Dixon, Hubard, Feinour & Brown, Inc. investment counsel

First Quarter 2018 Review & Outlook
by Whitney Brown

Also in This Issue

INVESTMENT OUTLOOK

- January run-up ends in market correction.
- Global economy in broad expansion.
- US-China trade relations a growing market concern.
- Upcoming mid-term elections may keep markets off pace until 4th quarter.

On the heels of a blistering run-up in January, the stock market sold off abruptly in the early days of February. After a strong and steady rise throughout 2017, January's accelerated move was not destined to last. The market has done a good deal of backing and filling since then involving several weak rally attempts followed by successful retests of the February low. During this correction, stocks in the Information Technology sector have come under much scrutiny, and for good reason. Growth stocks have led this market for some time now, and tech stocks offer some of the best growth opportunities available. Since the tech sector has grown to constitute 25% of the entire market cap of the S&P 500, when tech stocks tumble, the market will follow. It is well worth pointing out that throughout the lengthy bull market dating back to 2009, the tech sector has sold off numerous times only to come back strong. While sentiment can hold sway in the short run, the market always comes back to fundamentals. As long as technology drives growth in our economy, investors will find ample opportunities there.

Market Measures	1st QTR 2018	
S & P 500 (price)	-1.2%	
Dow Jones Industrial Average	-2.5%	
NASDAQ Composite	+2.3%	
Russell 2000	-0.4%	
MSCI EAFE	-2.4%	
Barclays Capital Inter Gov't/Credit Bond Index	-1.0%	
	3/31/18	3/31/17
10-Year US Treasury Bond Yield	2.74%	2.38%
Three-month US Treasury Bill Yield	1.71%	0.76%

Please see page 4 for important information about planned changes to the S&P 500 sector classifications that should better reflect the impact of technology throughout the information, communication, and entertainment segments of our economy.

To date, the global economic expansion is continuing at a healthy pace. Leading indicators are favorable, and the chances of recession this year in the US are minimal. Globally, recession odds are also very low although there has been some slowing in Europe. Strength in the US economy is allowing the Federal Reserve to "normalize" monetary policy by raising short-term interest rates and pulling back from their massive quantitative easing program. But, even while the Fed is very gradually tightening policy, central banks abroad are still very accommodative. Markets will keep close tabs on the Fed, looking for signs in the economy that could spur monetary policy to become more aggressive.

Any optimistic outlook on the economy should be tempered with a cautious view of the direction of US trade policy, particularly with China. Taking steps to ensure the US is getting a fair shake in trade deals makes great sense, but forcing a massive reduction in the US trade deficit could have unintended consequences. Much of the money spent by the US to buy foreign goods comes back in the form of foreign investment primarily in US securities and especially US Treasury securities. That flow of funds helps keep yields low and provides capital for the US economy. Reducing the flow could in turn reduce capital expenditures and any ensuing productivity gains thus creating a drag on growth instead of the intended boost from more domestic manufacturing.

Setting aside the recent volatility, we can see that the market-driving fundamentals have not really changed yet. The correction has been driven more by a shift in sentiment from too much optimism or fear of missing out (FOMO) to concerns that possible or proposed monetary, regulatory, and trade policy changes could impact corporate profits or even tip the economy into recession. The greatest impact has been on the largest capitalization stocks that

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Advantages of Utilizing a Registered Investment Advisor by Jim Hall

The investment services industry utilizes many different designations and acronyms which can be confusing since they are not necessarily self-explanatory. Without doing further research, one particular designation, "RIA" (Registered Investment Advisor) may not be fully understood or appreciated.

We at DHFB, operate as a Registered Investment Advisor. We believe this designation is crucial as it differentiates us from stock brokers, insurance agents, financial planners, and others who may offer investment services while also referring to themselves as various types of financial, wealth or investment consultants, advisors or managers.

As opposed to advisors operating without this distinction, the designation, "RIA," requires us to be fiduciaries for our clients and therefore always act in our clients' best interest. It eliminates the inherent conflict of interest that might entice us to buy or sell any particular stock or fund because we might get paid a commission or an extra fee. We do not accept any compensation based on product sales. Further, there is no temptation to utilize insurance strategies that might reward us with hefty commissions when another investment would be more appropriate.

Because we are not concerned with selling products, our interests are aligned with our clients' interests. We are able to take a more holistic view of a client's current situation relative to their future goals and can better craft solutions to achieve those goals. As always, we welcome questions and are always available to meet with clients and assist in future planning.

