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KUMMER FINANCIAL STRATEGIES, INC.

*Helping You Create Financial Independence*

**December 22nd, 2017**

## Weekly Market Update

Amid tax reform passing and Congress averting an end-of-year government shutdown, equity markets managed to eke out small gains this week. The S&P 500 Index gained 0.3%, the Dow Jones Industrial Average rose 0.4%, the Nasdaq Composite added 0.3%, and the Russell 2000 Index of small-cap stocks finished the week 0.8% higher. Meanwhile, a proxy for developed international markets, the iShares MSCI EAFE exchange-traded fund, finished the week 0.2% higher. A proxy for emerging markets, the iShares MSCI Emerging Markets exchange-traded fund, gained 0.7% on the week.

The yield on the 10-year U.S. Treasury rose 14 basis points to 2.49% while the 2-year U.S. Treasury yield gained 6 basis points to 1.90%. Oil prices rose 1.7% while gold added 1.6%. The S&P GSCI, which measures the returns on a basket of commodities, was up 2.3%.

The tax reform drama in Washington garnered a lot of attention to start the week with U.S. equity markets reaching new record highs on Monday as the tax bill was closing in on becoming a reality. For the remainder of the week, market action was somewhat muted, however, despite some upbeat economic data. Tuesday and Wednesday saw modest declines with technology stocks weighing on overall sentiment as they are widely seen as a group less likely to benefit much from the lowered corporate tax rate. In addition, long-term interest rates hit their highest levels since March. Tax reform passed both houses of Congress by Wednesday with only Republican support and little last-minute drama. Thursday saw a short-term government funding bill pass Congress, postponing the potential for a government shutdown for another month and President Trump signed both bills on Friday. Markets finished the week on a negative and relatively quiet note.

In economic news, housing data surprised to the upside while the U.S. economy grew a tick slower than previously estimated. Housing starts quickened to their fastest pace in over a year in November and existing home sales jumped the most in seven years. The annualized pace of sales was the highest since 2006 while supply of homes remained extremely low. The pace of new home sales reached its highest level in over a decade in November, which may explain why homebuilder confidence hit its highest level since 1999. Meanwhile, the third estimate of U.S. GDP for the third quarter was revised a tick lower to a 3.2% annualized pace. Slower consumer spending was the primary reason for the slightly softer reading, but overall the economy remains in good shape and could see 3%-plus growth over the fourth quarter. Manufacturing data for the Philadelphia region unexpectedly improved, suggesting a pickup in manufacturing activity in December. The core PCE Index, which is the preferred inflation gauge of the Federal Reserve, remained relatively subdued, rising only 1.5% from a year ago. Personal spending rose more than expected while the final University of Michigan's consumer sentiment reading fell to its lowest level since September. Next week we get a few economic data points, including the latest home-price index from Case-Shiller. We also get pending home sales data, the Conference Board's consumer confidence for December and a regional manufacturing gauge.

With tax reform now signed into law and government funding extended to mid-January, market participants will likely turn their focus towards the Fed, interest rates and earnings growth. Many economists expect the tax reform bill will boost economic growth over the short-term. Some estimates suggest we could

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see 3%-plus growth materialize over the first two quarters of 2018. Couple this with the corporate tax rate being lowered from 35% to 21% and it would appear the near-term earnings picture is set to improve. It's difficult to gauge the magnitude of the improvement and not all industries or sectors will likely see marked improvement. In aggregate, estimates post tax reform have ranged from 5-10 percentage-points higher than what was already expected. The consensus earnings growth estimate for S&P 500 companies prior to the passing of tax reform was around 11% for 2018. The lower tax rate could boost that up to 16-21% next year.

Potential beneficiaries of the tax bill include small-cap stocks, which typically have higher tax rates. Meanwhile, multinational companies could suffer a little with the application of a regional tax system. So, there are likely to be some areas of the market that outperform other areas as a result. While we believe the potential for faster near-term economic growth represents a favorable backdrop for earnings, we think there is still the potential for disappointment, particularly later in 2018 as the year-over-year comparisons become more difficult. Despite this, we continue to believe equities remain more attractive than bonds in the current environment.

One of the potential risks to financial markets remains the pace at which the Fed normalizes interest rate policy. Faster economic growth could result in more rate hikes than the Fed or markets currently anticipate. The Fed has suggested three rate hikes in 2018 would be appropriate. The market has been expecting only two. We think there is a good possibility for four. A faster pace of rate increases could push interest rates across the maturity spectrum higher at a quicker pace than what would be ideal for equity markets. We saw a strong up move this past week in the 10-year U.S. Treasury yield, but markets took the increase in stride. Regardless, we think interest rates are likely heading higher and that volatility across asset classes will likely increase from the very low levels we've seen this past year.

As we head into the last week of what has been a remarkable year for investors, we think markets remain vulnerable to a near-term pullback. It is difficult to identify a potential catalyst for one given the very favorable global economic backdrop. Equity valuations remain elevated and investor willingness to pay more for a dollar of earnings may soften, particularly if we see interest rates move substantially higher over a short period of time. Despite this risk, we believe the potential for faster earnings growth and a low risk of a recession unfolding over the near term will likely continue to support risk assets. Global growth remains healthy, leaving us to favor stocks over bonds while having an international tilt in our dynamic positioning.

Regardless of the market's near-term direction, it is important to remember that setting the appropriate strategic asset allocation for your circumstances and risk preferences are important steps to executing your financial plan. If you would like to discuss your asset allocation, time horizon, or risk tolerance please contact us at 303-470-1209 and we would be happy to address your concerns. We are here to assist you, your friends, family or in any way we can.

Disclosures:

- Kummer Financial Strategies, Inc. is an independently registered investment advisor.
- Investors should be aware of risk when investing, including potential loss of principal.
- Past performance is not a guarantee of future results. Rebalancing, asset allocation or alternative strategies may or may not produce positive results. Thank you.

Performance, economic, and market statistics were provided by Yahoo Finance and Ned Davis Research.

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