WALKER FINANCIAL ADVISORS, INC.
Registered Investment Advisor

Private Client Update ____ January 11, 2018

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Happy New Year! I trust this finds you well and in good spirits after receiving your year-end report. We are fortunate to have owned a well-crafted mix of securities and post our best returns since 2009. Our process tailors each client's asset allocation to meet their objectives and risk tolerance level. Safety and minimizing downside risk take on greater importance when the earnings years stop, so the majority of clients have balanced portfolios with less than half in stocks. On a consolidated basis across all client accounts, we started the year with a 45% allocation to equities and produced a net average total return of 11.48%. for 2017. We have been trimming back a bit lately to rebalance and lock in some gains.

The Economy, Markets & Taxes – The synchronized global recovery has kept stock markets in rally mode, and the positive economic environment is providing a solid foundation for continued gains. The Republican led Congress was able to come together with President Trump and pass major tax legislation in December. Combined with regulatory relief, U.S. corporations are the big winners with their top tax rate being cut from 35% to 21%. In addition, foreign-held cash may be repatriated to the U.S. at a favorable 15.5% tax rate. This will shift billions back to the private sector for discretionary spending. Many companies will reinvest in the business, and/or choose to share the windfall with employees via bonuses, and shareholders via increased dividends. The good news for individuals is that all of the tax benefits of qualified retirement savings plans and IRA's were left intact.

Market sentiment has gotten a bit frothy lately and valuations are stretched with the S&P 500 trailing price to earnings (P/E) ratio at 22.5. This compares to a long-term average of 15.5 since 1929. The U.S. stock market is not cheap, but growing earnings and capital flows to stocks keep the uptrend intact. The ninth anniversary of the current bull run is coming up in March, and there are no signs of a recession on the horizon. This is now the second longest bull market on record, only surpassed only by the tech bubble which peaked out in March, 2000. The President appointed new Fed Chair, Jerome Powell who is expected to maintain the gradual pace of interest rate increases initiated by his predecessor. At this point in the cycle we have sold off our interest sensitive stocks in the utilities, REIT, and telecom sectors. Our industry exposure in concentrated in financials and technology stocks, along with a few consumer and energy issues. Can the news get any better? We will soon see when quarterly earnings reports start coming in.

Bitcoin – We have watched in awe as this digital currency took the world by storm last year. I am still skeptical of any long-term investment merit, but here's what I've learned so far. Bitcoin and other cryptocurrencies are built on blockchain technology. Blockchain is a world readable digital bulletin board with a ledger that offers a transparent, tamper-proof system to validate transactions. Computer scientists, or miners, work to find bitcoins. The Japanese inventor of Bitcoin in 2008 stipulated there would be a finite supply of 21 million, and currently about 12.5 million have been mined. The CBOE has legitimized this new asset class by recently allowing the trading of futures contracts on Bitcoin. The momentum gathering behind blockchain is significant and American companies are leading the way. When something is written to the bulletin board it sticks there forever. Any web-shared blockchain is meant to be impossible to edit or forge. Microsoft is making blockchain available for project trials through its Azure cloud computing service, as there are varied additional applications for the technology.

Common Stocks – Technology stocks were our star performers last year. Software companies **Microsoft** and **Intuit** have transitioned from the old subscription license model to software as a service with smaller recurring monthly revenue. Microprocessors from **Intel** and **Qualcomm** are being used in more applications as artificial intelligence and automated processes continue to replace human workers. Intel has admitted to a chip design flaw recently and we are monitoring the situation to avoid further fallout. Mobile devices have never been more popular, and with the new iPhone X, **Apple** has set the bar high. **Alphabet** (formerly Google) has a new voice activated assistant and they continue to have the dominant market share in digital advertising and search.

