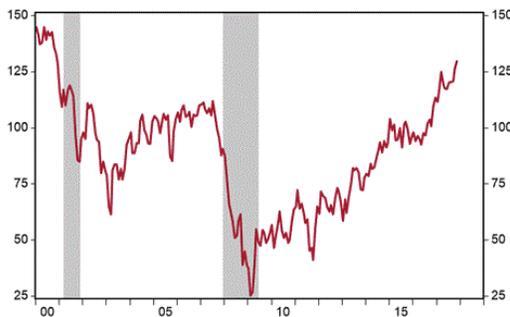


***“Weak people revenge. Strong people forgive. Intelligent people ignore.”***

Albert Einstein, theoretical physicist, 1879-1955

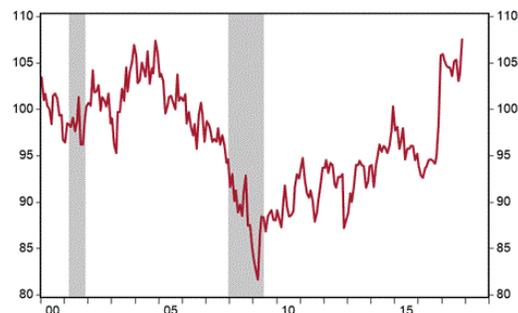
- **2017...** Perhaps best illustrated as..... $1 + 1 = 3$
- **On the one hand...** The news could hardly have been worse. Hurricanes, earthquakes, and fires kill and obliterate. Foreign and domestic terrorists slaughter innocents. Anger, fear, and disillusionment are widespread. Rampant chauvinism is exposed. Diplomacy and decorum are abandoned. Threats of nuclear war abound. Cyber theft touches millions.
- **On the other hand...** The U.S. economy continued its slow, methodical, now over eight-year-long improvement. Unemployment declines to a 17-year low. Home sales are the fastest in 11 years. Business and consumer optimism is high. Coordinated efforts by the world’s central banks finally ignite economic acceleration in Europe and Japan.
- **Difficult to process...** The disconnect between the news, the tweets and how people perceive the world around them stands in stark contrast to the economy. See below:

Conference Board: Consumer Confidence  
SA, 1985=100



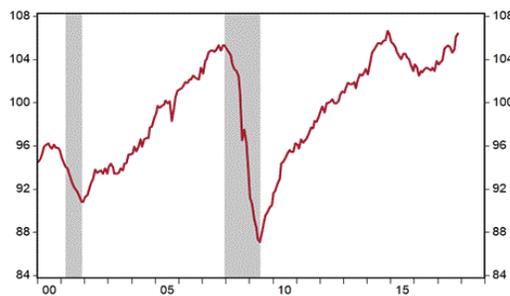
Source: The Conference Board/Haver Analytics

NFIB: Small Business Optimism Index  
SA, 1986=100



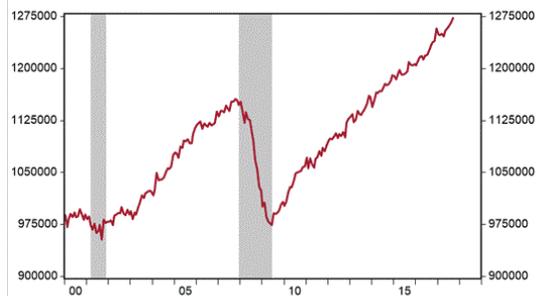
Source: National Federation of Independent Business/Haver Analytics

