FROM THE DESK OF BOB CENTRELLA, CFA: ***January 10, 2018***

2017 Summary & 2018 Outlook

Wow! Need I say anymore about 2017 for the financial markets. **Happy New Year** to you and if 2018 is even half as good as 2017 it will be a great year! It was a record-breaker in every sense of the word for stocks no matter how you sliced it. The economy is humming along above 3% growth, never a dull moment in politics, and we are only a month away from the winter Olympics. It was a year where you had to search to find losing markets around the world. And here in the US, the Trump rally or whatever you want to call it continued unabated. So that's yesterdays news, what about 2018? Should we hang on or is it time to sell? Well I can't tell you in the first paragraph, then what will I write about? For that, you will have to read on for my 2 cents worth…

The 4th quarter of 2017 was a good one as we completed our 14th straight month with a gain in the S&P 500 and 20th out of the last 21. In some respects, 2017 was the equivalent of a perfect game in baseball. A full year, 12 straight months, of positive returns for the S&P 500. The first time since at least 1970. Not a single day in 2017 saw prices drop below the year-end 2016 close of the S&P 500. No 5% correction in prices since October 2016. Total return of 21% for the S&P 500 while the Dow had an even stronger year with almost a 28% return. (Total return includes reinvested dividends.) So, if you invested in the market at any time during 2017 (except the last day of the year ☹, you made money!

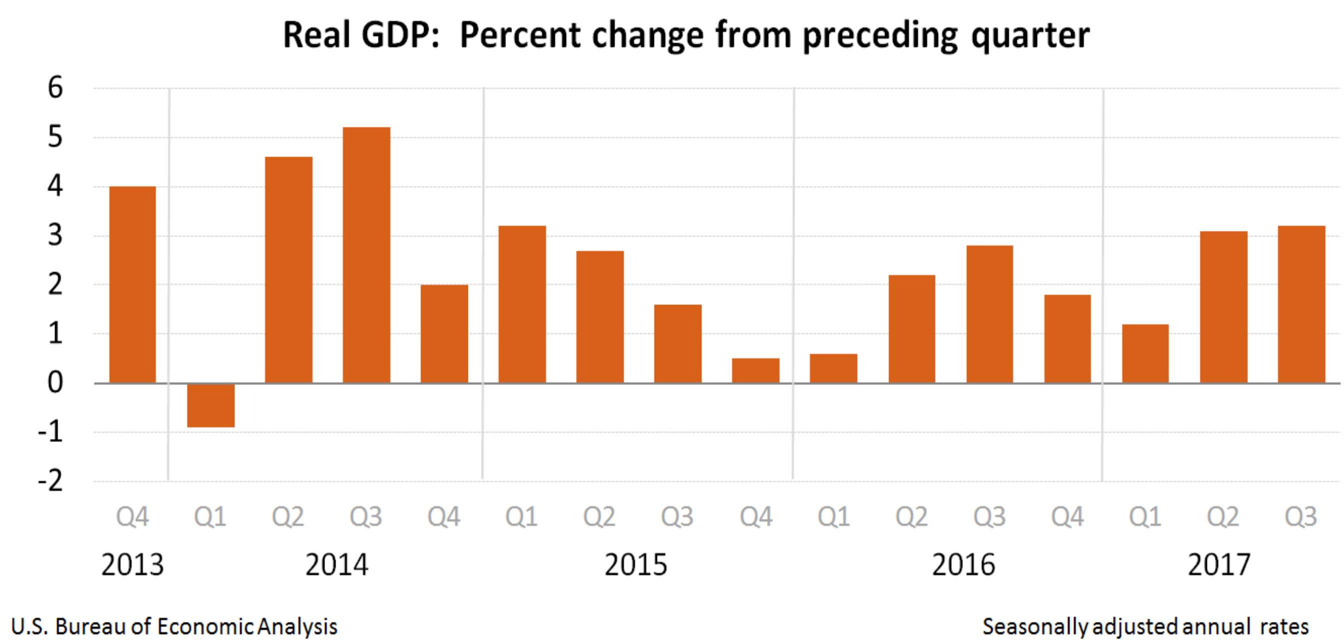
The number of new high records broken seemed to occur daily in 2017. But not all the fun was had in the US. There were many foreign markets which did much better than here in the US. Below in the 2017 scorecard for price gains for various asset classes. Bitcoin led the charge, rising 1,375% to close at 14,292 after reaching 20K in December. Bubble anyone? Meanwhile, good time to buy some OJ! Btw, last quarter you did well to buy lean hogs which rose 36% in Q4.

