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QUARTERLY PERSPECTIVE

DVI
DAVID VAUGHAN INVESTMENTS

EVERYONE IS ENTITLED TO HIS OWN OPINION, BUT NOT HIS OWN FACTS[1]

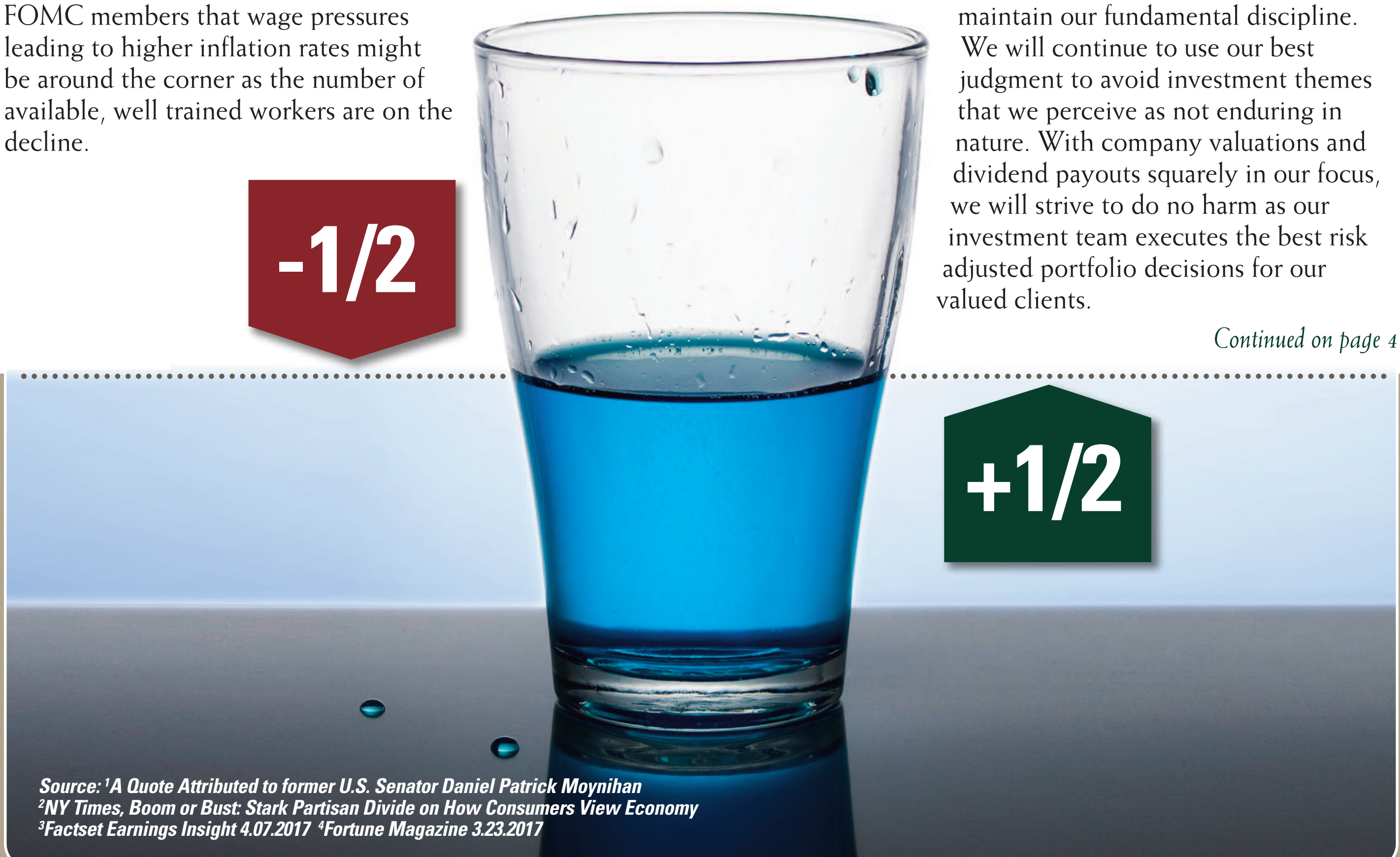
Will Williams *President*

The great partisan divide continues in Washington, a phenomenon that appears to be reflected in national consumer sentiment data as well. Recent survey results produced by the University of Michigan illustrated a growing gap between registered Republicans and Democrats as their researchers analyzed the overall change in consumer sentiment from mid-summer 2016 to December of that same year. In a historical outcome, Republicans recorded a 50% positive shift in the index, while Democratic economic optimism declined by over 20% during the same period.[2] The Federal Reserve Board must be aligned with the optimists as they have pushed the Fed Funds target rate up to .75 -1.00% with two successive quarterly rate increases in December of last year and here recently in March. Despite interest rates remaining historically quite low, the Fed appears to be committed towards regaining some of the Monetary Policy tool kit they have been working without since 2008. As the unemployment rate has declined to 4.7% in the month of February there is a growing concern among FOMC members that wage pressures leading to higher inflation rates might be around the corner as the number of available, well trained workers are on the decline.

So, from an economic standpoint, it is in this almost benign backdrop that we are faced with all kinds of contradictions and inconsistencies. Economic growth and corporate earnings growth all appear to be on rising, yet sustainable glide paths, but expectations are building for an economic transformation that is far from gradual. As an example, consensus earnings per share (EPS) growth rates in 2017 for the S&P 500 Index remain at nearly 10% and nearly $135 per share.