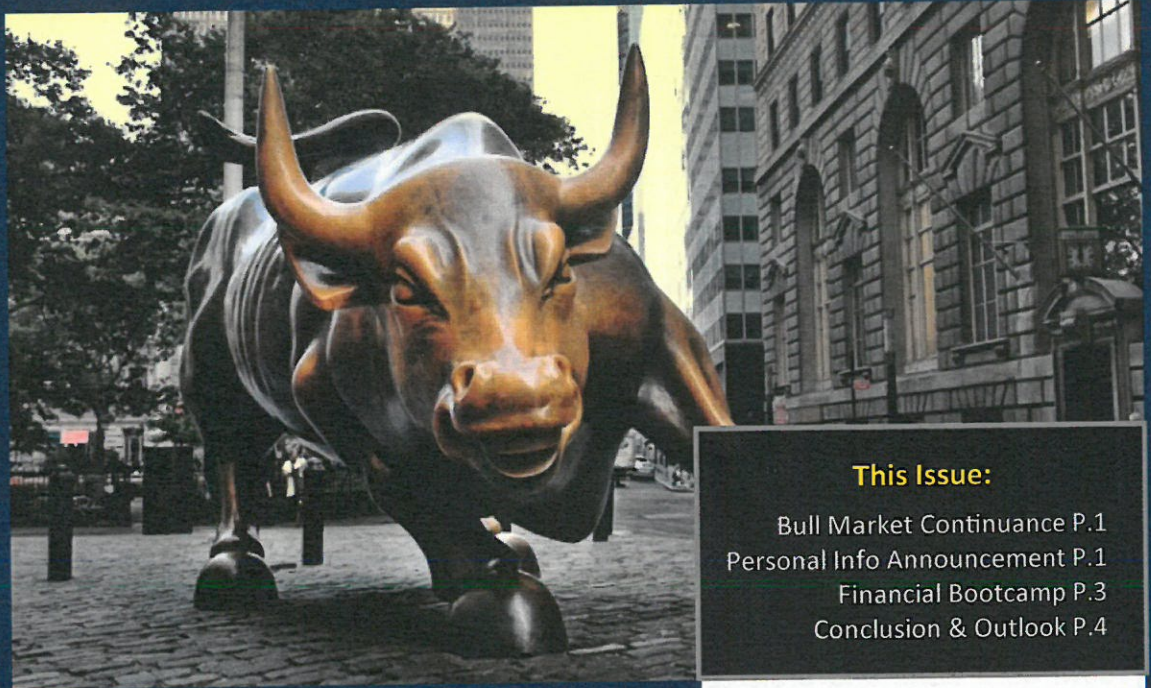




Southern Capital Perspective

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This Issue:

Bull Market Continuance P.1
Personal Info Announcement P.1
Financial Bootcamp P.3
Conclusion & Outlook P.4

Can the Bull Continue to Run in 2018?

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This is the question that investors have been asking as we begin the new year. There are a number of factors pro and con that have to be considered in order to come up with an intelligent appraisal of what the outcome might be. On the positive side there is an expanding global economy, a growing US economy, the recently passed tax act, reduced governmental regulation and a still accommodative monetary policy from the world's central banks. Potentially on the negative side there is a fully valued US stock market, an unusually long period of time since the last normal 5% to 10% correction, and the possibility that the FED and the other central banks might miscalculate and tighten monetary policy too rapidly. The following paragraphs will discuss the above-mentioned factors and which ones we feel may be the most influential.

An Expanding Global Economy:

Global gross domestic product (GDP) is the sum total of all goods and services produced by all nations of the world in a given year. In 2014, world GDP grew at a 3.57% rate and then declined in 2015 and 2016 down to a 3.21% rate. In 2017, it jumped to a 3.62% level and is forecast to continue to grow gradually through 2022 (see graph #1 from *statistica.com* next page).

