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# Sound Investments Inc.

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## Second Quarter 2017

### Summary

DJIA 21349

S&P 500 2423

NASDAQ 6140

Normally, the price / earning ratio values stocks at about 16 times earnings. Today, the ratio is about 19. The question is; is it overvalued? I don't think so, for the following reasons: 1.) Interest rates have increased but the 10 year treasury current yield is 2.7% and provides little competition for stocks. 2.) Corporate earnings -- an important determination of share prices -- are having a growth spurt. First quarter profits increased nearly 15% for the S & P 500 companies and another increase for the 2nd quarter is expected. 3.) Notwithstanding the difficulty getting health care legislation passed there is a good chance of passing an infrastructure spending bill. 4.) Companies may be able to repatriate overseas profits at a reduced tax rate. 5.) Corporate tax rates around the world are approx. 20% whereas our rates are 35%. With a republican controlled House and Senate, I believe this can get done, which will reduce the price / earnings ratio to a very reasonable 16.

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

### Markets: Spring into Summer

Fear took hold through the first half of May as U.S. Funds sank, fund outflows surged and pundits rang alarm bells about a summer swoon. Then, as has been a recurring theme, market resilience resumed as investors bought into the dip and pushed the major indexes to all time highs.

For the past three months ending June 30th, the strongest index was the foreign developed markets (EAFE), up 5.2% and the Nasdaq 100, up 4.7%. The Emerging Markets also did well, up 5%. After being the clear leader, from 2009 to 2016, the S&P 500 index trailed the group, edging up 1.2%.

### Upbeat Despite Uncertainty

At eight years and counting, this bull market is becoming one of the longest. Although stretched by any measure, the market has been remarkably resilient and for good reason. Investors today are benefiting from a rare period of sustained worldwide economic expansion. For the first time in 10 years, growth is rising in the U.S., Europe and Asia. The International Monetary Fund forecasts world growth at 3.5%, the fastest growth in 5 years.

In our last letter, we discussed the high level of optimism or confidence in the economy. Optimism is still sky high with both the Conference Board and Small Business Indexes at their highest levels since 2004. Citi Bank anticipates capital spending for their new plant and equipment, will be up 16% this year.

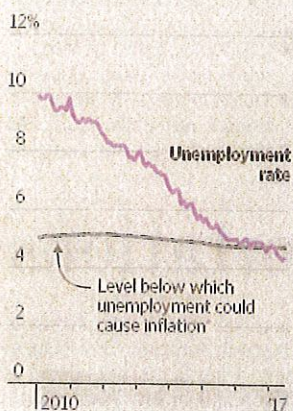
The back of this page contains a chart that shows how employment has improved, with unemployment rates trending

down. However, wage growth, has disappointed. This low wage growth has puzzled economists and they have advanced a number of explanations including globalization,

## Employment Picture Looks Bright,

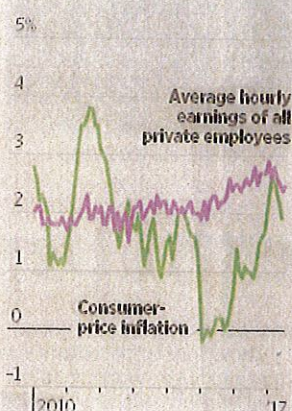
Unemployment is near its lowest point in decades...

Unemployment rate



...but earnings and inflation aren't picking up.

Change from a year earlier

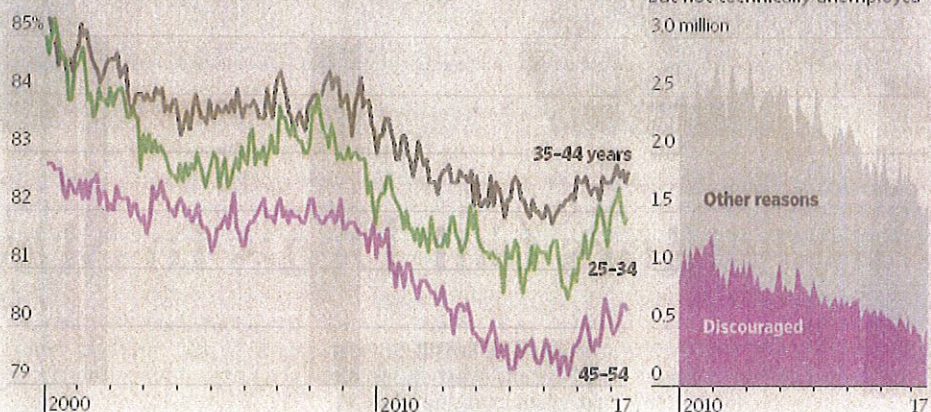


unemployment rates are near the point where inflation normally increases but so far, there has been little inflation.

