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First Quarter 2018
Equity Market Commentary

April 8, 2018

Tech's Come Undone

Tech's come undone,
They didn't know what they were headed for,
And when they found out where they were headed for,
It was too late.

They've come undone,
They climbed a mountain that was far too high,
And when they found out that they couldn't fly,
It was too late.

It's too late,
They've gone too far,
It isn't fun,
They've come undone
Not even tech stocks grow to the sky
Yes, it's the time for us to realize
It was too late.

It's too late,
They've gone too far,
They've lost the sun,
Tech's come undone

- *Apologies to The Guess Who, Undun*

Stocks started 2018 with a flourish, sprinting higher in January as enthusiasm over stronger economic conditions and the expected benefits of tax reform caught the imagination of individual investors who decided it was finally safe to get back into equities. After all, what could go wrong in an environment of historically low interest rates, accelerating economic growth and an Administration finally able to enact tax reform? Well, a not-so-funny-thing happened on the way to prosperity for the newest stock market investors. Suddenly, wage inflation spiked to worrisome levels, trade war concerns escalated as President Trump threatened huge tariffs on steel and aluminum, the yield curve flattened as the specter of slowing global growth entered investors' psyche and the firing of Secretary of State Tillerson created panic and turmoil in the Administration as many wondered if there were more forced retirements ahead. As we warned in our last quarterly letter, stock market investors had become too complacent, volatility was sure to rise and technology issues had become vulnerable to a correction as they were taking on Beanie Baby and tulip bulb characteristics. That correction came hard and fast late in the quarter and caused most major indices to slip into negative territory for the period. While the Nasdaq's early quarter heroics enabled it to eke out a gain for the period, the change in leadership we have been expecting and writing about appears at hand. Indeed, I am pleased to report that although our Equity Composite underperformed the broad indices for the quarter, it significantly outperformed for the month of March of 2018.

Fixed income securities also struggled in the first quarter due to the aforementioned trade war fears, wage pressures and burgeoning inflation. As expected, the Federal Reserve raised the Fed Funds rate by an additional 0.25% in March and warned that it expects at least three more hikes by the end of 2018. Bond investors are coming to grips with the possibility that the long-term bull market in fixed income securities may be ending. Intermediate-term bonds lost in excess of 2% for the period, while long term US Treasuries sank nearly 4%. Our decision to focus on shorter term fixed income securities helped us to protect our clients' principal and limit the damage from higher rates.

The mixed performance of the broad stock market would suggest a relatively subdued quarter, but actually, there were huge swings among sectors. Energy issues fared the worst (-6.6%), even as Nymex gasoline prices jumped 12.2% and crude oil prices rose 7.5%! Interest sensitive and generally more defensive issues also underperformed, as real estate issues sank 5.8% and utilities fell 4.3%. Encouragingly, small capitalization stocks (-0.08%) finally began to outperform the mega-cap dominated S&P 500 (-1.2%). More than two thirds of the 30 Dow Industrials fell during the quarter, with General Electric being stripped of its rank and 22% of its value, Proctor & Gamble swimming against the Tide (-13.7%) and ExxonMobil leaking oil (-10.8%).

With all this turmoil in stocks and investor angst over the implications of higher interest rates and possible trade wars, it's worth reviewing the fundamental economic backdrop. First and foremost, the domestic economy is on solid footing as businesses continue to grow, the economy is creating new jobs (ADP reported that in March 245,000 jobs were added) and consumers are already benefiting from the newly enacted tax bill. In February, Consumer Confidence reached its highest level since November 2000, and housing values rose in February by 8.8%, the fastest rate in four years. Auto sales continue at robust levels (January sales were at a 17.4 million annualized rate), the Architecture Billings Index registered positive readings for 16 of the last 17 months, North American truck orders have been very strong and housing prices continue to rise due to a shortage of available inventory. Lower corporate tax rates will cause

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higher levels of after-tax income and profitability for U. S. companies and the new tax bill offers clear incentives for businesses to spend on new capital equipment

One of the economy's biggest challenges is the shortage of available workers for skilled and unskilled jobs, which augurs well for individuals arriving or already in the workforce as higher wages will allow employers to attract workers and fulfill their labor needs. The downside to this growth is the impact higher costs affect companies' bottom line. Transportation and raw materials costs have begun to eat into corporate margins and, not surprisingly, investors are wary of the negative impact higher tariffs would have on profitability should a trade war with China ensue. There is no clearly defined timetable for the imposition of the trade tariffs by either the U.S. or China, and thus far there is simply talk of a May start date. It is important to note that thus far, we are having a war of words and not a trade war and, as with most things Trump, the bluster will prove much more damaging than the bite. We think this issue will die down in coming weeks and that cooler heads will prevail. We just need to accept the fact that brinksmanship is part of the playbook utilized by President Trump in an attempt to shape economic and political policy. The most important conclusion is that all the sound and fury is just a tale told by our President (apologies to William Shakespeare), and the economy appears unlikely to enter a recession in 2018.

With continued solid economic growth and lower corporate tax rates, corporate earnings should increase significantly in the year ahead. Oil companies should have the strongest growth as the past year's rebound in energy prices aids results. Energy issues have lagged the stock market advance of recent years and continue to represent some of the best values in the market due to their generous dividend yields and discount valuations. No one seems to be talking about it, but political tensions are escalating in the Middle East as Saudi Arabia and Iran are jockeying for power in the region. Last week, Yemen rebels, thought to be under Iranian influence, attacked and damaged a Saudi oil tanker in the Red Sea. Those who have a historical investment perspective remember the importance of oil shipping routes and how significant a disruption to any of the shipping straits could be. The risk/reward for energy issues appear extremely attractive at current levels and we remain overweight in the sector.

Not surprisingly, the technology sector offers few great values and should be considered vulnerable to a period of consolidation and lackluster performance as the previous years of heady performance are digested. We are also cautious in our outlook for the health care industry, as pressures continue to build for ways to limit price increases and companies look for ways to reduce costs. Warren Buffett of Berkshire Hathaway, Jamie Dimon of JP Morgan and Jeff Bezos of Amazon are teaming up to try to attack spiraling health care costs and President Trump has promised a major policy initiative to enact drug price controls. As such, we think it is a sector that investors should approach with caution.

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Instead, we would look to consumer discretionary, industrial and financial issues as offering better investment opportunities.

Historically, the next bull market's leaders are identified by their outperformance when the market corrects. The most recent market correction suggests that technology will be taking a back seat in the next advance and will likely be used as a source of funds as the market rotates into other sectors. We welcome the rotation out of growth stocks into value and are confident that our client accounts are well positioned for this more volatile market environment. We are honored to manage a portion of your investment portfolio and, as always, welcome your questions and comments.

Sincerely,

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James P. O'Mealia joined the Seelaus Asset Management investment team as the Head of Equity Portfolio Management in April 2017 as part of the firm's acquisition of Sunnymeath Asset Management, Inc. James manages separately managed equity and balanced accounts for institutions, foundations, and high-net-worth individuals, as well as five private limited partnerships.

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