Sather Financial Group, Inc.
Private Wealth Management

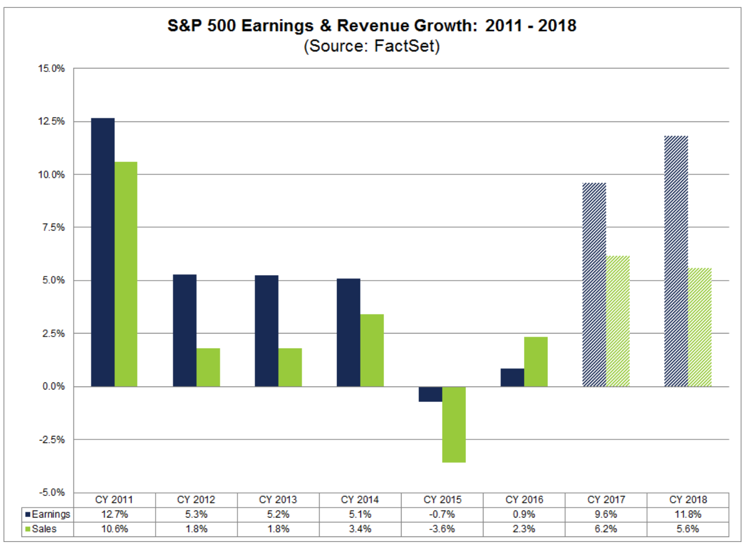
2017 End Of Year Commentary
Much Better Than Expected

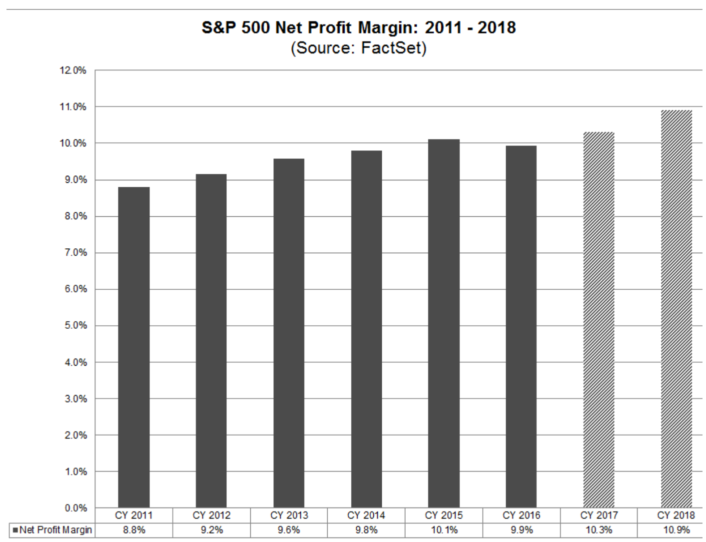
Coming into 2017 we had a new presidency to assess while navigating the usual villains like North Korea, Iran and Russia. Considering this, if one year ago we told you there would be significant damage from hurricanes and wildfires…. how would you have handicapped financial performance in 2017? It is a guarantee that if we offered a prediction, it would have been wrong.

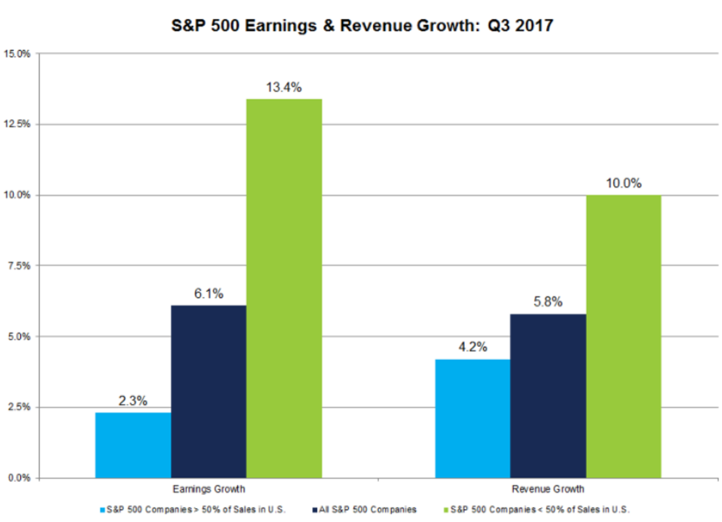
This serves as an effective reminder that the financial markets are quite resilient. Furthermore, there is a distinct difference between what our elected leaders say and what the economy will do. Despite the noise from both sides of the political aisle, the U.S. economy grew 3.3% in the 3rd quarter (a 3 year high), unemployment is the lowest it's been in 17 years, long-term interest rates remain low and profit margins continue to improve for corporate America.

