

Karp Capital
Management

Financial Focus

1st Quarter Report

Positioning Your Financial World in the Global Economy

April, 2017

STATE OF THE UNION

Now that we have a President Trump and not the candidate, we're seeing shifts in policy focuses that will change investment themes as his presidency progresses. We're already seeing less of a focus on the populist messaging of improving infrastructure and widening health care coverage. His preliminary budget focus has been defense spending with very little attention to infrastructure. The American Health Care Act did nothing to expand coverage, yet was trumpeted by the president. These shifts are what will reorient the focus of investors as the Trump rally loses momentum and more of the agenda is called into question.

Small cap stocks had a tough time in the first quarter of 2017, but finished off outperforming the broader market indices towards the end of the quarter. The movement of these more aggressive stocks suggest that investor confidence is changing course. Meanwhile, the S&P 500 which is dominated by large companies, ended the quarter with its best performance since the end of 2015. It looks like market sentiment has moved past the failed effort of health care reform in favor of optimism for comprehensive tax reform. Republicans are under pressure to deliver a legislative victory. Also, in order to gain bipartisan support, a large infrastructure spending program may be included in the tax bill. Together, these initiatives have refocused investors on President Trump's pro-growth agenda.

The Federal Reserve kept on pace with its projected rate hikes, signaling to the markets that the economy can handle marginally higher rates. Even countries where deflation was a main concern have seen their bond yields rise in tandem with the U.S. as international economies look to be picking up steam. The pace of global growth, a key driver of U.S. exports, is starting to improve which has been dormant for more than two years.

The overall fundamentals of the economy are strong, and have been improving since the end of last year. The record-breaking streaks of gains are definitely welcome, but investors need to keep in mind the potential for drops and dips in the market. You need to maintain



a balanced, risk-adjusted portfolio to help you weather inevitable volatility, especially if you're closer to retirement. We're monitoring the traceable macroeconomic trends that help guide asset growth and help tune out the noise. Alongside an allocation of mixed asset-classes and sectors we're looking for opportunities internationally to add to clients' portfolios as the global economy is set for continued growth. In this installment of Karp Capital Financial Focus we will discuss what's driving growth, the headwinds the economy faces and new global opportunities.

Market Performance

Here are the performance numbers for the major indices as of 3/31/2017: (total return)

	March 2017	Latest 3 Months	Latest 6 Months	2016 % Change	The Close
Dow Jones Industrials	-0.72%	4.56%	14.28%	13.42%	20,663.22
Standard & Poor's 500	-0.04%	5.53%	10.12%	9.54%	2,262.72
NASDAQ- Composite	1.48%	9.82%	11.99%	7.50%	5,911.74
Russell 2000	0.13%	2.47%	11.52%	21.31%	1,385.92
MSCI EAFE	2.87%	7.39%	6.66%	1.51%	1,792.98
Long Term Treasury Bonds	-0.55%	1.43%	-10.45%	1.31%	
Gold	-0.86%	8.64%	-5.87%	8.10%	\$1,249.13

U.S. stocks had their best first quarter in four years (S&P 500 +6.07%). Stocks generally outperformed most other asset classes, led by emerging markets (11.5%). In Q1, tech (+12.6%) and consumer discretionary (+8.5%) led, while energy (-6.7%) and telecom (-4.0%) lagged. For the quarter, performance was better for large companies vs. small companies, with large caps (+6.0%) beating mid (+5.2%) and small (+2.5%).

Sources: Thomson Reuters; WSJ Market Data Group, Dow Jones & Co., BTN Research, BofA ML.

Feeling Good



Consumers are feeling good and they're the main drivers behind growth in the economy. In fact, 70% of gross domestic product (GDP) is influenced by consumer spending. Household debt, as a percentage of GDP, is near a 10-year low and consumer spending is at an all-time high, showing that consumers, in general, are feeling pretty good about their current financial

picture. It's been a long, slow recovery but there are reasons to believe that better times are ahead. With low interest rates helping homeowners reduce their mortgage payments and the low price of gasoline keeping money in the pockets of Americans, we're seeing positive effects on consumer behavior. After years of job growth and recovery, the numbers illustrate that consumer confidence is high; retail sales are rising, despite rumblings from some retailers struggling to keep up with an increasingly internet-based economy.