## but Job Market Still Has Some Slack

It's a sign there may still be untapped supply in the labor market, including prime-age workers who were waiting on the sidelines...

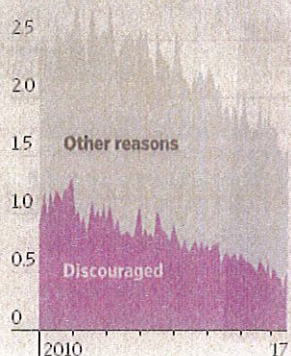
Share of the population either working or looking for work, by age



...and discouraged workers who are returning to the labor force.

Searched for work and available, but not technically unemployed

3.0 million



There is still an untapped supply of labor but an improved economy is pulling workers in.

reduced power of unions, automation and more people sitting on the sidelines. The lower chart shows an improving job market participation rate. A better economy is slowly pulling more American off the economy's sidelines.

### Is the Stock Market Too High?

I have often used the term Price / Earnings ratio. Normally, the values of stocks are about 16 times their earnings. Today, the ratio is about 19. The question is: is it overvalued? I don't think so, for the following reasons: 1.) Interest rates have increased but the 10 year treasury bills current yield is 2.7% and this provides little competition for stocks. 2.) Corporate earnings -- an important determination of share prices -- are experiencing a growth spurt. First quarter profits increased nearly 15% for the S & P 500 companies and another increase for the 2nd quarter is expected. 3.) Notwithstanding the difficulty in getting a health care legislation done there is a good chance of passing an infrastructure spending bill. 4.) The tax laws may be changed to allow companies to repatriate overseas profits at a reduced tax rate which will support spending and dividends. 5.) Corporate tax rates around the world are approx. 20% whereas our rates are 35%. With republican controlled House and Senate, I believe taxes can be reduced, which will reduce the price / earnings ratio to a very reasonable 16. (See chart on back of the page)

Most forecasters, or so called "experts", also feel the market could go higher, however corrections of between 10 to 20% occur every one to two years, with the last correction of 13% occurring in Feb 2016. Pullbacks of 5 to 10% occur every 7 months which means we are overdue.

### What Working Now

Three types of investments that are currently performing well 1.) Technology-focused funds 2.) Developed foreign funds, (i.e. Europe and Japan) and 3.) Emerging markets or less developed countries. Since 2010 to 2016 we were invested in American equities which served us well. However, in our March client letter, we stated we plan to have a market weight for internationals in the 20 to 30% range. (See chart on the reverse on back of this page)

### Conclusion

Not surprisingly, the market continues to hold it's own. The lure of lower taxes, rising earnings and the unattractiveness of low yielding bonds continue to underpin the market. This is very reassuring but there is a lot that could go wrong. We believe the markets will muddle through and be higher a year from now.

We continue to watch and monitor the portfolios. Please call anytime.

Once a year I am required by the Security Exchange Commission to offer to send a copy of my ADV part 2 to our clients. This outlines our companies policies and procedures. I would be happy to send it out, or better yet, make come by and explain it to you. Also, see the attached privacy statement.

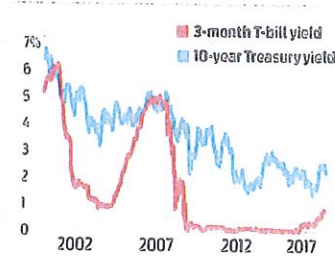
# The Case for Stocks

## WHY A HIGH-PRICED MARKET HANGS TOUGH

Valuations are high...



...but interest rates remain low...



...and corporate profits are improving.



Through April 30 SOURCES: FactSet, Federal Reserve Bank of St. Louis, S&P Dow Jones Indices

Kiplinger, July 2017  
Low interest rates and higher profits  
support the market.

