CARMICHAEL CAPITAL INC.

CLAUDE R. CARMICHAEL CFA, PRESIDENT
339 MAIN STREET, 2ND FLOOR, FRANKLIN, TN 37064
(615) 595-5800 – NYC (212) 580-5200 – FAX (615) 595-5825
claude@carmichaelcapital.net

April 14, 2017

2017 First Quarter Review
"A New Era"

Those of us who have been around Wall Street for decades know to be cautious when pundits and pontificators proclaim a "new era" of any kind. When used in regard to the stock market, this term usually becomes the last excuse for too-high valuations in the period just before they return closer to ground level and more in line with those valuations of the old eras. Similarly, "It's different this time," (meaning that old valuation measures don't apply) brings a chill to veteran investors who remember hearing the phrase during times immediately preceding both of the major market declines of the last 17 years. However, this time I have to agree. We are in a new era. And it *IS* different this time.

The first quarter brought a new president and no small number of surprising developments in politics and the economy. I can add little to the mountains of analysis that have been written in response to those. Suffice it to say we have always had to dig beneath the surface to discover underlying facts, and their context is usually open to interpretation. That is the nature of economic analysis. However, we appear to have entered a new era where information and disinformation compete on almost equal footing and where a credibility gap has so widened as to call into question (in some cases) the nature of our shared perception of reality. One logical effect of this change would be increased market volatility, since investors tend to pull back from investing during times of greater uncertainty. What I find most surprising is the lack of significant market reaction to those recent surprising, and sometimes shocking, developments. This is especially true when one takes into consideration that the market is not statistically very cheap (some say it is dangerously over-priced), that the economy is growing at a tepid rate, and that corporate profits have not been growing very much at all. Last year's GDP growth was put at just 1.6%, its worst showing since 2011. Even so, stocks had a nice, calm upward slant in general with the Dow Jones Industrial Average up 4.56% and the S&P 500 up 5.5%. The move was concentrated in larger company stocks as shown by the Russell 2000 Index, which rose only a little over 2%. An added surprise was the small rise in the price of 20 year US Treasury bonds, up a little more than 1% even in the face of the rate increases by the Federal Reserve Board. This is after the drubbing bonds took in the last half of 2016 as rates began to rise for the first time in years.

As mentioned last quarter, we added some exposure to stocks after the election when the promise of potential lower taxes, less industry regulation, repatriation of corporate cash, and infrastructure spending began to shine brighter than the vision of immediate disaster that had prevailed pre-election. As the market has advanced during the first quarter we have recently pared back some of those additions, as the risks seemed not to be fully discounted while the promises seemed to be fully priced-in. We did so in order to be prepared for any eventual market reaction to the possible growing gap between promise and performance on such key economic issues as healthcare and tax reform. The failure of the first has at least delayed the completion of the second. If investor expectations ratchet back, it may very well provide for a swoon as we enter the summer or fall.

We are constantly on the hunt for bargains but are finding them less often as prices have risen. The Federal Reserve Board has put investors on notice that more rate hikes are coming and the Fed's balance sheet will be shrinking. Since the Fed will be raising rates and buying fewer treasuries, bonds will now have a headwind that they have not had in years. It would not be surprising if the 30 year bull market in bonds has ended with the peak in prices and the bottom in rates reached last July. With stocks appearing vulnerable to disappointment and bonds under pressure from a reversal of monetary policy, it could be a still more-challenging investment world in the near future. A conventional interpretation is that either corporate earnings will be boosted by tax cuts and/or economic expansion (which would justify current valuations), or stocks will have to adjust to slower growth and reduced earnings expectations. The current market action implies that investors are not too worried about the potential for further disappointment. That always worries me. Consequently, we will proceed with caution.

We have responded to many last-minute requests for tax information and want you to know that we can usually provide the documents to you or your preparer very quickly should you need an extra copy. Please don't hesitate to let us help you with the information for your returns since it is part of our service and we are set up to respond quickly.

As is our annual regulatory duty, we assure you that we share none of your personal information with anyone without your express consent. We also offer to send you a copy of our regulatory filing "ADV brochure" upon request should you find a need for reading material guaranteed to induce sleep.

After I had talked her out of if a few times before, our wonderful office administrator of the past ten years is finally retiring. Alice Marie Carroll has entered her second retirement (the first was from AT&T corporate headquarters) and she is enjoying spending more of her time managing her local real estate properties. She has promised to visit, but I think her renovation projects may keep her more than a little busy.

Enclosed you will find your portfolio reports and statements. Please review them at your leisure and call us with any questions or suggestions. And good luck with tax time.

Sincerely,

Claude Carmichael CFA