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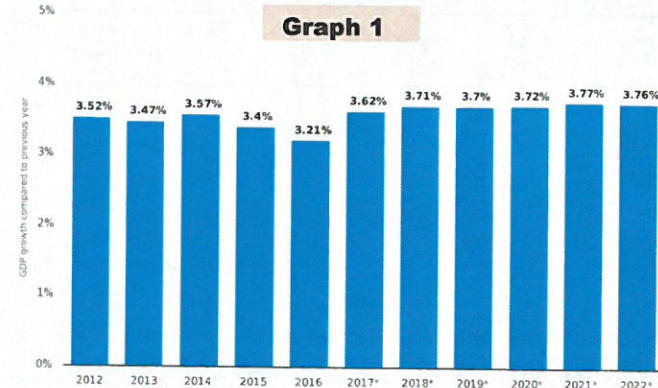
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Can the Bull Continue to Run? (cont.)

Growth of the global gross domestic product (GDP) from 2012 to 2022 (compared to the previous year)



Source: IMF, © Statista 2017

Additional Information: Visualization: 3D

statista

An expanding global economy is an enormous benefit to the US because the other nations and peoples of the world are potential customers for American goods and services. If they are doing well financially then they can afford to buy more products from the USA. The important aspect is the reversal of the downward trend and projected continued improvement.

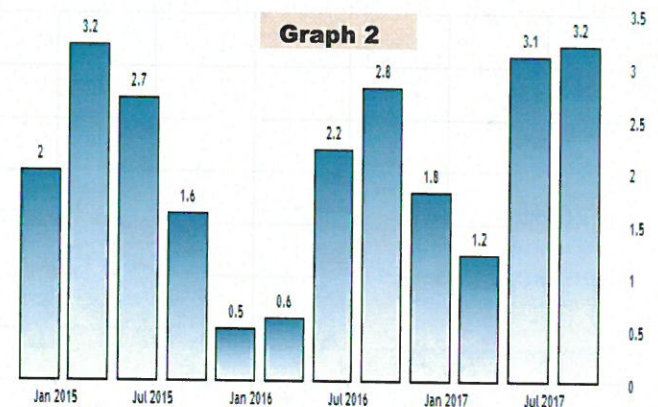
A Growing US Economy:

There are a number of metrics that indicate that the American economy is vibrant and is continuing to strengthen.

- The first metric is the growth rate of US GDP. Graph #2 above right shows a 3%+ rate of increase in the second and third quarters of 2017. The New York FED estimates that the fourth quarter will be around 4%.
- The second is the US unemployment rate. The Bureau of Labor Statistics reported that the rate is holding at 4.1% which is near a 20 year low and is expected to drop even further in 2018 (see graph #3 on next page).
- The third is US corporate profits. Graph #4, also on the next page, shows corporate profits coming

US GDP GROWTH RATE

US GDP Growth Rate



SOURCE: TRADINGECONOMICS.COM | U.S. BUREAU OF ECONOMIC ANALYSIS

off of lows in early 2016 and steadily growing through 2017. The expectation for 2018 is for profits to grow in the 10% range.

- The fourth metric is the market itself. The S&P 500, representing the entire market, shows a steady growth from late 2016 through early 2018. The expectation from the Wall Street pundits is for continued progress through 2018.

The Recently Passed Tax Act:

The reduction in tax rates should not only put more money in the hands of the consumer, but also give businesses more money to expand, hire and pay higher wages. The evidence of this is already happening in early 2018; a number of corporations have announced employee bonuses, hiring plans, and new factories to be built. According to an article in Forbes by Bill Conerly:

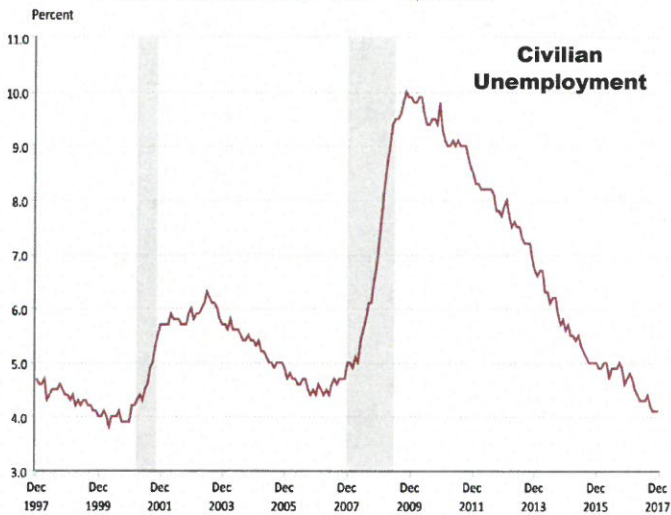
"The tax bill will boost the economy. The biggest impact will be the gradual improvement in economic growth year after year. A small increment added to our recent growth rates would be inconsequential in any one year, but the increments will cumulate and even compound. Twenty years from now, the difference will be significant." Forbes.com 12202017

