WINTER NEWSLETTER 2017

Blue Bell
PRIVATE WEALTH MANAGEMENT

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Letter to our Clients

2017 turned out to be a much better year in the equity markets than anyone had predicted. We have been advocating alternative ways to reduce risk versus the typical bond allocation. Just remember, reducing risk especially in markets that are accelerating quickly will reduce overall returns. This is exactly why we have been advocating the allocation of options and structured investments as a means to hedge as opposed to the more common bond allocation strategy. While both forms of hedging will reduce earnings in a rapidly rising market, the use of options and structured investments provided us the opportunity to have greater returns than bonds did. For example, the Barclays US aggregate Bond Index only increased 3.54%. Although Options and Structured Investments reduce portfolios' return potential, they still provide favorable returns in numerous market scenarios relative to the traditional equity/bond mixed allocation.

A more important discussion is our expectations for the upcoming year. We continue to believe that one must manage risk tolerance and continue to focus on long-term goals. When selecting investments, we attempt to determine what can go right, but more importantly what can go wrong. If necessary, we determine whether we are willing to forgo some possible profits in order to mitigate losses during declining markets. Risk goes both ways - typically driven by emotions of fear and greed. Over the last few years, those who tended to be too conservative have given up substantial gains. As a result, many investors are beginning to chase returns. Other investors still assert that the market is too high, and are waiting for a correction until they enter. On the other hand, overly aggressive investors have the opportunity to earn more substantial returns (as occurred during the dotcom bubble of 1998). However, many of these aggressive investors gave back not only their profits, but in many cases have substantial losses with a market correction. The significant losses realized by aggressive investors were exemplified in 2001 and again in 2007-2008.

It would appear that predictions for global stock markets today are predominantly positive, with plenty of room for continued upside performance. The perennial bears continue to attempt to attract headlines with overly negative predictions, in many cases caused by a black swan event. If you make 100 outrageous predictions, and two of them come true, you are certainly not correct. Naturally, this philosophy is no way for any serious investor to approach the management of their portfolio.

Letter to our Clients (Continued)

I am always looking to uncover value in my investment approach. While it becomes more challenging when every day we see the market reaching new highs, I feel that there are always opportunities for those who exercise due diligence and do their homework. In the short correction in January 2016, a distant memory for most, our investment strategy, combining closed-end funds, etfs, and options, along with buffered structured investments worked exactly as intended. In most cases, closed-end funds performed the worst due to widening discounts. However, these funds became better values since new investors were able benefit from the larger discounts and were our top performers going forward. Buffered structured investments with 10% downside protection in a laddered portfolio helped reduce the impact of the swift market decline. Option writing strategies helped offset the decline in the underlying ETFs as was intended. There is not one of us who can truly time a correction, thus being prepared is what a successful money manager must do.

We are pleased that we had very few investors overly concerned during that short correction. Hopefully, this is due to clients understanding our investment approach. We will experience a 10% or greater correction at some point and when that happens, sentiment will change and investors will become fearful and make foolish decisions. While we do not want a correction, we know it is inevitable. In many ways, corrections provide opportunities for investors who stay the course.

We see continued strength in the economy and corporate earnings. The addition of the new tax bill should have a substantial positive impact on consumers, most industries, and especially companies who have significant cash reserves overseas.

Repatriating this cash back to the United States should have a substantial impact on these companies. You may wonder what the corporations will do with this cash and their increased profits. The answer is that some have already given a portion of these savings to their employees in the form of bonuses for non-management personnel as well as increases in salary. Others may, and most likely will, increase share buybacks. This will enhance shareholder value. Many more firms will increase their dividend payments to shareholders. All of these uses should be very beneficial to the companies as well as their shareholders. In other words, it is likely that one of the best ways to benefit from the new tax bill is through equity investments.

In addition to these favorable actions, increased government spending on infrastructure, if done intelligently, should spread the benefits for many years. Not just stockholders, but everyone in the United States will experience these benefits. All of this being said, we believe we should stay invested in the stock market, avoid the bond market, and use sensible downside protection to reduce volatility.

Please remember to contact us with any changes in your personal or family situation. We appreciate the confidence you place in us. Wishing all a happy, healthy, and prosperous new year, we remain thankful for all of you.

