

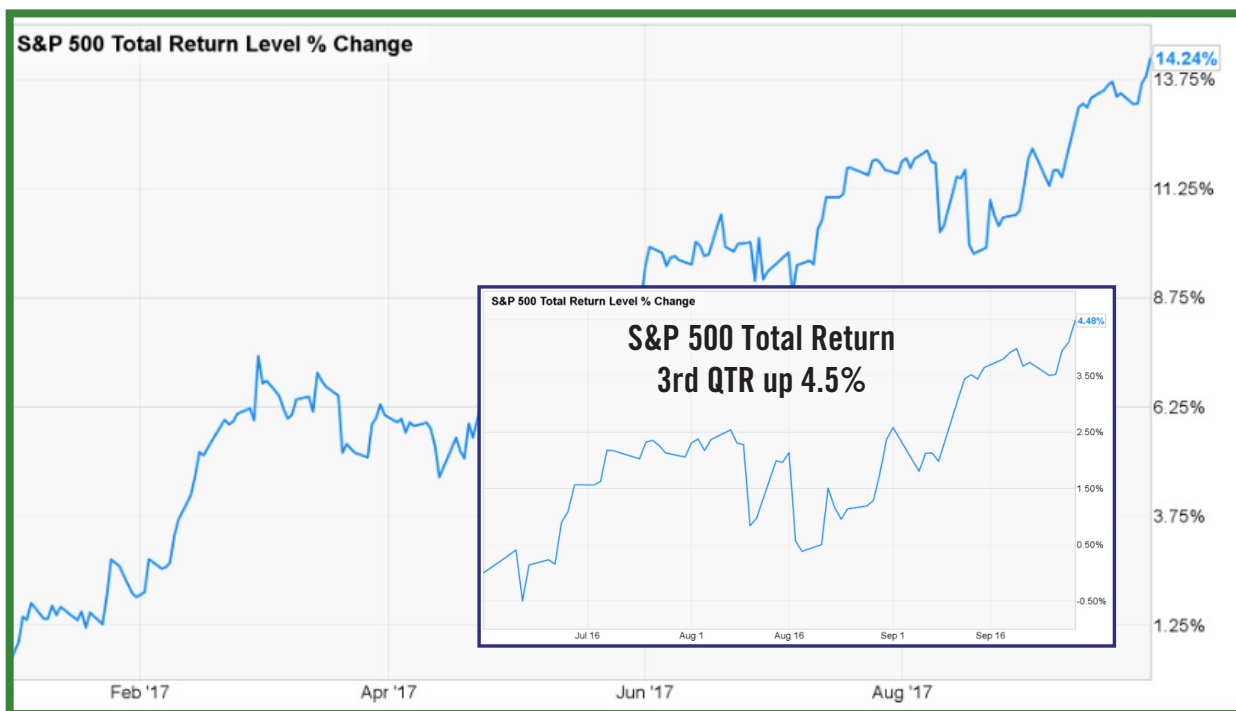
Dear investor:

HURRICANES, HEALTHCARE REFORM, NORTH KOREA - OH MY!

Investor sentiment remained remarkably strong in the third quarter in the face of so much chaos. In addition to horribly impacting so many lives, the economic devastation from Harvey, Irma, and Maria could exceed \$100 billion, easily one of the worst natural disasters to hit the U.S. in recorded history. While watching the healthcare reform debate we wonder which is sicker, the healthcare system itself or government's inability to make even a little headway to fix what is wrong with it. And if those issues aren't enough to send investors screaming into the night, there is always that frightening war of words between President Trump and Supreme Leader Kim Jong-Un.

The market resilience is rational because company earnings in the 2nd quarter were quite strong, proving perhaps that the positive earnings trend that began in the second half of 2016 seems sustainable for the time being. Also, companies have given guidance that their third and fourth quarter earnings are projected to show positive growth. Investors are also feeling hopeful that tax cuts will help to boost earnings.

S&P 500 Total Return
Year-To-Date Up 14%
And a New Record High!





