

Sound Investments Inc.

Second Quarter 2018

DJIA -24274 S&P 500 -2718.3

Summary

The case for the bulls (a growing economy and strong earnings) and the argument for the bears (rising interest rates and a possible trade war) would seem sufficiently offsetting to keep major market moves at bay in the short term. We expect significant rotational among the market sectors. Through it all however, earnings should remain strong enough to keep any downturns brief and shallow.

Our sense is that we're in a range bound market, that rises and falls based on the news cycle. We think a good motto for the times is, Keep Calm and Carry On! The market is richly valued and replete with uncertainty, yet still promising based on fundamentals.

This investment letter is mailed quarterly to our clients and friends

Markets: Halfway Through 2018

There is a saying that, "A picture is worth a 1000 words" -- and such is the case this quarter. On the last page of this letter there is a chart that shows an index of 7,000 stocks. During the first 6 months markets were basically flat. You will note the dark blue line which I label Short Term Resistance. The market has tried to go through this 3 times and has pulled back each time. Eventually it will go through but it may take several more tries.

Throughout the last quarter the more globally dependent Dow Jones underperformed while the much more domestically focused NASDAQ outperformed.

The rest of this report focus on the balancing act between the strong sales and earnings gains balanced against the geo political trade wars, higher interest rates, and the decade old bull market.

Economic Output -- Steaming Ahead

Growth steamed ahead at an annual rate of 4% in the 2nd quarter. Only once, in the past 9 years, has growth exceeded this pace. Furthermore, spending by consumers, businesses and governments look solid going forward.

Corporate earnings are growing too. Operating earnings -- (a measure of earnings without one time charges and gains) are estimated to have risen 27% over the 2nd quarter of 2017. Ned Davis research stated, "80% of U.S. companies are beating earnings expectations."

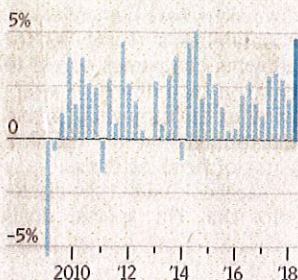
Newspaper headlines are echoing the same thought with articles such as:

More Jobs than Jobless: Job openings rose to 6.7 million compared to 6.3 million Americans who were unemployed. (see chart on page 2) For workers it's good

Heating Up

The second quarter may have been the strongest for the U.S. economy in years. But previous spurts of GDP growth in excess of 4% haven't been sustained.

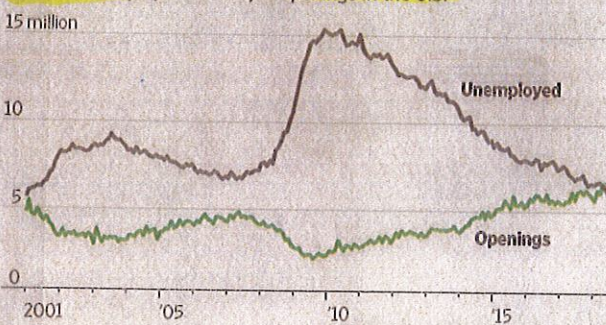
Annual quarterly GDP growth



After The Great Recession of 2009, it was easier to register 4% growth because there was so much slack in the economy. The recent 4% gain is quite a feat

Gap Closes

Level of unemployment and job openings in the U.S.

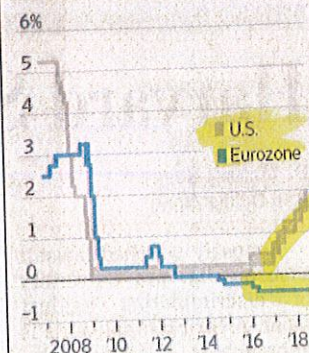


More jobs than jobless. Sooner or later this will cause wages to rise and may lead to some inflation.

Diverging

U.S. rates are rising while those in Europe are unchanged.

Interest-rate targets



The fact that the U.S. can raise interest rates significantly higher than Europe, will lead to a higher U.S. dollar, which may hurt trade.

◆ ECB to phase out bond-buying program..... A9

news, but it presents challenges for businesses. For instance, firms may need to cancel the third shift if they can't find workers or pay more to attract workers. Higher wages leads to inflation which has been creeping up in recent months.

Economic Growth in U.S. Leaves the World Behind. As the U.S. economy zips along Europe and China appear to be slowing down. In an indication of growing economic vigor here at home, the Federal Reserve Board raised interest rates in June and stated more rate increases may be store because of a strengthening economy and tighter labor markets. (see Chart on page 2)

So, if the economy is going gangbusters why isn't there more enthusiasm for stocks? You don't have to look far to see reasons for market weakness. Traders and analysis are focusing more on company **forecasts to gauge if growth, will continue and there is concern about the following:**

1. A stronger economy is driving up inflation (now at 2.9% in the past 12 months) and interest rates.
2. There are major differences with China, the European Union and the U.S. over tariffs and intellectual property. The rhetoric doesn't help either.
3. This extended bull market run, that began in the spring of 2009, is entering its 112th month as the 2nd longest recovery in U. S. history and while the path looks heathy, investors are wondering when things could come to end.
4. Trump is seeking to remake America's relationship with the world. It's another source of uncertainty that is unending of the World War 2 order, both politically and economically.

There you have it! The case for the bulls (a growing economy and strong earnings) and the argument for the bears (rising interest rates and a possible trade war) would seem sufficiently offsetting to keep major market moves at bay in the short term. We expect significant rotational among the market sectors. Through it all however, earnings should remain strong enough to keep any downturns brief and shallow.

Conclusion

Our sense is that we're in a range bound market, that rises and falls based on the news cycle. We think a good motto for the times is, Keep Calm and Carry On! The market is richly valued and replete with uncertainty, yet still promising based on sales and earnings.

We have generally remained fully invested over the past 8 years and have been well rewarded. Nobody knows but we do not see a major bear market coming however corrections of 10% are normal. We watch the market daily and welcome your phone calls.

Index of 7,000 stocks. This index is more "cleaner" than the S&P 500

High JAN 26
49.5

SHORT TERM RESISTANCE

failed twice
to break through.

SIX MONTHS ending June 30 → July 2018
A VERY FLAT MARKET.

When these lines
get down here it
generally indicates the
MARKET is OVERSOLD.

DATE ↗

50.00
47.963
46.00
44.00
42.00
40.00
2.00
1.00
0.00
-1.00
-2.00