Asset Class	**2017 %**	**Asset Class**	**2017 %**
Bitcoin	1375%	MSCI Asia ex Japan	47%
Hang Seng	36.0	Copper	31.3
Austria	30.6	MSCI Emerging Mkt	29.0
NASDAQ	28.2	Sensex India	27.9
Bovespa Brazil	26.9	**MSCI World ex US**	**25.5**
Dow Jones	25.2	Diesel	21.8
S&P 500	**19.4**	Nikkei Japan	19.1
FTSE Singapore	18.1	S&P Midcap 400	14.5
Euro dollar	14.1	FTSE Italy	13.6
Gold	**13.6**	Russell 2000	13.1
Euro Stoxx	10.1	Lean Hogs	8.5
Silver	7.1	US Natl Muni	2.4
US Total Bond	**1.0**	7-10 Yr US Treas Bond	0.1
S&P Telecom	-6.0	Coffee	-7.9
Natural Gas	-20.7	Orange Juice	-31.4

ECONOMY

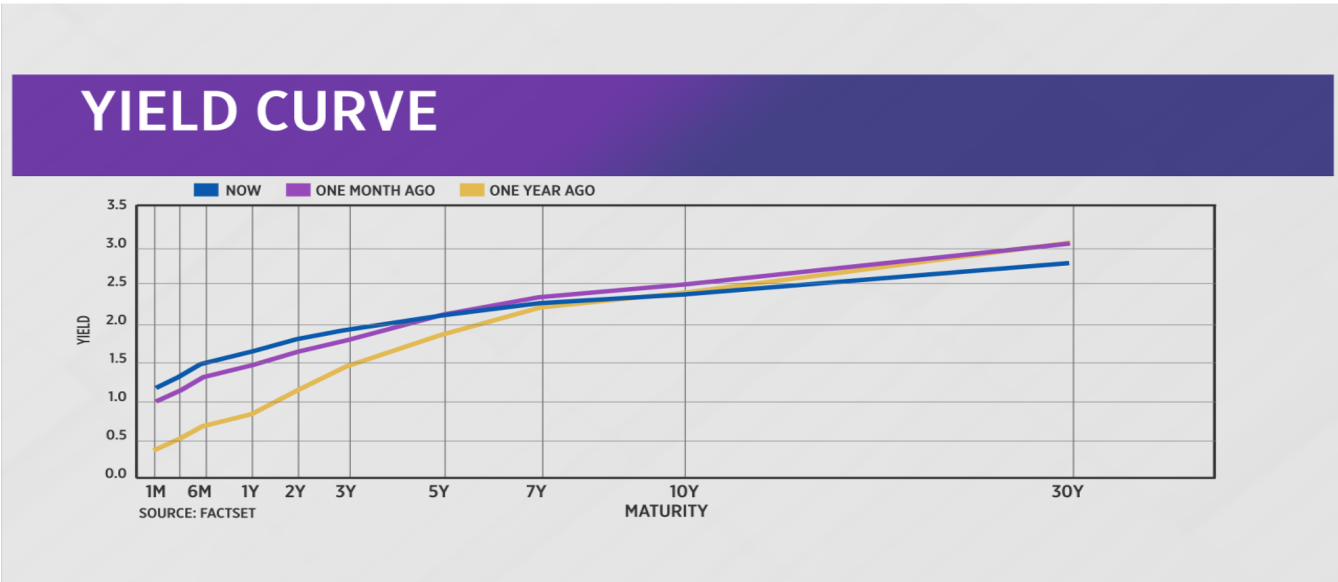
Q3 real GDP increased 3.2% following 3.1% in Q2 giving President Trump his first 2 official quarters of growth attributed to his administration at above 3%. The US economy is still plodding along in a stable fashion with unemployment near 4.1%, manufacturing growing and housing strong. As a reminder, for the last 20 years annualized real GDP growth has averaged 2.27%. The US economy is now entering its 9th straight year of growth but hasn't seen 3% annual growth since before the recession. Although 3% growth for the full year is not likely in 2017 due to a weaker Q1 (+1.2%), it is possible to see the next 2 quarters above 3%. The 2018 Tax bill is likely to have positive influences on growth in 2018 and 2019

as even though it may fall short for individuals it is very good for US companies. This could lead to the aforementioned GDP growth coming in at above 3% in 2018 and into 2019.



BONDS

One risk as we head into 2017 is there are some signs that inflation is picking up a bit closer to the Federal Reserve's target of 2%. The Federal Reserve will remain in focus as Jerome Powell becomes the new Fed Chair in the next month and President Trump fills several remaining seats on the Fed Board. Expectations are for 2-3 rate hikes in 2018 but there were some votes at the last meeting against further rate hikes. As the Fed has raised short-term rates, longer term yields have not budged much thereby flattening the yield curve. Further rate hikes without any parallel shift in the curve could cause an inversion which historically has been a precursor to a recession. How this shapes up in 2018 will be of great interest to investors and who fills the remaining seats may have an impact on that.