[3] Equity market volatility has once again dropped in the first quarter of 2017 to levels not seen in decades, despite political uncertainty in the U.S. and globally that is clearly on the upswing. Investors once again appear to be embracing riskier asset classes such as classic growth, technology and emerging market common stocks, even though individual investors have in effect missed much of the equity market rally dating back to 2009.

In the midst of what appears to be a bit of a perplexing time in the history of the capital markets, here at DVI we are inclined to once again stick to our knitting and maintain our fundamental discipline. We will continue to use our best judgment to avoid investment themes that we perceive as not enduring in nature. With company valuations and dividend payouts squarely in our focus, we will strive to do no harm as our investment team executes the best risk adjusted portfolio decisions for our valued clients.

Continued on page 4



Source: [1]A Quote Attributed to former U.S. Senator Daniel Patrick Moynihan
[2]NY Times, Boom or Bust: Stark Partisan Divide on How Consumers View Economy
[3]Factset Earnings Insight 4.07.2017 [4]Fortune Magazine 3.23.2017

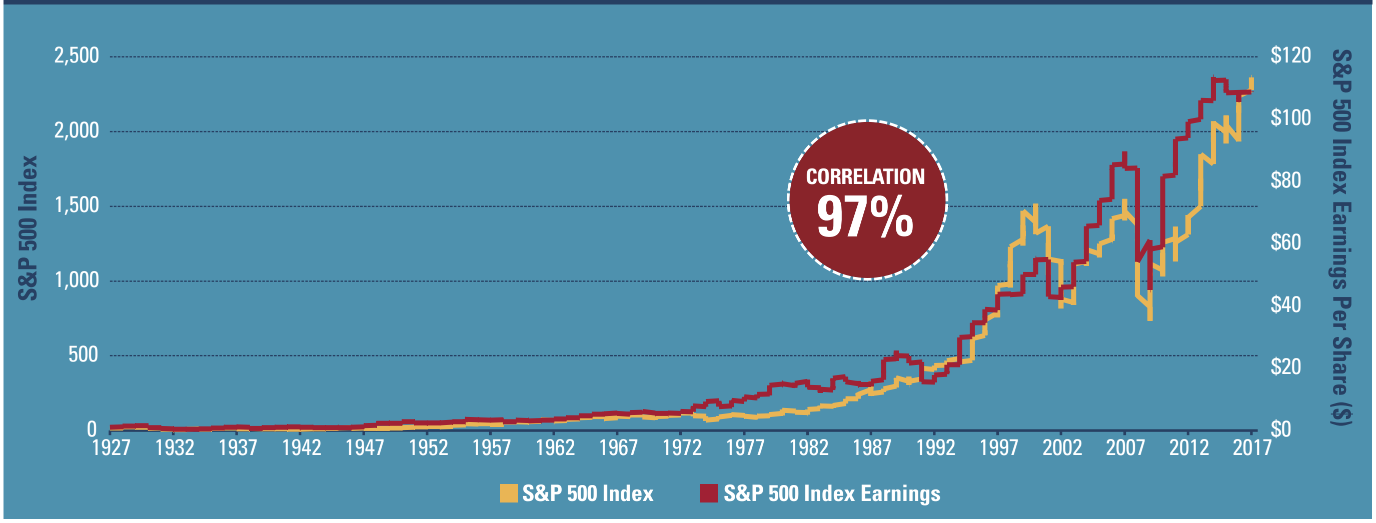
Brian Christensen, CFA
Senior Vice President & CIO

INVESTING AT MARKET HIGHS

As the stock market rises to record levels, investor concerns rise as well. The common question I get asked is, "Why are we investing when the market is at all-time highs?" First, I refer back to my summer 2016 article titled "Why Invest Now?" which still applies and can be found on the DVI website. Further, I've outlined below several additional items that support our long-term investment philosophies.