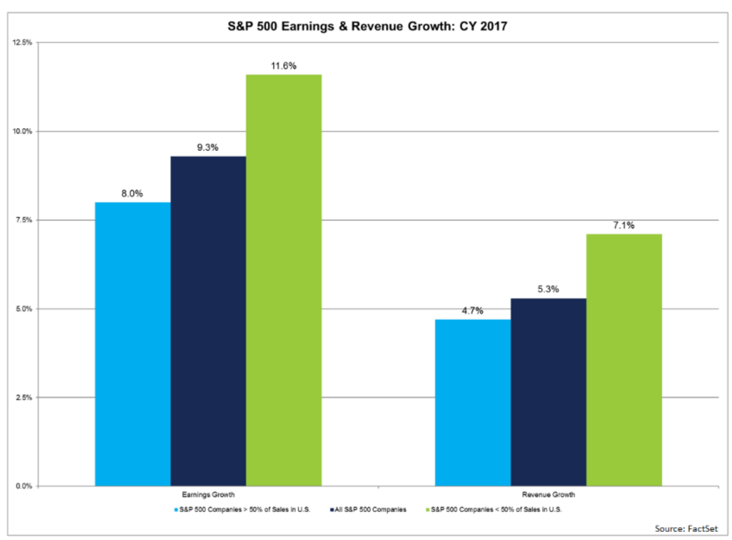
We are now 10 years removed from the Great Recession and the stock markets have performed much better than expected.

Estimated earnings growth rates for the broad stock market are nearly 12% for 2018. If this comes to fruition, it will be the best growth in earnings since 2011. As such, it should be no surprise that estimated corporate profit margins for 2018 are nearly 11%. If true, this will be the highest profit margins in ten years.









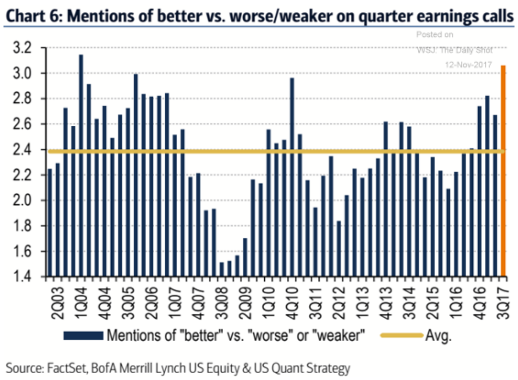
120 E. Constitution, Victoria, Texas 77901

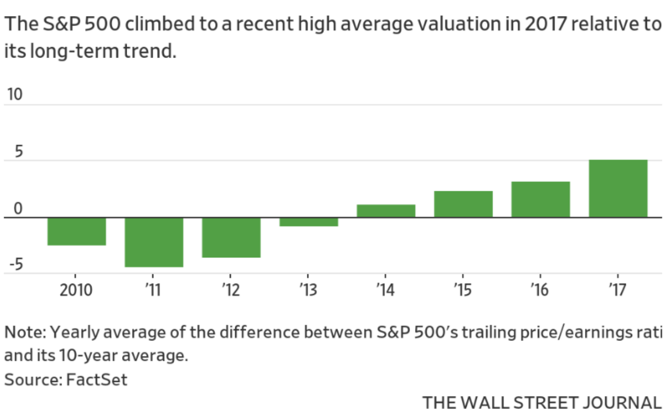
Corporate leaders continue to express optimism in conference calls as well as quarterly earnings reports, again reinforcing efficiency and improved profitability. Much of this is coming from technological innovation.