Stock Market Volatility and the VIX Index by Watt Dixon

2017 was a great year for US stocks. Stock prices rose in most sectors of the economy. Another characteristic of the stock market during 2017 was the low volatility that accompanied rising stock prices. The low volatility of 2017 was largely due to the strong fundamentals of the market and positive investor sentiment. Some of the factors that contributed to the low volatility are ending. Specifically, the Fed is moving to normalize monetary policy. This will mean less "hand holding" for market participants who have grown used to the Fed acting to prop up markets.

The most common measure of stock market volatility is known as the VIX. The VIX is calculated and published by the Chicago Board Options Exchange. The VIX shows the stock market's expected volatility over the next 30 days. The VIX is a forward looking index. VIX values of greater than 30 are widely thought to represent periods of higher market volatility and values below 20 represent periods of calmer market action. The VIX is a computed index, much like the S&P 500, although it is not based on stock prices. The VIX uses the price of options traded on the S&P, and then estimates how volatile those options will be between the current date and the options expiration date. Movements of the VIX are largely dependent on market reactions. A large sell off in stock prices will cause a spike in the VIX index and the inverse is also true.

The most recent market volatility is largely due to investors becoming nervous about trade tensions between China and the US, the world's two largest economies. These trade tensions coupled with the Fed's actions, following a year of very low volatility, have caused the markets to be jumpy. The Technology sector, which makes up about 25% of the market cap of the S&P 500, has been especially volatile in 2018.

To some degree, computerized trading methods and high frequency trading can contribute to market volatility. Computer driven trading methods are programmed to buy or sell when certain criteria are met. These types of trading methods do not make judgement calls as to market or external conditions.

It appears that the market volatility we have seen thus far in 2018 will persist, at least for the near future. The path of least resistance for stock prices still favors an upward bias, albeit with much more market fluctuation than we experienced in 2017.

Flattened Yield Curve (Updated from 1st Quarter 2015, Investment Outlook Article) by Stebbins Hubard

The yield curve for US Treasury securities (bills, notes, and bonds) illustrates the tradeoff between yield and maturity; usually the longer the time to maturity, the higher the yield, or return from interest. In the chart below, time to maturity increases as you move to the right along the horizontal axis. The yield increases as you move up the vertical axis. By plotting various maturities and the corresponding yields available in the market you get a positively sloped curve known as the yield curve. This relationship generally holds true for most bonds, not just U.S Treasury securities.

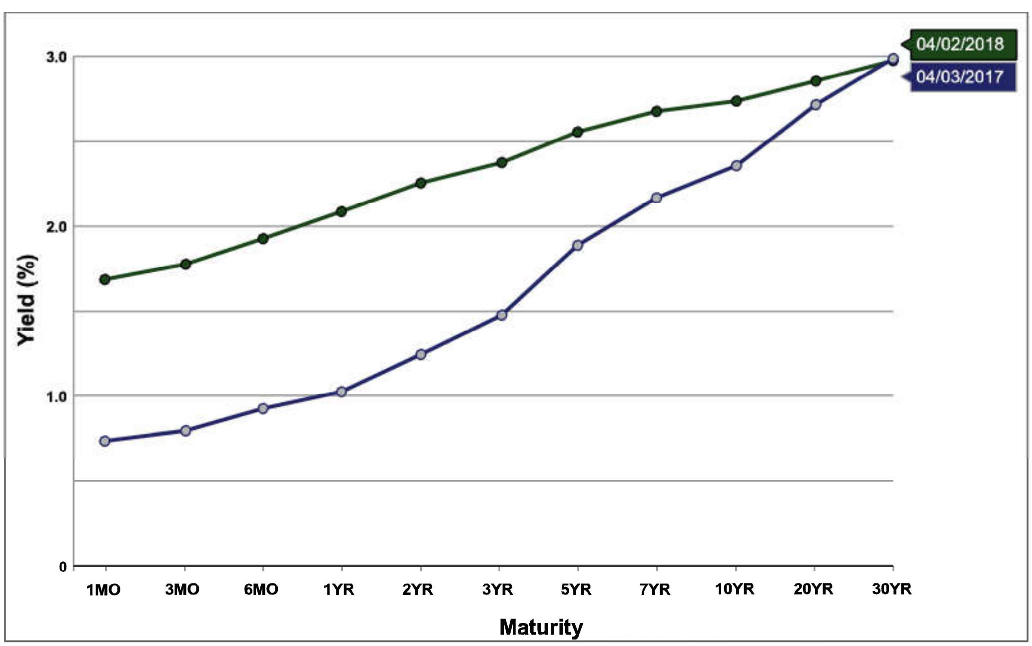
The longer your money is at risk the greater the return you expect. Since there is almost no risk of the US Treasury defaulting on its debt, the primary risk for holders of US Treasury securities is inflation. Owners of Treasury securities expect that the yield on their holdings will exceed the anticipated rate of inflation over the life of the bond.