Financial stocks carry our largest industry weight. Tailwinds include a better regulatory climate and higher interest rates, which helps the net interest margins for banks. I've always liked **Bank of America** and also enjoy being a stockholder with shares trading at a 17 P/E, and 30% earnings growth expected this year. **Charles Schwab** continues to benefit from more advisors becoming independent and adopting a higher fiduciary standard toward wealth management. Electronic payments stocks **Visa** and **Square** lit it up last year. We recently sold ½ of Square due to valuation concerns. **Berkshire Hathaway** is our largest equity holding and has significant insurance operations through wholly owned GEICO Insurance.

Amazon and **Costco** have been our mainstays in the consumer space for years, then last November we added **Home Depot** to the mix. The #1 home improvement retailer is benefitting from a strong housing market. In December, we also added the largest energy services company in the world, **Schlumberger**. With operations spanning the globe, all the major producers are customers and will be ramping up spending given the turn in light sweet crude oil to over $60/bbl. Energy was the worst performing sector in the S&P 500 last year, so we're excited about the rebound potential which is already showing up with Schlumberger and **Chevron**.

Your holdings may not include all securities discussed due to client inception date and manager discretion.

International Stock Funds – In general, valuations are better in many foreign markets, demographics are more favorable, and the economic and living standards are improving. Our enthusiasm is tempered by the political and currency risk inherent with foreign stocks, so we limit exposure to 15% of a total portfolio. We own several actively managed funds that complement each other and give us exposure to a broad cross section of foreign developed and emerging markets.

Treasuries, Bond Funds & ETF's – We've been playing it close to the vest and adding short-term U.S. Treasuries, which are considered the safest security in the world. Since the Fed has been raising the Fed funds rate, short-term Treasury yields have shot up. Our new buys have been T-bills and notes in the 6-month to 2-year maturity range. Current yields range from 1.59 – 2.00%, and are exempt from CA income tax. For taxable bonds, we own both the **Vanguard Short-Term and Intermediate Corporate Bond ETF's**. These high-quality ETF's carry a super low 0.07% expense ratio and current yields of 2.6% and 3.2%. Our two largest holdings are both actively managed bond funds, the **Pimco Income Fund**, 5.4% yield; and the **T. Rowe Price Institutional Floating Rate Fund**, 4.5% yield. Both funds are positioned defensively against higher rates and have shown remarkable share price resiliency.

California Municipal Bonds – For our higher tax bracket clients we own ladders of individual municipal bonds, with an overweight at the shorter maturity part of the yield curve. We are willing to forgo some yield in exchange for greater principal stability at this point in the Fed tightening cycle. Our relationship with Stifel in San Francisco has allowed us to buy many local Orange County bonds directly from the underwriter, thus eliminating any secondary market price mark ups. Through Schwab's Prime broker service, the bonds are easily credited to client accounts. Recent buys have been in the 1 to 3-year maturity range.

The allure of lush tax-exempt dividends is always tempting with CA muni funds and we are generally willing to participate. However, last quarter we sold all remaining positions in our CA muni funds to preserve capital. Interest rates started to tick up and share prices turned lower, so we chose to move to the sidelines. If inflation begins to stir, longer-term interest rates could also rise this year which would result in a slow bleed for the share prices of these funds. Unlike funds, individual bonds carry a set maturity date, so we know with certainty when our principal will be returned. We plan to hold all of our existing bonds until they are called, or mature.

401(k) Contribution Limit Increases – Effective for the 2018 tax year, the annual salary deferral limit goes from $18,000 to $18,500. For those age 50 and over this year, you are allowed an additional annual catch-up contribution of $6,000. Discretionary employer contributions may also be made in addition to the salary deferral.

Tax Planning – Schwab is scheduled to complete mailing the IRS Form 1099's by February 15, 2018, so please schedule your tax appointment accordingly. Our goal is to be a valuable part of your wealth management team, so we are happy to confer with your tax advisor regarding any planning opportunities to help minimize your 2018 tax burden.

We appreciate your business and value your relationship. Please let us know if there is anything we can do to be of further assistance to you.