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October 2017

Climbing a Wall of Worries to New Highs

The S&P 500 Index has risen over 14% since the beginning of the year which is quite impressive. The S&P 500 not only ended the quarter at a record high, it extended its quarterly winning streak to eight straight quarters. As far as September's reputation for being a weak month, it didn't happen.

It is not uncommon to hear some folks credit this year's run-up to the performance of a few large stocks. You see, the S&P 500 Index is what is called a "market-capitalization" weighted index. That simply means that the larger stocks in the 500-company index have a greater influence than the smaller ones. So, strong gains by some large companies are driving most of the returns. Right?

Well, not exactly.

While the market-capitalization weighted S&P 500 index's performance has beaten an equal weighted index (where each stock has the same weighting) in 2017, the gap is narrowing. The significance of this is that with the rally in 2017 becoming more broadly based (and not concentrated in a few select large companies) it could possibly make it more sustainable.

Index	Q3 Return	2017 YTD Return %
S&P 500 (large)	+4.48%	+14.24%
S&P 400 (midsize)	+3.22%	+9.40%
Russell 2000 (small)	+5.67%	+10.94%
MSCI EAFE (intl.)	+5.40%	+19.96%
Bond Yields	**Yield September 30, Quarterly Change**	**Yield, Year-end 2016**
3-month T-bill	1.06% +0.03%	0.51%
2-year Treasury	1.47% +0.09%	1.20%
10-year Treasury	2.33% +0.02%	2.45%
30-year Treasury	2.86% +0.02%	3.06%
Commodities	**September 30 Price, Quarterly Change**	**Year-end 2016 Price**
Oil per barrel	$51.67 +5.63	$53.89
Gold per ounce	$1,283.10 +40.85	$1,159.10

Washington, North Korea and Hurricanes

What is interesting and somewhat surprising is the continued lack of volatility in the market. Political gridlock in Washington has not had much of an impact on investor psychology. The same holds true of rising tensions with North Korea and the devastating hurricanes that slammed into Texas, Florida and Puerto Rico.

Recall the jump in shares immediately following the election. Republicans controlled the White House and Congress. Investors quickly seized the bullish reins amid expectations that tax cuts were a given, infrastructure spending and a ramp-up in defense spending would soon be in the pipeline, and pro-growth deregulation would be forthcoming. Think of it as a sugar and caffeine cocktail for economic activity. President Trump acted on the deregulatory front, but the rest of his agenda seems to be mired in a quicksand known as Capitol Hill.

The rhetorical volley between North Korea and the U.S. has been unsettling, and more is likely forthcoming. While we should all prepare for what could occur, so far it has not had an impact on the U.S. economy. Moreover, investors are beginning to price in the unpredictability of North Korea's rogue leader. Taken together, a more meaningful market reaction has been lacking. Without a significant increase in tensions, recent history suggests that the market impact will likely remain limited.

Lastly, Hurricanes Harvey, Irma and Maria have devastated local communities. While relief efforts are under way to address the humanitarian crisis, the longer-term effect on the U.S. economy is likely to be minimal. Shorter term, it is affecting the data and gasoline prices are up, but rebuilding efforts are likely to lend support to the economy in the months ahead.

Keep an Eye on the Fundamentals and Dow One Million

Longer term, we can not emphasize enough what drives stock prices – corporate profits, expectations of how corporate profits will perform, and valuations. What has been happening in Washington and North Korea has been barely more than a distraction for investors, as faster economic growth at home and overseas has lifted earnings. In addition, interest rates remain near historically low levels which reduce competition for stocks. Finally, stock valuations, while not inexpensive, are reasonable given the alternatives. All of this has been a powerful tonic that has kept volatility and the bears at bay and stocks moving higher.

To keep our eye on what is important as it relates to investments, we found a recent speech by Warren Buffett of interest. At a recent event commemorating the 100th anniversary of Forbes magazine, Mr. Buffett suggested that the Dow would be over **1 million** in the next 100 years (from its current reading of 22,700). That would be 45 times more than its current level. While that is a big increase, the idea is probably not very far fetched. In particular, that would require a rate of return of approximately 4% per year on average. That compares to the Dow being up nearly 300 times in the past 100 years. While a reading of Dow 1 million in 100 years has a nice ring to it, we all should be prepared for stocks' inevitable periods of ups and downs (some quite severe). In order to enjoy the financial rewards from owning equities, therefore, one must have a long term time horizon and the emotional fortitude to hold on through stocks' inherent volatility.

Tax Reform

As September came to a close, the Trump administration unveiled its long-awaited plan to reform the tax code. The plan is simply an outline, a blueprint that was the byproduct of negotiations between Trump officials and key Republican Senate and House leaders. It is a framework that is likely to undergo several iterations as it winds its way through the House and the Senate. With Congress tied to a tight schedule, details may not be finalized until early 2018, if then.

From an investment perspective, the outline was silent in regards to how it will treat dividends and capital gains. In addition, no mention was made of the 3.8% surtax on investment income that hits high-income Americans amongst other areas.

Retirement accounts could undergo changes. There has been some chatter about shifting retirement vehicles toward "Roth-style" accounts, which would eliminate the upfront deduction for contributions but make withdrawals from these accounts tax-free. We are sure that more is to come in this area.

From a business perspective, the outline lowers the top corporate tax rate from 35% to 20%, which has been highly coveted by investors. It also allows for a top rate of 25% on business income. Specific language, however, has yet to be written.

Simply put, tax planning becomes extremely tenuous given the high degree of uncertainty. If you have any questions or concerns on how these proposals might affect you and any actions that you might want to take, please don't hesitate to contact us.

Final Thoughts

We had a very successful Open House on September 30th. We hope all that attended enjoyed themselves and we missed those that could not come. We hope to make this a more frequent affair (perhaps annually). We will keep you posted.

In another milestone, we have our new website up and running. Please check it out at **www.hopwoodfinancial.com**. It is much more interactive and gives you a direct link to our portal which you have access to as a client.

Finally, thank you for the kind referrals. We do no advertising and grow only by word of mouth. Please keep us in mind if any of your friends are in need of a financial planner or investment advisor. The firm continues to realize our goal of prudent and controlled growth. This growth enables us to have the resources to continue to improve and expand our offering to each and every one of you. Thank you for your business.

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