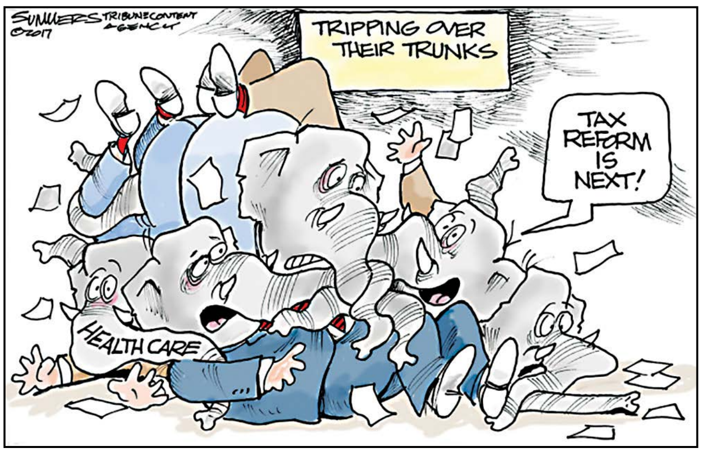
April 2017: "United We Stand, Divided We Fall"

We've all heard the phrase. Perhaps your introduction to the idea was via the Greek storyteller Aesop, the Bible, or President Lincoln's admonition in the Lincoln-Douglas debates that a "house divided against itself cannot stand." Whatever the context, the idea is a simple one. And certainly one the equity markets took to heart in mid-March as the Republicans stumbled with their first major legislative push to "repeal and replace" President Obama's Affordable Care Act. After all, if the Republican majority in the House of Representatives, let alone the Senate, cannot muster the votes to deliver a healthcare alternative to "Obamacare," how will they ever deliver on highly anticipated items such as corporate tax reform? The investor consternation resulted in eight consecutive down days for the Dow Jones Industrial Average – the longest streak since 2011 and just one day shy of tying a record that dates back to 1978. This mid-March market retreat was a fairly paltry 2%. Yet, it was a reminder that many investors are anxious about the market outlook if President Trump's perceived pro-growth agenda looks in jeopardy.



Despite stalling in March, the S&P 500 is up 6% year-to-date. It is up 11% since the election. The MSCI all-world index is up 6% year-to-date. This index has a 46% weighting in non-U.S. markets. Outside the U.S., emerging markets led the way with an 11% gain. The Barclays Aggregate Bond index is up just below 1% so far in 2017. The Bond index's muted 2017 return masks the volatility bond investors have experienced of late as expectations fluctuate around the number of Federal Reserve rate hikes in 2017.

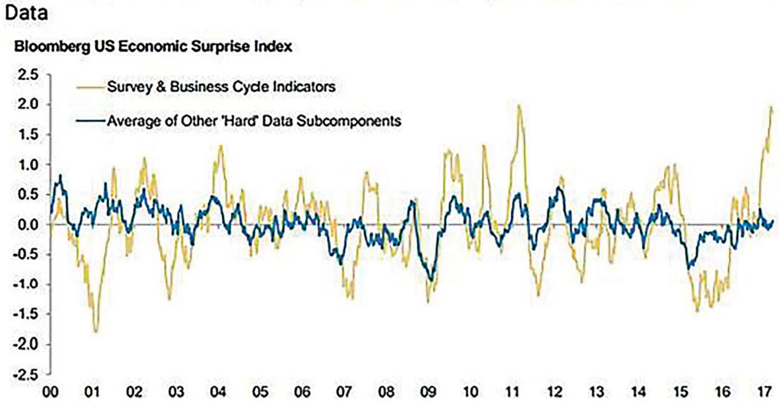
In our January commentary, we reiterated our thesis that "sell equities" was not the right call. We are sticking to this thesis in part because we recognize the inefficiency and performance danger of long-term investors jumping in and out of the market. We also believe Congress will deliver on some form of corporate tax reform. The stakes for the Republicans are too high to fumble again. Perhaps General Electric CEO, Jeff Immelt, clarified the political stakes recently noting that "if a Republican-led government can't achieve tax reform, why have the Republican Party?"

