WIMMER ASSOCIATES

QUARTERLY REPORT

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A LETTER FROM KATHY

Dear Friends,

The past year has provided an astonishing double rebuke to the ruling elites. The "experts" could neither fathom a Britain outside of the European Union, nor an America led by a gilded, political neophyte who sold a winning platform of populism to Middle America. Count us among the disbelieving who missed this populist message resonating across the Atlantic.

> *Anyone who isn't confused doesn't really understand the situation.*
>
> -Edward R Murrow

We have already seen that Washington under President Trump will no longer be business as usual, but we can't say with any confidence just how change will take place and to what extent. As financial advisors, we do value macroeconomic factors that have a real effect on consumer behavior and corporate financial performance. It is apparent that a business friendly policy will be promulgated by the new Administration, with a rollback on regulation and some form of tax reform for both individuals and corporations. There also appears to be a strong likelihood that cash reserves held overseas by US multinationals will receive a preferential tax rate of 10-15% if repatriated. Paradoxically, this could have the adverse effect of strengthening the US dollar if overseas cash reserves need to be converted into US currency, making imports cheaper and exports more expensive.

While we witness wailing and gnashing of teeth among investors, we strongly advocate remaining invested in the market. The market may or may not be reacting to the recent election, but it has moved very quickly to the upside since November 8th. It is impossible to time when to get in and out of markets. So it is imperative that investors remain calm through the unpredictable highs and lows on the stock exchange. A recent study by Michael Batnick at theirrelevantinvestor.com illustrated that over a ten-year period, hypothetical investors in a Vanguard Value Index fund would have realized a 5.9% annual return, had they kept fully invested over the test period. In fact, actual, real Vanguard Value investors only *realized* a 1.9% annual return over the ten year period, owing to skittishly diving in and out of the market, usually at the exact wrong time. Similarly, investors in the DJIA saw the index climb from 19,000 on November 22nd to an all-time high of 20,000 by January 25th, illustrating that markets can move rapidly and strongly, leaving sidelined investors out of luck.

We aim to provide sensible, stable financial advice to navigate our clients and their portfolios through the volatile financial markets, no matter how confusingly the political winds may gust. We will do our best to maintain an even management keel in these choppy waters.

Cordially,

Kathy Wimmer, CFA, CIC
President

KEY FACTS FOR 2017

- *Annual gift exclusion $14,000*
- *Estate, gift and generation-skipping tax exemption $5,490,000*
- *Highest marginal estate tax rate 40%*
- *IRA contribution limits $5,500, plus another $1,000 for those over fifty*
- *SIMPLE IRA and 401(k) contribution limits $12,500, plus another $3,000 for those over fifty*
- *401(k) contribution limits $18,000, plus another $6,000 for those over fifty*
- *SEP IRA contribution limits 25% of compensation, max of $54,000*
- *Top Federal tax rate is 39.6% on income over $418,400 (single filers)*
- *Top Federal tax rate is 39.6% on income over $470,700 (married filers)*

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Fiscal Year End 2016

The year 2016 was mostly positive for investors. The broad-based S&P 500 Index returned 9.5% excluding dividends, led by energy (benefitting from an end of year OPEC agreement to limit production), financials and telecommunications. Healthcare, which includes pharmaceuticals, medical supplies and hospitals, was the only losing sector last year, declining 4.3% as the presidential candidates played havoc with the nerves of health care investors. The technology-laden Nasdaq Composite Index returned a respectable 9.9% as of year end, while the IBB biotech index broke a seven-year record of double digit returns, showing a decline of 21.4% for the same period. Small cap stocks, as evidenced by the Russell 2000 Index, rose 19.5% in 2016. This was after an inauspicious start to the year, when the index declined by 8% in early January. This further illustrates why we advise clients to remain invested and not to fret over transient peaks and valleys in the market. According to S&P's Sam Stovall, overall fourth quarter corporate earnings should rise by as much as 8% year over year, with the energy sector's return to profitability driving solid quarterly returns.

