**President's Letter – April 2017**

As you thumb through a newspaper or boot up your computer to check your favorite financial site, you will undoubtedly come across articles by pundits meant to stir the "animal spirits." On one hand, the bulls argue that although stock prices appear high, the valuations are supported by low discounts rates, which are a product of the low federal funds rate. They point to "strong economic data" such as low unemployment and they base model inputs on rosy expectations for GDP. On the other hand, bears counter by citing the Federal Government's inability to pass meaningful legislation (i.e. healthcare reform and maybe tax reform) and unsustainable optimism in market sectors such as financials and industrials.

So, who is correct?

We are not sure it matters. A refrain that should resonate with our long-term clients is our belief that it is not possible to "time the market." A market forecast is only useful if it meets two criteria: 1) the prediction is actionable and 2) it has a certainty—or at least a very high probability—of being correct. If market commentators were able to do both of those things consistently, they would have retired to a private island rather than write articles or make guest appearances on CNBC. Alas, for all of their talk, these pundits are paid to increase their viewership, not to increase your profits!

While we never try to guess where the market will go next, we acknowledge the value in understanding our current position within the business cycle. As famed value investor Howard Marks points out, "you can't predict, you can prepare." The current bull market, now going on its 96th month without a correction of 20% or more, is the second longest in US history. As the market cycle progresses, we see two key indicators that might suggest we are approaching a peak: personal debt and risk-seeking behavior. Market corrections or recessions are often proceeded by the expansion of credit, whether it is margin debt in 1928 or mortgage debt in 2008. Today, we see unsustainable growth in the student loan market and in sub-prime auto loans. Defaults in either of these products are unlikely to cause a widespread market failure; however, as credit tightens, those saddled with debt may find it difficult to make big purchases in the future. Before a market peak, we often hear of "can't lose investments"—think of technology stocks in 2000. Now that the bull market has survived for eight years with relatively low volatility, pundits are touting the benefits of index funds, and investors are piling-in at a record pace. This sheep-like behavior is bound to prove destructive in the next correction.

It is often said in investing that "trees do not grow to the sky," meaning that the bull market will not persist forever, but we believe that at least in the short term, the market fundamentals are sustainable:

1. Corporate profits continue to increase. While not obvious from listening to the news, investor sentiment has been climbing steadily since November 8th. With improved

sentiment comes increased expenditures by both individuals and companies in a virtuous cycle that has pushed the stock prices higher.

2. Interest rates remain depressed. Low rates have a two-fold positive impact for businesses. First, companies can borrow money at a low rate and take on profitable projects such as expanding facilities and hiring additional workers. Second, when valuing stocks, a discount rate is used to determine a firm's value and that rate is based heavily on current interest rates. If the interest rate is low, the amount by which we will discount future cash flows will also be low, which results in a higher valuation.

As investors armed with these seemingly contradictory data, how are we to prepare for the unknown? First and foremost, we need to maintain our discipline. With regard to your portfolio, that means having the conviction to hold to your target allocation even as equity indexes hit new highs. Second, we must block out the noise. Wall Street and the financial media will have you believe that you can't make money if you are not making trades. Very frequently, however, the best course of action is inaction. We would rather wait for an opportunity to buy assets at bargain prices than take on additional risk trying to eke out a few extra points of return. Finally, we focus on what we can control. Because we know market cycles persist, we know this bull market will end at some point.

As stewards of our clients' capital, we strive to ensure you are prepared for any market environment. On the equity side, we continue to search for companies trading below their intrinsic value. We believe that even if the market does not provide a tail wind to your portfolio, the companies we own will generate strong returns over our investment time frame. Our fixed income approach is crafted with equal care. We buy bonds from highly rated companies and municipalities with fairly short maturities (or near-term call provisions). As the Federal Reserve raises interest rates, proceeds from these maturing bonds will be reinvested at a higher rate of return in a process known as "laddering." While we can't control the market, we can construct balanced portfolios with a value tilt that will be ready for whatever may come our way.

Enclosed with this letter you will find your quarterly statements, and please note that we have completed our annual Brochure ADV Part 2 update with no material changes. We will provide a copy to you upon request or you may find it on the SEC's website (www.advisorinfo.sec.gov). From all of us at Hayek Kallen, we are grateful for the trust you place in us every day. If you have feedback, questions, or if we can help you in any way, please feel free to contact us.

Sincerely,

Eric Kallen, President & Chief Investment Officer
Hayek Kallen Investment Management, LLC