
Sound Investments Inc.

Summary

The well regarded University of Michigan's consumer-confidence survey is near its highest level in more than a decade. Yet, the rising level of confidence hasn't translated into increased sales. Car sales have fallen, following a record 7 year run of rising vehicle sales, which peaked in 2016. In all, retail spending dropped 0.2% in March, pressured by falling receipts at car dealers, service stations and building materials. The consumer price index also dropped 0.3% in March.

We think the slowdown is more of a pause than a trend and we believe that the markets may have overreacted. On balance, the economy seems to be in reasonable shape.

This investment letter is mailed quarterly to our clients and friends.

1st Quarter 2017

DJIA 20663

S&P 500362

NASDAQ 5914

A Reversal

Markets have rolled ahead 10% since November, when Trump was elected. The Dow Jones Industrial average closed at a record 21,116 on Mar 1st, but has been recently edging lower, and closed at 20,453 on Apr 13 just before Easter. Since then, American markets have declined as it contemplates a multitude of issues, ranging from political uncertainty in Europe, lower bond yields, and a slowdown in consumer spending.

In March, foreign funds bested U.S. funds by a wide margin, led by emerging markets, which were up 3.7%. Developed foreign markets were up 3.2%. It's been almost 8 years since internationals have excelled. Since 2009, American stocks have led the world while foreign equities languished. We feel that we may be in the midst of a change and we will develop that case later on in this letter.

Signs of Health

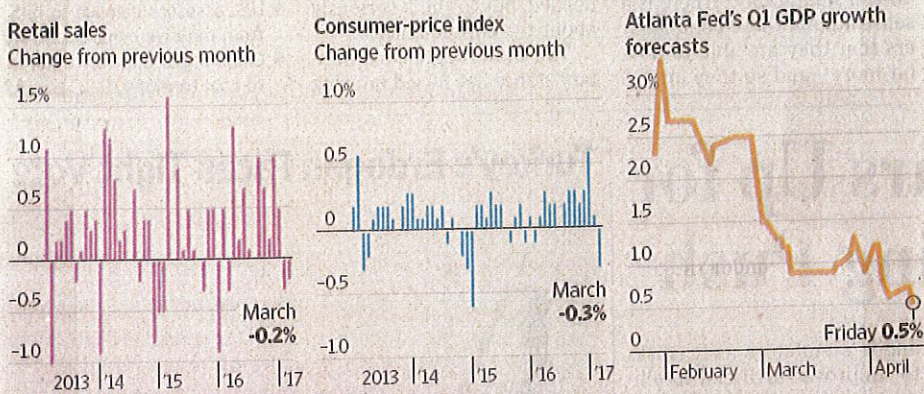
The percentage of workers who voluntarily left their job - the "nation's quit rate" - hit 1.8%, in 2017, the highest in the recovery and up from a low of 1.2% in September, 2009. Most quit to find a better job or already found one. Another factor influencing this, is that workers want a raise and are open to a change, as hourly wages grew 2.9% over the last 12 months. This is the strongest gain in more than seven years. These statistics continue to underline the fact that hiring growth has improved and the unemployment rate is below 4.8%.

The state of the economy changes from month to month and is seasonal in nature. For example, the well regarded University of Michigan's consumer-confidence survey, is near its highest level in more than a decade. Yet, the

Confident Consumers Fail to Spend

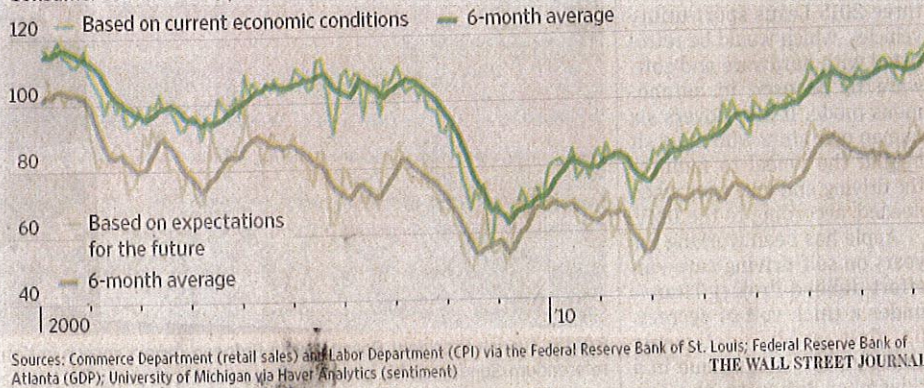
Economic data released Friday are at odds with rising consumer optimism.

Weak retail-sales and inflation figures point to an economy that decelerated early this year...



...indicating again that consumers' upbeat outlook isn't being reflected in their spending habits.