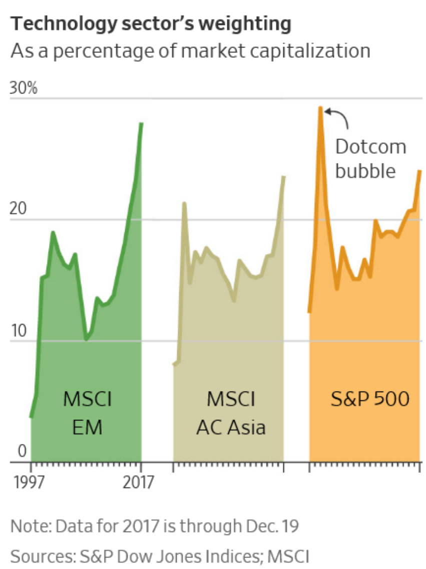
As such, the technology sector is comprising a larger and larger percentage of the S&P 500…now up to 24%.

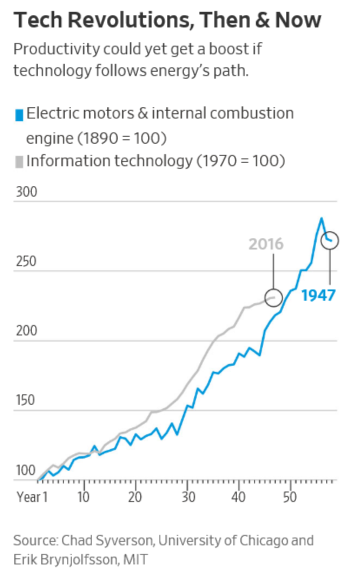
Many clients have questioned how much higher the market can climb. Admittedly, valuations are on the high side—but maybe not as high as they appear.

The current Price to Earnings Ratio of the Dow Jones Industrial Average is 21.77. However, the forward-looking P/E ratio, based upon the next 12 months' worth of earnings is 19.8. Despite the increases in prices, profits continue to improve while interest rates remain low.