2018 Wall St Projections

As 2017 comes to an end, we like to take a look back at the projections for the S&P 500 index that top Wall St. strategist made for the year and what they are expecting for 2018. Returns in the S&P 500 were propelled by optimism of corporate tax reform and a strong earnings season finishing the year with a 20.49% gain. The average projection among strategist for 2017 was a 4.12% gain in the S&P 500. The chart below contains their 2018 projections for the index, as well as their 2017 estimates. As a group, the average for 2018 is a 7.51% gain in the S&P 500. Analysts point to continued earnings growth, positive impacts of corporate tax reform and a strong global economy as a reason to remain bullish moving forward. Comments from each of the strategists can be found beneath the chart below.

Firm	Strategist	2017 Projection	% off target	2018 projection	2018 change %
Goldman Sachs	David Kostin	2300	-14.47%	2850	5.99%
Citi Group	Tobias Levkovich	2325	-13.54%	2800	3.96%
Deustche Bank	Binky Chadha	2350	-12.61%	3000	11.57%
UBS	Keith Parker	2300	-14.47%	3300	22.72%
Credit Suisse	Jonathan Golub	2300	-14.47%	2987	11.08%
Canaccord Genuity	Tony Dwyer	2340	-12.98%	3100	15.28%
Societe Generale	Roland Kaloyan	2400	-10.75%	2500	-7.03%
Morgan Stanley	Mike Wilson	2300	-14.47%	2750	2.27%
Piper Jaffray	Criag Johnson	2424	-9.85%	2850	5.99%
BMO	Brian Belski	2350	-12.61%	2950	9.71%
JP Morgan	Durbravko Lakos-Bujas	2400	-10.75%	3000	11.57%
Bank of America	Savita Subramanian	2300	-14.47%	2800	4.13%
RBC Capital	Jonathan Golub	2500	-7.03%	2625	-2.38%
Oppenheimer	John Stoltzus	2300	-14.47%	3000	11.57%
Jefferies	Sean Darby	2325	-13.54%	2855	6.17%
BlackRock	Kate Moore	2400	-10.75%	N/A	N/A
Average		**2350.875**	**-12.57%**	**2891**	**7.51%**

***As of 12/19/17**

Goldman Sachs, 2850

"The current equity market valuation is certainly stretched in historical terms but it does not appear unreasonable based on the high level of corporate profitability. The return on equity (ROE) of the S&P 500 equals 15.4%, which typically corresponds with a price/book multiple of roughly 3x. The index currently trades at a modest premium of 3.3x. Looking ahead we forecast ROE will expand to 17.5% in 2018, supporting an increase in valuation from the current level".

Citi, 2675

"We suspect that investors may not be willing to accord the same P/E for earnings generated by a lower tax rate versus one for underlying operating performance. Nonetheless, even if we assumed half the market multiple on the incremental tax-related EPS gains, it will still be additive to the S&P 500's upside potential."

Deutsche Bank, 2850

"The uptrend in global stocks is set to enter its tenth year in March 2018. "Market participants could demand a higher risk premium on account of the already longstanding cycle," said Chadha. Nevertheless, the outlook is interesting due to the strong global economy: "We believe that prices could continue to rise, possibly even beyond 2018"

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UBS, 3300

"We think our upside case, based on Congress delivering a tax cut, is more likely than our downside scenario and upside potential (S&P 500 at 3,300) outweighs the downside case by 2x," Parker said. "As the Fed continues to hike, equity valuations are seemingly pricing in higher rates, but not pricing higher expected medium-term profit growth or lower fundamental earnings volatility."

Credit Suisse, 2987

"P/Es have historically moved higher until the 10-year Treasury reaches 5%. However, the research presented in this note shows that this tipping point has likely fallen to 3 ½%, in response to the current slower-growth environment. With Treasury yields below 2 ½% today, this implies that stock valuations will not be challenged by rising rates for quite some time."

Canaccord Genuity, 2800

"We have remained focused on our 2018 S&P 500 (SPX) target of 2,800 and deemphasized the close proximity to our 2,510 target because (1) our positive core thesis remains firmly in place; (2) the many macro headwinds have become tailwinds; (3) over the past two cycles the equity market has seen significant gains as the yield curve approached inversion; and (4) since 1956, SPX gains of >12% in the first three quarters suggest a possible 4.6% median gain in Q4 2017".

Reminders

- If you mail a check, please make the check payable to "Charles Schwab & Co, Inc." with your account number written on the check.
- Prior year (2017) IRA contributions must be made by April 17th, 2018.
- Talk to your children about the benefits of starting a Roth IRA.
- SAVE NOW! Please consider setting up online access to view your accounts online and to receive your statements and trade confirmations electronically.