KEIM ASSET MANAGEMENT, LLC
Preserving Your Lifestyle

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A New Fed Chairman

Dear Investor:

President Trump's pick to head the Federal Reserve is Jerome Powell. While already approved by the Senate Banking Committee, he now awaits an expected approval by the full Senate. This should happen any time now, as Janet Yellen's term as Fed chair ends on Feb 3, 2018. Powell is a 64 year old Republican with an estimated net worth of $20 million to $50 million. He went to Princeton University and Georgetown Law School. From there, he has held many different positions in law, banking, and government. Although a Republican, he was nominated for the Federal Reserve Board of Governors by President Obama in 2011. This was a very big deal, politically speaking, and he took a lot of heat from his own party, with many voting against him. Various articles I've read paint a picture of a very intelligent, independent minded, and pragmatic person. He is middle of the road and not likely to be extreme in either direction. He has a lot of experience and has been involved in previous crisis management episodes concerning failed banks, a bid rigging scandal by Salomon Brothers, the former Wall Street powerhouse, and our recent problems coming out of the Great Recession. He has a very solid reputation and appears to be held in high esteem by his colleagues. He knows our system well, and I'm hopeful that he will provide the leadership we need to continue on the path of normalization.

The labor market is very strong, almost booming. For seven years in a row, the US has created over 2 million jobs a year. Unemployment is at a seventeen year low of 4.1%. The U6 unemployment rate, which is a much broader measure, has dropped from over 17% in December of 2009 to just 8.10% now. Several of the surveys we follow state that the biggest problem many business owners have right now is finding qualified workers. Some are raising wages to try and attract talent. While it is true that generally speaking, wages and compensation are not rapidly accelerating, they have been moving up steadily each year. Gradually rising income with low inflation has given workers a reasonable amount of buying power. On top of that, savings rates have declined, which I've mentioned before. We are now seeing a definite acceleration in the use of credit and credit cards in particular. The consumer credit report for the month of November showed the largest borrowing in 16 years, around $28 billion. This report covers revolving credit and non-revolving credit, but does not include mortgage debt. Borrowing was much stronger in September and October also. We can see that beyond a doubt, the American consumption machine is gaining momentum. It's taken a long time, but this shows me that the fear produced by the Great Recession is fading away. Reflating the economy has been the goal all along, and it looks like we may have arrived.

It seems pretty clear that we are entering a new phase of the recovery. GDP has been over 3% for the last two quarters. Estimates for the fourth quarter are in a range of 2.8% to 3.8%. That would make 2017 a very good year, one of the best in a long time. On top of this momentum, we do have a new tax plan that has been passed into law. As with anything political, there are a lot of opinions as to

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the benefits of the plan and the impact it will have. The other problem with this is trying to get objective information that is not biased by a political point of view. I've read a lot on this and can only offer you my opinion. Overall, I do believe it will be stimulative, particularly for the next few years. The reductions in the personal tax brackets will help put more money in people's hands. It will not be as generous for those of us who live in the high tax states like New York. Corporate tax cuts will also release capital as public data show that many corporations do in fact pay taxes at rates above the 21% in the new plan. The third element is the tax repatriation plan. This basically gives companies a break on profits earned overseas if they bring the money back home. This could affect well over $2 trillion of cash held outside the US. We don't know how much corporations will decide to bring back, but I expect it will be significant. The biggest complaint you hear is that when this has been done in the past, most of the benefits went to shareholders in the form of dividends and stock buy backs. While that does seem to be true based on the facts, I would point out that it's not just the "rich" who own stocks. Due to the significant participation in both 401k's and IRA's, many middle class and upper middle class Americans own stocks and they will also be rewarded if in fact, corporations increase dividends and buybacks. It's a certainty that some of this money will find its way into the economy. We see it right here in our office all the time as clients use some of their investment profits to buy cars, improve their homes, educate children and grandchildren, etc. I don't expect the tax plan to produce a "boom" or any kind of overnight miracle. I think it will contribute to the momentum that has been created by the last nine years of ultra-low interest rates and the overall progress that has been made reflating the economy to this point.

I'm sure you are aware that 2017 was a very strong year for the stock market with the S&P 500 up over 20%. With the economy doing well, most corporate earnings were very good. This has led to a market that many people believe is expensive. Others take the opposite view, and believe that the low interest rates justify higher P/E multiples. There is no way to prove who is "right". It's differing opinions that create buyers and sellers in the first place. At this point I think we need to remember that it's now been two years since the last significant correction we have experienced. Things have been going so well for stock investors that I think we are beginning to touch on some euphoria. I mentioned complacency in my last letter. It should not take us by surprise if we go through some sort of downturn in the coming year. I'm not predicting one, but am offering a reminder that corrections are a normal part of investing.

Please contact me anytime with questions or to discuss your portfolio.

Best Regards,

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