10300 SW Greenburg Rd.
Suite 115
Portland, OR 97223

Client Newsletter – January 2018

Market Rally continues into 2018

After a very strong 2017, U.S. equity markets again started 2018 in an exceptionally positive manner. In fact the year to date increase in January has already exceeded some analyst predictions for the entire year. Once more, the question arises, how sustainable is this rally?

The U.S. stock market has benefited from a strong global economy. The global markets are rising in concert with one another, in a convergence not often seen. Indeed, some foreign stock markets have performed even better than the U.S. However, during this time, the U.S. dollar has dropped dramatically in comparison to other currencies. So gains realized in other markets have to be discounted when recorded in U.S. dollars.

These currency risks are one of the reasons we choose to invest primarily in U.S. based companies. Another reason we are not investing directly in overseas markets is that the majority of our companies are themselves already doing business globally. These multinational companies carry our exposure to international markets, and they manage their own currency exposures.

The U.S. equity markets have also been strong because of the weak U.S. dollar. The weaker dollar makes the prices of goods U.S companies sell overseas cheaper to the foreign buyers. This makes it easier to sell goods to them and buoys the U.S. economy.

In addition, U.S. company earnings have been strong. Q4 2017 earnings on the S&P index are expected to be up 8.8% from the same period in the prior year. Earnings are forecast to be even stronger for 2018, up 13.7% and an additional 9.8% in 2019. With strong earnings growth, we should see even higher stock markets.

The tax reform bill passed at the end of 2017 is providing a near term boost to the market, but is expected to be a long term drag as a result of the massive deficit increase that most likely will accompany it. That effect is far enough in the future not to rattle the markets yet.

Interest rates are rising, with the benchmark ten year Treasury crossing 2.6%, the highest level in recent years. The Fed would like the rates to be higher, as they unwind the historically low rates used to provide stimulus to the economy during the aftermath of the 2008 financial crisis. It is anticipated that the Fed could hike rates three times this year. However the Fed will still be sensitive to inflation rates, the effects of interest rates on the economy, and the impact of higher rates on the cost of the U.S government debt.

Given these circumstances, what is an investor to do? Well, probably by now you know my answer: Stay the course. The fundamentals are strong; it is the headline news that is disconcerting. The headlines serve only to confuse. Keep in mind that over time the trajectory of the markets is to the right and

upward. On a calendar year basis, the market is up far more than it is down. Of course, we will have a correction. It is natural for the market to correct from time to time. Eventually we will have a bear market (a decline of 20% or more), but bear markets don't happen amid rising earnings.

Finally, there is risk from exogenous events; among these could be Fed policy mistakes (not likely), continued military aggression by Putin, Brexit/EU dislocations, or conflict over Korea (possible, but is North Korea likely to do more than saber rattling?) Kim Jong Un is very happy to use the U.S. as a foil to prop up his government. We only make his job easier by our own bellicose threats.

Of course there are Black Swan events, Unknowns and Unknown Unknowns. Still, stay the course.

Call if you have any questions.

Best,

William D. Rutherford
Rutherford Investment Management

Phone: 503.452.1210 • Fax: 503.452.0120 • www.RutherfordInvestment.com