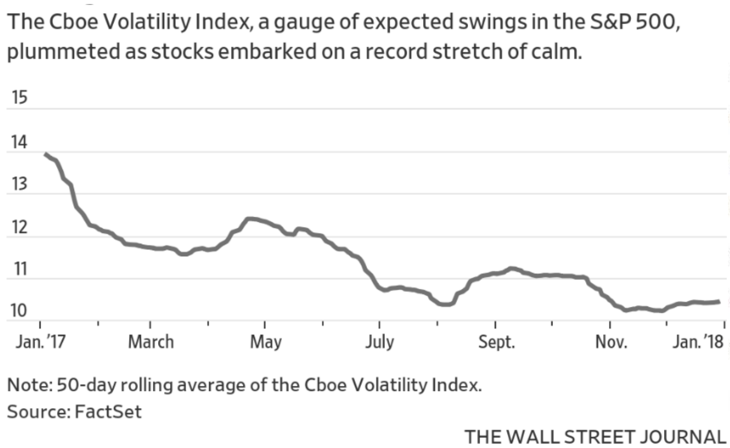


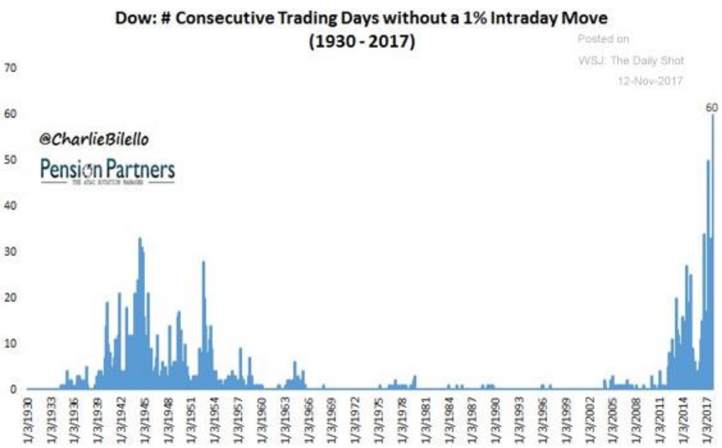




Stock Prices Often Follow Earnings

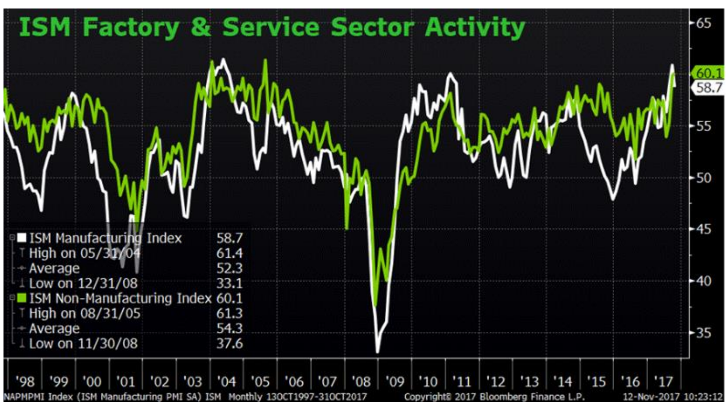
Amidst the backdrop of rising profitability, volatility has been eerily absent. We are not sure why volatility took the year off, but we are quite sure volatility will return when we least expect it.

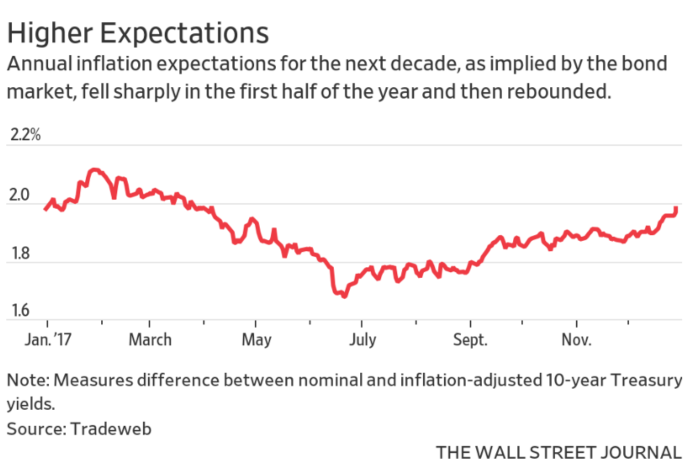


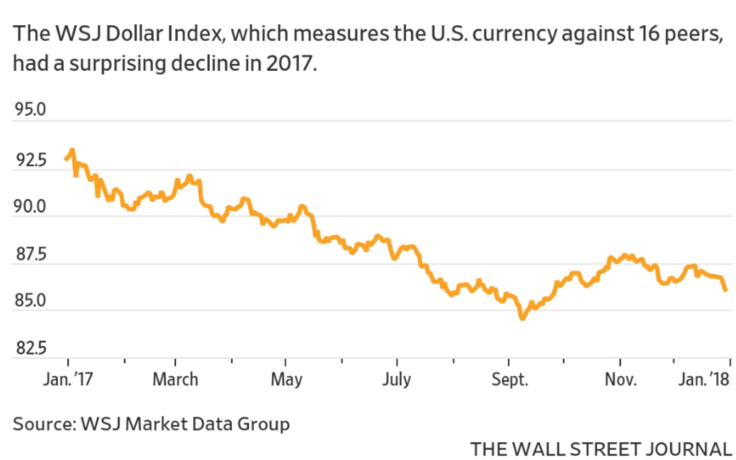


Both the Manufacturing and Service Sector indexes reflect a healthy and expanding economy. With unemployment low, consumer sentiment has also been positive. Furthermore, official inflation figures remain rather muted.

