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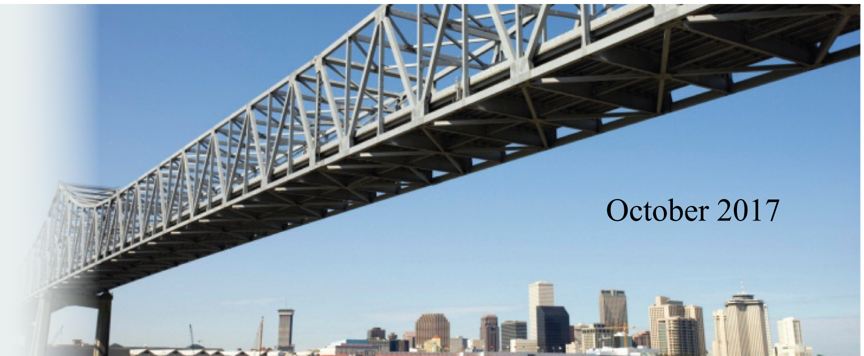

October 2017

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Economic Comments

The critical message coming from the Federal Reserve Bank's FOMC meeting in late September was the lowering of the rate-setters' long-run forecast for interest rates. Fed policy makers dropped their average prediction for long-run interest rates from 3.0% to 2.8%, thereby implying that if the economy were working perfectly, rates would not need to be as high to stop inflation from taking off. Normally, this pronouncement should be great news for the bond market, but instead investors seemed far more concerned about the prediction of another Federal Funds rate hike before year's end. However, this predicted rate hike is based on somewhat tenuous data as the Fed's preferred price gauge, the Personal Consumption Expenditures (PCE) price index, is not broadly supporting this additional rate move. The PCE price index rose 0.2% in August from a month earlier, yet the core index, excluding volatile food and energy prices, rose a more modest 0.1% on the month, less than most economists had expected. Meanwhile, personal income from sources like paychecks, investments and government benefits was up 0.2% in August.

A large unknown for both the Fed and analysts in general is the final economic impact of the devastating hurricanes to Florida, Texas and Puerto Rico. Many economists believe that the storms will appreciably depress economic activity during the third quarter with growth likely rebounding in subsequent quarters as rebuilding efforts take shape. As a result, prospects for 3Q17 growth have been substantially reduced to less than 2.4% from earlier predictions exceeding 3.0%.

Meanwhile, the most recent inflation report served as a warning that the current Goldilocks scenario could be coming to an end. While consumer prices rose 0.4% in August from July, much of the gain reflected hurricane driven jumps in gas prices. Core prices, which exclude food and energy, rose 0.2%, the biggest increase since February. The August figures end a run of abnormally weak inflation data that was starting to look more than a little unusual. With the U.S. unemployment rate low, the dollar weakening substantially, and the global economy being in the midst of an unusual synchronized expansion, all of these things should have been pushing inflation higher. Instead for much of the year, U.S. prices basically went nowhere.

Compared with a year earlier, headline prices rose 1.4% and so-called core prices were up just 1.3% - well below the Fed's 2% annual target and showing little evidence of a pending pickup.

As previously mentioned, price growth has been subdued in recent months, even with the unemployment rate hovering below 4.5%. Surprised central-bank officials had expected price and wage pressures to build in response to a tightening labor market. One-off factors, such as a sharp decline in prices for cell phone plans this spring, had been the scapegoats for the missing pressures while other policy makers have worried that the slump may reflect a shift in more fundamental forces.

Entering the 4th quarter, the Trump Administration finally laid out, in very broad strokes, its long discussed tax reduction and foreign cash repatriation plan. While there can be varied economic arguments to support tax cuts with deficits, central to the Trump plan is the idea that lower tax rates will create economic growth, thus added tax revenue, and that the nation's debt will remain

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basically unchanged.