Based on Department of Commerce's first estimate of fourth quarter Gross Domestic Product (GDP), the US grew at a disappointingly sluggish rate of 1.9%, versus 2% in the previous year's same quarter. The US economy has languidly grown at a 2.0% annual rate since the end of the recession. This reflects modest improvements in productivity, weak export growth and tepid consumer demand for goods and services. CNBC Economic Analyst James Pethokoukis grumbles that the "US has not had a 3% GDP year since 2005, (nor) a 4% year since 2000." It should be noted that fourth quarter Commerce figures are only preliminary estimates based on limited information. Oftentimes, Commerce's "estimates" are revised downward or upward in two later announcements. The greatest negative effect on fourth quarter GDP was a sharp increase in imports, along with declining exports which took 1.7% off quarterly growth.

The pronounced trade imbalance between the USA and other countries has politicians on both sides of the Congressional political aisle demanding policy changes that may upset the post World War II consensus on free trade. The dismantling of tariffs and import duties over the past sixty years has led an unprecedented number of people leaving poverty and a historical record stretch of peace throughout Europe. There has recently emerged in the USA a revisionist view, mistaken in our opinion, that the US has lost good paying manufacturing jobs to other countries due to free trade agreements that favor low wage countries. While it is true that free trade has caused true costs to some US workers in certain US industries, it is more likely that automation, new and more capital intensive technologies and lagging US educational standards have done the most harm to US workers.

The Organization of Petroleum Exporting Countries (OPEC) deal in November 2016 to cut the cartel's production by 1.6 million barrels a day rallied oil markets from $45 bbl. in early November to a high of $54 bbl. at year end. OPEC hopes to cut into a worldwide oversupply of crude oil and will revisit its production levels at the mid-year, based on quota compliance and new non-OPEC supplies. Already the US drilling rig count has rebounded, as shale producers are now capable of profiting at oil price levels as low as $38 a barrel. The active US oil rig count up was up in early February as shale recovers (highest since Oct 2015) and nearly double the pace of last year.

January employment figures showed creation of 227,000 new jobs, which was well ahead of the 180,000 consensus expectation. Furthermore, the labor participation rate rose slightly from 62.7% to 62.9%, indicating that more individuals returned to the work force. This edged the overall unemployment rate to 4.8% from 4.7% in December. Offsetting these two bright spots, wage growth was barely positive at 0.1% in January, which will not suffice to make the recovery more inclusive. The weak wage growth is further remarkable, as many states and locales instituted higher minimum wage requirements at the start of the year. The weak wage growth is another reason for the Federal Reserve to stay on the sidelines and forego further rate hikes at this time. Inflation is likely to remain muted as wages remain stagnant.

Manufacturers complain that they can't fill their employment need, because applicants do not have the basic mathematical skills to operate sophisticated, computerized machinery. A further hurdle to greater manufacturing employment is the astounding number of men with felony records. JPMorgan's Chief Investment Officer, David Kelly, recently shocked a large crowd of Chartered Financial Analysts by stating that 15% of American males have felony records.

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Fiscal Year End (continued from page 2)

This is a tremendous hindrance when seeking work. This partially explains why there is such a historically low worker participation rate today, as workers are dropped from unemployment measures after six months of not seeking or obtaining a job.

The Federal Reserve's Open Market Committee moved to raise short term interest rates shortly after the election. This was the first time in over a year and only the second time in ten years. On December 15, 2016, the Fed announced a 0.25% rate increase and signaled that it expected to raise rates by another 0.75% in 2017 in three sequential step ups. As usual, the Fed hedged its forecast of rate hike. The Federal Reserve Chair Janet Yellen stated "We have time to wait and see what changes occur," in fiscal policy under the new Administration. "Our decision to raise rates should certainly be understood as a reflection of the confidence we have in the progress the economy has made". The Fed has real concerns that tax reform and an infrastructure build-out could create over-consumption and wage pressures leading to incipient inflation and overheating of the economy. Any move by the Federal Reserve to quickly raise interest rates would most likely be quickly reversed as the new Administration will soon name three of the six voting members on the Fed's Open Market Committee.

