DELTA
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IN THIS ISSUE

Economic Comments

Providing virtually no surprise, the Federal Reserve's Open Market Committee raised overnight interest rates by 0.25 percentage points to 1.25% at its recent mid-December meeting. Having raised rates three times in 2017, the Federal Reserve has strongly signaled that it will raise rates three more times in 2018. Most Fed policy makers agree that they should continue raising short-term rates to prevent the buoyant U.S. economy from overheating. With inflation remaining puzzlingly weak, i.e. running below 2% for most of this year, some central bankers are concerned about moving too quickly and stalling growth. Despite these mixed concerns, most investors are convinced that the Fed is committed to its campaign of monetary tightening, a substantial change from a year ago when many investors assumed that the bank was content to raise rates once per year, at most.

U.S. employment numbers continue to be strong with the addition of 148,000 jobs in December, bringing the three month average to 204,000 while the unemployment rate was unchanged at 4.1%. On the economic front, the nation's economy grew by a solid 3.2% annual rate for the third quarter. While slightly slower than initial estimates, this growth was high enough to give the country the best back-to-back quarterly growth rate in more than 3 years. Moving forward, economists on Wall Street revised up their estimates of U.S. economic growth over the coming two years due to Washington's embrace of tax cuts and government spending increases. However, these growth projections will only be realized if businesses step up to the plate either by paying employees more and/or increasing capital investments. The current ability for consumers to push the economy is more limited as the personal savings rate, now at 2.9%, is at its lowest level since 2007. While the year's close showed personal spending rising smartly, additional wages will be needed to support increased consumer buying moving forward.

In the face of unexpected broad-based global economic growth stimulating energy demand and OPEC agreeing to cut production, oil prices ended the year above $60 a barrel, a milestone not seen in more than two years. On the back of resurgent prices, analysts expect a sharp increase in U.S. shale production with total U.S. production of 10 million barrels per day in 2018. If this forecast is realized, this year's production would top the prior record for U.S. output of 9.6 million barrels per day set in 1970.

As the year closed, the Trump Administration scored its first major legislative victory with the passage of its tax overhaul plan. The plan had two major components: the permanent reduction of corporate tax rates to 21%, or about even with most other developed countries, and a temporary 5-year modification of personal taxes. In voting on this tax plan, the only source of agreement between the two political parties was that neither can decide whether they care about the Federal government's rising red ink. More precisely, each party pretends to care about rising annual deficits, and the ever growing national debt, only when it suits its own interests and then shrugs off those concerns when it doesn't. In this spirit, Congress approved a mixture of permanent and temporary

(Continued on page 2)

Economic Comments continued from cover

tax cuts that will potentially increase the national deficit by an extra $1.5 trillion, above and beyond previously projected annual deficits.

If the recently approved tax cuts stoke U.S. growth rates, as expected by Republicans, and inflation as a byproduct, the expectation is that the Fed would try to stamp out the accelerating inflation by taking an even harder line on interest rate increases. These expectations have helped push up yields on short-term bonds, like the two-year note, which are especially sensitive to changes in monetary policy, but kept a lid on longer-term yields, which are more reactive to inflation expectations. In general though, the consensus of economists is that economic growth will remain far slower than its historical averages.

While economic growth in the second and third quarters was 3.1% and 3.2%, respectively, these growth rates were well ahead of the post recession pace of ~2.0%. In the long run, economists believe that growth rates are constrained by two forces: how many people are working and how productive they are. Demographics are set to hold down workforce participation as baby boomers retire while productivity growth has sagged sharply since the IT fueled surge of the late 1990s and early 2000s.

Some promise has started to show in stagnant U.S. wages. In U.S. cities with the tightest labor markets, workers are finding something long missing: faster-growing paychecks. Although fully anticipated by standard economic theory, wage growth has largely been absent since the current upturn began more than eight years ago. For the last two years, wage growth has been largely stagnant even as the unemployment rate has declined to the lowest level in 17 years. The issue now is when, or if, this new trend spreads more broadly across the nation.

Recently reported U.S. unemployment rate, at 4.1%, remains extremely low while wage growth and inflation have both been sluggish. This situation raises questions about whether the traditional relationship between unemployment and inflation may not be as tight as it once was due to changes in technology and an increasingly globalized economy.

While the near-term prognosis for the economy is positive, the overhang of the ever-growing national debt and the imminent explosion in entitlement spending for the Baby Boom generation represent ongoing structural challenges for the U.S. economy. These two issues will become increasingly burdensome to sustained economic growth. While these challenges can be overcome, the lack of political will or national consensus regrettably means that necessary reform in these areas will remain unaddressed for the foreseeable future.

Analyst Corner

While some claim that Amazon.com is taking over the retailing world, there are some retailers, such as Costco Wholesale Corp. (NDQ: COST) that have continued to prosper in today's challenging environment. The company focuses on selling a limited selection of goods in bulk directly from their warehouse stores to a restricted membership.

A key premise of COST's success is that they charge only slightly above the true cost of the items they sell with almost 3/4 of their profits coming from annual membership fees. As a result, the company has a devoted clientele. Additionally, they are known for their customer service, as their staff is paid substantially above market compensation. With a clean balance sheet, strong growth prospects and a rising dividend, the company has much to offer. While not necessarily a fit for all portfolios, we believe that Costco could provide an attractive addition to many portfolios.

