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Sound Investments Inc.

First Quarter 2018

DJIA - 24103.1 S&P 500 - 2640.9

Summary

See the charts on page 2 -- They do not show a perfect economy; but, it is what one would expect from an aging bull market, which just turned nine years old. **Our sense is that this market can go higher with continued good earnings and employment news**. We think rising rates will be contained.

Clearly, we have a lot to ponder. What's making things unsettled is a stronger and more vibrant economy that has the potential to force interest rates up a lot faster than previously anticipated. This lowers bond prices and may lower price/ earnings ratios

We welcome your calls

This investment letter is mailed quarterly to our clients and friends

Markets: A Step Back

In my last client letter, I discussed how last year was such a banner year, gaining more than 20% on a smooth up-trend. Then, I wrote about how the market will be tested by a correction, and that when the market is high--like it is now--it overreacts to bad news.

I wrote this report about January 15 and right on cue, after rising 4.5% by January 26, the market turned down. After 15 months of positive performance, the market headed south. It suffered two 10% corrections or declines this year—a response to higher interest rates, inflation fears, trade war threats, and Trump tweets. Small wonder investors are feeling less exuberant today than they were last fall when the market's honeymoon with President Trump's economic agenda was in full swing.

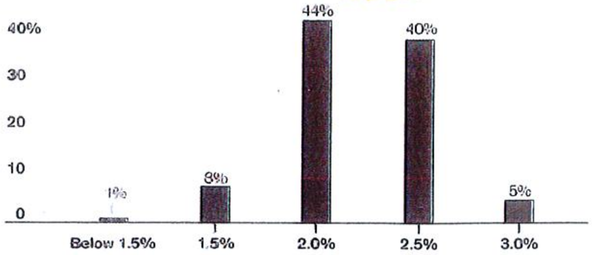
Returns for the first quarter are relatively flat; but over the last year remain strong.

What's Next?

Is this pullback the start of a recession, or just a correction? Let's have a brief look at the four primary causes of a bear market listed below:

1. **Rising Rates and Tight Money**: The interest rate is currently 2.8% on a ten year government is too low. Rates could rise to 3.5% or higher, and still be manageable. When interest rates go up bonds go down. I sold most of the long term bond holdings in Jan/Feb.
2. **High Inflation**: Currently, inflation is 2.2% (1.8% excluding food and energy)which is in line with Federal Reserve guidelines at 2%. Wage inflation is approximatley.2.5% and is gradually headed higher.

Predict the inflation rate in the next 12 months.



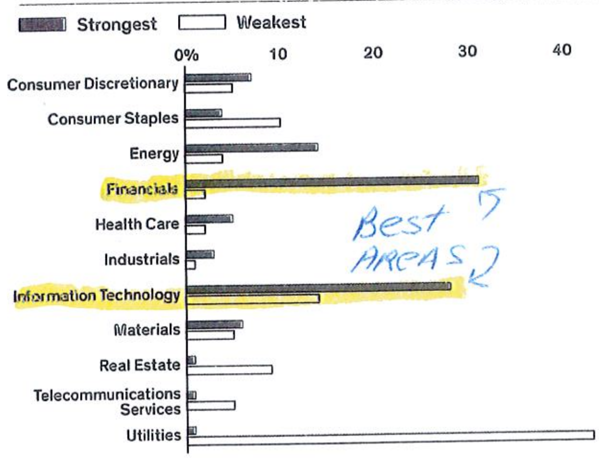
InFation is heading slightly Higher.

Will the global economy strengthen, weaken or stay the same in the next 12 months?

Strengthen:	**75%**
Weaken:	8
No change:	17

Stronger Internationa markets

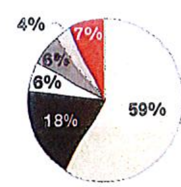
Which industry sector will be the stronger performer in the next 12 months? Which will be the weakest performer?



Best Areas

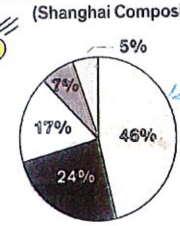
What asset class is most attractive today?

- Equities
- Commodities
- Cash
- Gold
- Real Estate
- Other



What major equity market will perform best in the next 12 months?

- Emerging Markets
- US (S&P 500)
- Europe (STOXX Europe 600)
- Japan (Nikkei 225)
- China (Shanghai Composite)



We have done well in emerging markets

Write Me a Check

Silicon Valley's venture-capital market is operating in high gear, with record levels of late-stage money flooding in. **Article on B5.**

Investments of at least $50 million in U.S. venture-backed companies, by quarter

NOTE: 1Q 2018 is through mid-March
Source: Pitchbook
THE WALL STREET JOURNAL.

Investors are willing to invest in start-up companies which shows continued confidence

3. **Rapid Growth**: Growth estimates of 2.6% remain on track, and business confidence remains strong.
4. **Over Valuation**: At its peak, the S&P 500 fetched nearly 19 times earnings estimates. Today the price/earnings ratio is 16.9, closer to the long-term average of around 15, so valuations are in line.

The above information <u>does not show a perfect economy</u>; but, it is <u>what one would expect from an aging bull market</u>, which just turned nine years old. Our sense is that this market can go higher with continued good earnings and employment news. We think rising rates will be contained.

A Decent Picture for Stocks

There are some issues that aren't picture perfect. However, there is a wonderful economy outlined, as follows:

- Statistics from Barron's predict a 9.6% gain for the year. See illustration on page 4.
- The latest poll of big money managers from Barron's finds that 55% are bullish, which is down from 61% last fall. Interestingly, the managers didn't turn pessimistic, but generally, turned neutral.
- The global economy is expected to improve as well, boosting the fortunes of U.S. multinationals.
- I subscribe to a number of investment letters that advise lower tax rates, less regulation, full employment, and the repatriation of corporate cash are all good situations for stocks.
- None other than Jamie Dimon, the head of J.P. Morgan, reports the global economy continues to do well. U.S. business sentiment remains upbeat, and consumers will benefit from job and wage growth.
- Venture capital is flowing into new businesses, again indicating confidence in the economy. See "write me a check" chart on page 2.
- Big money managers like Emerging Markets, Financials, and Information Technology are gaining momentum and will likely go higher.

Conclusion

Clearly, we have a lot to ponder. <u>What's making things unsettled is a stronger and more vibrant economy that has the potential to force interest rates up a lot faster than previously anticipated</u>. <u>This lowers bond prices and may lower price/earnings ratios</u>. There is an increased level of volatility in the stock market that, for years, had enjoyed remarkable stability. <u>So, we are raising some cash, but plan on staying the course.</u> We are keeping a watchful eye for developments that could cause a shift in market sentiment.

Our sense is the market will be higher a year from now. We welcome your calls.

BARRON'S

Market Week

April 2 throu

Index to S

Our Founder Clarence Barron

If history is a guide, stocks will stay volatile this year, according to DataTrek Research. The Standard & Poor's 500 moved more than 1% in either direction on 23 days in the first quarter; that's nearly triple the number of such days for all of 2017. In the nine other years since 1958 in which the first quarter notched 20 to 25 days of a 1% move, the remaining three quarters all had an above-average number of such days, and there was a mean total of 86 1%-days annually. The most historically volatile months lie ahead: April, June, August, and October. The silver lining: Average price performance during those nine years was 6.1% for the year, and the average total return, 9.6%.