(Note: The top line from the left shows the flattening today compared to 1 month and 1 year ago)

As you know, I've been neutral on bonds for several years now and I will continue hold that view through 2018 as I believe the Fed will raise rates at least 2 more times in 2018 and inflation will finally kick up to 2%. Last year, bond yields were basically flat by year-end after spending the year in a tight trading range, thereby producing a return of the coupon rate. The 10-year UST started 2017 at 2.45% and finished the year at 2.41%. Geopolitical risk could still keep a lid on the 10-yr moving much higher but with rate hikes and a strong economy ahead the curve will either invert as I mentioned earlier, or the longer-term yield must rise. I now think the trading range of the 10-Yr TB moves up to 2.20%-2.95% with 2.5% and above likely for the near term. I wouldn't be surprised to see the 10-yr at 3% in 2018. Of course, I predicted this for a few years now … but I think it may finally happen.

Outside the US, economic growth is accelerating as world markets move to new highs. Easy monetary policy is still there but the ECB and the US Fed are beginning to pullback on bond purchases. Low rates outside the US could keep the 10-yr relatively attractive compared to other developed countries but it is possible rates rise around the world.

So, my recommendation for fixed income is still to be in short to medium term securities (1-3 yrs.), including corporates, agency and some floating rate debt. I'm wary on high-yield as spreads have tightened and with US rates moving up, HY debt becomes less attractive. I'd still stay clear of longer-term maturities for now as you risk price erosion and capital depletion. The bond bull market may finally be over for now. Look for 2018 to be flat overall, but still necessary part of a balanced portfolio as a hedge.

STOCKS

As I said last quarter, let's cut to the chase. Are stocks overvalued? I said I didn't believe so then and I'm sticking to that theme for 2018. What can drive stocks higher in 2018? First, the economy remains on solid footing, second, corporate profits will be strong, third less regulation as a result of executive orders should help companies in many industries, especially financials and fourth, the tax reform bill gives an added 6-10% increase in earnings. Although stocks rose 20% in 2017, earnings are likely to have grown 12-14% during the year. Given the added cushion of earnings from the tax reform bill, you can argue that the earnings multiple on future earnings is similar to where we started 2017. In 2018, corporations are expected to deliver another year of double digit earnings growth. Finally, a wildcard the Trump Administration holds is an infrastructure bill. Look for this to be talked about or enacted heading into the midterm election. If so, this will be good for 2019 earnings.

I will give you that the market is not inexpensive. But at 18.4x forward EPS, it's not crazy expensive either. I also think a pullback of 5% would be healthy for us to reset some valuations. My biggest concern is the level of bullishness among investors. The recent AAII investor poll saw bearishness at a very low level. A healthy dose of skepticism is good for stocks, and we don't seem to have that at the moment. That has translated to a lack of volatility and possibly complacency among investors. If we do get a pullback, will it be met with buying as we've seen in the past year or will investors panic sell to lock in gains?

Having said all that, I too believe that 2018 will be a good year overall. I'm going to go out on a limb and say that we will have a down month or 2. But by the end of 2018, barring an unforeseen political or geopolitical event, I look for double digit returns in stocks. Not all stocks will react equally, so it should be stock pickers year.

You may see a healthy rotation to different sectors based on valuation, so I still favor a diversified approach. I continue to like financials, industrials, energy and technology stocks balanced out with the other more stable sectors. Materials stocks could also do well with any infrastructure bills being passed. On the oil front, the price of WTI Oil finished the year on the upside with a barrel quoted at $60.42, a gain of 12.5%. It appears the OPEC agreement to limit supply is working to stabilize oil prices. If the price stays in the $60's or higher, Energy stocks should have a good comeback year. Regarding foreign stocks, with Global GDP accelerating in 2018, I recommend exposure to international stocks through broad-based ETFs as the easiest way to own companies rather than individual equities unless you have the time to do the research. I also like exposure to Mid and Small cap stocks here and abroad.

SUMMARY

In summary, Forza's recommendation remains consistent as before – we still like equities, are cautious on bonds but would maintain both in the overall allocation of assets for balanced portfolios. On a fundamental basis, we prefer equities to bonds and would have exposure to international stocks and bonds. With the S&P 500 having moved up 20% in 2017, we're looking for stocks to rise with expected corporate earnings growth. And we expect earnings growth to be double digits in 2018 due to a solid economy and effects of the tax reform bill. Corporate earnings are upon us and we should keep an eye on what the outlooks are and how they may spend any repatriated cash from abroad.

Regarding bitcoin, I have no predictions to make as I still don't understand the whole thing enough. I imagine it will be very volatile and you will get some consolidation at some point. There will be winners and big losers. Be careful. I did consider changing the name of my company to **Forza Blockchain Investment Advisory** as I'm sure I would drum up millions of new business! But I decided to forge on as is. (Just kidding 😊)

I hope you avoid the flu (I didn't) and enjoy the winter. Feel free to email or call at 908-344-9790 if you want to discuss anything.

-Bob