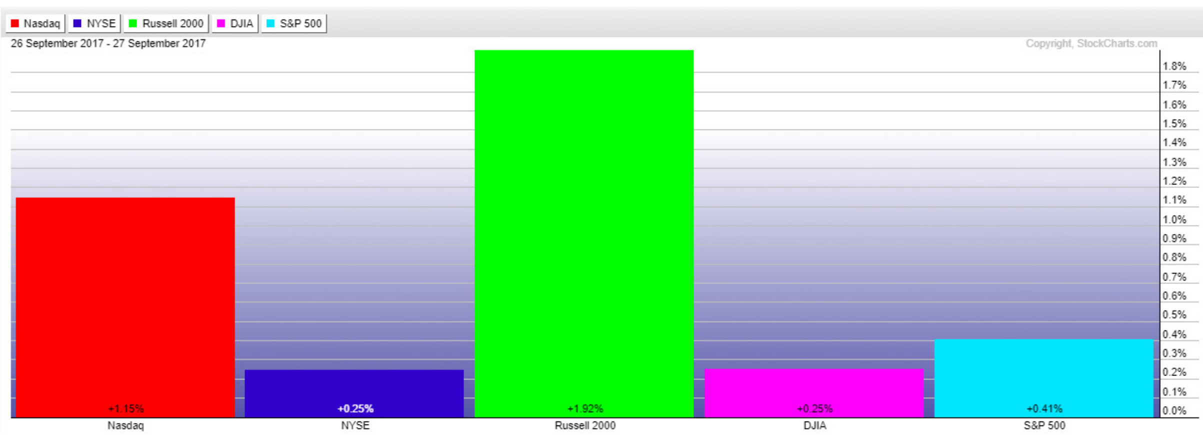
GBA Financial

Monthly Newsletter
October 2017

COMMENTARY

Here comes the second big swing from the Republicans – tax reform! Though Republicans currently control the White House and both chambers of Congress, we have yet to see any major legislation passed. The attempt to overhaul health care, seemingly the top priority for Republicans, has failed. Now the focus for Washington is tax reform, one of the major issues President Trump ran on during his election campaign. Markets reacted positively to the announcement, especially small caps and technology stocks (2 day price performance of major US markets in chart below). In the bigger picture, small cap indexes look to be breaking out of an 11-month range, which started after the initial rally small caps saw after the U.S. election. If this continues to play out, we could see a rotation from large caps to small caps. We did see a few smaller breakouts like this earlier in the year that ended up failing, but this attempt is quite a bit stronger, in our opinion. Early this year, we made a tactical move to overweight small caps with the outlook that they would perform well over the next 2-3 years. We haven't seen this play out just yet, but the Russell 2000 (small cap index) has built a large base (trading range) and typically when you see a breakout from a large base pattern like this, we typically see a big move (big bases = big moves).



Turning back to tax reform, we haven't seen a major change to the U.S. tax code since the last one was passed in 1986 under President Ronald Reagan. That said, this new proposed tax reform is far from a sure thing (especially in light of the health care reform failure). Under the proposed tax plan, the current seven tax brackets would shrink to three: 12 percent, 25 percent, and 35 percent. The plan would also benefit corporations, dropping the current tax rate of 35 percent to 20 percent. The U.S. corporate income tax is one of the highest in the world, although many U.S.-based multinational companies pay much less than the 35 percent because of the many, many tax loopholes and tax breaks. The proposal also offers companies holding money abroad a one-off levy if they brought cash back to the U.S. that has been kept overseas (think of big tech companies). After that, foreign earnings would be *(continued on next page)*

ECONOMIC HIGHLIGHTS

S&P 500	2,519.36
DJIA	22,405.09
NASDAQ	6,495.96
OIL	$51.67/barrel
GOLD	$1,284.80/ounce
10-YEAR TREASURY YIELD	2.33%
UNEMPLOYMENT	4.4%
GDP	3.1% (Q2 third estimate)
CONSUMER PRICE INDEX (CPI)	+0.4% / 12 month change: +1.9%
CORE CPI	+0.2% / 12 month change: +1.7%

Gross Domestic Product (GDP): Second quarter GDP looks very strong with the third estimate coming in at 3.1 percent. The economy is showing strong momentum.

Employment: The most recent report saw unemployment numbers increase from 4.3 percent to 4.4 percent and average work weeks decrease from 34.5 hours to 34.4 hours. It wasn't all bad as the economy added 156,000 jobs and average hourly earnings increased by 2.5% year-over-year.

Inflation: Personal consumption expenditures (PCE), the primary measure of consumer spending on goods and services in the U.S. economy, came in very weak. Core PCE was only able to move up by 0.1 percent month-over-month and 1.3 percent year-over-year. We'll see how the Fed handles this info as we look toward the December 13 meeting.

(cont'd.) tax-free. In addition to the big companies with money overseas, the next biggest beneficiaries would be companies that do most of their business within the U.S. due to the new "pass-through" tax rate (think small cap companies). As of right now, small businesses profits "pass through" directly to the owners and are taxed as personal income (currently at 39.6 percent). The new proposed plan would set the "pass through" rate at 25 percent. This could be a significant boost to small business.

In another big news, the Federal Open Market Committee (FOMC) announced the unwinding of its roughly $4.5 trillion balance in October. The committee also held rates steady, but have indicated that they still expect to raise rates once more this year (if this happens, we expect it occur at the December 13 meeting). The unwinding, which was expected by the market, will begin by allowing $6 billion in treasuries and $4 billion in mortgage-backed securities (MBS) to maturity and NOT have that those proceeds reinvested back into the treasury and MBS market. From there, the allowed amount to maturity will be increased every 3 months by $6 billion for treasuries and $4 billion for MBS until we reach a total of $30 billion per month of treasuries and $20 billion per month of MBS maturing and not being reinvested back into the market. With this unknown, we preemptively made a move in our fixed income portfolio. Our investment team decided that reducing the exposure in the portfolio related to MBS (agency, non-agency, and commercial MBS), was prudent for a couple of reasons: the effects the FOMC balance sheet reduction would have, tight option adjusted spreads (OAS), and the uncertainties and lack of historical data on the unwinding of Quantitative Easing. With our other positioning in the fixed income portfolio, we continue to be weighted towards low duration, which historically tends to do better in a rising interest rate environment. We are maintaining our position of underweight to government treasuries and overweight to corporate, high-yield, floating rate, and global bonds.

Overall, the long-term view of the economy is strong, with many indicators pointing to a bullish economy and strong stock market. An improving economy and strong balance sheets for U.S. consumers and businesses should continue to drive the economy forward which should lead to an increase in investors' risk appetite. Here in the U.S. we are seeing health rotations in the stock market between style, size, and sector. This action speaks to how strong the current bull market is. International Equity have had a nice run this year as investors looked past the possible Brexit downside. Brexit talks have been very quiet in the news but we are starting to see some blips here and there. Time is ticking on talks and we are looking for indications that we'll see a quality agreement. Emerging markets have benefited greatly from a falling U.S. dollar and commodities rally, but the U.S. dollar is finding support. We really like emerging markets, as we have positioning in EM equity and bonds, but we're not ready to increase exposure at this moment.

MARKET TRACKER

Index	3 Mo	1 Yr	3 Yr	5 Yr
S & P 500	4.48	18.61	10.81	14.22
MSCI EAFE	5.47	19.65	5.53	8.87
BARCAP AGG BOND	0.85	0.07	2.71	2.06

Data as of 9/30/2017. Investments cannot be made directly into an index.

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