In March, the Conference Board Consumer Confidence Index (CCI) generated the highest reading seen since December 2000. This may translate to several quarters of positive performance and economic growth, though there's concern that this type of growth can

run concurrent with inflation, devaluing savings and income. The question is, will the Federal Reserve be able to get ahead of inflation without stymieing economic growth? So far, the Fed has signaled that the economy can handle rate increases to head off concerns of inflation.

We believe the U.S. consumer will continue to spend. Over the last year we have been adding selective consumer companies and as a core holding the Consumer Discretionary exchange traded fund (XLY) to clients' portfolios. Housing is set to take another leg higher given the pending home sales numbers. We should see modest gains in sales over the next few months, perhaps returning to the highs reached in April last year. Looking further ahead into the second half of 2017, a sustained increase in pending home sales requires mortgage applications to pick up very soon. We think this is a decent bet, given easing lending standards and strong employment gains.

Governing is Hard

The candidate Trump seems to have been buoyed above all his rivals because of his populist messaging and dramatic focus on national security issues. His repetitive promises to Make America Great Again, in part, was a promise to dismantle a lot of the regulations from the Obama administration. He talked of literally building a better America, lifting hopes that infrastructure spending would not only improve America's roads and bridges but also stimulate the economy and put money in the hands of the working class. After the election, his win resulted in the Trump Rally; equity markets spiked with the anticipation of a more corporate-friendly economic environment and increased government spending.

Things are not turning out to be as facile for the President, even with the Republicans controlling Congress. Many items on President Trump's economic agenda have taken a back seat to the austerity measures promulgated by Republicans since the financial crisis. Trump's national security agenda is being shot down by federal courts and so far the first attempt to pass major legislation, the American Health Care Act, was defeated by Republican infighting. The thing that has been touted as the first action item of the new Congress will turn out to be one of the harder pieces of legislation to bring to fruition.

The politics and repercussions of such huge

reforms are complicated, as Democrats found out in 2010. It will be difficult for the House to placate the far-right members of the party while still having a palatable bill for the moderates who are already facing pressure from constituents well before midterm elections. Because of the recalcitrant attitude of some members of Congress, repealing and replacing the Affordable Care Act (Obamacare) has been taken off the legislative agenda for the foreseeable future.

These roadblocks are sure to dampen the market's expectations on what is possible to achieve under this new administration. Investors are going to start re-evaluating which part of the agenda has carte-blanc and which parts will be politically difficult to achieve. The House Freedom Caucus will surely prove to be an obstacle for Paul Ryan as any demand coming from the caucus will rattle Republicans in more competitive districts. With health care reform off the table, the senate will need Democratic support to pass any sizeable tax cuts. Since the attempt to offset cuts with spending has already been curtailed, any measures that will increase the deficit will need 60 votes in the Senate; Republicans have 52. Either there will be a conclusion



to congressional gridlock or we'll continue treading the same water we have for years. We are cautiously optimistic. Republicans at this point have a choice between a budget-neutral tax reform plan that is limited in size, or a go-for-broke plan with a 10-year tax cut that is not subject to budget neutrality.

We're focused on aspects of the domestic economy that are poised to do well independent of major shifts in fiscal policy, such as commodities, cyclical stocks, technology and manufacturers. While political news dominates the headlines, it's important to remain focused on your goals and keep the larger trends in mind. The news can move the markets, but your long-term goals remain the same. Managing risk is key to meeting your goals and avoiding some of the volatility in the markets.

International Orange

The lack of economic growth in international markets has been a concern of investors and central banks alike. 2016 was a year of drastic measures to stimulate economies suffering from deflation. Central banks even went as far as to lower rates to below 0%. Worries about slowing growth in China spooked many investors away from the continent as a whole. Nationalism rose around the world, first with Brexit then with the election of Donald Trump, resulting in uneasy relationships with long-time allies, mainly continental Europe.

The Dutch elections broke the trend as voters steered away from the populism that had overtaken much of the western world. France, too, will have their moment of truth as Marine le Pen hopes to take la Patrie down the same path as the U.S. and U.K.

