Investment Review and Outlook – Fall 2017

During the spring and early summer, we saw consumers exercise a considerable degree of restraint that now seems to have been reversed. In September, Americans flocked to the nation's car dealers, clothing and accessories stores, furniture outlets, and purveyors of food, beverage, health care products, and increasingly to the internet for their needs. The result was a welcomed recovery in retail spending from previous months, the best showing so far during 2017, even as a trio of hurricanes severely impacted a significant number of highly populated areas of the U.S. that are very important to the overall health of the economy.

The present aggressive consumer spending trend is a very positive development as we move into the important holiday shopping season and as employment levels continue to expand. Overall U.S. gross domestic product for second quarter 2017 was recently revised upward to 3.1%, the first time that measure has been over 3% since the first quarter 2015. And, surprisingly, today the Commerce Department reported its initial third quarter 2017 GDP estimate of another 3.0% advance, compared with a forecast of 2.7%, despite effects from the recent hurricanes. This six-month stretch of economic expansion is now the strongest since 2014.

A surprising double-digit jump in new home sales was recorded during September to a nearly 10-year high, as new home inventory continued to weaken. A much stronger-than-expected rise in durable goods orders was also reported. A continuation of the modest improvement in industrial production and factory utilization that we are currently seeing, along with projected consumer spending and investment in hurricane-related infrastructure projects and residential rebuilding, should support further economic growth into 2018.

The continuation of the current economic up-cycle, now in its 9th year, will likely be influenced by new business-friendly policies going forward. Tax reform will be very important, lowering the corporate tax rate from the highest in the world to a competitive level, a strong incentive for corporate America to repatriate the massive trillions of dollars held off shore for potential investment in the U.S. In addition, the easing of some regulatory hurdles that have previously stifled business activity has resulted in increased capital spending and new job creation. These and other measures should go a long way toward helping sustain the current expanding level of economic activity well into next year.

Recently reported Q3 2017 corporate earnings results have largely exceeded expectations and have validated the present upward momentum in the overall economy. We continue to monitor these reports carefully to determine how companies in our portfolio universe have performed and for indications about what might lie ahead for them.

A solid showing on the corporate earnings front very is important for the stock market bulls to be reassured. The market retains its resilience, with equities extending their gains on good news and often rebounding quickly following reports that disappoint, whether related to the economy, global matters, or some domestic political event. This sequence suggests staying power for the U.S. equity market. Given the present healthy economic backdrop, the case for stocks remains positive and we are optimistic about further progress during the months ahead. As the year winds down and we enter 2018, we are mindful of the likelihood of occasional periods of security price volatility that create opportunities to reposition portfolio holdings.

The market is currently on course to fashion a wire-to-wire gain for 2017, with key indexes continuing to press ahead. This is also most impressive, given the prolonged nature of the current bull market and the likelihood that the Federal Reserve may resume raising interest rates before yearend. But again, corporate fundamentals and the overall economy are on firm footing.

Meanwhile, geo-political concerns remain. At present, these center on the aggressiveness of North Korea in their missile testing activities, in direct defiance of United Nations warnings and economic sanctions. In early September, the United Nations Security Council unanimously adopted a US-drafted resolution to impose new sanctions on North Korea, a move that came one week after the rogue nation carried out its sixth and largest nuclear test. In addition, there are ongoing concerns in other international hotspots, especially in the Mideast region.

<u>Investment Strategy</u>: With overall positive economic fundamentals most likely to be in place for 2018, and perhaps beyond, our investment strategy continues to seek out high-quality companies, both in the U.S. and abroad, that have an attractive growth profile, a strong balance sheet, and are reasonably priced in the market. These are among the criteria that we employ during our research process as we strive to identify new investment ideas. Companies that qualify for inclusion in our client investment portfolios need to measure up to this research discipline and pass the test. This time-tested approach of carefully evaluating corporate fundamentals and the industries in which they operate reduces the element of negative surprise and provides a measure of downside protection when the stock market experiences periodic setbacks.

Mindful of the longevity of the present bull market run, we are being quite selective. Currently, our research is targeting companies in healthcare, financial services, aerospace/defense, and other capital goods sectors, along with transportation. There are also some interesting developments to study in the newer industrial technologies, such as robotics and in the cyber security-related world. Furthermore, there are potential investment opportunities with new high-tech entities that offer consumer-related goods and services.

Many companies within the above industries appear well-positioned to have continuing success, developing above-average revenue and profit growth, both in the short term as well as over the longer run. The careful addition of quality securities, including those abroad, remains a prudent approach to portfolio building. In fact, additional exposure in overseas markets, where economic expansion has improved nicely, is likely to be an even more important investment strategy during 2018 and beyond.

We welcome your comments or questions.

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