December 2017

Dear Clients,

Happily, 2017 provided strong returns for equity investors as the S&P 500 rose 21.6% for the year, improving approximately 6% in the fourth quarter with our seasoned portfolios in line with the index for both periods. From my non-scientific observation of general client mindset, the year began with investor trepidation and foreboding, fearful of a crash from the run up in late 2016 post the presidential election. Geopolitical fears were abundant with worries about a Trump presidency, possible impeachment, Brexit, potential North Korean and Iranian conflicts as well as a hard landing for the Chinese economy. Pundits continued to predict an end to our nine year economic expansion, rising inflation and increased equity volatility. The opposite of consensus was delivered. We continued to benefit from an accelerating domestic economy with increased global participation, low market volatility, low inflation and stable interest rates ending the year at the same level as they began (using the US Ten Year bond as a proxy). The addition of a pro-business political climate and the promise of reduced tax rates further reinforced the benign and supportive backdrop for investment, producing continued inflows and generous outlier returns.

We have been consistent in our investment strategy and our portfolios continue to benefit from these ongoing themes; digitalization and interconnection of all things, the recovering financial segment and ongoing global economic prosperity. During the closing quarter our best performing holdings were in the information and technology, communication and internet services and financials segments which along with healthcare represent our largest portfolio weightings. Strategically, we continue to fine tune portfolios with trims as positions reach target valuations and additions in undervalued companies with improved future prospects, however, our sector allocation remained mostly unchanged. We are appreciative of the success in 2017 but we have more tempered enthusiasm for 2018 as valuations have generally increased in many of our positions thereby limiting upside. We continue to take our cues from economic data points and individual corporate reports and will make portfolio revisions accordingly. We remain positive and in an invested posture, willing to tolerate market fluctuations for longer term appreciation.

We are not without concerns, specifically the concentrated run up of the largest internet stocks collectively known as FANGs (Facebook, Amazon, Netflix, and Google, now Alphabet). Positively they are all remarkable businesses with dominant market share disrupting the economic status quo of the leaders of yesteryear. Their sheer market dominance and monstrous market capitalization are the factors we believe may begin to limit their growth potential. Regulators and politicians are noting their increased dominance and social influence, be it in media and content distribution and so called fake news or in the economic effects via directed search results and the decline of the brick and mortar Main St. and mall retailer. Their deep pockets, untaxed offshore cash pools, and market dominance present a perfect target for populist reform. While we continue to believe future prospects to be positive, we will reduce weightings in these positions due to the aforementioned risk factors and the outsized position they represent in our portfolios, in line with prudent portfolio management.

All in all we remain constructive for 2018 and continue our positive investment thesis, utilizing volatility to improve our portfolio mix. As always, do not hesitate to contact us if you have any questions on your portfolio or our commentary. Wishing a Happy and Prosperous New Year to all.

Best regards,
Beech Hill Advisors