Civilian unemployment rate, seasonally adjusted

Graph 3

Click and drag within the chart to zoom in on time periods

— Total — Men, 20 years and over — Women, 20 years and over — 16 to 19 years old
— White — Black or African American — Asian — Hispanic or Latino



Hover over chart to view data.
Note: Shaded area represents recession, as determined by the National Bureau of Economic Research.
Persons whose ethnicity is identified as Hispanic or Latino may be of any race.
Source: U.S. Bureau of Labor Statistics.

“The Trump Effect: Business, Anticipating Less Regulation, Loosens Purse Strings

By Binyamin Appelbaum and Jim Tankersley

A wave of optimism has swept over American business leaders, and it is beginning to translate into the sort of investment in new plants, equipment and factory upgrades that bolsters economic growth, spurs job creation — and may finally raise wages significantly.” January 1, 2018

Accommodative Policy from the World’s Central Banks:

Money remains cheap and abundant. The three major central banks have created enormous amounts of money in recent years and have extremely low interest rates.

-The US Federal Reserve has a \$4.5 trillion balance sheet that it intends to reduce 10% by the end of 2018. This means that by the end of the year the FED will reduce the \$3.5 trillion that it added to combat the 2008 crash by \$450 billion. This leaves a great deal of extra cash still in the system. In regard to interest rates, the FED funds rate is 1.5% and the FED indicated that it is targeting 2.00% for 2018, 2.50% for 2019 and 3.00% for 2020. Therefore, interest rates will remain relatively low which is good for business and the markets.

-The European Central Bank (ECB) has a current balance sheet of approximately \$5.3 trillion and is not reducing it, in fact it is adding QE (Quantitative Easing) of about \$36 billion per month. Official Interest rates in the Eurozone are set at 0.00%. Therefore, monetary policy is extremely accommodative.

-The Bank of Japan (BOJ) has a \$4.6 trillion balance sheet and is still adding QE of about \$550 billion annually which is an 18% reduction from the previous year but it is still adding not reducing. The BOJ has kept its short-term rate at -.1%. Therefore, in Japan, monetary policy is also extremely accommodative.

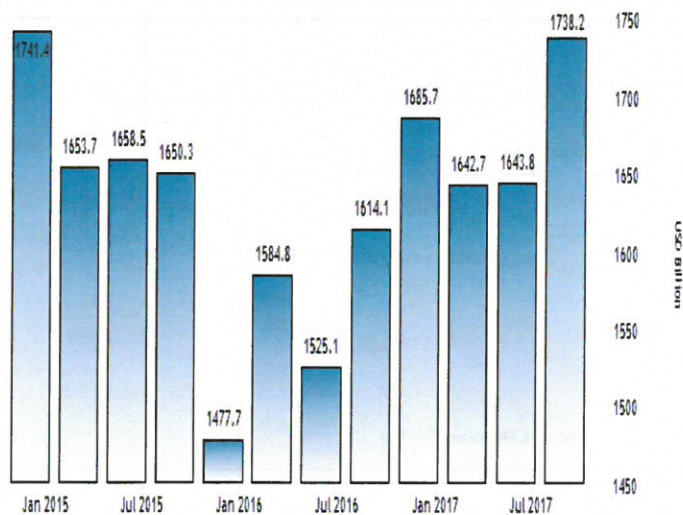
Financial Literacy Bootcamp

Coming February 24th, Southern Capital Services will be hosting a financial literacy “bootcamp” for middle school and high school-aged students. If you have any children or grandchildren that you would like to have them attend, please contact Eric at 251.410-6441 or 251.626.1140.

US CORPORATE PROFITS

US Coporate Profits

Graph 4



SOURCE: TRADINGECONOMICS.COM | U.S. BUREAU OF ECONOMIC ANALYSIS

Reduced Government Regulation:

It was recently announced by the Administration that as many as 22 regulations were rolled back for every new one that was added. The importance of this rollback is that businesses, especially small ones, are able to survive and prosper instead of being crushed by the high cost of regulatory compliance.

