THE NEW TWO POWER WORLD

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BE TEDDY BRIGGS
KEY POINTS

Tectonic plates are shifting globally.

2. Tax reform  Rebuilding the Arsenal of American Manufacturing
3. Trade  Re-orienting supply chain
4. Labor  That 70’s Show
5. Defense  Wake Up Call
6. Energy  *Structurally* Positive
7. Politics  1890s dynamics, in reverse
8. Debt Bomb  The Chickens are coming home
9. Regions and End Markets
10. What to Sell, What to Buy
#1

UNITED STATES VERSUS CHINA

Its a Two Power World
#1 UNITED STATES VERSUS CHINA

![Chart showing manufacturing employment trends]
#1 UNITED STATES VERSUS CHINA
#1 UNITED STATES VERSUS CHINA
#1 UNITED STATES VERSUS CHINA

China military spending\(^{(1)}\) in the Asia Pacific region likely exceeds the United States and continues to rise.

\(^{(1)}\) Adjusted for wage rates.
#2 TAX REFORM:

How To Explain the Benefits of Corporate Tax Reform to **ANYBODY** in less than two minutes.

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-tax profit</td>
<td>1,000,000</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Taxes</td>
<td>(350,000)</td>
<td>(210,000)</td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td><strong>650,000</strong></td>
<td><strong>790,000</strong></td>
</tr>
<tr>
<td><strong>INVESTMENT</strong></td>
<td><strong>5,000,000</strong></td>
<td><strong>5,000,000</strong></td>
</tr>
<tr>
<td><strong>ROI</strong></td>
<td>13.0%</td>
<td>15.8%</td>
</tr>
</tbody>
</table>

(1) Has been 100% effective to date including millennials. Has not been attempted with Senator Elizabeth Warren we put our probabilities at 1/1024th minimum!
#2

CORPORATE TAX REFORM

Rebuilding the Arsenal of American Manufacturing
#2 TAX REFORM: Proof in the Pudding....

Northern Ireland (1993)

- Rampant “Gang” Warfare
- 40% tax rate
- Disillusioned populace

Very similar to parts of Chicago.....
#2 TAX REFORM
Negotiate a cease fire\(^{(1)}\), slash the tax rate and attract capital and...

(1) Kudos to George Mitchell
#2 TAX REFORM
#3

TRADE

Re-orienting Supply Chain
#3 TRADE

**U.S. Merchandise Trade Balance (1895-2015)**

Sources: US Census Bureau, Department of Foreign Trade, Measuring Worth
#3 TRADE

China
- Key Rival
- Made in China 2025 targets multiple western industry positions

Germany
- It AIN’T about the trade imbalance
- Defense: Stop being sissies
- Iran: When we say get out, get out!

Mexico (and Canada)
- USMCA survives with tweaks. DT + AMLO both like deal
- AMLO wildcard (Airport cancellation – optics only or a sign of the future?)
- Mexico may benefit from U.S. in spite of itself
#3 TRADE

Made in China 2025

1. New advanced information technology (Silicone Valley)
2. Automated machine tools and robotics (Japan, Germany)
3. Aerospace and aeronautical (Boeing, UTX, HON, GE)
4. Maritime equipment and high-tech shipping (Korea, Japan, N. Europe)
5. Modern rail transport equipment (Alstom, Bombardier)
6. New-energy vehicles and equipment (Big 3, Japan, Cummins)
7. Power equipment GE, Siemens, others
8. Agricultural equipment Deere, Agco
9. New materials 3M
10. Biopharma and advanced medical --
#3 TRADE

Supply Chains Are Re-orienting

Rockwell Automation has already identified and set mitigation plans for $90MM China tariff impact ($0.40 per share) – ½ price, ½ buying elsewhere.

Others are waiting for mid-year to see how it plays out but their tone has changed.

They won’t admit it, but they like somebody standing up for them on the IP side.
LABOR

That 70's Show
#4 LABOR

The 40 year flood....

