Quarterly Client Newsletter

4th QUARTER 2017 REFLECTION

BY ALEC BETHURUM
SR. PORTFOLIO MANAGER

2017 will likely be a year that is remembered for the strong returns in Equity Growth Stocks. Lead by several well-known and widely owned tech-oriented stocks, the S&P500 realized very strong full year returns. This certainly has surprised the pundits who predicted negative investor sentiment fueled by a highly contentious political climate at home and a hostile geo-political environment abroad. However, there is an old adage on Wall St. that a bull market climbs a wall of worry and this was certainly the case in 2017.

So, let's look at the positive news from 2017 that lead to the rally. First, sparked by a significantly less restrictive regulatory environment, domestic GDP saw a strong up-tick in 2017 with continued acceleration into the back half of the year. Since the end of the recession, US GDP had averaged 2.1% growth on an annualized basis. Last year, GDP rose to 2.53% for the full year, with the last two quarters averaging 3.1%. On a global basis, we saw analyst estimates for 2018 growth rise from 2.6% to 3.2%. This increase contributed to rallies in both European and Emerging Markets stocks.

The second driver to the accelerated returns in US equities was the recent passage of domestic tax reform, and the anticipation of this reform. The most important element of the recent legislation was the significant reduction in corporate tax rates from 35% to 21%. This is significantly accretive to corporate earnings (the E in P/E ratio), and thus is immediately supportive of higher equity prices. As Warren Buffet smartly remarked on CNBC, the government is essentially a part owner of the profits of every domestic business through taxation. In 2017 they were a 35% owner. In 2018 they are a 21% owner, which leaves a bigger portion for all other shareholders and increases the value of that stake. The new law also provides opportunities for multinationals, like Apple, to repatriate large amounts of cash generated by international earnings at more favorable tax rates. This influx of cash should generate increased capital expenditures and additional debt retirement and stock buybacks, all good things for equity holders.

In fixed income, bears continue to call for an end to the now 37-year bull market in treasuries and high-grade debt. On this front, we have continued to be very cautious and have sought out more specialized securities to gain exposure to bond-like yields while trying to avoid the negative risk/reward characteristics of more traditional exposure. Broadly, this approach was successful in 2017 as various Preferred Securities and Baby Bonds performed well.

As we look forward to 2018 we are cautiously optimistic on domestic and international equities driven by a continuation of the trends mentioned above. We are also excited to continue to expand our stable of potential opportunities in several additional alternative investment vehicles. In addition, we recently increased exposure to Reinsurance, as the significant number of events last year resulted in an increase in insurance pricing and thus greater expected returns to investors. And, we added exposure to our market neutral funds which have the potential to generate returns regardless of stock market direction.

We look forward to another profitable year for our clients and remind you to look out for information on our quarterly conference call where we will address some of the other events of Q4 including the tax reform bill and BitCoin.

TAX REFORM TIP
BY ZACH EMSLIE, CFP®

To help clients better understand the recent tax reform changes, we've posted a useful reference sheet on our website. The changes are too numerous and detailed to cover in this newsletter, though we'll mention one interesting and lessor known aspect of the bill related to a rule change allowing 529s to be used for elementary and secondary education expenses including tuition.

The allowable state tax deduction associated with 529 contributions varies state-to-state, so its applicability depends on your state of residence. For those who live in states such as Kansas and Missouri, making contributions to a 529 to cover tuition costs can result in a state tax savings. If you are not funding a 529, but find yourself paying for educational expenses, this is a benefit worth exploring. Please contact us or check with your tax professional for guidance.

2018 QUARTERLY INVESTOR CALLS

- Tuesday, January 23
- Tuesday, April 24
- Tuesday, July 24
- Tuesday, October 23

All webinars will begin at 10am CST.

To register: 816-531-2254 or info@sterneckcapital.com

WIRE REQUESTS AND STANDING INSTRUCTIONS
BY REGAN ERVIN, CHIEF OPERATING OFFICER

To further ensure the safety of client assets, we will be conducting verbal verifications on every wire request, which include third-party disbursements as well as like-titled requests. Standing transfer instructions are exempt from this level of verification, except when initially being set up. Also, in the rare case standing instructions to third-parties are requested, we will adhere to specific guidelines outlined by the SEC, which largely require us to over-communicate the status and activity related to having these types of instructions in place.

MUTUAL FUNDS
BY FRANK STERNECK, CO-FOUNDER & CHIEF INVESTMENT OFFICER

Many of you have observed the inclusion of mutual funds into your portfolios, prompting the question, "Why do you like mutual funds today?"

The answer is not so much a function of us changing our views (both positive and negative) toward the mutual fund structure, but rather, there are numerous unique strategies that previously were available only through private, institutional channels, now being offered in a mutual fund structure. Not only do these funds offer more liquidity than their private predecessors, but in many cases the fees are considerably lower. Many of the mutual funds we find attractive fall into the non-correlated arena, which is unique to other asset classes in your portfolio. Being we are agnostic regarding security selection, you can be sure the inclusion of any funds to your portfolio is because we believe it will contribute positively toward meeting your goals.

Your entire SCM team and I wish you and your loved ones a healthy and prosperous 2018!