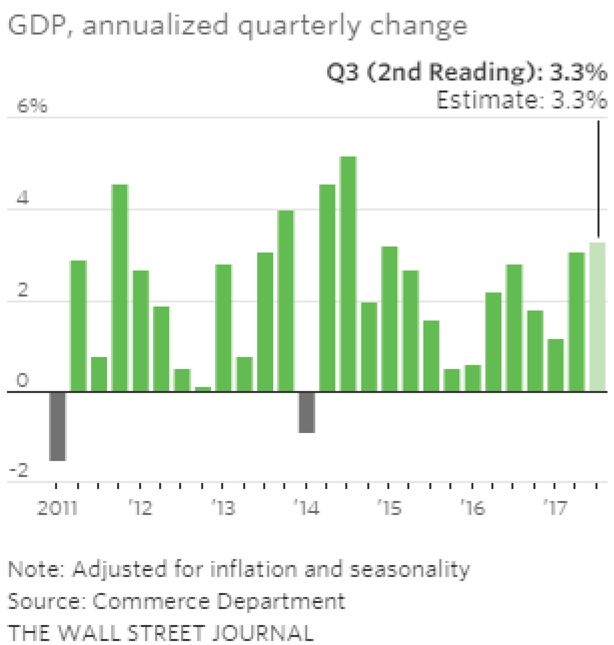
MARKET AND ECONOMIC REVIEW & OUTLOOK

AN UPDATE FROM THE ADVISORS AT GASKIN ASSET MANAGEMENT ***CHARLOTTE, NORTH CAROLINA***

Predicting the future has always been a risky business. This year has proven to be no different for most prognosticators. After all, who would have imagined a Dow Jones Industrial Average* (DJIA) above 24,000 at the end of November? Not only has the market hit new highs this year but according to Bespoke Investment Group there has never been a day when the S&P 500** was down for the year in 2017.[i] In other words, the low for the S&P 500 this year was experienced on the first trading day of 2017. It has clearly been a good year for the markets thus far. The U.S. equity markets have pushed forward in spite of what has felt like incessant political bickering which even failed to yield a replacement for the Affordable Care Act. And while U.S. politicians fought among themselves, North Korea, home-grown terrorists and others have reminded us that we do not live in a safe world. Yet as of this writing, the U.S. stock market keeps pressing forward.

The big news on Saturday morning, December 2nd, was the Senate's narrow passage of the much talked about tax bill. Republicans have promised a tax bill aimed at reducing taxes on corporations and middle-class taxpayers. President Trump, along with many "supply-side" economists, believes tax relief will provide stimulation to the economy sufficient to push Gross Domestic Product (GDP) to a sustained growth rate above the post-crisis rates averaged since the Great Recession. As a reminder, supply-side economic theory is centered in the belief that lowering taxes and decreasing regulation will lead to economic growth and thus a larger economy from which to generate new jobs and a larger tax base. Economists and politicians have vigorously debated the effectiveness of supply-side policies for increasing growth and tax revenues for decades but especially since President Reagan made supply-side economics a kitchen table phrase in the early 1980's. The debate will continue but this year and next will likely provide evidence for both sides to consider.



With a high-level view of the economy and markets, it would seem to us that many U.S. businesses and the equity markets are banking on relief and the expected growth following the anticipated tax cuts. As of this writing, however, the tax bill is still just a bill sitting on Capitol Hill. The current bill recently passed by the Senate will need to be reconciled with the House bill. We imagine the final bill will look different from the one recently passed. Further, with the narrow Senate passage, we would expect a bit of horse-trading to cobble together a "passable" bill that will reach the necessary 51 votes in the Senate.

In the meantime, the economy appears to be picking up steam going into 2018 but some worry whether or not the current growth rate is sustainable. GDP grew at an annual rate of 3.1% in the second quarter followed by a rate of 3.3% in the third quarter. As quoted in *The Wall Street Journal*., New York Fed President William Dudley recently stated, "Not only do I think the economy's in good shape today, I think the economic expansion is going to continue for some time."[ii] The nonpartisan Congressional Budget Office (CBO) recently reported that total

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economic output in the third quarter was slightly above the maximum sustainable level.[iii] To put this into clearer perspective, this marks the first time actual gross domestic product has exceeded potential GDP since the fourth quarter of 2007 prior to President Obama taking office. This is big news for the economy in our judgment.