The management of short-term interest rates is not the only concern on the Federal Reserve's mind these days. The size of the Federal Reserve's balance sheet remains astonishing high, at $4.5 trillion as a result of the Fed policy known as "quantitative easing" or (QE). The intent of QE was to drive down long-term interest rates, creating monetary stimulus which allowed home and stock prices to reflate after the 2008 financial crisis. A side benefit of QE was to allow the US government to fund its fiscal deficits at record low interest rates. It now seems, however, the Fed wants to "normalize" interest rates. That means addressing its record holdings, including US Treasury bonds, as well as mortgage backed securities, while also guiding short term interest rates up to combat incipient inflation. The inevitability of unwinding the Fed holdings has been known for years. It's time appears to be drawing near. As the former Chairman of Economic Advisers, economist Herbert Stein once wryly stated: "If something cannot go on forever, it will stop."

Mortgage holders should take careful note. According to Moody's Analytics Inc., the unwinding of the Federal Reserve's bond portfolio could push 30-year mortgage rates past 6% within 3 years.

According to the Bureau of Economic Analysis, "For 2016, the US trade deficit was $502 billion or 2.7% of Gross Domestic Product (GDP), up $2 billion from $500 billion in 2015. Exports were $2,209 billion in 2016, down $52 billion from 2015. Imports were $2,711 billion in 2016, down $50 billion from 2015." China and Germany had trade surpluses of $347 billion and $65 billion, respectively, in 2016 with the United States.

The pronounced US trade imbalance with China and Germany (and to a lesser extent with Mexico, Japan and others) has politicians on both sides of the aisle demanding policy changes that may upset the post World War II consensus on free trade. Congress and the President need to tread carefully before instituting the much discussed "20% border adjustment tax" on imports that would invite retaliatory trade measures by foreign trade rivals and opening up the possibility of a multilateral trade war.~

A Glance Ahead

There is the well-worn yarn that investors hate uncertainty and that sudden or sharp changes in public policy can lead to dislocations in financial markets. We are fairly confident that the checks and balances in the US structure of government mitigates the likelihood of health care reform blowing up the system, massive new fiscal deficits to fund a mass infrastructure build-out or unfunded tax cuts or a trade war that would only increase domestic prices and open the global economy to greater trade restrictions and countervailing duties, where all parties would lose. Let's hope we're heading to "fair trade" from "free trade" and not to overt protectionism. Both Federal Reserve Chair Janet Yellen and Vice Chair,

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We strive to optimize our clients' financial well being by coordinating investment decisions with other professionals in the fields of taxation and estate planning.

A Glance Ahead (continued from page 3)

Stanley Fischer have counseled that the Fed's announced plans to raise short-term interest rates three times this year is subject to how fiscal policy is rolled out by the Administration and Congress. Amid "significant uncertainty" , Fischer stated "I don't think anyone quite knows what's going to come out of the process which involves both the administration and Congress in the deciding of fiscal policy and a variety of other things" per Bloomberg.

Noted economist, Rudiger Dornbusch (and longtime co-author with Stanley Fischer) counseled long ago that "in economics, things take longer to happen than you think they will, and then they happen faster than you thought they could." Here we caution that panicked reactions on the part of investors to first, the mid-Summer Brexit vote, and secondly, the US presidential election, have left sidelined investors relatively poorer as nearly all US major market indices have climbed to record heights in short bursts of time. We find it difficult sometimes to not be detached from politics when supplying financial advice, e.g., our belief that defense contractors are likely to benefit from a larger US defense budget. We think, however, it best to remain steadily in the market, riding out both the highs and the lows. Excessive and emotional trading is the enemy of the smart investor and good long-term investment returns.~

Disclosure: "Be careful about reading health books, you may die of a misprint." Mark Twain Keep that in mind as you read these articles. We obtain data from sources we believe are reliable but they should not be relied upon for making life-changing decisions.