

INVESTMENT OUTLOOK

- ◆ Growth stocks lead in second quarter.
- ◆ Crude oil and energy stocks slump.
- ◆ Reflation likely to revive as global economy strengthens.
- ◆ Equity markets focus on fundamentals not news.

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Second Quarter 2017 Review & Outlook by Whitney Brown



In the second quarter, equity investors returned to the reliable growth stocks of the past several years, finding much to like in tech, healthcare, consumer discretionary, and industrials. Well run companies in these areas are better situated to grow earnings even in a slow growth economy. Markets continued backing away from the global reflation trade (also referred to as the Trump trade) that had seen bond yields surge and cyclical value stocks gain favor in the second half of last year, especially after the presidential election. The cyclical areas like financials, energy and commodities are much more dependent on macroeconomic factors such as higher interest rates and rising commodity prices to achieve consistent earnings growth.

Bond yields retreated even as the Federal Reserve boosted short-term rates in March and again in June. Energy was by far the worst performing market sector as oil and gas stocks followed the fading fortunes of crude oil prices. Continuous improvement in fracking techniques by U.S. shale producers has effectively nullified OPEC production cuts and kept a lid on global energy prices.

On the upside of the market, tech titans like Facebook, Amazon, Alphabet, and Microsoft carried much

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of the load early in the quarter for the NASDAQ and other major indexes. Consensus thinking had them overbought and overvalued toward the end of the quarter. Signs of life in the healthcare sector were a welcome relief as a number of big pharma and biotech issues drew strong investor interest in June. Political pressure on drug pricing seems to have abated while revision of the Affordable Care Act is bogged down in Congress.

With the Fed hiking short rates twice this year and longer term yields retreating, the yield curve is flatter. Often that can be a sign of economic slowing. At the same time, stocks have marched higher, usually a good leading indicator of growing economic strength. The apparent contradiction will be resolved one way or the other, and there is other evidence to consider. Toward the end of the quarter, financial stocks snapped out of the doldrums and bond yields enjoyed a notable bounce. That could be a good indication that reflation will win the day. Internationally, the great majority of equity markets in other regions and countries are in durable uptrends. Leading economic indicators abroad are also favorable which lends credence to the market action. If stocks lead the economy and earnings follow, then we may expect to avoid recession for some time and see corporate earnings catch up with market valuations.

There is much to worry about in the world, and the political situation at home seems as fractious and chaotic as anyone can remember. Yet, markets have a way of looking through the smoke and confusion and focusing on the fundamentals. Generally, the fundamentals are sound with stable GDP growth, low unemployment, low inflation, and a well-capitalized financial system in the U.S. A market correction in the near term would not change these fundamentals and could offer a base for a renewed uptrend later.

Market Measures	2nd QTR	YTD
S & P 500 (price)	2.6%	8.2%
Dow Jones Industrial Average	3.3%	8.0%
NASDAQ Composite	3.9%	14.1%
Russell 2000	2.1%	4.3%
MSCI EAFE	5.0%	11.8%
Barclays Capital Inter Gov't/Credit Bond Index		
	<u>6/30/17</u>	<u>6/30/16</u>
10-Year U.S. Treasury Bond Yield	2.30%	1.47%
Three-month U.S. Treasury Bill Yield	1.02%	0.27%



The digital world has become a scarier place, fraught with nefarious players who are out to defraud you and steal your identity. Recent headlines blast us with the possibility that foreign agents are hacking our systems and software. So what can you do to better protect yourself?

★**Home or small office networks.** Many of us have some type of home network which uses a cable modem, router, or wireless access point to connect to the Internet. Many people install these right out of the box without setting up password and encryption protection. If it is beyond your technical prowess, call in an expert. Often your cable provider will help secure your network. Plan on changing the password regularly.

★**Avoid connecting your mobile device or laptop to unsecured wireless networks when traveling.** Many hotels provide wireless connections to their guests; ask if the connection is encrypted.

★**Establish a robust password maintenance program.** There are apps available that will help you store and maintain your passwords. Passwords for your devices should employ upper and lower case letters, numbers, and special characters, the more random and complicated the better. Unfortunately the most widely used passwords are “password” or “123456”. Hackers will bypass this weak protection in a flash.

★**Change your passwords frequently** for your home computers and any online service (e.g. banking, PayPal, Amazon Prime, especially where credit cards and bank information are stored). Also, with these online services, you can use an additional strategy: **two-factor identification**. Every time you login to one of these services, it will text a six digit number to your cell phone that you must enter before proceeding.