With some exceptions due to bubbles such as the dotcom tech craze of the late 1990's and the real estate bubble of the middle 2000's, the stock market has historically served as a pricing gauge for the value of companies and has thus provided a reflection of the economy. However, since investors sometimes let their emotions override what would otherwise be their better judgment, the markets can exaggerate both a positive outlook and a negative one. One of the big questions on many minds today is "Are we acting rationally now or are we getting carried away a bit?" To begin to answer that question, we really need to look at the numbers, such as price to earnings (P/E) multiples. According to Ben Levisohn in *Barron's*, equity valuations are definitely not "cheap" at roughly 18 times consensus earnings estimates for next year.[iv] Levisohn goes on to highlight one of the fears many investors have today – a "melt-up". Unlike a bubble, a melt-up is a slow but consistent move upward in prices characterized with few pullbacks and low volatility. You can imagine what some fear could follow a melt-up – a melt-down. Just as with Christmas candles, melting down generally leaves you with less than what you had to start, or at least it doesn't look quite the same as it did. All else being equal, we would prefer to avoid a melt-down. Then again, how much more upside might be available before things cool off in the markets? With economic growth accelerating and the potential for supply-side benefits in 2018, it may be a while before we experience a slowdown. Balancing the risks of overheating with the potential for more market upside will be the challenge going into this next year.

Have you put up a Christmas tree this year? If you use a live tree, chances are someone else cut it down for you with the use of a chainsaw. I am not a Christmas tree farmer but I do like to use chainsaws from time to time to clear downed trees and trails. If you have ever used a chainsaw, you know how they can dramatically increase the speed and effectiveness for getting work done. This could be said of countless tools and modern conveniences we enjoy today. Many of those tools which multiply our efforts – especially chainsaws – come with some degree of risk. This may sound overly cautious to some, but I wear a helmet with face shield, gloves and even leg chaps when using a chainsaw. Even with the safety of my protective gear, I still carefully handle the saw to avoid risking a blade kickback knowing that it's within the realm of possibilities. Balancing the opportunity with risk is the key to staying safe while getting the job done. We prefer to approach investing in general, and this current market cycle in particular, with a view to opportunity and a healthy respect of the potential for risk.

We are entering a period of economic growth that is both exciting and a bit frightening at the same time. In our judgement, we believe those who allow fear to dictate their investment decisions will likely miss opportunities and sustain subpar long-term performance. In a recent *Barron's* piece, Anatole Kalestsky, chief economist of *Gavekal Dragonomics*, examined the current market conditions.[v] Kaletsky believes that the "exuberance" of today's markets is far from irrational as Alan Greenspan deemed the late 1990's to be. With tame inflation and robust global economic growth, he believes the dangers of overheating are years away. Further, with rising corporate profits and low interest rates, further expansion is not only possible but probable. We agree with this view from a long-term viewpoint but cautiously recognize that a market correction is also likely along the way. We will provide more detail regarding our outlook and views for 2018 in our next newsletter.

Please allow me to close with warm wishes and gratitude from the entire team at Gaskin Asset Management. We feel very fortunate to have enjoyed a good year both professionally and personally. Thank you so much for demonstrating your continued faith and confidence in us during this transitional year. As you settle down with family and friends to enjoy this special time of year, we wish you peace, happiness and goodwill.

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[i] Editor (2017, Nov. 27) "Barron's Market Week", Barron's, p. M1
[ii] Mitchell, Josh & Timiraos, Nick (2017, Dec. 1) "Economy, Markets Rev Up", The Wall Street Journal. p.A1
[iii] Leubsdorf, Ben (2017, Nov. 30) "Economy Hits Full Stride For First Time in 10 Years", The Wall Street Journal. p. A2
[iv] Levinsohn, Ben (2017, Nov. 27) "It's Our Party, and We'll Fret if We Want To", Barron's, M3
[v] Kaletsky, Anatole (2017, Dec. 4) "Investor Exuberance Is Perfectly Rational", Barron's, p.39

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