Market Comments

Robust corporate earnings growth, record-low volatility and wide spread global economic expansion helped stocks broadly beat expectations. Globally, stock markets soared in 2017 creating more than $9 trillion in new market value. Almost every major market ended up with double digit gains as improving economic growth and strong corporate profits convinced investors to buy. When combined with global central bankers largely keeping their high levels of economic stimulus in place, a global stock rally followed.

If anything, the central bank's efforts to hold down borrowing costs and the lowered yield from relatively safe government bonds encouraged investors to seek additional risk in the stock market, even as valuations rose. For the first time in several years, U.S. markets lagged overseas markets, even as the S&P 500 advanced more than 21%. Expectations for lower corporate taxes also helped fuel the U.S. rally, sending the Dow Jones Industrial Average to 71 record closes - the most ever in a calendar year. U.S. gains came on the backs of big gains by technology as the sector surged upwards by more than 38%. In fact more than one quarter of the S&P 500's gains came from just five tech stocks, Amazon.com, Alphabet, Facebook, Apple, and Microsoft. Telecom services was the market laggard losing 1.25% as investors sought companies with more dynamic growth.

The years that live on in stock market lore tend to be the scariest ones, but 2017 deserves a mention for the opposite reason. It has been the most docile in most investors' living memory. The stock market's so-called fear gauge, the CBOE Volatility Index or VIX, has seen nine of its 10 lowest readings ever this year. Put in layman's terms, the market is only anticipating smooth sailing for the foreseeable future. In fact, there wasn't a single day last year when the S&P 500 fluctuated more than 2 percent, a level of low volatility unseen since the mid-1960s.

On the fixed income side, the U.S. bond market closed out the year with yield spread between the 10-year Treasury and the 2-year Treasury being only 0.53 percentage points, or less than half its more typical differential. This so-called flattening of the yield curve has often been a harbinger of slower growth, or even recession if the curve becomes inverted. Yet many analysts, including Fed Chair Yellen, have discounted the gloomy forecast typically provided by a flattening yield curve. Instead, they view the shrinking of the current yield premium of certain specific recent events rather than an indictment of the economy.

Survey data show that individual investors believe the market will deliver more strong gains in the coming year. After eight years of solid returns, investors have become accustomed to buying stocks after even small pullbacks, gaining confidence that the market will rebound and continue its run higher. Corporate profits have been strengthening and the tax overhaul is expected to further boost earnings at many firms. More broadly, economists say growth across the U.S. and globally is hitting its stride after years of tepid recovery.

In general, optimism has become widespread among a broad group of market watchers. Nearly two-thirds of investment newsletter writers were bullish on stocks in mid-December, nearly a three-decade high, according to a weekly survey conducted by Investors Intelligence. Historically, investors have rushed into stocks with the most excitement near the end of a bull market, ignoring economic and financial metrics that might otherwise urge caution, for example a rise in short-term Treasury yields relative to long-term ones. About 60 percent of individual investors think the stock market will go higher in the next six months, the highest percent since 2010, according to a survey by the American Association of Individual Investors. For every bearish investor, there are nearly four bulls.

At the same time, the expansion of bullish sentiment is raising concerns among contrarians, who say the red-hot market could exhaust itself in 2018. U.S. stocks already trade at historically high levels; they recently hit 18.5 times their next 12 months' projected earnings, the highest in more than 15 years, according to FactSet. While the stock markets are expensive by most metrics, they can stay at these levels for prolonged periods of time.

To summarize our thoughts as we enter 2018, we turn to the renowned economics professor Burton G. Malkiel, and author of the classic "A Random Walk Down Wall Street," who recommends that investors "stay the course." If a portfolio has come unbalanced and requires re-balancing, it should be done. Otherwise, we recommend, and Professor Malkiel agrees, "do not try to time the market." Wiser words are rarely heard!

Performance as of 12/31/17

	Close	Month	1 Year
DJIA	24719.22	1.92%	28.11%
S & P 500	2673.61	1.11%	21.83%
NASDAQ Comp.	6903.39	28.24%	0.43%

	Year end yield	Prior Year end yield
10 yr. U.S. Treasury	2.40%	2.48%

Planning Thoughts

Having spent so many years raising them, a lot of things change when your child turns 18. Once children turn 18, parents can no longer make legal decisions for them or receive information about them that is considered private, unless they have the child's permission. For parents who are still fully financially supporting their children and paying for their college education, the legal sea change can come as quite a surprise.

Without express written permission, parents cannot be notified of their child's college grades or even their enrollment status. For this reason, we encourage families to take the initiative and have certain key documents drawn up. With a health-care power of attorney, parents can be given the ability to make decision about their child's health care. A HIPAA authorization allows doctors to speak about the child's medical condition. For children hesitant about sharing private medical information, the HIPAA authorization can set limits on how much or what type of information is shared. Finally, a durable power of attorney should be done in favor of the parent to allow them to manage their child's finances. This power of attorney can be effective immediately, or at a future point, such as when your child is otherwise incapacitated.

If you need to discuss this subject further, please do not hesitate to call us. And finally, a healthy and Happy New Year to all!

Partners

Clifford F. Favrot, CFA CFP™

Gerard A. Plauché, CFA

Ainsley D. Bishop

Frank A. M. Williams, Emeritus

Operations Manager

John T. Egnatchik

Office Manager

Angelle M. Verbois

Contact Us Toll Free:
1-888-522-9019

228 St. Charles Avenue, Suite 1100, New Orleans, LA 70130
504-522-9019 PHONE • 504-522-9676 FAX

www.deltafinad.com

DELTA FINANCIAL ADVISORS
Investment Counsel