UNIFIED FRAMEWORK FOR FIXING OUR BROKEN TAX CODE

It may not be the catchiest name for a tax plan, but the Unified Framework for Fixing Our Broken Tax Code is the one that President Trump and the Republican leadership released on September 27th. The plan is missing several important details that will be addressed amid the labyrinth of negotiations that Congress, lobbyists, and the Administration will have to deal with to get to a final deal. We think some version of tax legislation will get done. The procedure will be for the House and the Senate both to approve the same budget resolution in order to then move forward with reconciliation instructions that will allow the Senate to pass the bill with a simple majority vote.

As the framework stands now, most everyone will be paying lower taxes including the wealthiest individuals. The Committee for a Responsible Federal Budget (CRFB) estimates that revenue increases (many of which are completely unspecified in the proposal) would offset about \$3.6 trillion of the gross \$5.8 trillion cost, for a net deficit increase of \$2.2 trillion over 10 years.

This net deficit needs to be offset by spending cuts or economic growth to keep the deficit neutral and get the bill passed. It is highly debatable if tax cuts, i.e., supply-side economics, can stimulate enough economic growth in the years following the cuts to recover the lost government revenue.

Politico recently looked at the effects on economic growth when this country increased or decreased the top income tax rate since World War II (<https://www.politico.com/interactives/2017/gop-tax-rate-cutwealthy/>).

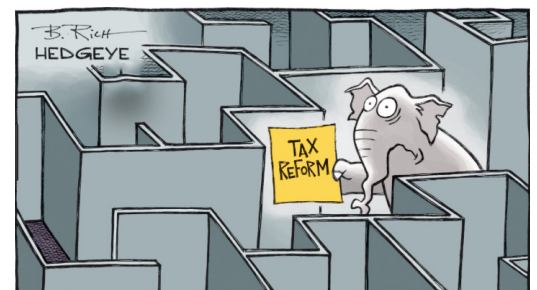
Their conclusion was that it is a mixed result. Here is a brief rundown:

- In 1963-1965 Kennedy and Johnson significantly reduced the top tax rate from 91% to 70%. It didn't work, GDP slowed from 5.25% to 2.0% growth within the five years after the cut.
- In 1981-1982 Reagan cut the top tax rate from 70% to 50%. It worked, GDP growth grew from a negative 3.0% to a positive 2.5% within the five years after the cut.
- In 1986-1988 Reagan cut the top rate again down from 50% to 28%. It didn't work, GDP growth fell from 3.5% down to 2.0% within the five years after the cut.
- In 1992-1993 Clinton raised the top rate to 39.6% (before that George H.W. Bush had raised the top rate slightly). It worked, GDP grew from 1.5% to 3.25% within the five years after the increase.
- In 2001-2003 Bush cut the top rate to 35%. It didn't work, GDP fell from 2.0% down to 1.0% by 2007, leading into the Great Recession.
- In 2012-2013 Obama raised the top rate back to 39.6%. It didn't work, GDP growth stayed pretty much the same at 1% over the next several years.

Clearly, other factors besides tax rates are in play to impact and influence economic growth.

Highlights from the newly released plan:

Individual taxes would collapse the current seven brackets into three: 12%, 25%, and 35%. There may be a fourth higher bracket above the 35% rate, but that's still unclear. The income thresholds within the new structure are not specified. No changes would be made to the capital gains and dividend tax rates. The standard deduction would nearly double. State and local tax deductions would be eliminated (high tax states like NY, NJ, MD, CT, and CA will have something to say about this). The mortgage and charitable deductions, and the exemption on municipal income would remain as is. The estate tax and the alternative minimum tax would both be repealed.





Business taxes would be lowered from 35% to 20% for corporations; businesses that pass through their taxes to their individual returns (partnerships, S corporations, sole proprietorships) would be taxed at the 25% rate. Business owners would be able to deduct expenses immediately for at least five years. Deductions for bond interest would be limited, but those limits have not been specified.

Corporate foreign income that is stockpiled and “trapped” offshore would be taxed once but there are no details on the tax rate. Future repatriated foreign income would be taxed only by the territory where profits are earned in.

