January 12, 2018

"Climbing a Wall of Worry"
-Wall Street proverb

Many times during 2017 we were asked how the stock market could be performing so well while the tone of political discourse was so poor. Our answer was, and remains, that business is driven by the economy and the global economy is in a sweet spot of synchronized expansion. Admittedly, actions taken by government do influence the environment in which companies conduct business and the loosening of regulations and the lowering of corporate taxes are favorable changes that will impact future results. Hence, while some may be ambivalent about a rancorous Washington environment the market marches onward.

Corporate earnings were strong in 2017 as the accelerating revenue growth that became evident in the third quarter of 2016 continues. Earnings increased 10% in 2017 and are projected to do so again in the coming year. US GDP, which had been languishing in sub 2% growth since the financial crisis, accelerated to 2.5% in 2017 and is projected to expand nearly 3% in 2018. Unemployment of 4.1% is at a 16 year low which is expected to translate into higher wages for workers as companies compete for labor.

The Federal Reserve raised the discount rate three times in 2017 and has expressed interest in raising rates another 3-4 times in 2018. The ten year treasury yield has risen to 2.5%, but remains less appealing to investors than the returns available in the equity bull market. As rates reset higher, bond yields will become more attractive to investors and cause a reallocation of capital away from equities but we don't think that is likely in the near term. We respect the actions taken by the Fed to reset interest rates since we believe it is important to move rates higher proactively before inflationary pressures creep back into investors' mindset.

During the quarter we made some changes in client portfolios. We sold holdings of Celgene due to our concern the company will be challenged replacing the revenue from Revlimid when it loses patent protection in a few years. We also sold client positions in Schlumberger to book losses in order to offset capital gains. We purchased shares of Zoetis, Inc., an animal pharmaceutical company, since we see a secular change in how people care for house pets. We purchased shares of DowDuPont based upon the upside we see from the merged companies.

As we look forward into the New Year we are encouraged by the strengthening global economy and strong outlook for corporate earnings. However, we believe it will be difficult for the market multiple to expand further from its already elevated level. At 19x projected earnings, the market is discounting a lot of the positives. We expect equity markets to be more volatile than they were in 2017. As Warren Buffet famously said, "be fearful when others are greedy and greedy when others are fearful". We admit to being concerned by current market valuations but we also recognize that when economic conditions are strong, valuations market can remain elevated for extended periods of time. When the inevitable market correction arrives we intend to use it as an opportunity to buy high quality businesses that temporarily become "on sale".

Thank you for entrusting Ayrshire Capital Management LLC with the management of your investments. We look forward to speaking with you in the coming months.

Sincerely,

JM Sam Nevin, Jr.
Managing Partner