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Dow Jones Industrial Average: 24,831

We contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle.

- *Winston Churchill*

Where does the market go from here? Now that the Dow Jones Industrial Average is down 6.7% from its' high of 26,616...I contend that the market has significant upside from here.

It seems that we are just now seeing the results of the tax reform bill, passed in December 2017. "The Tax Cuts and Jobs Act of 2017" was the largest tax reform since 1986, and the first major reform to the tax system in 30 years. During the fourth quarter of 2017 (which was reported in January of 2018), corporate America took large charges before the end of the year, to take advantage of the tax laws under the old system, in my view this clouded the performance of many U.S. corporations, and their earnings.

The first-quarter announcement season is shaping up to be one of the strongest earnings season in 7+ years.* With the shuffling of the accounting figures out of the way, Corporate America is now demonstrating the power of the most advanced economy, the most productive workforce, and an economy that thrives on technology. In addition to a more accommodative tax structure, the government is officially trying to remove regulations that were roadblocks to productivity.

Between the tailwinds of government deregulation and the lowering of the corporate tax rate by 40%, corporate America is thriving...consider the following stats, according to FactSet *:

- Revenues up by 8.2%
- Earnings have increased by 24.2%....the best growth rate since 3Q of 2010
- Employment is at its lowest level in 2001

The first quarter of 2018 was impressive, but (in my opinion) the inertia of the economy is not going to diminish any time soon, for instance Wall Street analysts are expecting earnings for the S&P 500 companies to grow by 18%, in 2018.* Additionally, there is a principal in Economics & Finance called the MULTIPLIER EFFECT, which states that if dollars are injected into the economy, the growth effects of the dollars has more than a 1:1 ratio...the ratio could be as much as 3:1.

<https://www.investopedia.com/terms/m/multipliereffect.asp>

So, when I review the 1Q earnings results, I cannot help but to believe that the growth of the economy, which is personified through the U.S. stock markets, is going to continue and (my belief) gain more steam throughout the coming months. Plainly, the economy (and the markets) will ebb and flow over time, but the growth drivers unleashed through the tax reform and deregulation should overshadow any short-term news events that may captivate the news outlets (and Twitter).

To put a bow on these thoughts, observations, and Finance 101 lesson...as investors, we need to ask ourselves what industries or sectors will benefit from the new catalysts in the stock markets. I cannot give specific investment advice (in this commentary), but there are two areas that I think make sense to evaluate:

1. **Mid-Cap companies.** Mid-Cap companies tend to be strictly U.S. companies that were paying corporate taxes at the 35% level, and now their tax rate is 21%...a 40% reduction. It was estimated by Wells Fargo Investment Strategy Team that the reduction of the tax rate will generate a growth of earnings of approximately 36% ***.

Additionally, Mid-Size companies tend to not have the foreign exchange risk that most large Multinational company's experience.

2. **Convertible Bonds.** This investment class is a hybrid: growth characteristics of equity investments, but also the more conservative traits of traditional bonds. The interesting thing about these investments is that historically convertible bonds provide upside of the market, with historically less downside risk of the equity markets. ****

I hope you (and your family) have a safe and fun summer. Certainly, if you need anything please do not hesitate to contact me. Further, if you know of someone that can benefit from my service, please give them my name...referrals are always appreciated.

* Navellier Market Mail: May 8, 2018
<https://navellier.com/get-to-know-us/weekly-marketmail/the-best-earnings-week-of-may-7-2018/>

** Kiplinger: February 1, 2018
<https://www.kiplinger.com/article/investing/T052-C008-S002-how-to-cash-in-on-corporate-tax-cuts.html>

*** Wells Fargo Investment Institute: January 3, 2018

**** Convertible Bonds: July 8, 2014
<https://www.ai-cio.com/news/convertible-bonds-defense-against-downside-equity-risk/>

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