We will, nevertheless, maintain equity exposure at the low end of most clients' target ranges given their risk tolerance. We'll also be patient allocating new capital. The potential unintended consequences of seemingly cheap money forever, and higher equity valuations, have affected our view of stocks' near-term risk versus potential reward. And the reality is Washington remains deeply divided over trade, taxes, regulations, and entitlements, all topics about which the market cares deeply.

Hard or Soft Economic Data?

The past few weeks there has been a plethora of articles and Wall Street research highlighting a divergence between the hard and the soft economic data. The Wall Street Journal explains how hard data is quantitative and includes economic reports such as retail sales, durable goods orders, and gross domestic product. Soft data is more qualitative. It would include consumer confidence, investor sentiment, and business forecast surveys. Some fear robust soft data without hard data suggests that markets have gotten ahead of themselves. Others argue increased investor and consumer confidence (soft data points) are precursors to investment and spending that translates into economic activity (eventual hard data). Then there is the question of whether historic hard data

Exhibit 1: There is a Record Gap Between the Strength of 'Hard' and 'Soft' US Macro Data

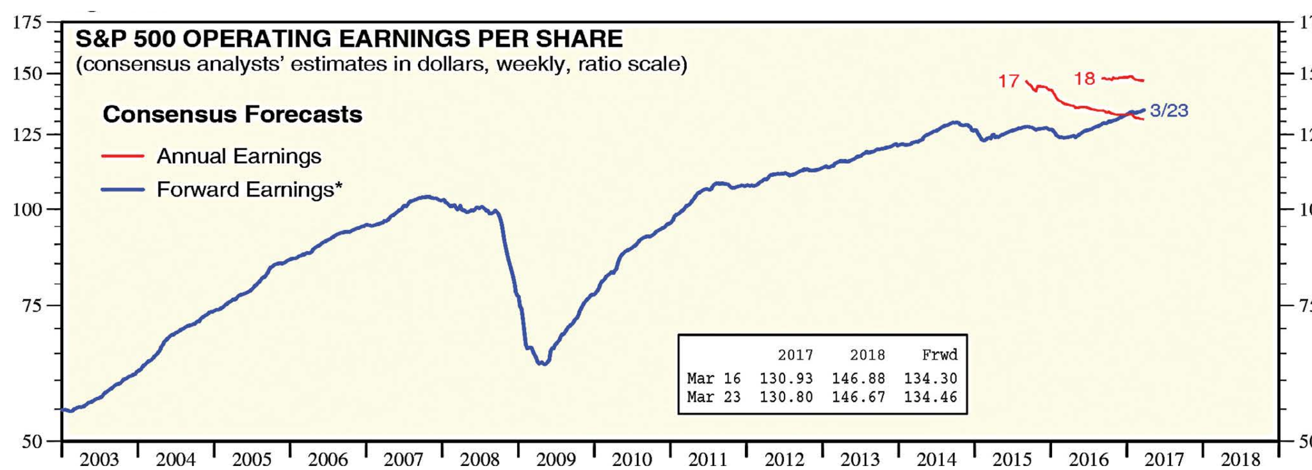


Source: Bloomberg, Morgan Stanley Research metrics fully capture the economic activity of today's rapidly changing "shared economy."

Economists are certain to keep the debate alive. Yet for investors who own a share of a company's stream of earnings, nothing much resonates like corporate earnings growth. It is from these earnings that companies return capital to shareholders in the form of dividends, share repurchases, or paying down debt. Fourth quarter corporate earnings proved healthy up 22%, according to a Commerce Department report last week. The fourth quarter of 2016 was lapping a particularly bleak report due to the earnings drag of the 2015 energy crash. For the year, corporate profits were still up an improved, albeit much more modest, 4%. If Republicans (and maybe even a few Democrats) can unite to push through some pro-growth policies, 2017 or at least 2018 profit growth could accelerate.

S&P Earnings. With or Without the Stimulus?

