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Money Managers You Can Trust

January 2018 Thoughts and Insights

We would like to start 2018 with wishes of health, peace and prosperity to you and your families.

From an investment perspective, 2017 was a great year. The U.S. economy continued to improve and unemployment dropped to 4.1% which is nearly a 20-year low. Inflation remained low which allowed the Federal Reserve to begin its buyback program and slowly raise rates. This equity-friendly environment caused the S&P 500 to surge +19%, which was three times more than many of the Wall Street projections. Fixed income and gold experienced solid returns as well.

So what should we expect looking forward? U.S. equity valuation levels may be high, but we still believe that based on fundamentals, stocks will continue to show strength through 2018. However, given the low volatility environment, we are still at risk for a sudden and swift move down, at which time we would look to deploy more cash.

Bull markets don't die of old age or over-valuation. Something negative, usually unwanted inflation, becomes the catalyst for a downturn. So, even though we are bullish for the next 12 months, there are a few topics that we will be watching closely.

<u>Geopolitics:</u> Even though we spent much of 2017 dismissing the market risk posed by geopolitics, the impact it poses may change in 2018. Entering 2017 many investors were intensely focused on the Brexit vote and the U.S. election, but the acceleration in global growth outweighed any potentially negative impact from either trade disputes or military threats. We want to be open to the possibility that the opposite could happen in 2018.

<u>Natural disasters</u>: While every year has its share of natural disasters, 2017 saw an extraordinary number of fires, hurricanes, typhoons, earthquakes and landslides. 2017 ranked as the most costly year ever for natural disasters. Despite the widespread destruction they leave behind, disasters tend to spur economic growth. An increasing wave of disasters may mean the repeated costs of rebuilding will begin to outweigh their boost to growth.

<u>Return of inflation</u>: Inflation is probably our biggest worry. Market prices continue to reflect a low risk that interest rates will increase enough to trigger a recession in the near future. Yet, global demand may finally start to exceed capacity for the world economy in 2018 as the world's output gap turns from negative to positive. The shift from excess supply to excess demand may lead to a rise in inflation just as it did the last time the gap turned positive in 2004. The market consensus is that inflation will remain the same as in 2017. In fact, of 74 economists tracked by Bloomberg only five expect even a half of a percentage point rise in inflation in 2018. So, given the very high degree of confidence among economists in there being no change, inflation has the potential to surprise in 2018. Some rise in inflation seems likely and will help lift corporate earnings, (and our cash interest rates). The big risk is that inflation surprises more significantly and forces central bankers to raise interest rates more quickly than anyone is expecting—this is what has ended many past economic and market cycles.

Whether or not these particular surprises come to pass, a new year almost always brings surprises of one form or another. We do know that having a well-balanced, diversified portfolio and being prepared with a plan in the event of an unexpected outcome are keys to successful investing. For now, we are enjoying the upward momentum of the stock market. But we remain vigilant.

Since everyone is talking about it, we want to write a quick note on bitcoin. In 2017, Bitcoin became one of the market's greatest speculative crazes. It remains to be seen whether it can live up to the hype, and DTIM will watch it and the other crypto currencies from the sideline.

Lastly, cyber security theft is very much relevant to our world, and we have attached another supplemental sheet on tips to prevent fraud. Coming soon, DTIM will also begin to use encrypted e-mail and use the ShareFile service that is located on our website to communicate account statements/forms. A few extra steps will be needed for you to access your information electronically, but we feel these steps are well worth the effort to protect you.

As always, we remain dedicated to serving your investment needs according to your goals. Please call or write with any questions or concerns you may have.

Michelle & Jim