★**Protect your mobile devices.** An iPad or a cell phone are windows into your digital world. If you lose one and it is not protected with either a passcode or fingerprint technology, you are vulnerable to identity theft and possibly asset theft.

★**Anti-virus, web browsing, and email protection.** All of your devices should have anti-virus protection (IOS devices, such as iPhones, are not as vulnerable as Windows to hacking). But to be truly secure, your desktops, laptops, and tablets should utilize an entire suite of protection, usually known collectively as Internet Security. Some well known and affordable Internet Security packages include: AVG Internet Security, Kaspersky Internet Security, McAfee

Total Protection, Norton Security Deluxe, and Trend Micro Maximum Security. All of these are total protection packages and not just basic anti-virus. Once you are protected, make sure that the software is allowed to update itself, and that ongoing scans are enabled.

★**Use social media and email cautiously.** Avoid disclosing information that a hacker might use to gain access to your online accounts. Never disclose your address, social security number, or financial account information.

★**Be wary of using “the cloud” to store data.** Many cloud applications have been penetrated and personal data exposed.

★**Be aware of telephone scams.** One scam involves someone pretending to be from Microsoft, claiming that they have noticed vulnerabilities on your computer and offering to fix the problem for a fee.

So, are you now totally protected? Not quite.

★**You are the weakest link in the chain** and the criminal element will try to get you to let them in. If you fall for their schemes (usually in an important looking email requesting information or threatening to lock/suspend your account), all of your protection is in vain. If you click on a link in a “**spear-fishing**” email, it may allow the sender to install remote controls on your computer that can capture and send your keystrokes and personal data. It can even turn your computer into a piece of its network, sending out spam and downloading and distributing files in small pieces to other networks. And it can hold your computer hostage through Ransomware.

★★**Where do you turn for help?** A good place to start is with your internet provider. Cox, for example, offers a Security Suite powered by McAfee. The Geek Squad at Best Buy will assist you for a fee. The product they promote is Trend Micro. Local computer shops provide valuable assistance. Charles Schwab issues cybersecurity warnings and educational materials. While we are not in the business of promoting one solution over another, it is important that you know that help is out there and you should seek it out to increase your protection.

Dixon, Hubbard, Feinour & Brown employs many strategies to keep your data safe and protected. These include web browsing, email, software and hardware management by Tech Squared, Inc., firewalls, physical perimeter security, a robust password maintenance program, and encrypted email for sending sensitive client information. Above all we believe in ongoing employee education regarding spear-fishing and other forms of hacker intrusions.



We seem to be living in a very strange time. The news publications and shows are devoting many columns and hours to relay stories of divisiveness and rancor in Washington. Based solely on the coverage, one would expect to find the equity markets stalled or even in a downward spiral. In fact, the opposite is true. Equity markets continue to grind higher and have frequently been recording new highs. It certainly seems counter-intuitive to think “bad news” would contribute to favorable times in the equity markets.

There are some possible explanations behind this performance. An old axiom in the news industry is “*bad news sells.*” Since all of the news organizations strive to sell more copy and garner greater market share, their bias will naturally be to focus on the more negative stories and emphasize areas of political disagreement. As discussed before in prior newsletters, the

market does tend to focus on economic trends and profits even though they aren’t touted as “newsworthy.” During the past couple of quarters, most companies have been reporting earnings that have exceeded forecasts and have often “guided higher,” meaning they believe their results in future quarters are likely to exceed analysts’ earlier expectations.

When researching other possible explanations for glowing market performance in light of bad news, it turns out economists have noticed this phenomenon and have actually created an index to track it. The Philly Fed’s Partisan Conflict Index is currently at record highs. Over time, the Index confirms equity markets have risen at a faster pace when anxiety levels are high (see chart below).

There doesn’t seem to be a definitive answer behind why this index charts in this manner, but economists theorize it may be because partisanship prevents major legislation from being passed and allows the marketplace to solve its own issues rather than having governmental solutions that might unwittingly create interference.

Another possible explanation revolves around the theory that the bad news and anxiety serve to temper market enthusiasm and will tend to keep enough pessimism in the market that “exuberance” doesn’t become pervasive.

It does seem odd, but perhaps as investors we should continue to root for more partisanship and “bad news” coverage.