The consensus estimate for 2017 S&P earnings stands at $131 as of last week. At the beginning of 2016, the estimate for 2017 was $136. This is typical. Analysts' forward estimates are usually aggressive. There are unknowns that must resolve themselves over time, and for Wall Street strategists generally in the business of selling investments, life is much simpler to take the glass half-full versus half-empty view. It is tough to remember, however, a period when these unknown swing factors for the earnings outlook were greater than they are now. Corporate execution, including how well companies manage rising wages and whether considerable productivity gains are still to be had, is an important factor influencing the earnings outlook. Potentially more influential, given the range of policy actions seriously on the table for the first time in years, are any changes to corporate taxes, trade policy decisions that will affect currency translations, and infrastructure building incentives. Another new variable that could offset these potentially pro-growth policy actions, is the extent to which nationalistic trends push otherwise global economies to act locally versus globally. As a reminder, almost 44% of S&P 500 company sales are to individuals and entities outside the U.S. Clearly, these are not on the margin factors. A 7.5% reduction in the corporate tax rate could boost S&P EPS by roughly 6% even before companies deploy the additional cash flow. While any policy shifts would take time to filter into the system, overseas cash repatriation or an infrastructure plan would further boost earnings growth.



Source: Yardeni Research

The significance of these swing factors is why we must consider the value of the market relative to trailing and forward earnings estimates and weigh near-term risks versus reward when determining market exposure in the context of risk tolerance. At 20X trailing EPS, the market trades well-above its long-term historical average of 16X. At 18X estimated 2017 EPS and 16X more stimulated 2018 EPS, the market is valued more reasonably, especially in the context of today's still historically low interest rates. Of course, for anyone considering the 2018 consensus estimate remember the assumption glass behind this estimate is likely half-full.

The Sector Reversal Trend Continues

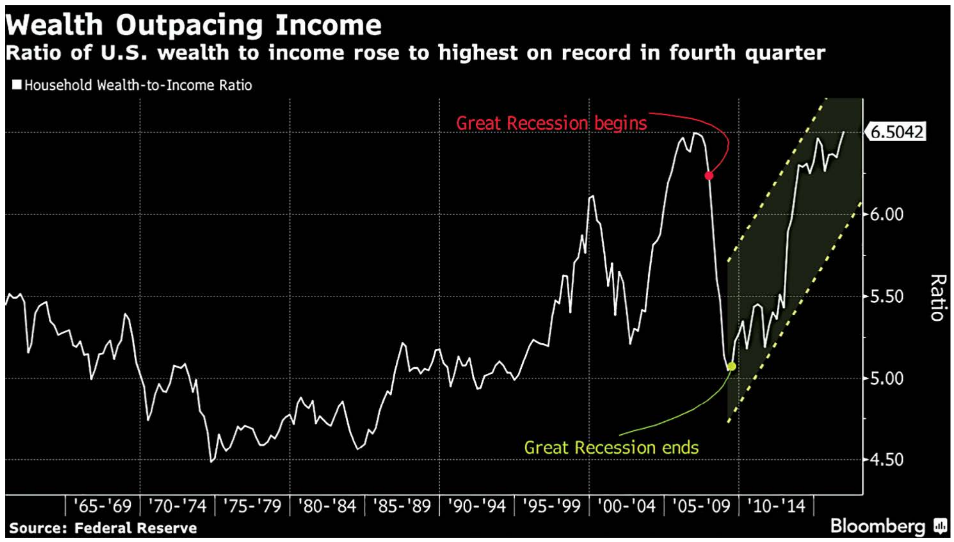
Last year's equity sector loser, healthcare, was the first quarter's winner. Similarly, last year's winners, energy and telecom, are the year-to-date laggards and the only two sectors with negative returns in the first quarter.

Large-capitalization technology stocks Apple, Alphabet (a.k.a. Google), Facebook, Amazon, and Microsoft are all off to strong starts in 2017. Their gains have fueled the Nasdaq's 10% year-to-date return. As noted by one market follower, these five companies' almost $3 trillion combined market capitalization now exceeds the gross domestic product of every country in the world but four.