<table>
<thead>
<tr>
<th>YEAR</th>
<th>POP (Mil.)</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>750</td>
<td>US. W. Europe, Japan Two superpowers, 10-20% of world.</td>
</tr>
<tr>
<td>1972</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1979</td>
<td>+1,400</td>
<td>China</td>
</tr>
<tr>
<td>1989</td>
<td>+ 300</td>
<td>Central, Eastern Europe</td>
</tr>
<tr>
<td>1998</td>
<td>+1,200</td>
<td>India</td>
</tr>
<tr>
<td></td>
<td><strong>3,650</strong></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>United States</td>
<td></td>
</tr>
</tbody>
</table>
#4 LABOR

When a shortage isn’t a shortage....

- Participation
- Public Education
- Higher Education Vs. Vocational
- Healthcare
- Immigration
Myth: Labor Force Participation is Declining owing to Retirements
#4 LABOR

Fact: Labor Force Participation has declined owing to Bad Parenting!

<<<----- Very Bad Parenting

<<<----- Divorce, kids college debt, no savings?

<<<----- Sad.
#4 LABOR

Fact: And Perhaps Excessive Welfare Benefits
#4 LABOR

Public Education
Higher Education

Selected US Consumer Goods and Services, and Wages

Last 30 years administrators per student
Up 250% in the U.S.

The school I teach at should have $3MM of
annual overhead spend not $11MM.

And to be blunt about 1/3 of the students
really should not be in college but in a trade
program where they would graduate sooner,
learn more, and have no or little debt.
#4 LABOR

**Healthcare**
- Ongoing issue.
- We need cost innovation, we aren’t getting it.

**Immigration**
- Companies want to cherry pick
- Blue collar wants higher wages and respect
- Administration wants to move people to work from welfare
- Political opponents want clients

Labor Prices WILL continue to rise

Requiring automation and skill development
#4 LABOR

Higher wages require higher levels of automation

- Germany: $43.76
- Japan: $31.99
- Denmark: $45.48
- U.S.: $34.74
- China: $5.00

U.S. needs more.

(BLS statistics for 2012 ex China which is an L&C estimate)
#5

DEFENSE

Wake Up Call
#5 DEFENSE

It is all about China...

United States Versus China: $600 billion versus $215 billion

- Normalize China military wages to US base = 7x = $130 billion.
- Operations: U.S. must travel 5-10K miles just to get to the party.
- China spends primarily in Asia/Pacific, possibly outspending U.S. on an adjusted basis.
#5 DEFENSE

