SACAJAWEA & COMPANY, LLP
Economic & Financial Research

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Hello,

I have very mixed feelings about the past year. Our management returns, typically 8% or more, were reasonable by long-term trends but disappointing compared to the S&P500's 22%. The reason for the underperformance was that we held a lot of cash in your portfolios. This made them extremely safe, but limited our upside in a strong year. Without a significant correction, we have not found stocks at good prices to buy with all our cash. I wake up every day hoping today will be the day some stocks begin to fall and we can get you fully invested again.

Donald Trump has been in office for over a year now and my feelings about his term are mixed as well. Our economy is clearly doing very well. The unemployment rate is down to 3.9%. It has been this low only one other time in 40 years. The current bull market in stocks is the second longest in history, beaten only by the bull market of the 90's that ended in the crash of 2000. The U.S. GDP growth is improving, growing as fast as 3.2% Q3 2017, yet inflation continues to be low. Trumps administration is reducing government regulations in many areas, including the banking industry, bringing optimism to Wall Street. Trump also managed a large corporate tax cut from 35% down to 21%. This is more in line with other developed economies. The result is public companies reported very strong earnings growth in Q1 2018, up about 20% over the same quarter last year.

There is good news for the U.S. internationally as well. Europe, which was recently in a recession, grew 2.5% in 2017. China, at 6.8%, continued its strong growth and emerging markets were also expected to grow over 4% in 2017. Their stock markets also had strong returns, with Europe +10% and China +11%. Trump also successfully pressured the NATO nations to increase their defense spending to the levels agreed upon in the treaty, reducing our payments. His negotiation tactics may have contributed to North Korea's stated willingness to end their nuclear arms program (though I still believe their research facility was destroyed and their economy is not strong enough to rebuild it right now).

The market appears to be focusing on these positive events and rallied strongly, but it may be too optimistic if you dig deeper. The corporate tax cut has freed up large sums of cash for companies to use as they think best. The optimist believes companies will use the funds to invest in new equipment, research and development and worker training, which would lead to strong growth in the future. There are signs companies are increasing their capital investment. For example, business investment grew 6.1% in Q1 2018, which sounds great until you realize is was 6.8% in Q4 2017 and 7.2% Q1 2017, before the tax cut. However, they are using much of the tax savings to buy back their own stock, raising prices without improving future growth.

Trump also managed to push through an income tax bill that reduces many tax rates. However, many of these reductions end after 2025. He had promised to simplify the tax code and eliminate many of the tax breaks for the wealthy. Unfortunately, many tax breaks for the wealthy survived. The carried interest break for venture capitalists is one of the most offensive, but it survived despite Trump's promise to end it. There are even a few new breaks, including a large one for real estate developers. On top of the new tax law, Congress passed a budget with major increases in defense and social spending. The net effect of these two events is generally accepted to be a large increase in our government deficit going forward. This will raise interest rates and put a drag on our economy.

Internationally, Trump has implemented a few tariffs on imported goods and threatened many more. It is unknown how many of the threatened tariffs will actually be implemented, but other countries are stating they will retaliate. Widespread tariffs (a trade war) is widely accepted to be damaging to world economies. Some believe implementing tariffs was a major contributor to the Great Depression. In a simplified explanation, factories built to make products for export cannot sell as much as before tariffs. They then lay off workers, reducing the worker's ability to spend money. This slows down the economy as a whole, causing a recession or possibly a depression. Trump appears to be antagonizing our allies in other ways as well, by threatening to scrap NAFTA, pulling out of the Paris Accords, and the Iran Treaty. The fear would be that given a global economy, isolating the U.S. economy would limit future growth. Only time will tell if his "America First" tactics work.

On a different note, the Federal Reserve (Fed) has begun to raise interest rates to more normal levels. They have also begun the process of selling the large collection of municipal bonds and other assets they purchased to force interest rates down. This normalization process is needed so that when the next recession hits, the Fed will have the ability to stimulate the economy. It has been shown that countries with higher interest rates intervene in a financial crisis more aggressively and recover more quickly. One question I have is whether the Fed has gotten better at managing the business cycle. It may have improved given that the two longest growth periods ever have occurred in the last three cycles. This would be good for the economy, with fewer recessions and fewer periods of high unemployment.

So what are we doing? We stand ready with a portfolio of good companies we have analyzed, picked prices we want to buy them at, and have the cash on hand to do so. We are also in the middle of a year-long project reviewing over 3,000 companies, looking for new companies we want to invest in. In this process we are testing to see if we can include younger companies. It may be that with the high rate of change in our economy, fewer companies will be able to survive for 30+ years. Finally, we are considering longer business cycles and how that might affect our investment strategy.

We thank you for your confidence in us. Please call any time if you have any questions or would like to speak with us.

Sincerely,

Will Wrean