Life is good for private tech investors as well with over 150 companies raising private capital at valuations in excess of $1 billion. Based on its most recent capital raise, nine-year old privately held Airbnb's valuation is $31 billion. This compares to ninety-year old lodging peer Marriott's $36 billion market capitalization.

Of note, Apple now represents 3.7% of the S&P 500. The stock's 24% gain thus far in 2017 has contributed about 15% of the S&P 500's year-to-date return. Most of our clients own Apple directly or via broad market exchange traded funds. While still arguably a cheap stock, Apple's over $750 billion market cap may present certain practical constraints to significant appreciation from today's levels. We're also anxious to see the release of the ten-year anniversary iPhone later this year, some models of which are expected to retail for $1,000. The first iPhone was launched in 2007 at which time Apple's market capitalization was roughly $90 billion.

Market and Housing Gains = Record Household Wealth = Increased Nationalism?



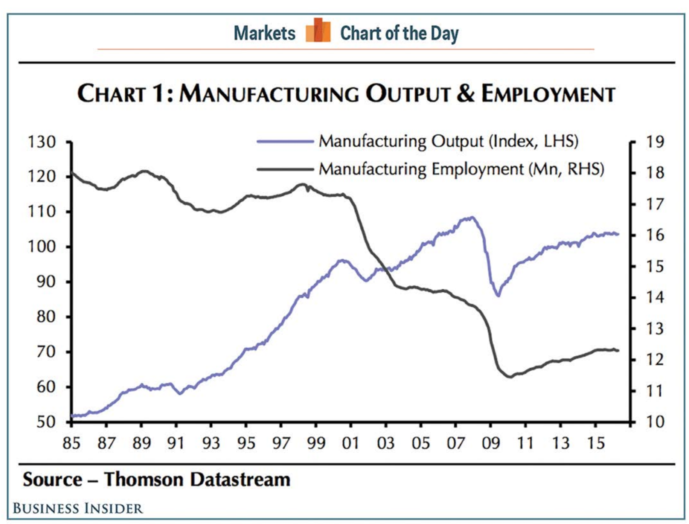
Stock market gains and a robust housing recovery have resulted in U.S. household net worth exceeding $93 trillion, according to a recent Federal Reserve report. Because disposable incomes have grown much slower, the wealth to income ratio is at record levels. While wage rates are improving, the investor class has disproportionately benefited from the post Great Recession recovery. This is true at home and abroad, and has undoubtedly contributed to rising nationalism around the globe. Many market observers believe the potential spreading of nationalistic fervor, and its anti-trade policy bias, represent the greatest threat to global economic growth. As a result, investors are watching the polls in Europe and elsewhere as intently as the hard and soft data.

Has Our View on Bonds Changed? or Admittedly, We Are a Broken Record on Bonds

As you know, we've resisted the temptation to reach for yield via longer dated bonds. Considering a 1% change in rates can result in a 20% decline in a thirty-year U.S. Treasury issued at today's prices, buying long-bonds could be like "picking up pennies in front of a steam roller." During the first quarter, the yield on the Ten-Year Treasury eclipsed 2.6%, which was the highest yield since 2014 but well below its thirty-year average of 5.1%. Angst around the successful passing of fiscal stimulus and only modestly improving hard data, contributed to a rebound in bonds and the yield on the Ten-Year ending the quarter at 2.4%. We'll continue being patient, accumulating five and up to ten-year bonds during periods of volatility when we can at least get dimes and quarters to compensate us for the risks associated with any increase in interest rates.