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>THE BIG STICK</strong></td>
<td>United States</td>
<td>595,472</td>
<td>(236,441)</td>
<td>(56,025)</td>
<td>122,590</td>
<td>436,113</td>
<td>(40%)</td>
<td>(10%)</td>
</tr>
<tr>
<td><strong>EUROPEAN THEATER</strong></td>
<td>NORDICS, POLAND, UKRAINE</td>
<td>38,690</td>
<td>9,037</td>
<td>32,913</td>
<td>56,755</td>
<td>21,716</td>
<td>23%</td>
<td>85%</td>
</tr>
<tr>
<td></td>
<td>UK, CANADA, FRANCE, GERMANY, NETHERLANDS, BELGIUM</td>
<td>200,161</td>
<td>63,024</td>
<td>194,167</td>
<td>326,209</td>
<td>205,381</td>
<td>31%</td>
<td>97%</td>
</tr>
<tr>
<td></td>
<td>ITALY, SPAIN, PORTUGAL, AUSTRIA, SWITZERLAND, GREECE</td>
<td>63,944</td>
<td>32,687</td>
<td>81,002</td>
<td>129,318</td>
<td>45,250</td>
<td>51%</td>
<td>127%</td>
</tr>
<tr>
<td><strong>MIDDLE EAST, ISIS</strong></td>
<td>SAUDI ARABIA</td>
<td>85,354</td>
<td>(72,876)</td>
<td>(66,636)</td>
<td>(69,397)</td>
<td>9,185</td>
<td>(85%)</td>
<td>(78%)</td>
</tr>
<tr>
<td></td>
<td>UAE, OMAN, KUWAIT</td>
<td>38,540</td>
<td>(25,863)</td>
<td>(19,554)</td>
<td>(13,225)</td>
<td>20,038</td>
<td>(67%)</td>
<td>(51%)</td>
</tr>
<tr>
<td></td>
<td>ISRAEL</td>
<td>17,512</td>
<td>(11,080)</td>
<td>(7,885)</td>
<td>(4,649)</td>
<td>37,431</td>
<td>(63%)</td>
<td>(45%)</td>
</tr>
<tr>
<td></td>
<td>TURKEY</td>
<td>17,669</td>
<td>(7,56)</td>
<td>7,701</td>
<td>16,157</td>
<td>7,128</td>
<td>(4%)</td>
<td>44%</td>
</tr>
<tr>
<td><strong>PACIFIC RIM</strong></td>
<td>JAPAN</td>
<td>46,346</td>
<td>47,983</td>
<td>94,098</td>
<td>140,913</td>
<td>(1,886)</td>
<td>102%</td>
<td>203%</td>
</tr>
<tr>
<td></td>
<td>SOUTH KOREA</td>
<td>38,640</td>
<td>(9,360)</td>
<td>5,279</td>
<td>19,919</td>
<td>24,036</td>
<td>(24%)</td>
<td>14%</td>
</tr>
<tr>
<td></td>
<td>TAIWAN</td>
<td>10,310</td>
<td>337</td>
<td>5,660</td>
<td>10,983</td>
<td>17,077</td>
<td>3%</td>
<td>55%</td>
</tr>
<tr>
<td></td>
<td>SE ASIA</td>
<td>38,159</td>
<td>10,606</td>
<td>34,888</td>
<td>59,371</td>
<td>31,037</td>
<td>28%</td>
<td>92%</td>
</tr>
<tr>
<td></td>
<td>AUSTRALIA</td>
<td>27,753</td>
<td>1,156</td>
<td>15,690</td>
<td>30,184</td>
<td>3,546</td>
<td>4%</td>
<td>56%</td>
</tr>
<tr>
<td><strong>OWN THING</strong></td>
<td>INDIA</td>
<td>51,116</td>
<td>(7,229)</td>
<td>14,715</td>
<td>36,659</td>
<td>30,705</td>
<td>(14%)</td>
<td>29%</td>
</tr>
<tr>
<td></td>
<td>PAKISTAN</td>
<td>9,246</td>
<td>(3,750)</td>
<td>(1,002)</td>
<td>1,747</td>
<td>9,404</td>
<td>(41%)</td>
<td>(11%)</td>
</tr>
<tr>
<td><strong>All</strong></td>
<td>1,278,953</td>
<td>(203,205)</td>
<td>334,669</td>
<td>872,543</td>
<td>696,150</td>
<td>(16%)</td>
<td>26%</td>
<td>70%</td>
</tr>
<tr>
<td><strong>Ex US</strong></td>
<td>683,481</td>
<td>33,236</td>
<td>391,594</td>
<td>749,953</td>
<td>460,047</td>
<td>9%</td>
<td>57%</td>
<td>57%</td>
</tr>
<tr>
<td><strong>Ex US, Saudi Arabia</strong></td>
<td>598,127</td>
<td>106,111</td>
<td>458,230</td>
<td>810,350</td>
<td>450,862</td>
<td>18%</td>
<td>77%</td>
<td>75%</td>
</tr>
<tr>
<td><strong>Europe</strong></td>
<td>302,795</td>
<td>104,748</td>
<td>308,520</td>
<td>512,292</td>
<td>272,348</td>
<td>35%</td>
<td>102%</td>
<td>90%</td>
</tr>
<tr>
<td><strong>EUROPE ex Pretenders</strong></td>
<td>238,851</td>
<td>72,062</td>
<td>227,518</td>
<td>382,974</td>
<td>227,098</td>
<td>30%</td>
<td>95%</td>
<td>95%</td>
</tr>
<tr>
<td><strong>Middle East Oil Producers</strong></td>
<td>123,885</td>
<td>(98,758)</td>
<td>(86,190)</td>
<td>(73,622)</td>
<td>29,223</td>
<td>(80%)</td>
<td>(70%)</td>
<td>24%</td>
</tr>
<tr>
<td><strong>Pacific Rim</strong></td>
<td>161,247</td>
<td>50,061</td>
<td>155,715</td>
<td>261,369</td>
<td>73,809</td>
<td>31%</td>
<td>97%</td>
<td>46%</td>
</tr>
<tr>
<td><strong>Ex Japan</strong></td>
<td>114,901</td>
<td>2,778</td>
<td>61,617</td>
<td>120,457</td>
<td>75,685</td>
<td>2%</td>
<td>54%</td>
<td>66%</td>
</tr>
</tbody>
</table>
Putin
The best fights don’t happen because the bully is deterred.

