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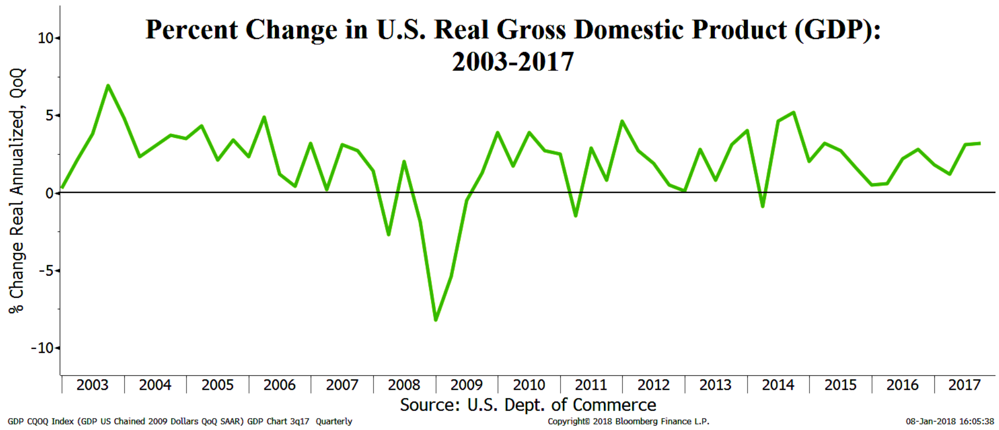
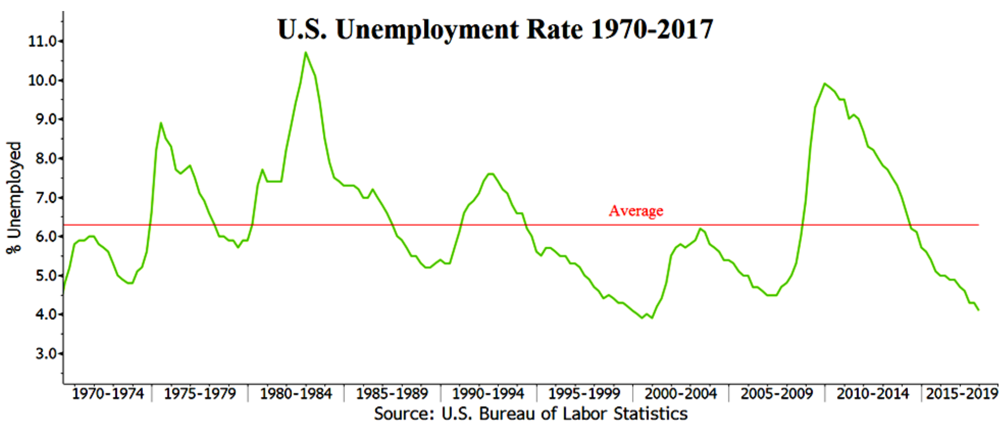
CLIENT BULLETIN: 2017 Review-2018 Outlook

Economic Overview: All signs point to continued growth in 2018.
At its December meeting, the US Federal Reserve marginally pushed up its economic growth forecast for 2017 to 2.5%, but sharply raised it for 2018 — to 2.5% from its 2.1% estimate in September, in an apparent nod to the Republican tax-cut stimulus. Policymakers also increased their growth estimate to 2.1% in 2019 and 2% in 2020, up from 2% and 1.8% respectively. They now expect the 4.1% unemployment rate to fall to 3.9% by the end of next year, below their prior forecast. At Cypress, we expect solid GDP growth in 2018, with only a minimal risk of recession.

