WIMMER ASSOCIATES

QUARTERLY REPORT

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A LETTER FROM KATHY

"Winter is coming!" - Jon Snow, Game of Thrones

Dear Friends,

As the US economy begins its ninth year of modest expansion (second longest streak of all-time), pundits, academics and other rogues insist that the good times have been had and that the "not so great recovery" is about to expire. We disagree. The US economy grew at an annualized rate of 3.0% in the second quarter, which is the highest in six quarters. Europe matched the same growth rate, which was the strongest on the Continent since 2010. Yet, experts fret that we have reached full employment, which inevitably will lead to tight labor markets, wage pressures and inflation. The truth is that there are many individuals who previously dropped out of the workforce and are now returning to the work force to fill open positions. While one cannot absolutely rule out a future decline in the economy, there really is no evidence that this "Goldilocks" economy, not too hot, nor too cold, is in for bleak seasonal change.

Equity markets continue to climb and reach all-time highs. Investors have been rewarded with stellar gains, as the broad based S&P 500 Index returned 8% in the first half of 2017 and the technology-laden Nasdaq 100 rose 14% on the back of tech giant "FANG" stocks, i.e., (Facebook, Amazon, Netflix and Google, renamed as Alphabet). The second quarter's year-over-year 9.8% rise in S&P earnings is the most robust seen in years. What is interesting is that the companies that have done the best in growing revenues and earnings are those who generate revenues outside the United States, such as Boeing, Microsoft and the FANG stocks.

While there are always potential headwinds to economic growth and corporate earnings, it appears that the US Federal Reserve is mindful not to do anything too drastic with its monetary policy, which might tip the United States into recession. Instead, the Fed is following a path of incremental policy steps to tighten the money supply. The Fed raised short-term interest rates by 0.25% in June, the third rate hike since the November election. Some analysts are concerned that the yield curve is flattening, meaning short and long term rates are converging. A "flat" yield curve is often a precursor to an economic recession. We remain sanguine as the Fed has assured that further rate hikes will be "data dependent," which is Fed speak for allowing the central bank ample wiggle room to steer policy. The Fed would like to begin selling off its $5 trillion balance of long-term debt, which should gradually raise long-term rates and steepen the yield curve. We see this reduction of the Fed's balance sheet as a sign of normalization, after nine years of extraordinary monetary policy including qualitative easing and near-zero interest rates.

The International Monetary Fund is projecting 2.3% annual Gross Domestic Product (GDP) growth in the US and 3.5% globally for 2017. Economists are generally aligned in thinking that GDP will accelerate modestly in the second half of the year, which may help strengthen the dollar, improve wage

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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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A Letter from Kathy (continued from page one)

growth and reduce unemployment. Supply-side economists believe that the US's potential GDP growth rate is much higher, but is being held back by a Byzantine tax structure, weak infrastructure and over regulation. Considering the polarized state of affairs in Washington, the hope for consensus towards positive legislative policy initiatives is limited at best.

We, therefore, believe that the growing economy and ascending stock market reflect fundamental strengths, rather than idle hopes that anything in Washington will get done.

There is still time to grab a book, sunscreen and head to warm waters before the long days of winter set in. We foresee relatively smooth sailing for the equity markets and the US economy for the time being. We will review the first half of the year below in our newsletter and elaborate on our positive guidance for the remainder of the year.~

Cordially,

Kathy Wimmer, CFA, CIC
President

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Second Quarter 2017

All but four of the world's thirty largest equity exchanges rose in the first half of the year. This remarkable correlation is also noted for its lack of volatility, as central banks have continued their coordinated policies to keep interest rates low in an effort to "reflate" economies and asset values. Much of the strength in equities can be attributed to: accommodative monetary policy; a recovery in commodity pricing, especially energy, copper and iron ore versus a year ago; lower indebtedness on corporate and household balance sheet; a greater willingness on the part of bankers to take on risk in the form of lending; and an end to an era of punishing bank fines from governments around the world seeking compensation for pre-2008 banking practices.

The tech sector has led the recovery in equity markets in the US. In addition to the previously mentioned FANG stocks, old line technology stocks such as Microsoft and Oracle continue to grow, as major and mid-size corporations are shifting their computing to the "cloud". Cloud computing is still in the early days of development and is led by the erstwhile internet book seller, Amazon. Amazon Web Service has become a major contractor to the government and business. The S&P 500 information technology index led the overall market with a gain of 16.4% in the first half of 2017.

The financial sector appears healthy; all the major US banks passed the Federal Reserve's annual "stress test". In addition to recapitalizing their balance sheets, the financial sector has benefitted from stricter underwriting standards, despite constant grumbling at the burden of over regulation. The S&P 500 financial index rose 6% in the first half of the year, slightly underperforming the overall market, after climbing dramatically in the years following the Great Recession.