Does Putin look worried about European defense capability?

Europe
Under spending 2% commitment by $100 billion per year.

Under spending Cold War (1988) by $232 billion per year.

Defense Ministers of Norway, Sweden, Germany and Netherlands
#5 DEFENSE

U.S. needs to boost defense spend by at least $100 billion per year.

Europe as well, but isn’t. By rights it should be higher.

Japan government is raising spending within constitutional constraints and limited public support.
#6

ENERGY

Structurally Positive
#6 ENERGY

1. **Global** growth (even if slower)
2. **Venezuela** is a shambles
3. **Mexico** must recapitalize its energy assets
4. **Iran** sanctions
#7

POLITICS

1890’s Dynamics, In Reverse
#7 Politics

1890’s Dynamics, In Reverse

1. **U.S. (1890’s in reverse)** – socialists have (most) levers of power, populists want less government. Mid-terms broadly as expected.

2. **Germany** – Merkel going down, AfD at peak if centrists can take back CDU.

3. **France** – Macron’s star falling back to earth.

4. **UK** – remains a shambles. Theresa, Boris, Nigel, Jeremy.

5. **Mexico** – stay tuned.

6. **Canada**- you know, eh, its Canada.
#8

DEBT BOMB

The Chickens Are Coming Home to Roost

Source: Congressional Budget Office and Office of Management and Budget.
#8 DEBT BOMB

<table>
<thead>
<tr>
<th></th>
<th>2016 1.24%</th>
<th>Current 3%</th>
<th>LT Infl. 4%</th>
<th>1988 8%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Debt (rounded)</td>
<td>$21,000,000,000,000</td>
<td>$260.4B</td>
<td>$630B</td>
<td>$840B</td>
</tr>
<tr>
<td>Population</td>
<td>330,000,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households with income &gt;$30K (2014)</td>
<td>88,923</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>= Debt Per Person</td>
<td>$63,636</td>
<td>$789</td>
<td>$1,909</td>
<td>$2,539</td>
</tr>
<tr>
<td>= Debt per household &gt;$30K</td>
<td>$236,160</td>
<td>$2,928</td>
<td>$7,084</td>
<td>$9,446</td>
</tr>
</tbody>
</table>
#8 DEBT BOMB

Total Federal Spending 2015: $3.8 Trillion

- Medicare & Health: $1,051.8 billion - 27%
- Military: $609.3 billion - 16%
- Interest on Debt: $229.2 billion - 6%
- Veterans' Benefits: $160.6 billion - 4%
- Food & Agriculture: $135.7 billion - 4%
- Education: $102.3 billion - 3%
- Transportation: $85 billion - 2%
- International Affairs: $50.2 billion - 1%
- Energy & Environment: $44.8 billion - 1%
- Science: $29.8 billion - 1%
- Social Security, Unemployment & Labor: $1,275.7 billion - 33%
- Housing & Community: $61.5 billion - 2%
$630 billion, or 60-65% can be explained by increased welfare spending as a % of GDP.