It is also worth noting that immediately after the presidential election the U.S. Dollar strengthened significantly. Since then, the Dollar has weakened relative to other currencies. This is neither unexpected nor of concern. However, we continue to think that over the long-term, the purchasing power of the Dollar will continue to weaken. As such, investors must continue to accept some principal risk if they are to maintain purchasing power net of taxes and inflation.



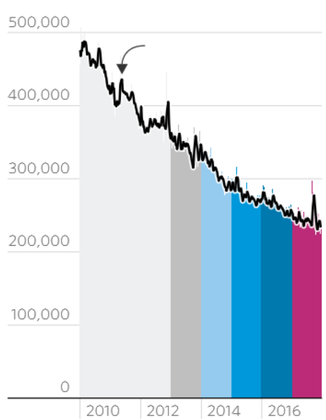




Given a strengthening economy, the Federal Reserve followed through on increasing short-term interest rates. As such, over the past three years the Fed Funds rate has increased from zero to 1.5%.

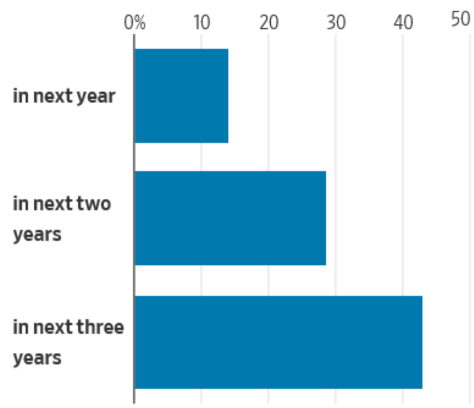
Note: Inflation and unemployment are seasonally adjusted Sources: Federal Reserve Bank of St. Louis (inflation); Labor Dept. (unemployment, Fed funds target)

Initial claims for unemployment benefits, seasonally adjusted



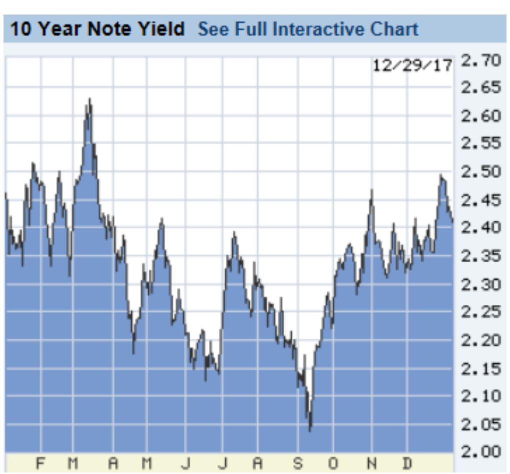
Source: Labor Department via the Federal Reserve Bank of St. Louis

U.S. forecasters saw the average probability of a recession under 50% even three years out.



Note: Survey conducted Dec. 8-11, 2017
Source: WSJ Survey of Economists
THE WALL STREET JOURNAL

Although the Federal Reserve has raised short-term interest rates, it has been interesting to observe that longer-term rates have not moved much at all. The yield on the 10-Year U.S. Treasury finished the year at 2.41%--which is a lower yield than produced a year ago.
As such, the "spread" between the two-year and the ten-year has continued to compress.



Bond Barometer
The gap between two-year and 10-year U.S. Treasury yields, a traditional measure of the yield curve, shrank sharply.

Source: Tradeweb
THE WALL STREET JOURNAL

We are intentionally holding off writing an in-depth commentary on the new tax reform package. We have studied it enough to know that different people will have variability in outcomes. As such, there are no "one-size-fits-all" conclusions and many details have yet to be fully revealed.

Some outcomes may surprise quite a few. We have received calls from clients convinced they will receive a large tax increase…only to find out they will probably benefit from a tax cut.