Important to the potential passing of the Administration's proposal, previously fiscally responsible Republican Senators Bob Corker of Tennessee and Pat Toomey of Pennsylvania have agreed that next fiscal year's budget resolution could add $1.5 trillion over 10 years to deficits. One could argue that the economy needs stimulus, especially with the current unemployment rate, likely near as low as it can go without raising inflation pressure, and the Fed has been raising rates. However, we believe that permanently widening deficits is risky when the publicly held federal debt, now 77% of GDP, is on track to hit 91% in a decade as aging baby boomers start aggressively drawing on the entitlement programs of Social Security and Medicare. A $1.5 trillion tax cut would push debt levels close to 100%, according to one fiscal watchdog group. Mr. Trump and Congressional leaders came into office saying they were going to shrink, not expand, deficits. Despite the many recent economic speed bumps, though, the overall U.S. economy seems in decent repair. Time will tell what, if any, tax changes will ultimately be passed by Congress.

Market Comments

Wall Street continues on an almost unabated roll 8½ years since the last bear market growled. The just finished quarter clocked in an almost 4.5% gain, thereby bringing the year's S&P 500 return to more than 14.0%. Leading the herd has been the technology sector with a year-to-date advance of more than 27.3% as investors have grown increasingly enamored of the sector's prospects. Conversely, the much unloved energy sector has dragged down performance with year-to-date returns of negative 6.6% in the face of concerns about both near-term energy demand and the potential prospects of renewable power diminishing the longer-term fossil fuel demand paradigm.

As we look forward to the remainder of 2017, and start to anticipate 2018, history does offer a few clear lessons. Stocks have been overvalued, by long-term standards, for most of the past three decades. So, on average, you were more likely to have missed consistent gains than to have dodged a crash if you got out of the market entirely. Investors today who hold large positions in the hottest stocks of the past few years — including, but not limited to, the so-called FANGs, or Facebook, Amazon.com, Netflix and the parent company of Google (and which have largely driven the aforementioned YTD 27% technology sector advance) — should consider trimming their more out-weighted and/or more aggressive positions. The thing to remember is that in prior busts such as 1929, 1987, 2000, and 2008, the stocks that had previously gone up the most also tended to fall the farthest.

At least one prior market driver is fading for now. With the exception of the recent announcement from WalMart, stock buybacks are on the retreat after years of increasing steadily. According to S&P Dow Jones Indices, companies in the S&P 500 spent roughly $120 billion on stock repurchases in the 2nd quarter of 2017. While not a substantial decrease from the year ago period, it is the fifth consecutive quarter in which the trailing 12-month figure for buybacks has dropped. A bigger market driver, profit growth, is expected to rebound to 11% in the fourth quarter, although Wall Street's projections have been falling recently, especially the closer we get to announcement season. Projections for the third quarter, for instance, were as high as 7.5% in June but have recently shrunk appreciably following the previously mentioned storm season.

One Trump card, pun intended, for stock investors has been the low rate of inflation. The risk here is that investors are being lulled into a false sense of security. The calm of the 1960s was broken in 1967, when core inflation jumped more than 2 percentage points in just 12 months, and highly-valued stocks proved vulnerable. If the unexpected inflation boogie man again turns out to be lurking just off screen, Hollywood's scriptwriters may yet have a plot worth watching. As an aside, one meaningful contra indicator is giving cause for worry - the herd mentality of the retail investor. Recent surveys show that a near record 65% of retail investors are bullish about market prospects for the year ahead…..truly a cause for potential concern.

The most obvious market challenge for continued stock advances is stock valuations relative to earnings. At 18 times forward earnings, the S&P 500 discounts a future that is very similar to the last five years of steady earnings growth

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and low interest rates. That seems to be an overly optimistic outlook. The first place to look for a negative catalyst is geopolitical risk simply because an 18 times P/E market multiple clearly puts the odds of an unexpected shock at close to zero. To endanger the current market rally, such an event would have to hurt consumer confidence materially and/or raise the specter of inflation.

Uncertainty over Federal Reserve policy could also pull equities lower. The chances of this are greater now than at any point since the early 1990s, given that the Greenspan/Bernanke/Yellen era may be drawing to a close. President Donald Trump's choices for chair and Fed governorships could remake the central bank, or at the very least put in place a new team for markets to learn to trust.

While we are not trying to be overly pessimistic, we are trying to highlight the many concerns that exist after more than 8 years of persistent market advances. At its core, we return to our premise that investors stick to an investment policy and asset allocation that allows them both to meet their financial goals as well as sleep at night. After the last wonderful 8 years, we are far more likely to see some rocky times in the future rather than continued rosebuds.

