending could stem, somewhat surprisingly, from the contentious debate on income inequality. The discourse and proposed solutions, thus far, have centered around policies of income redistribution with little constructive discussion on methods to increase middle class employment and incomes.





Over the next few years, an optimist could envision the toxic income inequality debate morphing from a political class-warfare conflict into a bipartisan battle with the victor proposing the best new job creation policies. Programs that would provide employment in the higher paying sectors of the economy could be enacted. The extremists of both the right and left persuasions could find it expedient to become more compromising and constructive. Ironically, increased fiscal spending could be the catalyst for compromise that begins to simultaneously heal; our infrastructure needs, political discord, and national anxieties.

Currently, our portfolios have limited exposure to this evolving growth theme with positions in Boeing, General Electric, Deere, Caterpillar and selected railroads. As the possibility of changes in the political environment and public policy nears, when the needs, ability, and willingness for fiscal expansion finally coincide, we intend to increase our investments in the transportation, power generation/transmission, energy delivery, construction and water sectors.

With enduring good wishes,

Alfred R. Berkeley	James Fitzpatrick	Hugh Fitzpatrick	Ken Berents	Steve Reynolds

PRINCETON CAPITAL MANAGEMENT, INC.* • *47 Hulfish Street, Suite 500, Princeton, NJ 08542-3713
Phone: (609) 924-6867 • FAX: (609) 921-9502 • info@pcminvest.com • www.pcminvest.com