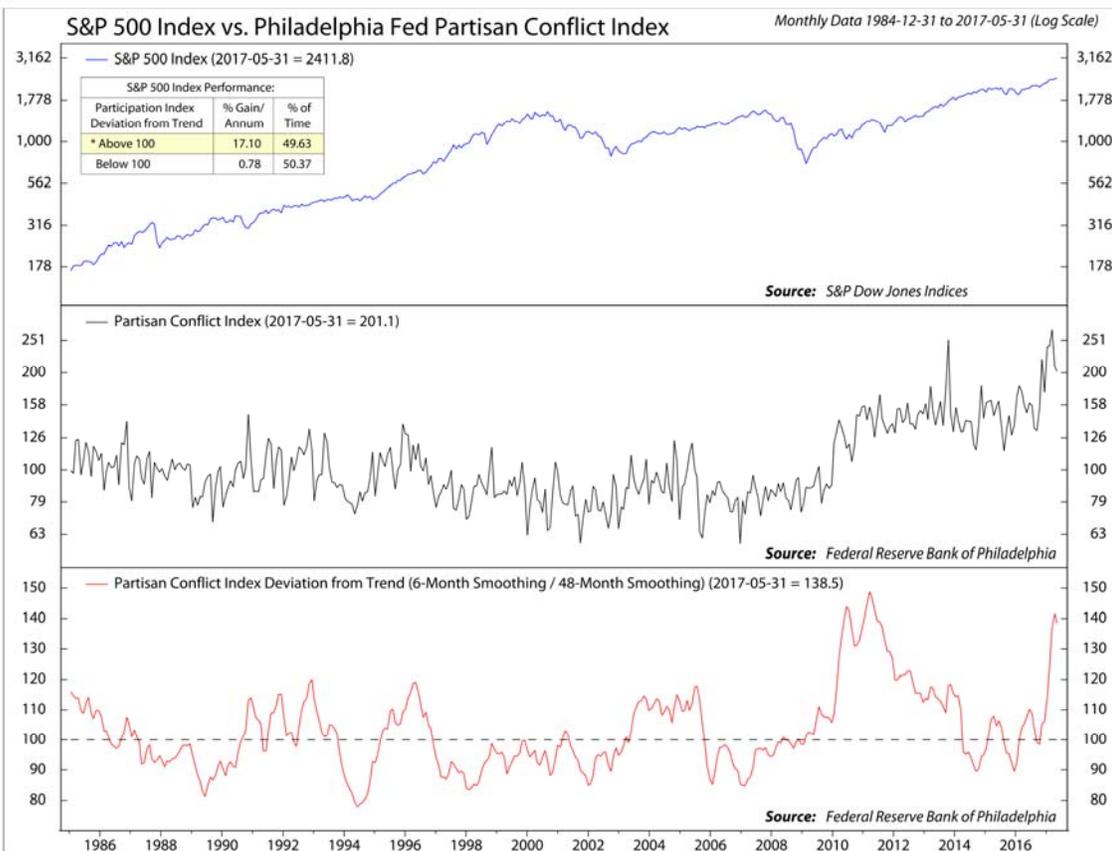


Chart Courtesy of Ned Davis Research Group

Providing Investment Management services for...

Individuals & Families
Trusts & Estates
Retirement Plans
Endowments & Foundations
Businesses



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Pre-Market Futures by Watt Dixon



While watching the morning news, one may hear the phrase “Stocks appear to be heading lower at the opening bell,” or perhaps, “The stock market looks to open higher when trading begins today.” There are different factors that go into what determines the pre-market futures.

While the financial markets have clearly stated business hours, developments outside of those hours continue to influence the value of securities and investor behavior. Geopolitical events and natural disasters can occur at any time. Events like the assassination of a president or a major terrorist attack are likely to indicate a lower market open.

Corporate data also plays a role. Earnings announcements made after the close or before the open can influence the market’s direction. In January, April, July, and October, the vast majority of companies release their results for the quarter. Good news from bellwether firms often leads to a higher stock market open. Bad news can have the reverse effect.

Other important news comes out before the markets open. A wide variety of economic releases, including

employment data, retail sales and gross domestic product results, are released at 8:30 a.m. Once again, both good news and bad news can sway the market open direction. Also, major foreign markets are open when the US stock market is closed. Developments in Tokyo, Germany and London all can impact the opening markets in the U.S.

While the pre-market futures are interesting on a very short-term time horizon, they don’t really factor in to a long-term investment plan. Knowing which way the market may open can sometimes be helpful in planning a stock buy or sell for that day, but it is far more important to understand the major market trends and underlying fundamentals.

A Note to Our Clients

Please disregard any mailing you might have received from the custodian of your IRA account regarding the DOL Fiduciary Rule. This new rule does not affect IRA accounts existing prior to June 9th. The new rule has created a great deal of confusion among asset custodians and brokers with respect to its implementation. It is very likely the rule will be removed or significantly altered. Please be assured we will continue to provide you with uninterrupted investment management.