March 14, 2017

Dear client,

Greetings from Boston! You don't realize how much you appreciate the California weather until you travel to a place where it is 10 degrees in March. To make matters worse, on Tuesday, we had a blizzard. In spite of the cold, it has been a treat to return to the Harvard campus where I originally met two of my life-long friends back in 1987. A lot has changed since then, including much of the campus. For example, while I am here, I am living in the new Esteves Hall. This building is as nice as any hotel and much different from when I had a room here that was the size of a closet. Back then it was called Baker Hall. I am here to learn more about start-ups, technology and valuation.

Speaking of which, how expensive is the U.S. stock market? No doubt that the U.S. stocks are historically high based on a number of metrics. However, interest rates are low and in that context, valuations are not at an extreme.

This market rally is based on three legs: optimism, technical indicators, and interest rates. Any of which would break the three-legged stool. Let's take a look at each one of those 3 legs.

Like him or not, since Donald Trump was elected, the global stock market has taken off. Markets are forward looking and the market psychics are looking into their crystal balls. What does our psychic envision? For one, if you believe that the U.S. is excessively regulated, then you might be happy to hear that the stock market thinks that the new administration will do away with many former regulations. You don't have to agree with the market if those regulations should stay or not, but the market believes that. What the market soothsayers are also telling us is that there is a good chance of lower taxes for companies and individuals in the immediate future through comprehensive tax reform. Lastly, the President wants to spend a whole bunch of money on infrastructure. The truth of the matter is that some of these dreams may not come true and there is a risk if they don't, the market could decline.

Technically, the market has room to grow for at least a couple of more months. When markets break psychological barriers such as 2000 or 20,000, the number in itself is meaningless. However, psychologically it is a different story. For example, when the market broke 2000 in 1987, the market continued to go up for a couple of months after breaking the barrier until Alan Greenspan raised interest rates in the fall of 1987. Today, at 20,000 the market is taking a cue from the same playbook. Interest rates are poised to go up at least ¾ of 1% this year. Those raises could knock a leg off the stool as well. I will have a better sense of this situation shortly after the Fed meets on March 15th. What worries me though, is the senseless investing by those uniformed investors who are jumping into index funds blindly. This is what is called a crowded trade and is the equivalent of the dot-com stocks that many uniformed investors jumped into in year 2000. They got burned in 2000 and many uniformed investors will get burned once again when these indexes pop because they are all invested in the same thing. That is one reason why I use them cautiously. If you look at the composition of your portfolio it comprises stocks, bonds and cash. We always have at least three asset classes. Within the stock portfolio, I have chosen large, small and foreign stocks and it is well diversified. The same goes for the bond allocation. This diversification is what helps insulate the portfolios in down markets. If we begin to have a stock market decline of a substantial nature after this Wednesday's (03/15/17) Fed meeting, I will begin to reduce the stock allocation beginning with the interest rate sensitive homebuilders. Some clients might ask, "Why don't you reduce the stock allocation before the Fed meeting?" My answer to this is that nobody knows with any certainty what will happen. Often, the markets trade on the rumor and sell on the news. In other words, the markets may already anticipate a further rate hike. Our research colleagues, BCA, have developed a remarkable set of signals that help guide my decisions and I need to read what will happen on Wednesday, March 15th, before I can determine which direction I will take. My gut feeling is that although the stock market has gotten ahead of itself, the stock market rally has a few good months or more to go.

For now, I am keeping our asset allocations intact, but I might lower the stock allocation a little bit (not wholesale, mind you) if my economic signals spell it out for me. At the moment, I am keeping the allocations where they are.

We have been putting the final touches on our social conscious portfolio and we anticipate rolling it out at our annual SFP event at the Balboa Bay Club on August 5, 2017. We hope you will join us!

On a housekeeping note, the U.S. Securities and Exchange Commission ("SEC") has issued a new ruling that is designed to protect client accounts against fraud and abuse. I am all for this! To comply with this new ruling, we have asked Fidelity to lower our Asset Movement Authorization (AMA) authority on your account from Level 2 to Level 1. Fidelity will also be notifying you of this action. This change will still allow us to process your EFT and wire requests if you have Standing Instructions set up on your accounts. Previously, we were able to process your first party wire requests without Standing Instructions. This may require some additional paperwork on your part. Nora will be contacting you if we need additional forms to be completed. If you have any questions or need clarification, please feel free to call us.

And finally, our next conference call will be on **Wednesday, April 5, 2017 at 6:30 p.m.** One of our long time clients suggested that I talk about a stock or two in our conference calls. He suggested that we discuss our rationale for buying or selling and some related facts. That was a great idea and we will be incorporating that into future conference calls, beginning with the upcoming call on April 5th, at 6:30 p.m. To access the conference call, **please dial the toll-free number: 1-800-914-8405. Once prompted, enter the access code: 5486434, followed by the # button**.

I look forward to seeing you in our portfolio review meetings in the near future.

Thank you as always and best regards,

Steven Yamshon
Investment Counsel