The tax plan, as it is currently written, is more tax cut than tax reform. It would modestly cut taxes for many middle income households and simplify individual taxes for everyone. The plan would benefit very high-income households through the repeal of the alternative tax and estate tax, and preservation of charitable and mortgage interest deductions.

ECONOMIC GROWTH

The current U.S. economic expansion is among the longest on record and it suggests to many that a correction is imminent. The typical cycle begins with robust economic growth which then encourages excessive borrowing and business expansion. Those conditions push interest rates and inflation higher, forcing the federal reserve to tighten monetary policy to slow down speculation and growth.

Although the current recovery has lasted a long time, data from the Federal Reserve suggest that the economy has captured only *half* the level of growth averaged in the past nine recoveries. Instead of robust growth, aggressive borrowing, and rampant inflation, the current recovery is defined by modest growth, a restrained reliance on credit, and low inflation. So, the key takeaway is that though the economy continues to expand, it has yet to approach full capacity and reach the limits that begin to constrain growth.

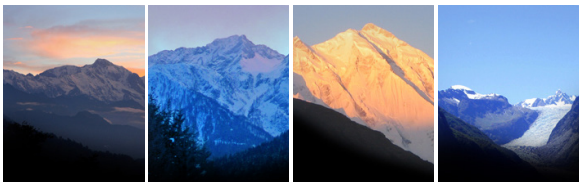
While stocks are not cheap relative to their historical price to earnings multiples, for now positive earnings are enough to support this bull market. The bull has sharp senses, though, and will sniff and snort at the first whiff of an over-heated economy. There is usually little warning when the stock market changes course. For this reason, we believe that understanding the underlying fundamentals of stocks and asset allocating between stocks and high quality short-term bonds is critical for limiting portfolio losses in a correction. We're okay with missing out on 100% of stock gains today in exchange for missing out on 100% of stocks losses tomorrow.

If natural disasters, political in-fighting and international threats of war can't distract this bull, it might just be one sturdy animal for the time being.

Sincerely,



Ellen P. Le, CFA
President



CYBER SECURITY

Cyber: (adjective) Relating to or characteristic of the culture of computers, information technology, and virtual reality.

Security: (noun) The state of being free from danger or threat.

Private and public networks around the world are incessantly under cyber attack, and the threats continue to proliferate. The recent Equifax breach was just the latest large corporate breach where hackers accessed people's names, Social Security numbers, birth dates, addresses and, in some instances, driver's license numbers.

By now many of you have determined if your data has been affected and whether or not you feel the need to freeze your credit. Note that a credit freeze makes it harder for someone to open a new account in your name, but won't prevent someone from making changes to you existing accounts.

Here are a few safety tips to consider:

- Freeze your credit with all three credit agencies, Equifax, Experian, and TransUnion. Freezing them lets you seal your reports and only you can "thaw" them with a personal pin number when you need to. Freezing your credit won't impact your existing lines of credit and use of your credit cards.
- Monitor your existing credit card and bank accounts frequently and closely for charges you don't recognize.
- Place fraud alerts with companies you have credit with to warn them that you may be an identity theft victim and they should verify that anyone seeking credit in your name is really you.
- Make sure all devices (smart phone, iPad, laptop, etc.) have strong passwords and automatically update anti-virus, anti-spyware, and anti-phishing software.
- Keep an ID-theft hard-copy file of key documents and information, such as credit reports (go to each credit agency site to get a free copy of your credit report once per year), passwords, and copies of drivers license, credit cards, passport.
- Stop unsolicited credit card offers since crooks can steal this from your mailbox to open an account. You can stop credit bureaus from selling your name to lenders by going to www.optoutprescreen.com.
- File your taxes early as soon as you have the tax information you need, before a scammer can file in your name first. Tax identity theft happens when someone uses your Social Security number to get a tax refund, open a bank account, or to get a job; the majority of these thefts happen to late tax files. If it happens to you, be sure to respond right away to letters from the IRS.
- Watch out for official government looking letters or postcards that are phishing for personal information. Make a habit of reading the fine print.

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"I'm no expert, but I think it's
some kind of cyber attack!"