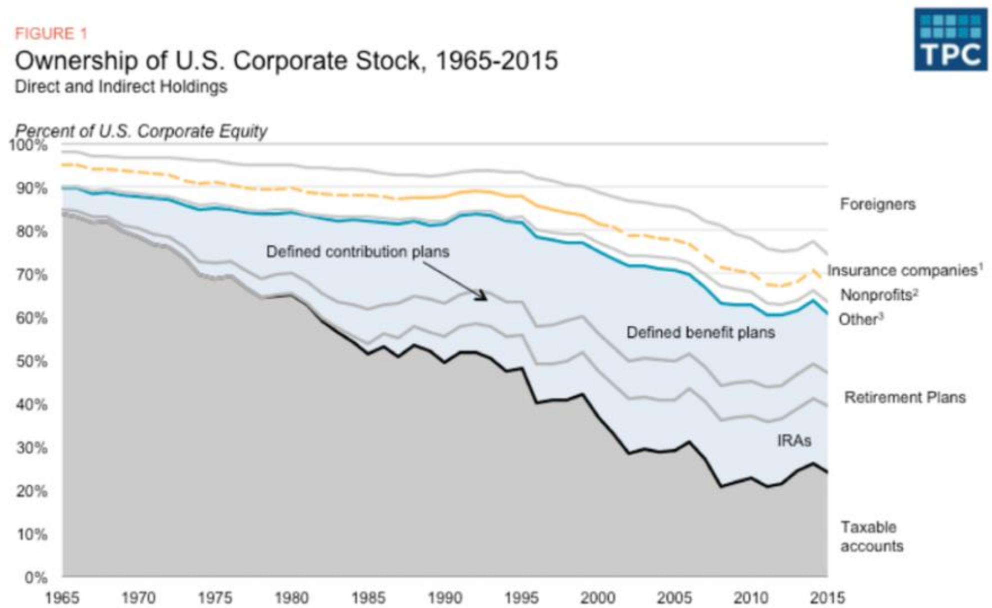
When it comes to the tax reform package, know that when a politician says it is 100% good….it is not. Conversely, when a politician says it is all bad or nothing but a tax break for the rich, this is also incorrect.

Stop listening to politicians for tax advise! The truth is somewhere in between in terms of who will benefit and to what extent.

For instance, it has often been quoted that the tax package is nothing but a break for rich corporations. As we have written previously, the U.S. had the highest and most punitive corporate tax rates in the world. This meant that corporations redeployed earnings to other countries with more competitive tax structures. As such, this benefitted every other country in the world to the detriment of the U.S.

Lowering corporate taxes increases earnings. Increased earnings means corporations can increase wages or dividends or expand their operations. In general, all of this, over time, helps the stock market to go up. As the chart below indicates, approximately 60% of the stock market is owned by pensions, 401k plans and individuals. Obviously, there are many rich people who own stocks.

However, pensions, 401k's and IRA's are the life-blood for the average person's retirement. Although it may not be immediately obvious, a rising stock market helps the average person.



Source: Board of Governors of the Federal Reserve System, "Financial Accounts of the United States;" Investment Company Institute. 2016, "The U.S. Retirement Market, Fourth Quarter 2015;" Barclay Hedge; Preqin; Tax Policy Center calculations.
(1) Stock held in non-taxable segregated reserves to fund annuity contracts and whole life insurance.
(2) Dashed lines indicate TPC estimates
(3) Primarily government holdings, but includes equities in 529 savings plans.

Lastly, as we say good-bye to 2017 and welcome in the New Year, we wish you health and prosperity. It continues to be a phenomenal journey. Thank you for the opportunity to work for you!

Sincerely,

Dave

Warren

Dave Sather, President
CERTIFIED FINANCIAL PLANNER™

Warren Udd, Vice President
CERTIFIED FINANCIAL PLANNER™

120 E. Constitution, Victoria, Texas 77901