As we look at the stock market indices reaching record highs we need to keep in perspective the underlying business fundamentals that drive stock prices. Most importantly, corporate earnings. The chart below tracks the S&P 500 Index and the earnings generated by the companies in the index.

CORPORATE EARNINGS DRIVE STOCK PRICES



Market Data from: Bloomberg and econ.yale.edu/shiller/data

Corporate earnings clearly drive stock prices so intuitively it makes sense that we are experiencing record stock market levels when corporate profits are reaching record levels. One can't simply look at an index and assume stocks are overvalued without first gaining an appreciation for the underlying fundamentals that drive stock prices. Earnings, revenues, cash flow, and dividends lead the list.

The question of investing at new market highs begs a look at the historical data. Since the market low in March 2009, the S&P 500 Index has posted 114 new all-time highs,[1] the most recent occurring on March 1st. During this window, the S&P 500 Index total return was nearly 270%. There have been over 1,000 new market highs going back to 1954. Data compiled by Bloomberg shows the index's 12-month return following an all-time high has been positive 73% of the time since 1946. Pretty good odds, I think.

Concerns about market corrections, or worse, are always on investors minds and even more so after long periods of time when one hasn't occurred. The average intra-year decline for the S&P 500 Index over the past 35 years has been 13.9%. However, the annualized total return for the same time period was 11.4%. Since 1945, only 90 out of 850 months (period ending 12/31/16) have been bear markets where the stock market has declined 20% or more. This represents only a little more than 10% of the stock market's experience during that period.[2] While corrections and bear markets can be traumatic, markets are resilient and recovery times have been relatively quick as shown in the table below.

Source: [1]Kimberly Amadeo, thebalance.com
[2]FactSet, Oppenheimer Funds

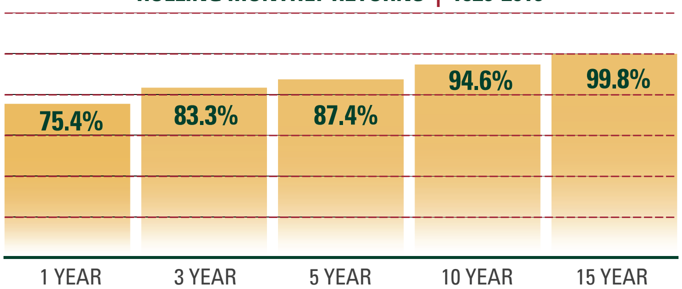
S&P 500 DRAWDOWNS & MARKET CYCLES SINCE 1945

Drawdown	Frequency	Average Time to Recovery
–5% to –10%	39 times	3 months
–10% to –20%	13 times	8 months
–20% to –30%	5 times	27 months
–30% to –60%	5 times	62 months

Source: FactSet, Oppenheimer Funds

Further support for investing with a glass-is-half-full perspective is the fact that over the past 90 years the S&P 500 Index has generated positive returns 73% of the time. Again, I like those odds. The details of those 90 years are shown in the chart below.

PERCENTAGE OF YEARS S&P 500 INDEX POSTED POSITIVE RETURNS
ROLLING MONTHLY RETURNS | 1926-2016



Source: Morningstar and Lord Abbett

Finally, history proves that patience and discipline are rewarded. The chart below shows the probability of a stock investor experiencing positive results over different time periods. As indicated in the chart, the probability of experiencing positive returns over a five year time horizon is 87.4%. As we've professed for years, investors with a minimum time horizon of three to five years, can confidently invest in the U.S. stock market. If your time horizon is shorter, reducing your allocation to stocks merits consideration.

So, why are we investing at all-time market highs? Because we are confident in the investment philosophy, process and disciplines which have been ingrained in the fabric of DVI now for 40 years, and we are confident in the underlying economic fundamentals visible today at the companies in which we invest.