The inflation rate is more predictable in the short term than the long term. Therefore, the risk premium (yield less the inflation rate) is usually much less for short- term bills and notes versus longer-term bonds. Inflation as measured by the Consumer Price Index rose from 2.07% for 2016 to 2.17% for 2017. In anticipation of a rising rate of inflation, the Federal Reserve Bank increased the Discount Rate from .75% in December 2015, 6 times to 2.25% over the last 15 months. The Discount Rate is the very short-term rate at which the Federal Reserve Bank lends funds to member banks on an overnight basis to satisfy reserve requirements. This increase has resulted in a rise for other short-term rates and thus a flatter or less sloped yield curve as indicated by the upper line in the chart below.

What is the changing yield curve telling us? The conventional textbook analysis says that when the yield curve flattens, the market is discounting an impending economic slowdown, maybe a recession. By contrast, expectations for strong economic growth and consequent inflation would cause rates to rise all along the curve. If an economic slowdown does occur, the yield curve could even invert with short rates exceeding long rates.

However, not every flattened curve has been followed by a slowdown. It is unclear if the current yield curve is predicting an economic slowdown since the flattening has occurred due to the Federal Reserve deliberately raising short-term rates while longer rates set by the market have remained essentially unchanged. From the chart below you can see over the last year the yield on the 1-year Treasury bill has risen 100 basis points (100 basis points = 1%) while the 10-year Treasury note has risen only 50 basis points, and the 30-year Treasury bond has stayed the same. The bond market seems to be telling us that inflation may be a concern for the short term but not for the longer term.

If the flatter yield curve is not a recessionary signal, what is it telling us? Much of 2017's earlier yield curve flattening represented a reversal of the 2016 steepening that accompanied surging economic growth and inflation expectations after the US presidential election. Markets had bet that fiscal stimulus and infrastructure spending would spur growth and inflation. Long-term yields jumped in response. Those market expectations unwound over the course of 2017 when policy changes were slow to materialize and weak inflation readings became the big surprise. Persistent demand for long-term Treasuries pushed 30 -year yields lower even as short-term rates rose. Long-term Treasuries could rise a little from here—but expect low-trend growth, plentiful global savings seeking income and other structural factors to keep them historically low. Whether the Fed can continue to succeed in checking inflation through monetary policy remains to be seen. There are other market-based forces working both for and against inflation in the global economy. For now anyway, the flatter yield curve is not saying slowdown.



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dominate returns in major indexes like the S&P 500. Mid cap and small cap stocks have generally held up well which speaks volumes about the underlying health of the market. The silver lining to the downdraft is that it has lowered valuations on a number of high quality growth stocks even as interest rates remain at very low levels.

The market is taking its time to regroup but should soon begin working its way higher. Mid-term election years can sometimes experience prolonged mid-year weakness and a spring/early summer rally could lead to further correction later in the summer and into early fall ahead of elections. Typically a fourth quarter rally would follow. Because the party in the White House usually loses seats in mid-term elections, the quality of any late-year rally could hinge on whether control of the either the House or the Senate shifts to Democrats. There is a lot of calendar left to play out in 2018, and absent signs of a major trend reversal the market still deserves the benefit of the doubt.

Dixon, Hubard, Feinour & Brown, Inc. is pleased to announce that effective April 1, 2018 we are a wholly owned subsidiary of Union Bank and Trust.

Planned changes to the S&P 500 sectors will reflect the evolving ways that people communicate and access information and entertainment. In recent years there has been a rapid convergence of the delivery of information and entertainment with the creation and organization of that content. Merger and acquisition activity among telecommunications companies, media companies, and internet companies is evidence of this trend. To better reflect the trend, the Telecommunications sector will become the Communication Services sector and will include companies from Consumer Discretionary that provide media and marketing content and services. It also will include selected other names from Information Technology in addition to retaining the traditional telecommunications companies.

One of the most significant changes will involve moving the entire Media Industry Group out of the Consumer Discretionary sector and into the newly constituted Communications sector. A notable result of these changes will be to reduce the concentration of mega cap tech companies in the Information Technology sector and to broaden and enlarge the former Telecommunications sector. These changes are scheduled to be implemented after the market close at the end of the third quarter on September 28.