I have found throughout my career that January is the month that most of my clients check their financial scoreboard. There isn’t anything magical about it. There isn’t a historical pattern that suggests market trends change at year end. It just seems to be the traditional season to review their portfolio. As such, it has become the traditional time for market strategists to publish their outlooks for the next year. Over the course of my career, I have found little value in these forecasts. My conclusion is that we should simply focus on the businesses that we own and be aware of the news that is affecting them. I decided that this letter should be focused on the news that I currently view as most important for the companies that we own and the earnings of those businesses.

“Forecasts may tell you a great deal about the forecaster, but they tell you nothing about the future.”
~ Warren Buffett

The stock market had a very strong 2017. The year ended with gains for almost every equity market in the world. The stock markets in the United States had an above-average year, but so did those for most of the larger countries in the world. Many of the stock market indices in Europe and Asia actually performed better than our markets. Many investors may be questioning their allocations after such strong returns last year, but those gains coincided with improving earnings for many of the largest companies in the world. According to FactSet Data’s press release on January 12th, the companies in the S & P 500 index are expected to report double-digit earnings growth for the 4th quarter, which would be the third time that happened in 2017. Overall, FactSet reports that the companies comprising the index grew earnings at an annual rate of 9.6% last year. In my opinion, this is the most important fact for an investor to keep in mind. Earnings are the primary basis for a company’s valuation. Earnings growth is my preferred reason for stock prices to grow. While it is unusual for stocks to rise without an occasional correction, that alone shouldn’t cause us to become pessimistic or anxious about the stock market. If earnings are consistently growing at rates like they did last year, then we shouldn’t be surprised to see stocks rise too.

The global economy has clearly improved over the past two years. The United States is the largest economy in the world by every measure, but it is still just one contributor. According to data from the World Bank, the United States economy represents less than one quarter of the total global economy. In the past few weeks, there have been headlines from China, Japan, and Germany about the strength of those economies. The World Bank has these countries currently ranked as the next largest in the world.
“By developing your discipline and courage, you can refuse to let other people’s mood swings govern your financial destiny. In the end, how your investments behave is much less important than how you behave.”
~ Benjamin Graham

“Your job is to find a few intelligent things to do, not to keep up with everything in the world.”
~ Charlie Munger

The Tax Cuts and Jobs Act of 2017 passed just before year-end. While we could spend a great deal of time discussing the positives and negatives of this legislation, the only element that I think pertinent to this letter is the law’s impact on corporate earnings. The earnings for the S & P 500 index were effectively flat from 2014 to 2016 at roughly $119 according to actual reported data from FactSet. The Wells Fargo Investment Institute just revised their 2018 earnings estimate for the index up to $152 as a result of the tax bill’s passage. The combined effect of the lowered corporate rates and the higher expensing rate caused our analysts to raise this forecast by $7 or 4.8%. While some companies may actually pay a higher tax rate under the new law, the effective tax rate for most companies should be lower. Therefore, I am expecting to see stronger earnings growth for the companies we own as a result of the tax bill.

If the earnings estimate from the Wells Fargo Investment Institute proves correct, that would produce a 27% increase in earnings for the companies that comprise the S & P 500 index in just two years. Based on the news that has been reported by the companies in our portfolio over the past few weeks, I do believe the firm’s forecast is relatively conservative. The point that I want to make is that our companies are benefiting from multiple economic growth in the United States. According to the state controlled economic bureau in China, that country experienced GDP growth of 6.9% for 2017. This was an improvement over 2016 and stronger than forecast. Japan reported last month that their economy had grown at a 2.5% real rate in the 3rd quarter, which was their seventh consecutive quarter of positive economic growth. That is the longest stretch for Japan since 1994. According to the Federal Statistical Office in Germany, that country’s economy accelerated in the 3rd quarter and was growing at a rate of 2.8% as compared to the prior year. The Bundesbank in Germany is now forecasting growth in 2018 of almost 3% for the largest economy in Europe. We do not invest based on economic forecasting, although I do believe that our companies will have a better chance of growing earnings if the largest economies in the world are accelerating into the new year.
positive factors right now. The global economy has improved. The largest countries are all participating in that expansion. The tax rate for companies in our country has been significantly lowered. All of these factors should make it easier for a company to grow their earnings this year. There are a multitude of events that could trigger a stock market decline or even a global recession. Barring a negative news event of that magnitude, corporate earnings should grow this year, and stock prices typically follow earnings.

In conclusion, the news looks promising for corporate earnings as we enter the New Year. I believe that the companies we own are well positioned to benefit from the improving global economy and also from the recently passed tax legislation. Regardless of economic forecasts, my focus will always be to own companies that possess outstanding fundamental qualities and are positioned for long-term success. We focus on owning businesses because, as Benjamin Graham taught us, that is the investor’s single greatest advantage in the stock market. By investing in businesses that we understand and admire, an investor should be able to keep their focus on their long term goals and prosper from the investment process, rather than getting caught up in the emotional roller coaster of the market.

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The Absher Wealth Management Group

Mike Absher entered the financial services industry in 1996 with A.G. Edwards and continued with the firm through subsequent acquisitions by Wachovia and Wells Fargo. He holds a Bachelor of Science degree in Economics from North Carolina State University. He is currently a Managing Director and a Senior PIM Portfolio Manager. The Absher Wealth Management Group believes that providing professional advice, ongoing investor education, and disciplined asset management to our clients is critical to our value proposition.

As a Financial Advisor who holds the Certified Investment Management Analyst (CIMA®) designation, Mike is dedicated to providing a higher standard of excellence and adheres to the professional code of the Investment Management Consultants Association (IMCA®). IMCA® granted Mike his professional designation after completing the CIMA® educational requirements held at the University of Pennsylvania’s Wharton School of Business. Mike focuses on helping clients with their portfolio construction, investment strategies, discretionary equity portfolio managements and wealth transfer strategies.

The Absher Wealth Management Group is a team of experienced professionals who have a shared belief that professional development is critically important to their client's success. The members of the team hold many advanced industry designations and continue to work on additional professional designations.

Jennifer Oravsky, CFP®, CRPC®
Assistant Vice President, Investment Officer
Financial Consultant
Jennifer.Oravsky@wellsfargoadvisors.com
(919) 969-4828

Kevin Mishoe, CFP®
Assistant Vice President
Registered Client Associate
Kevin.Mishoe@wellsfargoadvisors.com
(919) 969-4826

Gay Dingle-Butler
Client Associate
Gay.Dingle-Butler@wellsfargoadvisors.com
(919) 969-4829