FLIPPIN, BRUCE & PORTER, INC.
INVESTMENT COUNSEL

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With a modest 1% uptick in December, U.S. stocks extended a remarkable streak of 14 consecutive months without a negative return, the longest run since 1958-9. It is actually the first time in history that the S&P 500 generated no negative returns in any month for a full calendar year. The list of superlatives and records set in 2017 could fill the page, so we will not belabor the point here. Suffice it to say, by almost any measure, stocks performed very well last year.

Multiple factors came together to create a perfect environment for stocks to move higher. Following several years of global monetary stimulus to address sluggish economic growth, GDP improved for much of the world in 2017. The Organization of Economic Cooperation and Development, an intergovernmental organization whose membership is limited to developed economies, saw unusually synchronized economic expansion; all 45 countries monitored by the group grew last year. This stronger economic growth led to an upswing in corporate profits. According to FactSet data, S&P 500 companies showed earnings growth of 14% in the first quarter of 2017. The pace of growth moderated during the year, but once the numbers are tallied, earnings per share are projected to show the highest annual growth rate since 2011. U.S. consumer confidence moved higher in the fourth quarter, bringing the measure to its highest mark in almost 17 years. Lastly, the pro-growth policies trumpeted by President Trump, primarily reduced regulation and tax reform, stimulated the “animal spirits” of investors, providing added fuel for the markets.

There were certainly bumps in the road for the new president as he attempted to promote his agenda, but the passage of a tax bill by Congress in December was a significant highlight. Tax reform has long been a priority for the Republican party. Lower individual tax rates should help most taxpayers, and because of a higher standard deduction, the process of completing tax returns should be simpler as well. The reduction in corporate tax rates will likely prove to have the most economic benefit over the long term, as U.S. corporations will be more competitive on a global basis. Companies with mostly domestic revenues could see earnings per share increase by more than 20% once the new rates take effect. This should provide a significant boost to the financial flexibility of U.S. companies. The tax bill also lowered rates on repatriation of cash held overseas, which will be an additional boon for corporations. We expect wages to get a boost, capital spending to rise, dividends to be raised and share repurchase plans to increase, all of which should benefit consumers and investors.

As we enter the ninth year of this bull market, many wonder if stocks can continue their winning ways. Many positives remain in place to support equity prices. Earnings growth is projected to be positive again in 2018, boosted by improving U.S. and global economies, rising consumer and business confidence, reduced tax rates and continued share repurchases. Inflation and interest rates remain low, providing reinforcement for equity valuations that have expanded in recent years. Potential headwinds include the risk that inflation picks up and interest rates rise further than expected, likely pressuring the valuation levels investors are willing to pay for

stocks. Uncertainty over the administration and its actions, geopolitical turmoil or some other unforeseen event, risks that were essentially ignored by investors in 2017, could also pressure stock prices. While not enjoyable, a modest market correction would be a healthy development that should create additional investment opportunities and set the stage for extending the duration of the market advance.

As noted above, global stock markets enjoyed a banner year in 2017. Our portfolio returns were generally in line with the value benchmark, generating double-digit returns. One aspect of market performance that bears mentioning, however, is the relative performance of growth stocks in the U.S. compared to value stocks. Large-cap growth stocks, led by the so-called FAANG stocks (Facebook, Amazon, Apple, Netflix, and Google, now renamed Alphabet), significantly outperformed value stocks. In fact, the spread was the most pronounced we have seen since the technology bubble of the late 1990s. We will maintain our value discipline, as these cycles have played out many times over the years, most recently in 2016 when market leadership shifted and value stocks outperformed by a wide margin.

For additional firm wide information please visit our website at www.fbpinc.com or call us at 1-800-851-3804. As always we appreciate your continued interest in our firm.

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