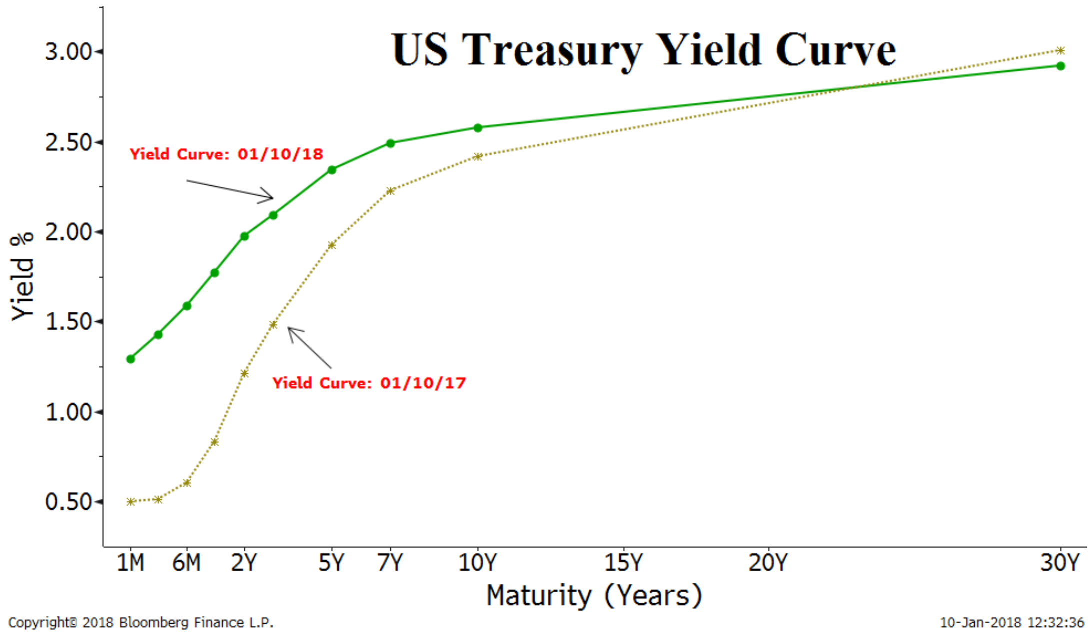




Monetary Policy: New Chairman…same course. Jerome Powell will replace Janet Yellen as the new Federal Reserve Chairman in February. Of all the candidates for Chairman, Mr. Powell's philosophy most aligned with Ms. Yellen's. Remaining optimistic about the state of the U.S. economy, the Fed last month raised its short-term federal funds rate for the third time in 2017—to a range between 1.25% and 1.5%. Policymakers signaled three more quarter-point hikes for 2018 and two such increases each in 2019 and 2020. Of course, if the newly-enacted tax cuts accelerate economic growth to the point where the Fed worries about an overheating economy, rate hikes could come at a quicker pace.

<u>Monetary Policy:</u> Cont'd.

Nevertheless, weak inflation data continues to confound Fed policymakers, and Fed Chair Yellen said after last month's meeting that "it could take a longer period of a very strong labor market in order to achieve" the Fed's 2% inflation target, a mark it now expects to reach by 2019. Since the Fed began steadily raising rates about one year ago, yields at the shorter end of the Treasury curve (0-5 years) have started to rise, the middle of the curve (10-20 years) has held steady and the longer end (20-30 years) has actually declined in yield!

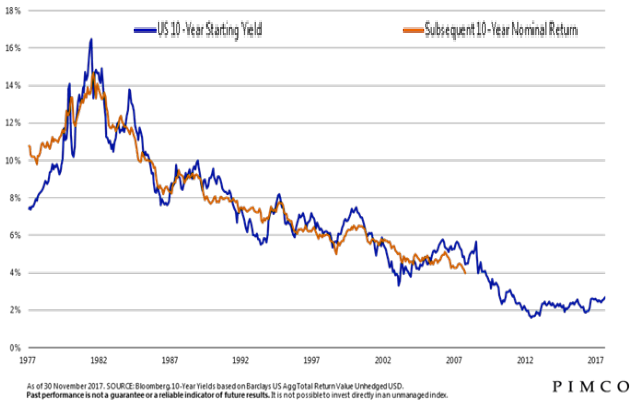


<u>Fiscal Policy:</u> Tax cuts to spur greater growth.

