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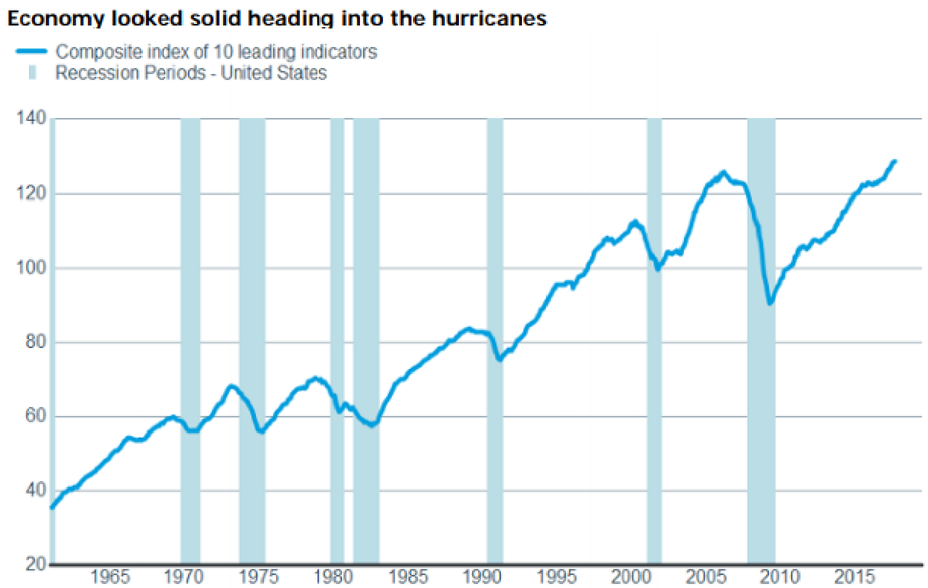
President's Letter – October 2017

As we enter the final quarter of the year it's a good time to look ahead. The fourth quarter of any year can be busy. With budget battles, hiring and firing announcements, money managers positioning for year-end and the all-important holiday season, the fourth quarter generally sees a fair bit of activity. Layer on top of this a significant 'discussion' by our esteemed leaders on tax reform and a potential change at the helm of the Fed, there is a lot to keep an eye on.

So far this year markets have shown a fairly low level of volatility, despite a number of issues that could have stirred things up a bit. The market's resolve has been impressive, both in the near term and over the 9 years that make up this current bull market. There is nothing to say that the resiliency of stocks can't continue, but risks of a pullback certainly exist with signs of investor complacency and heightened political and geopolitical uncertainties.

Despite the highlighted risks, there are plenty of reasons to be optimistic. The economy remains on sound footing, growing consistently but slowly. Signs of a recession, generally a harbinger of the next cyclical bear market, are not evident and consumer and business sentiment remains positive. Fed watchers remain very active these days both in terms of what actions the Fed may take in December (raise or not raise rates) and also in handicapping the President's decision about the next Fed Chairman. Markets have proven to be very accommodative to the actions that the Fed has taken to date (shrinking their balance sheet and raising rates) but the December decision is a tough one. Very little inflation appears to be in the system as interest rates remain low and prices remain under control so there doesn't appear to be a huge necessity for the Fed to take action. Either way, a less accommodative monetary policy remains on the horizon as the Fed takes steps to lessen the role that they have played in stimulating the economy.



Source: FactSet, U.S. Conference Board. As of Sept. 25, 2017.

How the markets react to further rate hikes remains to be seen, and Fed induced volatility remains a possibility. The most likely candidate to replace Janet Yellen as Chairperson is Kevin Warsh, a monetary hawk. Kevin was appointed to the Fed by George Bush at age 35, and is likely to be aggressive about shrinking the Fed's balance sheet and reducing the Fed's role – a pretty significant change from recent history. On a side note, I had the pleasure of working with Kevin when I was a young investment banker in the mergers and acquisitions department at Morgan Stanley (yes that does mean I am rooting for him!).

As the 4th quarter unfolds we will continue to remain focused on these issues and vigilant about overseeing your portfolios. Pullbacks are normal and oftentimes healthy for long-term investors, so in the event volatility rears its ugly head we will act in accordance with your long-term interests and continue to focus on the fundamentals. Diversification and discipline remain important as we finish out this year, which by all accounts has been interesting, to say the least. Please don't hesitate to call or email with questions or concerns. We always enjoy hearing from you and we remain grateful for the trust that you have put in us.

Sincerely,

Eric Kallen
President, Hayek Kallen Investment