Energy stocks shed 14% of their value in the first half of 2017, but earnings are improving. Drillers have become much more efficient. Many are now profitable at crude oil prices in the $30 dollar range. Refiners are having a stellar year, as throughput measures near 95% of capacity. Oil exports are booming, after Congress lifted its longstanding ban. Natural gas production is expanding, from the mountains of Pennsylvania, through the prairies of Oklahoma, down to the Gulf of Mexico. Natural gas has benefitted from the shale revolution. The abundance of natural gas has led to a chemical manufacturing renaissance in the Gulf Coast, as low cost natural gas fires generators and serves as a feedstock for the production of numerous chemicals. The US has started exporting liquefied natural gas from Sabine Pass, TX for the first time ever this year. A number of additional export facilities have been approved and are under construction. US natural gas prices at $2.50 mmbtu are half what Europe pays to import Russian and Qatari natural gas.

Except for nickel, all other industrial commodities, such as copper and aluminum, reached their highest level of

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SECOND QUARTER 2017 (CONTINUED FROM PAGE TWO)

pricing since 2014 indicating that the global economic expansion is spurring demand. Precious metals, including gold and silver, rose in the first half of year, which is often interpreted as hedging against the likelihood of imminent inflation gains. Wheat, hogs and rice rose more than 20% in the first half of the year, showing signs of underlying strength in global consumer demand. Sugar and orange juice prices fell approximately 30%, following good weather and strong crops in Brazil and Florida, respectively. If you are not seeing lower prices at the checkout stand, it is because manufacturers and retailers tend to be slow to pass on margin improvements to the consumer, but will generally try to pass on declining marginal costs as soon as possible.

The financial sector

appears healthy; all the major US banks passed the Federal Reserve's annual "stress test".

Second quarter GDP growth rebounded from an anemic 1.1% annual growth rate in the same period in 2016 first quarter to tally a 3.0% annualized rate gain. Real disposable income increased 3.5% at the end of June 2016, compared to only a 1.1% gain during the same period of 2016. This growth in real disposable income augurs well for increased spending and saving going forward. Non-farm payrolls climbed to 222,000 in June, achieving an overall unemployment rate of 4.4%. While the unemployment rate appears historically low, labor force participation rate rose to 62.8%, which reflects a positive move of individuals returning to work after previously dropping out of the work force. Ten years ago the labor participation rate was 66% which leads economists to believe that there remains room for the unemployment rate to be driven below 4% as the labor participation rate recovers to the norm.

According to the Institute for Supply Management, "Economic activity in the manufacturing sector expanded in June, and the overall economy grew for the 97th consecutive month." --- "The June Producer Manufacturing Index "PMI" registered 57.8 percent, an increase of 2.9 percentage points from the May reading of 54.9 percent." Any reading of the index over 50.0 is considered expansionary, whereas any score below 50.0 is considered contractionary for the economy. The June "PMI" numbers bode well for the second half of the year, as the economy appears to be gaining steam.

Increases in US home prices were steady in June, owing to lower unemployment, slim inventories, low interest rates and increased wages. The S&P CoreLogic Case-Shiller index of nationwide prices achieved the largest advance in three years, rising 5.8% on an annualized basis.

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The Federal Reserve Open Market Committee decided to raise the (short term) federal funds rate to a range of 1 to 1.25 percent, indicating that the Fed believes that the rise in unemployment and modest wage inflation justified the move. The Fed's minutes also stated that "The Committee currently expects to begin implementing a balance sheet normalization program this year, provided that the economy evolves broadly as anticipated. This program…would gradually reduce the Federal Reserve's securities holdings by decreasing reinvestment of principal payments from those securities." Thus, the Fed is signaling it is going to start reversing its Quantitative Easing monetary policy with "normalization" (or Quantitative Tightening) as the economy is healthy enough to withstand higher interest rates.~

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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.

Looking Forward

Although the economic recovery and concurrent stock market ascent are both getting a bit long in the tooth, we do not see any imminent signs of a recession nor a significant correction in the stock market. Of course, stock market corrections are normal. They simply set a new basis for future growth and allow investors an opportunity to purchase equities at a discount.

The US economic recovery should continue, as robust manufacturing, increased employment and rising wages feed future consumption gains. Personal consumption historically represents 70% of US GDP. The yield curve, the slope of short-term interest rates to long-term rates, remains normal, with long-term rates exceeding short-term rates. The current yield curve is considered positive, but flattening, as long term rates are declining while the Fed increases short-term rates. An inverted yield curve (where long-term rates are lower than short-term rates) is often a tell-tale sign of a pending recession.

We believe that the Fed's interest in selling off its $5 trillion balance sheet is an effort to bend the yield curve so that long-term interest rates exceed short-term interest rates. For this reason, we believe that the Fed will be especially cautious before raising short-term rates anytime soon.

"Winter is coming," but we do not foresee a dark period for the economy (or equities) for the foreseeable future. We remain confident in the intrinsic strength of both the US economy and the US stock market.~