The Tax Cuts and Jobs Act, signed into law by the President in December, maintains the same seven-bracket structure that was in force previously. However, Congress has tweaked the rates and the income levels at which they apply. That being said, the overall impact can vary significantly based on your state of residence and other deductions that have been modified within the new law.

The US corporate tax rate was reduced from 35% to 21%. Small U.S. domestically-oriented corporations that enjoy few tax loopholes will benefit considerably from the rate drop. Also, the owners of Sub S corporations who pay taxes on their profits at individual tax rates, up to 39% last year, will now have lower taxes on that "pass through" income. In contrast, the realized tax cuts will be less for large multinationals that already employ many techniques to reduce their U.S. tax liabilities, including leaving foreign earnings abroad since they are not taxed by the IRS until repatriated. That's a major reason that the overall effective U.S. corporate tax rate was 29% in 2016 compared to the statutory 39%—the 35% federal rate plus 4% for state and local taxes on average. Bottom line: all else being equal, the tax cuts should add about $13 per share to S&P 500 earnings, or 230 S&P points (18 P/E X $13). Our best guess is that most of this gain has already been priced in to the equity market.

<u>Fixed Income:</u> Safe yield but below average total return. Fixed income returned about 4% in 2017 as yields remain range-bound. The chart below from PIMCO explains that historically, for buy and hold investors, the starting yield on your bond investments are approximately your 10 year nominal return. With a starting yield on the 10 year US Treasury below 2.5%, it will be difficult to earn meaningful returns from this asset class in 2018. At some point, longer-dated Treasuries will offer safety and reasonable total returns, but that may not be until 2019 or later.



<u>Equity Markets:</u>
Can it get any better than this?
The S&P 500 returned in excess of 20% in 2017, surpassing our own optimistic expectations. We were confident that stocks would outpace bonds, but we did not expect it to be by a greater than 5-to-1 margin! With a growing economy, economically sensitive sectors performed best, led by Technology. The stable growth Consumer Staples sector, Energy, and the interest rate sensitive areas, REIT, Telecom, and Utilities trailed the S&P 500 by a wide margin. 2018 should be another positive year for stocks, with some of the lagging sectors (Energy, Staples) playing catch up to the sectors that performed well in 2017.

Financial Market Scoreboard
<u>Calendar 2017 Total Returns</u>

<u>Equity Indices</u>	
S & P 500:	+21.8%
Dow Jones:	+28.1%
Nasdaq Composite:	+29.7%
<u>Fixed Income Indices</u>	
Long Term Treasury ETF:	+9.2%
Barclay's Govt/Credit:	+4.0%

<u>S&P 500 SECTOR RETURNS 2017</u>

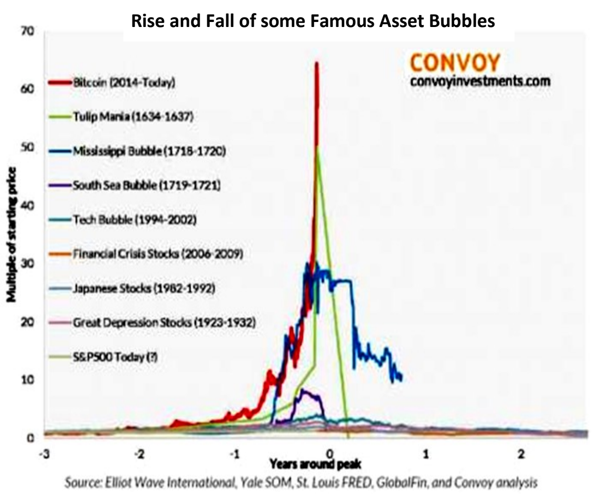
Consumer Discretionary	**23.0%**
Consumer Staples	**13.4%**
Energy	**-1.0%**
Financials	**22.2%**
Health Care	**22.1%**
Industrials	**21.2%**
Information Technology	**38.8%**
Materials	**23.8%**
Real Estate	**10.8%**
Telecommunications	**-1.1%**
Utilities	**12.1%**

