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Dear Clients and Friends,

The start of a new year is always a natural inflection point to consider the events of the past twelve months, and to assess the coming near-term future. This year is no different, with January ushering in a sweeping transition in national leadership with the prospect of far-reaching changes.

Throughout 2016 I wrote to you about factors that created uncertainty for stock and bond investors and that required caution on our part. Interest rates, corporate earnings, Brexit, and the presidential election all figured prominently in this mix and ultimately led to thin trading volumes on the stock market, a narrowly based rally at the end of the year, and a big question mark about the country's economic future.

The Markets Like Clarity

With the election of Donald Trump as President of the United States, the stock and bond markets have entered a new period of uncertainty.

The new administration's potential economic policies are as yet unclear to investors and may not be fully known for months after the new administration takes office. Greater clarity in the direction and scope of policies that affect corporate earnings, interest rates, the dollar, stocks and bonds could lead to greater confidence on the part of investors. For the time being, prudence dictates that we continue to maintain a cautious investment stance and to keep cash at higher-than-normal rates - I define "normal" to mean cash in the 3% to 5% range. As always, purchases will continue to be made selectively.

What We Do Know

From Mr. Trump's comments over the last year or so it is clear that, broadly speaking, his administration will focus on deregulation, lower taxes, fiscal stimulus, infrastructure spending, and possibly tariffs, with the overall aim of boosting economic growth from the current 1.7% GDP level to the 4% to 5% range. Achieving higher GDP growth rates will not be without challenges for the new leadership given that U.S. GDP growth over the last 30 years has averaged about 3%, and the last time annual GDP growth comfortably exceeded 5% was in 1984. At that time the very high interest rates of the previous few years had started on a downward trajectory that would ultimately last for the next 30+ years, bringing rates to near 0%.

Trump's goal of igniting economic growth by boosting fiscal spending and reducing personal and corporate taxes can certainly boost economic growth, particularly in the short-term. But it may also boost the federal budget deficit and result in higher borrowing costs. We have already seen the 10 year treasury yield rise by 74 basis points since Trump's election on November 8th, from 1.86% to a high of 2.61%, partly on this possibility. It has since declined to the region of 2.44%. As the Treasury borrows money to fill the gap between lower tax receipts and higher government spending, strong demand for money from Treasury borrowing is likely to result in higher interest rates for everyone and a stronger dollar as well - two factors that are counterproductive to economic growth.

Economic Growth and the 2009 Bull Market

Let me repeat one point that I wrote in my last letter to you because it bears emphasizing for perspective during times of uncertainty.

Economic growth is the foundation of stock market advances and the underpinning of a stable bond market. Historically, over the long-run the stock market has moved higher as American economic growth has moved forward, often despite government policies. On a secular basis, equity returns tend to stay well ahead of inflation and are one of the most effective ways to prudently grow assets over time. Commitment to a strategy that emphasizes investing for the long-run is key.

In the shorter-term, however, fiscal and monetary policies under individual administrations and Federal Reserve leaders can have undesired effects on companies by interfering with profit growth, which in turn affects stock prices and results in stock market corrections (price movements away from the general upward trend of the market). Short-term risks need to be perceived and managed.

The recent "Trump rally" has taken market indicators such as the Dow Jones Industrial Average and the S&P 500 to new highs and has prompted some to argue that we have entered a new and sustained bull market. The underpinning of the Trump rally is the market's expectation of potentially higher economic and corporate growth rates in the future. However, the rally has been led by a relatively small number of stocks, whereas broader participation by a larger number of names would have been a better confirmation of the bull market's resumption.

From my standpoint, and importantly, *the long-term bull market that started in 2009 is still intact and has never gone away* even as the market has been in a correction for almost the past two years. Whether corporate earnings growth does, in fact, pick up remains to be seen and may be more a question of when rather than if. An important determinant will be the Trump Administration's policies and actions, and the sentiments they engender among U.S. consumers and corporations.

Stay the Course

Whether the Trump Administration's policies ultimately benefit or mute general economic activity remains to be seen. Economic prognostications are subject to a myriad of factors and cross currents that are very difficult to predict. The better and more prudent course of action is to follow a sound investment process that balances long-term portfolio growth with short-term safety, rather than attempting to predict outcomes that are essentially unpredictable. For long-term investors such as ourselves, portfolio returns should be measured in years, not months or weeks. This is the right way to take advantage of long-term trends that ultimately lead to wealth creation.

Best to all,
V. Henry Astarjian