

"Cup of Joe"

What a year! 2017 has come and gone much like spring time…in like a lion and out like a lamb. In this email update, we will provide an overview of the events that influenced the economic growth, how the markets performed, and what we see for 2018.

We began the year with a new administration in the White House. They came in with a big agenda which included many new ideas and policies. The primary objective appeared to be tax reform, and yes, this was recently passed by both the House and the Senate, then signed into law by the President. The major accomplishment of this tax reform act was the reduction of the corporate tax rate from 35% to 21%. This will help the U.S. companies compete in the global marketplace. How will this affect you, our clients? Let's use Apple as an example since this is one of your largest holdings and resides in most of our portfolios. Apple held the vast majority of their cash overseas to avoid the high U.S. tax rates. Note: they could only spend it abroad, so this really didn't help the economic growth inside the U.S. Now that we have lowered our corporate tax rates and provided a path to repatriation (a tax holiday of around 15%), Apple has the incentive to bring their enormous cash hoard (now at $260 billion) back to the U.S. and pay taxes at a much lower rate. This tax savings can do a number of things that will help you, the stockholders. They can buy back stock, essentially decreasing the number of shares outstanding, thus increasing the stock's value. They can increase their dividend, which means more money in the shareholders' pockets. They can buy other companies to help with their growth prospects and, in turn, increase the company's value. And, they can pay their employees more money, which the government is hoping for, to boost wage growth. All good things for the stock market. The other part of tax reform reshuffles the past tax brackets and gives (most) Americans a tax cut. The government hopes that this will increase growth by giving businesses and the consumer more money in hopes that they spend it. This is commonly referred to as "trickle-down economics". **Trickle-down economics, also referred to as trickle-down theory, is an economic theory that advocates reducing taxes on businesses and the wealthy in society as a means to stimulate business investment in the short term and benefit society at large in the long term.* But, one consequence of a tax cut that economists worry about is the $1.5 trillion-dollar addition to our country's deficit. This was not a revenue neutral plan (they did not develop any new forms of revenue to replace what they gave away) and the government needs to produce future growth to pay for the tax overhaul. Although history does not look too kindly at this form of fiscal stimulus, it remains to be seen whether or not this will jump start the economy and get us over the 3% GDP hurdle (the goal of the administration). We are hoping it does!

Next on the docket appears to be infrastructure funding. With an infrastructure bill, a proposed trillion dollars could be spent to fix our nation's roads, bridges, airports, train stations, etc. The hope is that with this trillion-dollar spending package, it would boost the economy as well. In any event, most people agree that the infrastructure is falling apart at a rapid rate and therefore it would be money well spent! Another boon to the stock market in the short-term. But, one must look at how this bill will be paid for as well. Risks of increasing the nation's deficit and/or overheating the economy, thus creating inflation, are considered negative side effects that could have far-reaching implications on how long this bull market lasts. With fiscal spending comes inflation (demand for goods increases too fast and they become more expensive). And with inflation comes the Federal Reserve raising interest rates that would put a damper on the market run. This supports our decision to invest in treasury inflation protected securities, or "TIPS", to protect against potential increases in inflation.

How do we see 2018 unfolding, you ask? Let's look at the big picture. Unemployment is at historic lows. Consumer confidence is at record highs. There is no inflation, yet. And tax reform was just passed. Those are all positive elements that give us confidence in the economy. In terms of the stock market, we do not believe the bull run is over. What we do believe is that it needs a breather. The market doesn't go up in a straight line and a market correction would be a welcome sight. We also believe that any meaningful pullback would be short-lived. If and when this does happen, remember that this is common and healthy for markets. What you should also remember is that you CANNOT time these pullbacks. If someone stayed out of the market in 2017 thinking valuations were too high, they would have missed out on a tremendous year. Let me say this again…you CANNOT TIME THE MARKET!

Oh, oh, oh, what about Bitcoin? *Bitcoin is a cryptocurrency and worldwide payment system. It is the first decentralized digital currency, as the system works without a central bank or single administrator. The network is peer-to-peer and transactions take place between users directly, without an intermediary. These transactions are verified by network nodes through the use of cryptography and recorded in a public distributed ledger called a blockchain. Bitcoin was invented by an unknown person or group of people under the name Satoshi Nakamoto and released as open-source software in 2009. We have had many clients ask about this recent crypto-currency craze.* While we feel this digital currency/technology could play a key role in the future, it remains a highly-volatile, highly-speculative asset that we do not recommend for our clients. While it's fun to watch the craziness, we feel there are far safer ways to make money.

With some volatility sure to enter the markets in 2018, we remain cautiously optimistic. Our portfolio moves worked great in 2017, with our increased volatility portfolios beating the S&P 500 quite handily. Apple had a phenomenal year, up (46%) year to date. A new addition, Golar GLNG (26%), also had a nice pop towards the end of the year along with FedEx up (34%). Looking ahead, we also love the new addition of Disney. With the increased box office success (Star Wars) coupled with its new push into streaming video and it's purchase of Twentieth Century Fox, we are excited to see what the next few years will hold. We are also feeling great about our strong move into international equities that have benefited from the current global synchronized expansion. Our two biggest holdings internationally have also outperformed U.S. markets, with Vanguards Developed Markets fund and American Funds New World fund producing 24% and 29%, respectively, for the year.

All in all, we remain confident in our approach, while remaining cautious in our assessment of this ongoing historic bull run as we head into 2018. We hope everyone had a wonderful holiday and will have a very prosperous 2018. And, as always, we thank all of our clients for their continued support and referrals. Please note: if you have received this e-mail from a friend and wish to discuss an investment relationship with our firm, please feel free to contact us.

*Disclosure: Chapel Hill Investment Analysts owns shares in DIS, AAPL, FDX, GLNG, VEA, and

NWFFX.

-Joe, Ryan, and the Chapel Hill Investment Team

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