Yet, economically speaking, 2017 is shaping up to be much different than the last few years for international markets. Europe is showing signs of being in an early stage of an expansion cycle. The German Bund followed the U.S. Treasury higher to escape from negative yields and inflation in the U.K. is reaching targets set by the Bank of London.

With the United States leading the world in a



rising-interest-rate environment, we can expect the dollar to maintain its strength among its peers. It's because of this we've been adding exposure to various international markets to take advantage of both growing economies and our own domestic strength. As the economic leader of continental Europe, Germany has been an attractive avenue of growth. Germany is still experiencing trouble with its European counterparts, particularly ongoing struggles with Greece adhering to agreed-upon austerity measures. On the other hand, Spain and Portugal are showing signs of strength and their governments are bringing sovereign debt levels more in line with regulations set by the European Commission. Uncertainty around the

Brexit has kept us away from the U.K. as global markets are assessing the impacts of removing one of the largest trading partners from the European Union.

In February 2017, Chinese imports were greater than in February 2016, even though exports were down. This is because China is moving from an export-driven economy to an import-focused economy fueled by domestic demand. This not only helps the United States' balance sheet but also smaller,

export driven economies around the world.

Global industrial indicators have consistently surprised to the upside since last fall, with Purchasing Managers Index (PMI) in Europe and China hitting multi-year highs, largely as a result of policy action. We'd be surprised if this momentum is sustained for the whole year, but the outlook for the next couple of quarters is favorable as a driver for short term stock market performance. Buoyed by rises in commodity prices and increased demand from developed nations, emerging markets have been some of the fastest growing markets in 2017. We're adding to our position through a variety of ETFs (exchange traded funds) to take advantage of multi-national growth.

First I Was Afraid, I Wasn't Diversified

At the most fundamental level, investment decisions are determined by two factors: risk and return. While investors may have different goals for portfolio returns and varying appetites for risk, the objective is consistent; maximize returns relative to risk. This is best accomplished through diversification, but constructing a portfolio with a variety of assets does not mean this has necessarily been achieved. Correlation is the key. Correlation, in the finance and investment industries, is a statistic that measures the degree to which two securities move in relation to each other. A composition of assets with low or negative correlation is quintessential for effective diversification. The U.S. stock market is comprised of multiple economic sectors, and these sectors may generally move in the same direction as the market over time, but they do not move in unison with one another.

Retail, telecommunication and energy have failed to keep up with bullish market gains in 2017, which was charged by technology and health care sectors. Expectations for a specific

company, sector, or industry can be derived from economic indicators, but indicators can be misleading and trends can expire. Investing heavily in areas of large expected gains can produce large profits, but hedging through diversification in a variety of companies and sectors is prudent and necessary.

Diversifying equity investments in international markets is another useful strategy to minimize risk. International growth is often a factor of the region and the size of an economy. Diversifying by regions and by developed vs. developing markets can help achieve gains in a variety of market environments.

In addition, an asset allocation mixed with fixed income and equities is a very effective way to minimize portfolio risk. Typically bull markets move in line with increasing interest rates, and as interest rates increase the value of bonds decrease. During any time period returns can be higher for either fixed income or equity investments, but because of the negative correlation between the investment types, a

combination of both assets will significantly minimize volatility in a portfolio.

One or two sectors can drive the gains in any given index, especially if the gains are significant enough. Exposure to those sectors will boost the performance of your portfolio, but because of how indices are weighted, a well-diversified portfolio won't always keep pace with the markets in the short term. Focusing on month-by-month numbers can be risky. An investment strategy should align with long term goals, not current market trends, and investment goals should be risk-aware. If you're young and starting your portfolio, by all means, overweight your investments in equities and focus on aggressive growth. You have a lot of time to make up for any negative outcomes from high volatility. If you have an expectation to use your hard-earned savings in the near to intermediate future, your focus should be on risk-adjusted returns and the steadiness of just income. Give us a call to discuss your risk tolerance and investment goals.

Zero to One Hundred – Real Quick

During the first quarter of 2017, the major equity indices experienced the most record closes since January 1987. It took the Dow Jones Industrial Average 24 days to go from 20,000 to 21,000. These quick and sizable gains extended the post-election rally and continued the boon to equities.