All Things Automated? Clearly, the World Is Changing

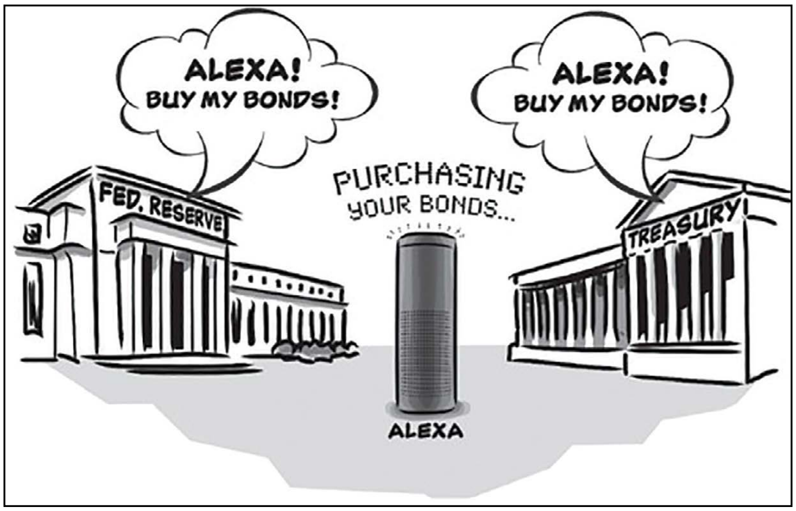
For years, manufacturing has sought to automate tasks historically performed via manual labor. One National Bureau of Labor study cited 670,000 jobs lost to industrial robots from 1990 to 2007. Looking at data from the 1980s to today show that manufacturing output is up 60% yet manufacturing employment is down 40%. Improved worker productivity, including lots of robots, have resulted in increased output with fewer units of labor.



Of course, these already fairly dramatic changes are before recent innovations in artificial intelligence solutions. Anyone using a virtual assistant like Amazon's Alexa, Apple's Siri, Microsoft's

Cortana, and now Samsung's Bixby, understands we are at the tip of the iceberg for how technology will change the workplace. Few politicians understand how significant these changes are and how soon they will further transform the workplace. Bill Gates recently suggested we tax the robots. Others remind us to be careful with policies that could stifle innovation. They insist we survived the tractor, sewing machine, and for movie goers, the IBM mainframe that eliminated the need for human "computers" that helped launch man into space as documented in Hidden Figures.

Automation is not just in manufacturing. The investment industry has seen an acceleration in the use of computers to execute various strategies. A few years ago robo-advisors emerged, which utilize asset allocation algorithms to rebalance individual accounts via a usually small selection of broader market passive investments. Just last week, Blackrock announced it is reshaping what little "active" (versus its huge "passive") money management business it had left. Blackrock's goal is to harness the power of "human and machine."



We get it. With over three-quarters of managers trailing their benchmarks in recent years, firms must reduce costs and find something to excite prospective investors, and in Blackrock's case, shareholders too. Having first adopted many low-cost passive exchange traded funds for many of our clients over ten years ago, we welcome other firms focusing on the costs of the underlying investment product. The accelerating rush, however, warrants evaluation. The Heisenberg principle is one idea that comes to mind. That is, the law of diminishing returns when too many people observe those benefits even to the point of creating the opposite of the strategy's intended objective. For example, an investment perceived to have low volatility becomes highly volatile once too much capital rushes in to claim the perceived benefits. The maturation and ultimate success of robo-advisors, smart-beta quant strategies, and algorithmic trading, is yet to be determined. In the meantime, we continue to find value in preserving flexibility and seeking to understand the things in which we are investing. This approach will help us evaluate the best options for our clients when inevitably the unexpected happens for which there is no algorithm.

No Time Like Tax Time to Update Your Plan

While the computer traders don't yet have a seat at our investment decision table, several clients have found our new planning software remarkably helpful in charting their spending, savings, and retirement plans. The analysis is included in how we serve clients and a valuable way to test one's risk tolerance and investment objectives. Please contact us if interested in this exercise. In addition, we are publishing periodic intra-quarter investment and planning pieces. Recent topics include cyber-risk management, investing 101, and multi-generational giving. Some of these pieces we distribute broadly via email, but all are posted on our website at www.woodmontcounsel.com. You can also access your statements via a login on the Woodmont website. As a reminder, the statements accessible via the website and distributed via an Orion link are updated daily to reflect account activity, holdings, and performance. We know many of you check your accounts via Schwab or another custodian. That is an easy option, but remember the Woodmont appraisals are the best source for reviewing your holdings and evaluating performance relative to market benchmarks.

Thank you for your continued confidence. Best wishes for a wonderful spring season, and please know we look forward to discussing your investments and answering any questions you may have.