Poverty ties to single parenthood and lack of education.

What works for Murphy Brown does NOT work for Yolanda.
#8 DEBT BOMB

I do not anticipate any massive instant cultural shift but there are things we can do over time, including... (* = pipe dream)

- Close Department of Education (saves $100B per annum).*
- Means testing of social security. (This will happen in 2028 because that is when Brian turns 65).
- Greater emphasis on healthcare innovation toward efficiencies (come on, Jeff Bezos!).
- Vocational versus college starting in high school for the 50% who don’t need college (or college debt). Companies getting off the “degree plus experience” pot which doesn’t work. Seeing signs already.
#9 Regions & End Markets

**Regional**


**LatAm** – wait and see on Mexico, constructive on Brazil.

**Europe** – 2% growth at best. China slowdown, Merkel going down is unsettling for Germany.

**China** – U.S. trade aggressiveness is having an impact. Capital wants out, badly.

**End Markets**

**Power** – good activity for suppliers (ex GE which is a shambles).

**Energy** – oil price pull back, talk of ending OPEC has spooked many. Reality is that large projects are still needed. Mining – strong.

**Construction** – benefitting from O&G, commercial activity and mining. Infrastructure bill is *highly* unlikely.

**Truck, Vehicle** – Class 8+, Auto =/-. EV for real.

**Agriculture** –

**Aviation** – Defense strength will continue. Commercial is strong + bus jet finally kicking in.

**HVAC** – steady but unspectacular growth likely.

**Automation** – EMR, ROK two of the most optimistic companies we follow. Also HON (the Amazon play).
#10 What to Sell, What to Buy

Fighting some headwinds. Weak EM currencies, slowing China, rising interest rates and valuations are fair to full.

<table>
<thead>
<tr>
<th>Company</th>
<th>Ticker</th>
<th>Current Price</th>
<th>Target/Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ametek</td>
<td>AME</td>
<td>$74.45</td>
<td>$80</td>
</tr>
<tr>
<td>End markets are strong. Cash machine. Go nuts below $70, fade at $80.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Honeywell</td>
<td>HON</td>
<td>$150.32</td>
<td>$160</td>
</tr>
<tr>
<td>“Me too” buy. High growth (+7 core in 3Q) owing to Intelligrated (Amazon) leverage. Load up at $140.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United Technologies</td>
<td>UTX</td>
<td>$130.71</td>
<td>$150</td>
</tr>
<tr>
<td>Executing against multiple headwinds – Otis pricing, GTF ramp. Risk of COL deal being dinged.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Emerson</td>
<td>EMR</td>
<td>$68.49</td>
<td>$80</td>
</tr>
<tr>
<td>Aggressive at/below $70. Strong process, rising backlogs, solid cash flow and strong balance sheet.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General Electric</td>
<td>GE</td>
<td>$8.59</td>
<td>Review</td>
</tr>
<tr>
<td>Trust in Larry Culp...he will figure it out.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Caterpillar</td>
<td>CAT</td>
<td>$126.91</td>
<td>$90-110</td>
</tr>
<tr>
<td>25% of last 3 years cash flow is under spending on capex versus depreciation.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dover Corporation</td>
<td>DOV</td>
<td>$86.42</td>
<td>$90</td>
</tr>
<tr>
<td>Could retest recent $90 high but cost cutting in a 4% GDP economy doesn’t seem right.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3M</td>
<td>MMM</td>
<td>$201.10</td>
<td>$200</td>
</tr>
<tr>
<td>Fairly valued after recent hiccup. FX, ERP, Roofing and Drug Delivery.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rockwell Automation</td>
<td>ROK</td>
<td>$169.27</td>
<td>$175</td>
</tr>
<tr>
<td>Grab’em below $160.</td>
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</tbody>
</table>