Industrial Production Index  
SA, 2012=100



Source: Federal Reserve Board/Haver Analytics

Real Manufacturing & Trade Sales: All Industries  
SA, Mil. Chn. 2009\$



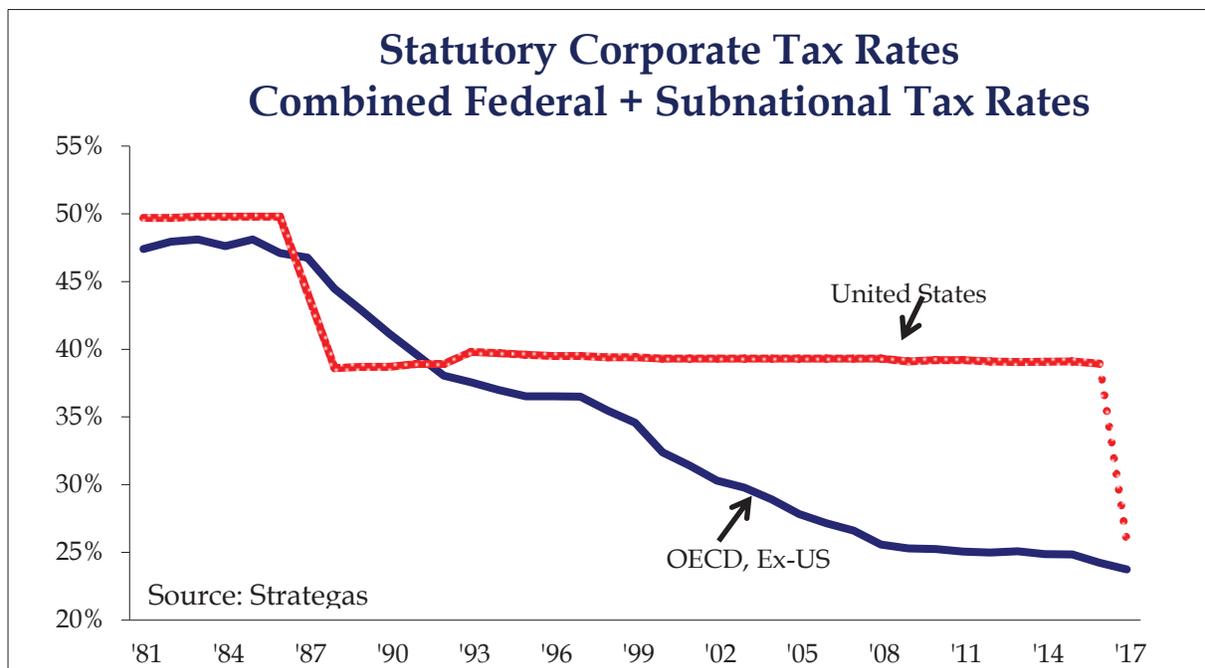
Source: Bureau of Economic Analysis/Haver Analytics

- **And in the financial markets...** the contrast to the headline news could not be more profound. In a year where investors were given every reason to be fearful:

*Year-to-date total return through 12/19/2017:*

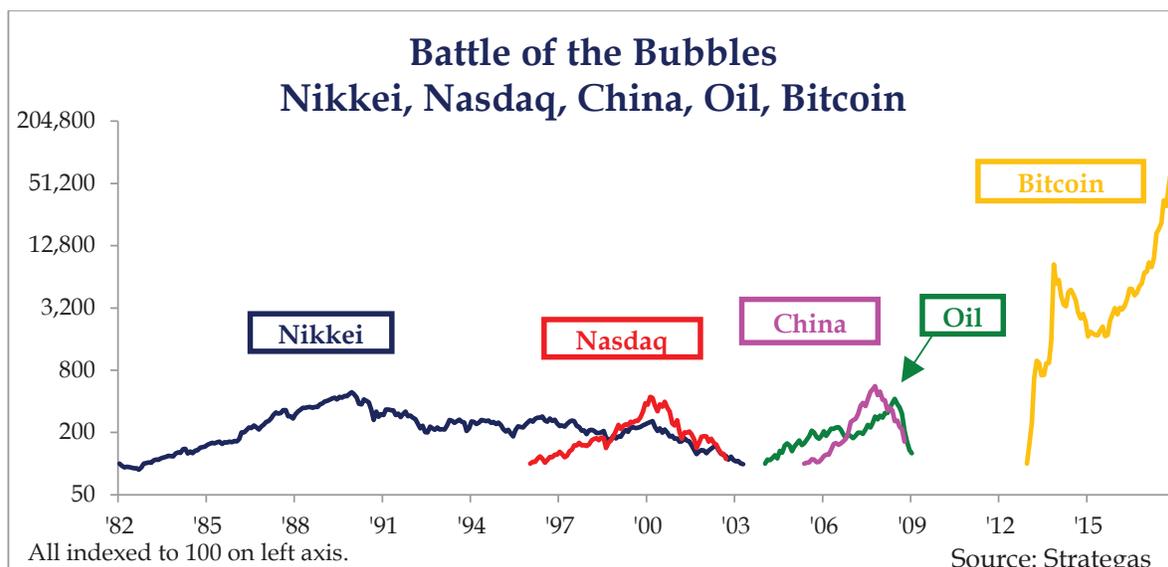
Standard & Poor's 500 Stock Index:	+ 22.13%
MSCI Europe, Asia, Far East Stock Index:	+ 24.29%
MSCI Emerging Markets Stock Index:	+ 34.29%
Barclay's Intermediate-Term Bond Index:	+ 1.94%
U.S. Inflation Rate (CPI, 12 months):	+ 2.20%

