LIONS AND PACKERS AND BEARS WHO CARES?

As the calendar turns to 2018 we must admit to occasionally straying from our normal analysis of management teams, financial statements and stock valuations. It is easy to find ourselves dissecting whether our local football team can go on the road and beat Philly and whether a potential home game in the Super Bowl is really just a cruel set up for the ultimate "punch to the gut" of a long suffering fan base.

Football analysis aside, we thought it would be a good time to write about the age old question of stock market prospects relative to bonds. We would offer the caveat up front that we are not financial planners, but we are students of the equity markets, including factors that can influence the broader trend for the equity market. Individual investors should consider their own financial situation and goals and consult with a financial planner in determining the proper allocation to stocks, bonds or any other asset class. However, in terms of the attractiveness of bonds relative to stocks we tend to think that at least for 2018 the backdrop appears to favor investing in the stock market.

Bond Yields Remain at Historic Lows

For context, 10-Year U.S. Treasury rates have remained in the 2-2.5% range throughout the past two years and the highest quality 10-Year Corporate Bonds offer yields that remain near historic lows based on U.S. Treasury data shown on the right. Bond yields are predicted to move higher over time. At some point, higher yielding bonds could be attractive enough to pose a risk of capital flowing out of equities. However, in our view we have not reached a point in time where that is the case.

HIGH QUALITY CORPORATE BOND YIELDS

Source: U.S. Department of the Treasury

Relative to Bonds, Stocks to Benefit More From Tax Reform

As we highlighted in our July newsletter, U.S. tax reform provides a significant benefit for many U.S. based publicly traded companies and a catalyst for stocks to continue to appreciate. The tax cuts should fuel increased future earnings making stocks less expensive. The tax cuts also bolster U.S. corporate balance sheets, which could help fund acquisitions and increase dividends. A case could be made that declining corporate taxes potentially have a negative effect on the Federal Government's balance sheet, which back U.S. Treasury Bonds. The prospect of investing in U.S. Treasuries with the potential for inflation and lower U.S. corporate tax receipts in the future seems far less attractive to us than prospects for the stock market. While corporate bonds may be backed by companies that have more financial strength thanks to relaxed corporate tax rates, their fixed interest coupons over a holding period offer limited returns for investors.

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Favorable Backdrop for Small and Large-Cap Stocks in 2018

Our traditional focus has long been on small-cap stocks with uncommon innovation that leads to potential for significant growth and stock appreciation. We still see plenty of companies that fit that description with many larger companies as potential acquirers with more capital at their disposal. Over the past several years we have also refined our approach to our large-cap stock investment strategy to better capitalize on opportunities in that area of the market. We are encouraged about the early results in 2018 and see good prospects in the years ahead driven by U.S. based large-cap portfolio holdings that benefit from increased earnings and cash flow from reduced taxes. Many of our holdings also provide significant dividends that approach the yields of many of the high quality bonds depicted in the treasury data on the prior page. In our view, these types of "blue chip" stocks have prospects to perform significantly better than corporate bonds in 2018.

—Dan Garofalo &
Adam Engebretson
Senior Portfolio Managers

CLIENT SERVICE CONTACTS

Our Portfolio Managers Dan Garofalo and Adam Engebretson are the best contacts for any client service needs you may have.

Both Portfolio Managers are available to discuss your portfolio or any questions you may have. As always, you can reach our office at 800-333-9128. Dan can also be reached at 952-841-0457 and Adam can be reached at 952-841-0452.

DAN GAROFALO
Senior Research Analyst, Senior Portfolio Manager

Dan Garofalo joined Kopp Investment Advisors in 2013 and currently serves as Senior Portfolio Manager, Senior Research Analyst and is a member of the firm's Investment Committee. He focuses on a broad range of health care areas including medical devices, diagnostics, drug development and health care infotech and brings more than 10 years of health care industry and investment experience in managing client portfolios. Prior to joining Kopp Investment Advisors, Dan was an equity research analyst at Piper Jaffray and also worked for a major pharmaceutical company. Dan holds an M.B.A. from the Carlson School of Management at the University of Minnesota as well as a B.A. in Business from the University of St. Thomas in St. Paul, Minnesota.

ADAM ENGEBRETSON, CFA
Senior Research Analyst, Senior Portfolio Manager

Adam Engebretson joined Kopp Investment Advisors in 2015 and currently serves as Senior Portfolio Manager, Senior Research Analyst and is a member of the firm's Investment Committee. He focuses on the technology and consumer sectors. Prior to joining Kopp Investment Advisors, Adam was an equity research analyst at Piper Jaffray covering several industry groups. He began his investment career in 2005 with Raymond James Financial Services. Adam holds an M.B.A. from the Carlson School of Management at the University of Minnesota as well as a B.A. in Business from Bethel University in St. Paul, Minnesota. He is a Chartered Financial Analyst and a member of the CFA Society of Minnesota.

REMINDER Kopp Investment Advisors is an investment adviser, not a financial planner or financial consultant. We manage your account for long-term capital appreciation. Assets allocated to the Emerging Growth strategy should represent the aggressive equity portion of an overall portfolio, while assets allocated to the TQM strategy should represent that portion of an overall portfolio with growth as its primary goal. Our investment strategies involve risks, including liquidity risk, market risk and management risk. Each respective investment strategy should be used in a program of diversified investing and not as a complete investment program. You should let us know immediately in writing of any material change in your circumstances that might affect the appropriateness of your investment strategy or the manner in which we manage your account. We rely on you to keep us up-to-date.

 January 19, 2018