Consumer sentiment Q1, 1966 = 100

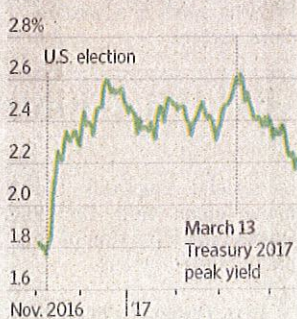


All three of these charts show a slight slowdown.

Consumer confidence is near an all time high but spending has not kept up.

Falling Back

Yield on 10-year U.S. Treasury note



Note: Yields fall as bond prices rise.

Source: Tullett Prebon

THE WALL STREET JOURNAL

A slower economy tends to lower interest rates, however, this could reverse quickly if the economy picks up.

rising level of confidence, hasn't translated into increased sales, (see charts on the back of this page). Also, car sales have fallen following a record 7 year run of rising vehicle sales, which peaked in 2016. In all, retail spending dropped 0.2% in March, pressured by falling receipts at car dealers, service stations and building materials. The consumer price index also dropped 0.3% in March. As a result of a possible slower economy, bond yields have dropped, (see chart on page 2), however, this could turn on a dime or reverse quickly.

Earnings are projected to grow over 10% in the first quarter powered by energy's rebound, which were a battered sector early last year.

So, Is the Trump Rally Over?

We think the slowdown is more of a pause than a trend. There is a long history of 1st quarter numbers, being wrong due to seasonal adjustment errors. Our cautious optimism reflects the fact that the labor markets are near full employment and wages are rising. Also, retail spending was likely delayed by the late Easter and slower than normal disbursements of tax refunds. We think the markets may have overreacted.

On balance, the economy seems to be in reasonable shape, with even the president of J.P. Morgan, Jamie Dimon, pronouncing that consumers and businesses are healthy. On the back of this page, Zacks Investment Research, project solid earnings gains into 2019. Supporting this view, the numbers show increased industrial output, capacity utilization and building permits. First quarter earnings are just being released, and so far, the results are decent. Such durability suggests the economy will gradually strengthen over the course of the year. We believe Trump will achieve many of his goals but the market seems fully priced now and it could take 9-18 months to enact changes in our budget and legislation.

Asset Allocation

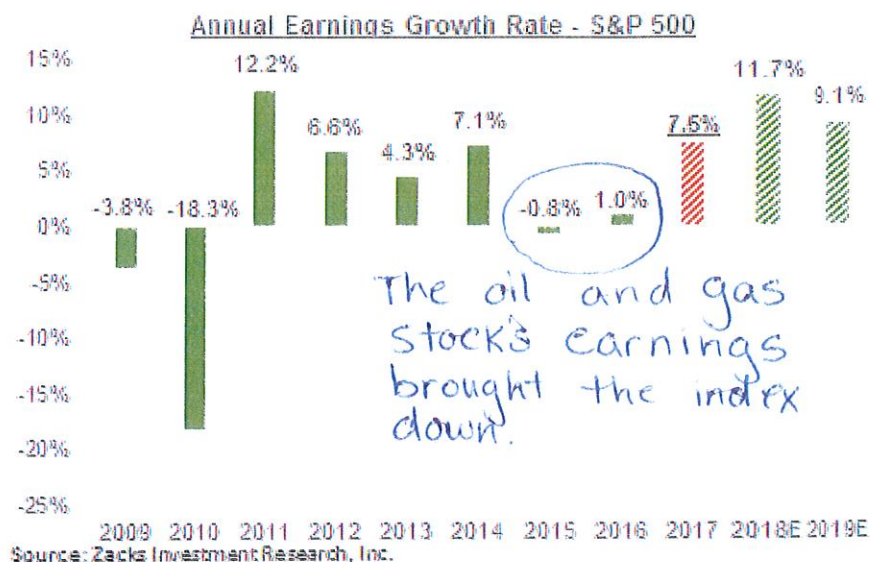
On the back of this page is a chart of the S&P 500 index that shows the great recovery we've had since 2009. Clearly, stocks aren't cheap like they were 4 to 7 years ago, but a return of 7 to 9% per year, is certainly doable. For the first time in 8 years, international equities are doing significantly better. Valuations are simply better overseas. For example, price earnings ratios, (i.e. the price of the stock divided by earnings per share), are relatively high, at over 18, while the same type of company in Asia or Europe, trades at 14 and sports a dividend and is growing faster. Since 2009, it's being an American led stock market and that is where we have invested. However, going forward, we plan to have a market weight for international investments, which is in the 20 to 30% range of a portfolio.

Conclusion

The stock market has come a long way in recent years and we believe that care and selection remain prudent investment strategies at this time. Please call anytime.

See attached flyer on the Shredding Party that I am hosting on Tuesday, May 23rd, at my office building. The event will take place in the back parking lot and Lunch will be served in the board room.

Chart 11 – Total Annual Earnings Growth



Good earnings growth is projected for 2017/2018.

The oil and gas stocks earnings brought the index down.

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