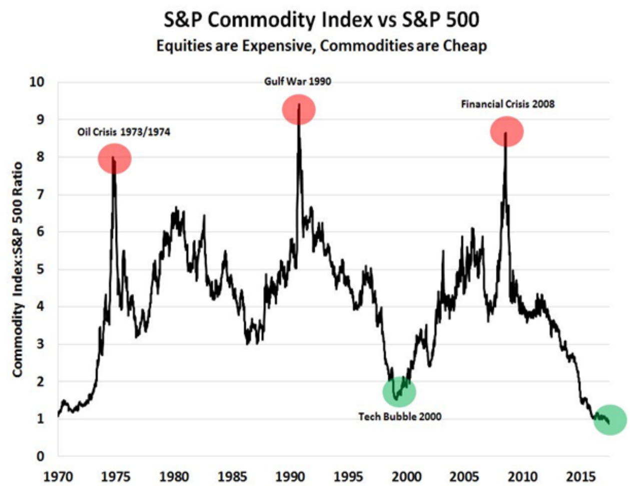
<u>Investment Outlook:</u> Bubble watch…Bitcoin or Bitcon?
For a while now, many have talked about a "bubble" in equities, a "bubble" in bonds, and even a "bubble" in passive investing. From our perspective, the only bubble we see is in cryptocurrencies, like Bitcoin and Ethereum. Cryptocurrency is a digital currency, created and held electronically. No one regulates it. Cryptocurrencies aren't printed like dollars or euros – they're produced by people, and increasingly businesses, running computers all around the world, using software that solves mathematical problems. Bitcoin is the first example of a growing category of money known as cryptocurrency. Some of the problems with Bitcoin as a currency are: 1) its price is too volatile. Currencies need to be a store of value so as to encourage investment and facilitate transactions. If prices are constantly changing, investment or stable transactions cannot take place. 2) The security of the blockchain that makes cryptocurrencies like Bitcoin so secure makes processing of Bitcoin transactions very slow.

Investment Outlook: Cont'd.
In fact, because of a limit on the number of transactions which can be completed in a day, it sometimes takes days to complete a simple transaction. Its very security negates its value in everyday use. To us, Bitcoin is only useful as a speculation and right now the speculation has reached bubble status. Bitcoin and other cryptocurrencies meet the criteria that many researchers believe are the five main characteristics of financial bubbles:

1. Available liquidity—central banks have clearly provided a sea of liquidity.
2. Leverage—the listing of futures contracts may be just the beginning.
3. Democratization—individuals globally are active participants.
4. New issues—there are over 1,000 cryptocurrencies.
5. Turnover—trading volumes have soared.

By some measures, the cryptocurrency mania is the biggest financial bubble in history, surpassing the tulip mania of 1634-1637. We don't know how this ends well. Stay tuned!





One area that doesn't appear to be in a bubble is commodities. Commodities are the cheapest they have been versus stocks going back to 1970. Growth has been sluggish and inflation has been very low, but that may be changing. Worldwide economic growth is accelerating almost everywhere and inflation is starting to slowly show signs of waking. As investors, it is difficult to invest in this theme through the commodities themselves. At Cypress, we are currently invested in some energy and agricultural stocks that should benefit from a rise in commodity prices. These stocks lagged the S&P 500 last year; however, we believe they are positioned to do better in 2018. Another area that could do well in 2018 is international equity markets, especially emerging. While riskier, emerging markets tend to do well when commodity prices are rising and/or the U.S. dollar is declining (which has been the case for most of the last 12 months).

Administrative: As required by Cypress Capital Policy, we are providing our updated Corporate Privacy Policy for 2017.

Disclaimer: Any projections, outlooks, or assumptions should not be construed to be indicative of the actual events which will occur. Discussions, market conditions, objectives, and strategies set forth herein are specifically subject to change if market conditions change, or if the Adviser believes in its discretion, changes and/or modifications are warranted accordingly. January 2018