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THE ECONOMIC OUTLOOK - - TILT TOWARD VALUE

Looking ahead to year-end and beyond, we expect the global economy to continue to grow at a solid pace underpinning equity market valuations which have expanded significantly this year as shown in the Scorecard below:

Index	Equity Returns 12/31/16 - 11/27/17	Annualized GDP
S&P 500 (US)	+18.3%	+2.5%
MSCI (UK)	+15.7%	+1.7%
MSCI (Germany)	+27.9%	+2.0%
MSCI (France)	+29.6%	+1.6%
MSCI (Japan)	+23.5%	+1.5%
Shenzhen CSI 300 (China)	+31.5%	+6.8%
MSCI (Australia)	+15.5%	+2.4%
MSCI All Cap World (ex US)	+21.7%	+3.6%

Abroad, despite uncertainties over the Merkel government, Europe is having a good year. The rise in the German IFO Business Climate Index to a 17 year high is signaling expansion. In Japan, exports have been a driver of economic activity and the Bank of Japan continues its accommodative monetary policy. Policy tightening in China appears to be targeted, limited to the financial sector. Takeaways from recently released forward-looking manufacturing and non-manufacturing PMI data show a broad-based rise across the major components of Chinese output, new orders and export orders.

OUTLOOK

In the US, the economy’s growth rate last quarter has been revised upward to the fastest pace in three years. GDP grew at a 3.3% annualized rate, withstanding major hurricanes, thanks to stronger business spending that helped cushion a softer pace in consumption. A sustained expansion in business investment should

partially support above-trend growth in 2018. While we have seen some mixed economic data this quarter, the Fed is highly likely to raise its discount rate by 0.25% when it next meets in mid-December. Subsequent rate hikes are likely to be more sensitive to inflation, which has been soft, than to growth, which has been solid.

Readings of both the LEI (Leading Economic Indicators) and our firm's proprietary Economic Model increased again in October signaling expansion. Going into the holidays, US consumer confidence climbed to a 17 year high in November, a sign Americans are growing more confident about the economy and the labor market. Even though US durable goods orders fell – 1.2% in October, the general uptrend appears to be in place. We continue to believe there is pent-up capital spending demand as well as in housing where existing home sales rose +2.0% month-over-month in October. Hurricanes have contributed to recent noisy data, but rebuilding along the Gulf and Atlantic coasts should be a catalyst going forward. And most important, both the most recent manufacturing and non-manufacturing PMI readings remain well above 50, portending expansion.

A key consideration ahead is whether the package of tax and fiscal policies/regulatory changes, likely to hit the President's desk in December, however they are eventually configured, help boost productivity. Productivity, measured in output-per-hour growth, has for several years been a major headwind, along with poor population trends, to more rapid GDP expansion. Increasing business capital outlays will translate into improving productivity. Productivity is important because, at full employment, there is a need to pay *capital and labor* (in the form of rising wages) not *capital or labor* as was the case earlier in this business cycle when unemployment was higher.

EQUITY INVESTMENT POLICY

All in all, absent the passage of a tax package, we expect economic growth in the US to expand at a 2.25% rate next year, slightly above the 2% trend growth of recent years. Assuming tax reform passes, we see faster growth, in the 3.0% + range, with 2018 S&P earnings per share jumping by 14% to $150. S&P 500 earnings per share could increase further to $158 in 2019. The extended profits cycle should support a rising US equity market over the forecast period, despite the certainty of nasty "corrections" and sharp "pullbacks" along the way. We, therefore, recommend clients' equity portfolios remain fully invested given expected higher profits, the lack of attractive fixed income alternatives and a forward stock market valuation of about 17.5 times earnings.

We maintain concentrations in *value* shares such as financials, energy, industrials and consumer stocks as well as in reasonably priced *growth* companies where revenues are forecast to rise by more than 10% annually for several years. Interestingly, the magnitude of underperformance of *value* stocks relative to *growth* shares over the past decade has been significant so tilting a bit away now from *growth* toward *value* appears warranted.

As the table above shows, investments abroad have this year generated returns superior to those of companies domiciled in the US, reversing the trend of recent years. Despite their greater volatility, shares of companies headquartered abroad in both developed and emerging markets are targeted to represent 15% of clients' equity exposure as they remain relatively undervalued.

FIXED INCOME INVESTMENT POLICY

Fixed income portfolios under our supervision remain invested with preservation of principal as the overriding consideration. Portfolios have a short ladder of high quality, marketable corporate obligations with durations of about 1year.

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As we enter our 24th year in business, we send season's greetings to our valued clients and friends. We wish you and yours safe and enjoyable holidays and a happy and healthy New Year.

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