S&P 500 INDEX | POSITIVE VS. NEGATIVE YEARS | 1926 - 2016

Source: Morningstar and Oppenheimer Funds

2017 MARKS DAVID VAUGHAN INVESTMENTS 40TH ANNIVERSARY

Trust, Discipline and Steady Growth

Read our story in the April issue of IBI magazine.

peoriamagazines.com/ibi/2017/apr

Maggie Bilby, CFP®
Relationship Manager

CAN I GET RID OF THIS?

One of our objectives here at DVI is to provide value to our clients by taking often complicated subjects such as estate planning or stock market analysis, and explaining and breaking them down into straightforward and easy to understand concepts. In addition to addressing these complicated and often confusing issues, we also frequently get more mundane questions (particularly this time every year) such as, "How long to I have to keep my tax returns?" or "Can I get rid of this?". If your 2016 tax return has been added to the top of one of those dreaded stacks of paperwork, it's probably time to do a little organizing. Here are a couple of best practices as well as IRS guidance on how long to keep records.

Tax Documentation

In most cases, you should plan on keeping tax returns and supporting documentation (W2s, 1099s, expense tracking, charitable donation records, etc.) for three years. Keeping tax returns for the three-year time period is tied to the IRS statute of limitations. The period of limitations is the period in which you can amend your tax return to claim a credit or a refund, or the IRS can assess additional tax (www.IRS.gov). There are, however, exceptions to this three year rule such as:

- If you omit more than 25% of your gross income from your return, the IRS has six years instead of three to assess an additional tax.
- Keep records for seven years if you file a claim for a loss from worthless securities or bad debt deduction.
- Keep records indefinitely if you do not file a return or if you file a fraudulent return (neither of which we recommend!).

Store returns and documentation in a fireproof box or scan and upload to a cloud based system or back up device, such as the vault in the DVI Client Portal. The IRS does accept digital copies of documents as long as they are legible. Tax documents that you are getting rid of should go in the shredder to prevent identity thieves from obtaining sensitive information.

Investment Statements

The IRS does not provide guidance on maintaining investment statements but we can offer some suggestions as best practice. If you are comfortable in going paperless, electronic delivery and saving to the cloud is the best way to reduce clutter and the threat of identity theft. If you prefer to receive paper, continue with the three year IRS rule but skinny that paperwork down by only keeping monthly statements for the current calendar year and the year-end statement for each account for the previous 3 years. For instance, as of right now, you should keep your January, February, March and April 2017 statements (and for the remainder of 2017), but only keep the December 2016, 2015 and 2014 statements for prior years.

Regardless of what you decide to maintain or shred, know that DVI has access to prior years' custodial statements and records for our clients (for the time period we have been engaged). We also maintain cost basis records and non-deductible IRA contributions for our clients as well.

CONTINUED FROM PAGE 1: EVERYONE IS ENTITLED TO HIS OWN OPINION, BUT NOT HIS OWN FACTS

Only in Washington... And soon to be in the Headlines once again

Fannie Mae and Freddie Mac, the once privately held GSEs, (Government Sponsored Entities) that underwrite nearly 65% of our nation's residential mortgages were placed into conservatorship by the Federal government back in the fall of 2008. This was in response to the fallout from the Great Recession and the material price decline in mortgage securities held by these two "too big to fail" financial institutions. An estimated $187 billion dollars were infused into their balance sheets to provide them the ability to ride out this economic perfect storm.

Well, as the housing market began to recover, so too did the economic prospects of these two GSEs. In fact, beginning in 2012 they returned to profitability and through a net worth sweep instituted by the Obama administration, $256 billion dollars has been returned to the U.S. Treasury.[4] In 2016, their combined net income was approximately $20 billion dollars or nearly equal to the profitability of banking giant Wells Fargo. It has not been lost on investors in these two publicly traded companies, with both common and preferred shares outstanding, that in effect they have been subsidizing the government in recent years. The government position is that without the government backstop these two entities do not have the balance sheet resources to stand on their own.

There is currently a move afoot to privatize both institutions, which could result in even more funds to be returned to the federal government to help either pay down our nation's debt or to be used as a resource to help fund much needed infrastructure spending in the U.S. However, it is likely that such a move would increase borrowing costs to residential homeowners, a political hot potato in Washington.

Source:[4] Knowledge @ Wharton, Can Trump or Anyone Bring Back American Manufacturing, November 30, 2016

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