Planning Thoughts

Following the massive data breach by one of the world's largest credit bureaus, we are all having to devote valuable time to better protect our personal financial information. In today's world, anyone who has ever purchased an item on credit has a credit bureau report. Without your approval, authorization or payment, there are three primary companies that collect and sell your personal information to other third party lenders: TransUnion, Experian and Equifax. Several weeks ago, Equifax belatedly notified the country that almost half of their clients' vital financial data (including Social Security and drivers' license numbers) had been stolen. With this information in hand, a motivated fraudster can readily do damage to many a credit worthy citizen.

To prevent this painful outcome, we believe that most people should have their credit files frozen or locked. By freezing or locking your credit information, the credit bureau is denied the right to release your information to any lender except for companies with whom you already have a business relationship. Because lenders will not open an account without checking up on you first, the locking of your credit data has the effect of blocking thieves from taking out new illegal loans in your name.

Despite the hassle, and modest cost, it is our recommendation that both young and old borrowers alike should implement a credit freeze or lock with all three major bureaus. TransUnion is offering a free "True Identity" service which allows you to lock and unlock your credit profile at will in exchange for some modest marketing on their part. Given the additional flexibility, and same level of safety provided by a credit freeze, we are recommending this option be considered for TransUnion. With either a credit freeze or a credit lock, you will need to remove the lock or freeze whenever you are seeking to acquire credit from a new lender. To put in place, and/or remove, a freeze with either Experian or Equifax, there is often a small fee which varies by state. Additionally, you will need to provide a previously provided (by the credit bureau) freeze code.

If you want to pursue these proposed freezes and/or locks, you will need to go to each company's web-site and type in credit freeze for Experian and Equifax and True Identity at TransUnion. While initially the three companies' websites were crashing due to the massive volume of requests, website responsiveness has substantially improved in recent days.

Having covered the what-ifs and how-to-do's of credit freezes/ locks, what else should you be doing to protect your financial records?

First off, you should check your credit reports for accuracy at least annually by going to the well named AnnualCreditReport.com website where you can access your credit bureaus from the 3 big firms once a year at no cost. If you check just one firm every 4 months, you can stay on top of the situation pretty much year round.

To prevent someone co-opting your Social Security account, you should go to SSA.gov and create a user ID and password to claim full control of your SSN number. Once you have your user ID and password in place, you should periodically check the reported data to make sure it is correct.

Additionally, you can reach out to your local Department of

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Motor Vehicles and request a copy of your driving report. If there are reports of accidents/activities that you did not cause, this would be a huge red flag that someone is driving around with a driver's license in your name.

Your bank accounts are unlikely to be at risk as a hacker probably did not steal sufficient data from Equifax to access them. That being said, two-factor authentication, if available, on your liquid financial accounts could make a lot of sense. In recent months, more and more firms have started offering this higher level of security. Consumers should also close any bank accounts that they are not using, as by leaving an open account dormant, you are inadvertently exposing yourself to more risk.

Other areas that can be of risk are tax refunds, but the IRS will currently only issue Identity Protection PINs if a fraudulent return has already been filed in your name. This is a problem that needs to be fixed but will likely rquire action by Congress to be remedied.

There are other services such as LifeLock that handle some/all of the protections we have discussed above – but at a substantial ongoing cost. If you take on the several items listed above, you should likely be fine. That being said, in today's ever evolving world, there are no guarantees short of keeping all of your cash in a home vault with all of your financial records. This approach, however, would only set you up for another set of potentially even worse headaches!

For those of you who have remaining concerns about identity theft in general, the government has an excellent web-site located at https://www.usa.gov/identity-theft. In any case, do not hesitate to call us if you would like to discuss this key matter in more depth.

Performance as of 9/30/17

	Close	Month	YTD	1 Year
DJIA	22,405.09	2.16%	15.45%	25.45%
S & P 500	2,519.36	2.06%	14.24%	18.61%
NASDAQ Comp.	6,495.96	1.05%	20.67%	22.29%

	Quarter end yield	Prior Year end yield	Yield 1 year ago
10 yr. U.S. Treasury	2.33%	2.48%	1.61%

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