- **Hardly a wiggle...** The stock market's rise was even more notable by its absence of volatility. There hasn't been a decline of as much as 5% in over 365 days. That's not simply unprecedented, it's fairyland.
- **Are expectations too high?** No doubt, this year's advance in stock prices has been assisted by the expectation that tax reform would fuel future economic activity.
- **We think it will...** While the soon-to-be-inked tax bill is hardly the simplification promised, it should have a positive influence on economic activity.
- **Over \$200 billion...** in tax relief could enter the US economy in 2018 alone, of which \$120 billion will accrue to individuals and small businesses. (Strategas Research Partners)
- **Led by the media...** We think the economic benefit of the tax changes may be underappreciated and that the notion they're just good for big corporations is biased or misguided. Indeed, smaller pass-through companies stand to be significant beneficiaries.
- **Competitive footing...** For large, multi-national companies, the change in the tax code places U.S. domiciled businesses on a more competitive footing internationally:



Note: OECD: Organization for Economic Cooperation and Development

- **Deficits...** Despite the potential economic stimulus, it seems highly unlikely the benefit will offset the negative influence these changes will have on the Federal *budget* deficit. Still, to the extent U.S. multinationals are not penalized by bringing foreign-born profits back home, the *trade* deficit should shrink. We'll be watching.
- **Emblematic...** of how bizarre this year has been ..... (drumroll, please).....
- **Bitcoin!** That's right, Bitcoin, the so-called *cryptocurrency* whose value has risen over 1,000% in 2017.
- **We're skeptics...** and yes, we're prepared to be labeled dinosaurs and cynics for our skepticism. Having read the enormous volume of what's now in print on the subject, it still strikes us that it's a "Come on in...the water's fine!" kind of moment.
- **Blockchain technology...** provides a digital ledger allowing Bitcoin holders to transfer value from themselves to another without an intermediary such as a bank.
- **Its proponents...** argue that it takes "big brother" out of the loop and provides a means of exchange without central bank influence over the value of the currency.
- **Exactly!** While this might allow commerce to take place without detection, the lack of regulation, the lack of liquidity, and the potential for fraud undermine the notion that Bitcoins represent a store of value.
- **Bitcoin is an "app"...** You read that right. Bitcoin is an application of cryptographic technology. Exchanges -- with other Bitcoin owners or for goods and services -- employ a blockchain which requires an enormous amount of computing power to function properly. As for Bitcoin as a currency, its' value is no more than what someone might be willing to pay for it or exchange for it.
- **17th Century Dutch tulips would blush...** at the rampant speculation seen in Bitcoin's price. And, while we believe the underlying technology could be transformative for the banking and financial industries, we would opine that those lured into Bitcoin should be prepared for the day when everyone has left the pool.



- **Away from such speculation...** those of us with our feet on the ground face the on-going challenge of how best to invest the monies we have earned and saved.

- **To be sure...** absent an exogenous event, it's reasonable to assume the US economy will not only continue to grow in 2018, but will do so at an accelerated rate.
- ***“So it's full steam ahead for stocks, right?”*** You should know us better than that by now...
- **Things are changing.** The post-Great Recession climate has been one of caution, punctuated by increased regulation and unprecedented central bank intervention. Today, with the economy having finally reached full employment, taxes and regulations are being eased and the central bank is gradually reducing excess liquidity in the banking system. Economic activity and borrowing should accelerate...taking wages, corporate earnings, interest rates and inflation higher.
- **Boom, Bust?** Perhaps the most important influence of these changes could be a return of the business cycle. No longer would caution, regulation, and zero interest rates produce a slow economic recovery and a *“there is no alternative”* investment climate, but one where economic expansion (Boom) could lead to excess (Bust).
- **Long absent volatility...** would return.
- **Whether gradual or abrupt...** we cannot know, but we do believe the entrenched, 8+ year **hunt for yield** could be coming to an end. Should money market funds, CDs and short-term bonds again offer reasonable returns in exchange for their low risk, buying stocks at valuations 30% higher than the historical average could become much less compelling.
- **Discipline and process...** and the careful balance of risk and reward would -- as has been proven through history -- trump everything. And, yes, that's a pun.
- **As for the future...** It's a fool's errand to premise one's investments upon predictions. That said, we are mindful that change is the only constant.
- **For a glimpse...** of what the future might look like, we would invite you to watch a video of a presentation given by Tony Seba, author and entrepreneur. With the caveats that the video is nearly an hour in length and that his conclusions are highly predictive, we think you will find it time well spent....

<https://www.youtube.com/watch?v=Kxryv2XrnqM>

- **Thank you...** To all whose eyes may fall upon this letter and especially to those who enable us to perform the work we love, the twenty-seven of us send a prayer of thanks....

*...for each new morning with its light*

*...for rest and shelter of the night*

*...for health and food*

*...for friends and love*

*...for everything thy goodness sends.*

Ralph Waldo Emerson

**Year End 2017**



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