A New Year’s day article in the New York Times (nyti.ms/2DJjRvx) states the case for the impact of deregulation:

On the Negative Side ...

A fully valued stock market:

The consensus among large portfolio managers is that the market is at least fully valued and probably overvalued. However, many of them also say that other factors like low interest rates and growing corporate profits can extend market advances beyond normal historic Price to Earnings ratios (PE). Presently the PE calculated on trailing earnings is at 22.09, and on forward earnings is estimated to be 19.25. Normal is considered to be in the 15 to 16 range. It is also interesting to note that most of these managers are remaining fully invested. High PE's are a call for some caution but are not good timing signals for stock trading. An example of this is when Alan Greenspan, the Federal Reserve Chairman, said in December of 1996 that stock market investors had "irrational exuberance," the PE at that time was about 19.5. In 1997, the market was up 33.4%, in 1998 it was up 28.6%, and in 1999 it was up 21.0%. Every market era is different and no one is saying that now is like the 1990's, but it is important to be aware of historical perspective.

The unusually long period of time since the last normal 5% to 10% correction:

The market has experienced an abnormally low amount of volatility in recent years. Table #1 supplied by the American Funds Capital Group gives some historical context as to what normal volatility in terms of frequency of corrections has been since 1900. The experts have not been able to absolutely identify the reason for this low volatility. It may be attributable to the trillions of dollars that central banks have injected into the system or the impact of technology with all of the computer trading based on algorithms. The market pundits and gurus expect volatility to return, but no one can accurately predict it.

The possibility that the FED & other central banks might miscalculate & tighten monetary policy too rapidly:

The activity of the central banks, adding money (QE) and keeping interest rates extremely low, was triggered by the 2008 financial debacle. These bankers did all that they could to bail out the system and they were largely successful. The difficulty now is how to unwind all that stimulus and low rates without causing major disruptions in the world economy. The barometer is inflation; virtually all of the central banks want to see an inflation rate of 2%. Currently, the overall inflation rate is slightly below 2%, but it is rising. If it is surpassed, then the bankers could panic and act too quickly to reduce their balance sheets and raise interest rates causing disruptions in the world stock and bond markets. This is a possibility but not a probability because the bankers generally err on the side of being overly accommodative rather than too restrictive.

A History of Declines (1900-December 2016)

TABLE 1

Type of Decline	Average Frequency ¹	Average Length ²	Last Occurrence
-5% or more	About 3 times a year	47 days	August 2015
-10% or more	About once a year	115 days	August 2015
-15% or more	About once every 2 years	215 days	October 2011
-20% or more	About once every 3½ years	341 days	March 2009

Source: Capital Research and Management Company

¹Assumes 50% recovery rate of lost value.

²Measures market high to market low.

Conclusion and Outlook

At this time, there seems to be more pluses than minuses for 2018. The biggest favorable is the growing US economy with expected GDP to be 50% to 100% greater than the sluggish 2% rate in the post "Great Recession" era (2009-2016). All of the various factors — the tax act, the regulation rollback, expanding global economy, accommodative monetary policy, and more people employed — contribute to corporate profits. These profits are the "E" (earnings) in PE and the more "E" that you have, the more "P" (price) that it can support — higher stock prices. To say that conditions are favorable for 2018 does not mean that we think it will be like 2017; favorable does not necessarily mean fabulous.

Don't we wish that every year could be like 2017? The market was great, the economy turned the corner and is finally beginning to see the type growth rates that usually follow a severe recession. More people have jobs including minorities, and wages are beginning to rise while taxes have been cut for most Americans. So much for basking in the afterglow of 2017... it's time to look forward.

2018 should be a good year because the factors that were discussed in this article are more positive than the potential negatives. That is not a guarantee that it will turn out to be a good year, but based on the various economic factors, it should be. It is likely to be more volatile with one or more corrections. Not only is a correction overdue but the lofty stock prices could be more vulnerable to volatility. The first week of January has been very strong and if it continues, would exceed our more modest expectations. On the other hand, remember that a so-called "black swan" exogenous event, like war with North Korea, is always possible and could negate our positive outlook.

We wish all of our readers a happy and prosperous 2018!