

October 2017 Thoughts and Insights

Last week's news out of Las Vegas, combined with the devastation from the hurricanes, and now fires in California have weighed upon all of our hearts. Our thoughts and prayers are with everyone affected by these recent tragedies. In addition to these challenges is the massive data breach at Equifax, which affects almost all of us. Along with our usual thoughts on the markets, this letter will also cover some important facts regarding data security and some important steps to take.

Although it has been a challenging quarter for the human spirit, the 3rd quarter has been smooth for the markets. In fact, the economic backdrop has not really changed over the course of 2017. Growth continues to be steady and stock prices have been climbing. However, there is a certain nervousness and skepticism among investors as virtually all of the equity indexes are at all-time highs. With that in mind, we would like to address some of the key questions on our client's minds.

1. **How long can the US economy continue to grow?** In general, fast economic growth leads to short business cycles, while slow growth produces long business cycles. We are now into the 8th year of an environment of slow growth, so the economy remains strong and stable. In baseball terms, we would be in the seventh inning of this expansion, and we may go into extra innings as there are no hard signs that would indicate a recession is coming. Such signs would include lower demand for high yield bonds, high volatility, inverting yield curves and high unemployment, none of which are currently the case.
2. **When will the Fed raise rates?** Last week the Fed kept rates on hold, as expected, and announced the start of winding down its balance sheet. The Fed's comments were a bit more hawkish than anticipated, and we suspect there will be another interest rate hike in December. We expect rates to continue rising gradually as the economy improves. This is why we continue to focus on shorter maturities and higher coupons.
3. **What are the main positives and negatives from a political perspective?** We hear political questions most often, but the boring reality is that fundamentals influence market performance far more than politics. That said, politics can affect markets around the margins. From a positive perspective, we think an easier regulatory environment (fewer new regulations and less enforcement of existing ones) has been positive for equities. On the negative side, a lack of progress on President Trump's pro-growth agenda has been a headwind and has caused investor uncertainty. Looking ahead, we believe the president and Congress will come together on a modest tax cut, most likely a corporate tax reduction, which should provide fiscal stimulus.
4. **Are equity valuations stretched?** Equity valuations may be stretched relative to their own history, but a more important comparison is valuations versus other asset classes. Stocks are still a better option relative to bonds and cash.
5. **Where are the best investment opportunities in stocks?** Selectivity is always important, and it may be even more so now. Today we see the best investments in cyclical areas of the market such as technology, financials and health care.

As a reminder, our low volatility environment also has not changed which means that if there is a pullback, which would be normal, the decline may be swift and sharp. If this happens we will be ready to invest some of our cash at low prices as the long term trend is still higher and the prices will quickly revert higher.

Regarding the security breach at Equifax, it is yet another huge reminder that we must all remain diligent with our on-line data. We have only seen the tip of the iceberg relative to the Equifax debacle. As such, be proactive and remain vigilant to prevent becoming a victim. Listed below are some important things to remember regarding the security of your financial information.

1. Religiously read and scrutinize your bank and credit card statements every month. If you see something that does not look right, contact the institution immediately. They will generally suspend the payment of the suspicious transaction pending a more thorough investigation. If you have moved to all-online access (no monthly hard-copy statement), make sure you are thorough in reviewing transactions on a regular basis.
2. Use credit cards instead of debit cards. If someone has hacked into your world, a credit card offers a grace period in which you can review your statement before payment is due. However, if someone hacks into the debit card, the burden falls more on your shoulders.
3. Change passwords regularly and be careful of where you access Wi-Fi. If there has been a breach, determine what accounts are affected and immediately change those passwords. Furthermore, reduce your vulnerability to someone stealing passwords by not using public Wi-Fi. Public Wi-Fi allows keystrokes to be more easily monitored, allowing information to be stolen.
4. Monitor your credit reports closely. Not only can these reports have errors that can hinder your ability to get credit, but it's a good habit to be in to see what accounts have been opened in your name. This service is available for free on an annual basis by going to: annualcreditreport.com/index.action.
5. Evaluate a credit freeze. This offers the most serious level of protection. It literally freezes the ability for anyone, including you, to open new credit of any kind in your name or Social Security number. Although it works very well, it can also be a bit of a burden to undo. Allow yourself at least a week to lift a credit freeze once you have submitted the necessary information. This is important to consider if you plan on financing a new car or applying for a mortgage. It is also important to understand that a credit freeze does not stop someone from accessing an existing credit card and using it. As such, a second reminder to review your credit and debit statements religiously!
6. If you do become a victim of identity theft:
 - a. Contact the police and Federal Trade Commission. Although cybercrime may not involve a gun and masked robber, it is still a crime. To get needed protection, contact the local police and the FTC to obtain their official reports. These reports must go in your credit files. Not only does this help law enforcement track and catch criminals, but it is necessary for your protection, too.
 - b. Contact the Social Security fraud hotline (oig.ssa.gov/report-fraud-waste-or-abuse). In some cases, we have seen clients who have had their Social Security numbers used for fraudulent purposes. Depending on the level of severity, they not only had to prove their innocence, but then apply for a new Social Security number.
 - c. Put an alert in your credit report and send a copy of the ID theft report (consumer.ftc.gov/articles/pdf-0094-identity-theft-affidavit.pdf) to all the credit reporting companies. Although this may sound like closing the barn door after the horses are out, you want proper documentation that you have reported this and are working with the authorities.

We have covered a lot of ground in this newsletter, so if you have any questions or would like clarification on any of these points please don't hesitate to write or call. As always, we remain dedicated to serving your investment needs according to your goals.

Michelle & Jim