Abner Herrman & Brock
asset management

Investment Review and Outlook **July 2018**

"Full Steam Ahead"

Economic Outlook

U.S. economic growth is accelerating. This is long awaited and welcome news. Economists are expecting the second quarter to report almost 4% GDP growth. Unemployment is approaching historic lows and consumer spending continues to increase. Companies have used the new tax cuts to invest in their businesses, repurchase shares, increase dividends, and buy competitors. Including the benefit of the new lower tax rates, corporate earnings are estimated to increase approximately 21% in 2018.

Despite these positive trends in economic health, many investors remain cautious about the future. Investors are concerned that the stimulus from tax cuts will fade at the same time the Fed is increasing interest rates and reducing its balance sheet. Inflation rates have begun to move up as a result of the improving economy. Earnings growth is expected to slow to 10% in 2019 from the 21% expected increase in 2018. Many investors believe that the anticipated slower growth in corporate earnings will have a negative impact on stock valuations. This scenario portends that stocks are overvalued because earnings growth rates are slowing. The rise in interest rates may offer a relatively more attractive investment alternative to stocks than was available in the recent past. Another concern is the flattening of the yield curve, defined by the difference in the interest rate yield between short and long term bond investments. Today, the difference between the 2 year and the 10 year Treasury note is approximately 0.30 of a percentage point, and the difference between the 10 year and 30 year Treasury note is approximately 0.13 of a percentage point, both of these are the narrowest they have been since the financial crises. In past economic cycles, a flat yield curve has suggested slowing economic growth. A greater concern is the possibility that the yield curve will invert making interest rate yields on longer term bonds lower than the interest rate yield on shorter term bonds. Historically, an inverted yield curve has forecast a high probability that a recession is likely to occur. Furthermore, worries include geopolitical issues such as the impact associated with the ongoing trade negotiations.

In spite of these concerns, current economic prospects appear positive. Real GDP annual growth, which is adjusted for inflation, averaged 2.15% in the past several years. In the first quarter of 2018, Real GDP growth was 2.81% with forecasts of 3% growth for all of 2018. The U.S. economy is expected to continue to benefit from the recent tax cuts, less regulation, and the potential for an increase in infrastructure spending. Inflation has remained relatively low and is likely to increase at a modest rate as a result of the change in the major components of the U.S. economy. Today the U.S. economy is largely based on services as opposed to the past U.S. manufacturing based, industrial economy. A service economy is one that is less cyclical as it is not comprised of factories that require large capital investments that employ large labor forces. Today's U.S. service based economy is taking advantage of and benefiting from e-commerce and technological improvements that enable these companies to improve their profitability without the pressures to raise prices. These same factors have reduced the pressures on wages as the need to increase employment is diminished by the advancement in technology.

The potential for positive benefits from trade negotiations, reduced government regulations and increased spending on infrastructure and defense will be a positive for the US economy. These positive trends lead us to expect stronger corporate earnings for business than is generally forecast. We believe the current flat yield curve and possibly an inverted yield curve during this cycle is more likely correlated to the outlook for modest inflation. Typically, longer term interest rates are inherently a reflection of expectations for future inflation. Our analysis does not suggest a basis for an economic slowdown or recession given the strengths in the underlying statistical trends discussed above.

Fixed Income Outlook and Strategy

AHB bond portfolios are structured recognizing a flattening of the yield curve and the expectations for modest increases in inflation. We have taken advantage of the higher short term rates and reinvested bond maturity proceeds and new cash in attractive shorter term bonds. We monitor the fixed income market and pay close attention to the Treasury as well as the corporate bond and municipal bond yield curves to reposition the portfolios accordingly. These investment decisions have enabled AHB to provide enhanced value in client portfolios. AHB client bond portfolios are laddered to reinvest bond maturities and interest income appropriately as market changes occur. We continue to maintain an active and detailed analysis and valuation of all bonds held in client portfolios. We will not hesitate to sell a bond position in a client portfolio should our research and analysis indicate a deterioration in the quality or outlook for the credit quality.

Equity Outlook and Strategy

With respect to client portfolios that are invested in equities we remain committed to structuring client portfolios based on our positive outlook for the U.S. and global economies. All client equity portfolios and the equity portion of balanced portfolios are well diversified by sector, industry and company. We continue to favor investing in the Industrial, Technology and Financial Services Sectors of the economy. We have also invested client portfolios in companies that are in the process of change or have introduced new products or services that offer growth.

To Our Clients

Please also know that we greatly value the many opportunities you have provided us with either managing a portfolio of a client of yours or those that have referred AHB to a prospective client. We are aware the investment community has consolidated to offering investor's only opportunities to invest their assets into a Fund commingled with other investors who may have different investment objectives.

AHB remains among the few investment management firms that offer clients the opportunity to have their assets invested in a separately managed portfolio of individual bonds, stocks or a balanced portfolio of stock and bonds to meet the specific objectives of the owner. Once again we thank you for giving AHB the opportunity to be of service to you. We greatly value this opportunity and want you to know that we are always available to speak and meet with you at your convenience.

Enjoy a pleasant and safe summer.

Investment Policy Committee

Abner, Herrman & Brock Asset Management

Founded in 1981, Abner, Herrman & Brock Asset Management manages portfolios individually structured to assist each client in achieving their investment objectives. Stock portfolios are managed utilizing a Core Equity philosophy, investing in both large capitalization value and growth disciplines with an objective of long-term, after-tax appreciation and below market volatility. Portfolios are diversified across economic sectors, industries and companies. Bond portfolios are managed to provide a high rate of current income and total return. Portfolios are invested in staggered maturities of U.S. Treasury, government agency and investment-grade corporate bonds and where appropriate, investment-grade municipal bonds. Portfolio managers are available to meet with clients upon request.

Please visit our website at www.ahbi.com for a more detailed description of our investment **Philosophy, Process and People.**