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Greetings,

The past year was about the closest thing to perfection for the market, as the broad market had a positive return each and every month. That was the first time that has ever happened. There wasn't even a 3% pullback last year. I am not sure if that was a good thing or not. In past years, clients on occasion would ask me what I thought the market returns would be for the coming year. Now, we all know not to ask that question since no one (including yours truly) can accurately predict market returns over a one year period. Since the market had such a furious rally in 2016 post-election, many of the talking heads thought that the 2016 late year rally would take away from last year's gains. Of course, that did not happen. While I detest being a wet blanket (I like that term), I do not expect the coming year to resemble the past year in any way, shape or form. I expect at least one pull back of 3% and most likely, a 10% correction in addition to that pull back. Historically, that is normal. With both short and long term interest rates going up, I expect an increase in volatility.

After a post-recession 7 year snooze, the economy is showing serious signs of life. The GDP growth rate for the past 2 quarters was just over 3%. It is expected to be in the 3% range for the fourth quarter that was just concluded. We are now looking at the strongest growth numbers in 12 years. The unemployment rate is at a 17 year low. Inflation is under control and interest rates remain low, for now. Stock market valuations are stretched. Corporate profits have been strong and are expected to receive a boost from the tax bill that was recently signed into law. While it is true that the market is a bit on the pricey side, in this low inflation, low interest rate environment, with an economy that is picking up steam, stocks warrant a higher valuation than in past years. The global economy is also improving which is also a reason why the stock market did so well last year.

During the past couple of years, on occasion, I have heard from people who have called this stock market a "bubble". When asking these people why they thought it was a "bubble", the response generally was more emotional than logical. In my view it was a lack of understanding as to what is happening and just as importantly, not knowing the strength of the companies that make up the market, in addition to what we own. The last stock market "bubble" was in 1999 and early 2000. It was a terrible time for me to be an investment advisor. The reason being was because many technology companies with no earnings (and some with no revenue) were having its stock prices double and triple within a year, sometimes less than a year. Other large cap technology companies that had strong earnings growth were having its prices go up too much and way too quickly. Wall Street "analysts" who should have known better got the speculative fever and were raising their price targets which further stroked the flames which pushed the prices up even more. The PE (price to earnings) ratios for these large cap technology companies were two to five times higher than they are now. This market doesn't resemble the market of the late 1990's and early 2000 in any way whatsoever. Anyone who believes that this market is a "bubble" simply does not remember what that market was like. I do remember.

The biggest change to the tax code since 1986 was signed into law two weeks ago and will take effect in 2018. There are many details that still have not been released. I wrote much about the tax bill in the last investment letter. I wrote that I had mixed feelings about it and I still do. Rather than go into details (If I did, this letter would be way too long), I will send out a letter next week with my thoughts on it. For now, I will say on the negative side what bothers me the most is the complexity of it. The politicians promised that it would make things simpler but instead, it is more complicated than ever. What also bothers me is that politics entered into it as much as economics. Since it was written totally by one party (the Republicans) this should not have been a surprise. On the positive end, I believe the overall economy will be better off with the new law than before it was signed, at least in the short run. I believe that the stock market will do better because of it in both the short and long run. The stock market will greatly benefit from the territorial tax system, repatriating the cash abroad and the much lower corporate tax rates.

If you have any questions or anything that you would like to discuss, please by all means send me an email or give me a call.