It took until March 21st for the S&P 500 to experience a 1% decline, breaking a

streak that lasted over 100 days. With an already improving economy and promises of deregulation and tax cuts, investors put the money to work that they had sitting on the sidelines. Even those who are apprehensive about what the Trump economy entails seem to have turned a little more bullish than they were leading up to the election. Consumers are more optimistic than any year since

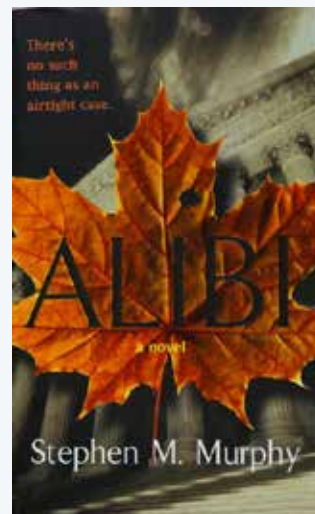
2000, according to the latest University of Michigan survey. The survey of small business owners conducted by the National Federation of Independent Business showed that optimism jumped from 94.9 last October to 105.9 during January, remaining at 105.3 in February, making the first two months of 2017 the two most optimistic readings since December 2004.

Featured Client: Judge Stephen Murphy

Karp Capital would like to congratulate our client Stephen M. Murphy on his recent appointment as a judge to the San Francisco County Superior Court bench. Stephen was an attorney in San Francisco for over 34 years, the last 19 as a sole practitioner representing employees in civil rights litigation. He graduated from the College of the Holy Cross in Worcester, Massachusetts and the University of San Francisco School of Law.

One of Stephen's most memorable cases ended with a \$6.5 million judgment against an employer for discriminating against his client. The accommodations for his client's agoraphobia were suddenly, and without explanation, terminated, causing the client a nervous breakdown. So far, during his brief tenure on the bench, Stephen has noticed a trend arising from alternative living situations due to the affordability problem plaguing the city. Many San Franciscans are seeking restraining orders against housemates, oftentimes because people are living with several strangers just to afford a place to live.

Alibi – Outside of his successful legal career, Stephen has also published several books. His published works include both fiction and non-fiction. His first novel, *Alibi*, is a novel inspired by a murder trial he worked on while clerking for the justices of the New Hampshire Superior Court. The sequel, *About Power*, features the same protagonist, attorney Dutch Francis. Other works include compilations of interviews with bestselling lawyer novelists and books of photography. Stephen's books are available on amazon.com and blurb.com.



All of us at Karp Capital Management thank you for your continued support. It is a privilege to help you, your family and friends reach financial goals. Please remember that we appreciate your support and we're flattered when you refer your family and friends. If you know someone that would enjoy our commentary on the market, please share the newsletter with them. If they would like to receive our quarterly commentary please direct them to sign up for the email edition at karpcapital.com.

If you have any questions on the preceding analysis, or would like to review your portfolio's performance, please call us at 877-900-KARP. At Karp Capital, we care about your financial world and how it is positioned in the global economy.



Peter C. Karp

Karp Capital Management Corporation

Mailing Address: 2269 Chestnut Street, #308
San Francisco, CA 94123

Office Address: 221 Caledonia Street
Sausalito, CA 94965

Tel: 415 345 8185

Fax: 415 869 2832

Email: peter@karpcapital.com



Karp Capital Management and Peter Karp are on LinkedIn and Brightscope.

If you no longer wish to receive the Karp Capital Management Financial Focus newsletter, please contact us to be removed from our mailing list.

Although information in this document has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness, and it should not be relied upon as such. All opinions and estimates herein, including forecast returns, reflect our judgment on the date of this report and are subject to change without notice. Such options and estimates, including forecast returns, involve a number of assumptions that may not prove valid. Further, investments in international markets can be affected by a host of factors, including political or social conditions, diplomatic relations, limitations or removal of funds or assets, or imposition of (or change in) exchange control or tax regulation in such markets. The past performance of securities or other investments does not necessarily indicate or predict future performance, and the value of investments. This document may not be reproduced without our written consent. Securities offered through Infinity Financial Services, member FINRA/SIPC. Karp Capital Management is not an affiliate of Infinity Financial Services.