MILLER VALUE FUNDS

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The custom of offering a market outlook on some regular basis, usually at least once a year but often after every calendar quarter, is mostly harmless because it is quickly forgotten, even when it turns out to be mostly right. Since the beginning of this bull market in March 2009, the correct outlook has barely budged: The path of least resistance for U.S. stocks is higher. I believe it remains so, and will until either this expansion ends, or stocks become expensive relative to bonds and cash. Both appear to be a good ways off.

The first quarter of 2018, though, marked a sharp break from calendar 2017, one of the most remarkable years in market history. U.S. stocks declined in the first quarter, something that did not happen in any month in 2017. After peaking on January 26th, stocks quickly fell 10% as volatility spiked.[1] Both were dramatic departures from the environment prevailing last year. The market did not have a correction greater than 3% in 2017 and volatility was the lowest on record. While I believe stocks will gradually work higher over the year, I think it will be in the context of considerably higher volatility as the external policy environment has grown considerably more problematic.

After the election of President Trump, the consensus was that his rhetoric, unpredictability, and disdain for convention would be reflected in more volatile stock prices. That did not happen because none of those things had any impact on the economy, earnings growth, or cash flows. The new administration's focus on reducing regulations and cutting taxes were the only salient policy measures, and both were, of course, positive for stocks. The underlying economic backdrop barely budged: Economic growth continued its post crisis pace of about 2%, job growth, earnings growth, low inflation, low interest rates (all of the drivers of this long bull market) remained intact. As 2017 wore on, it became clear the global economy was entering a synchronized expansion, further solidifying what Jesse Livermore referred to as "underlying conditions."

The market this year looks, acts and feels different, and rightly so. Last year policy was business and market friendly. This year tariffs and the possibility of accelerating trade tensions are both business and market unfriendly. The large deficits expected as a result of the tax cuts are coming as unemployment is low and wage gains are accelerating, raising the spectre of inflation moving ahead of the Federal Reserve's 2% target, and triggering further tightening beyond what the market expects. The yield curve is the flattest it has been during this expansion, an early sign the market is concerned about the Fed over tightening and putting the expansion at risk.

The greater risk to the market this year, in my opinion, is not economic, it is political. The President has replaced two key and moderate foreign policy advisors with hard liners in Mike Pompeo at the State Department and the even more bellicose John Bolton as National Security Advisor. Bolton last year authored an Op Ed on the case for a preemptive attack on North Korea. The expected meeting between President Trump and Kim Jong-un of North Korea carries more than the usual risks attending meetings with foreign heads of state. The Mueller investigation is another possible source of

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[1] As measured by the CBOE Volatility Index

market turmoil, with the continuing speculation Trump will fire him or Deputy Attorney General Rod Rosenstein (or both), potentially setting off a constitutional crisis similar to what happened in 1973 when President Nixon fired Archibald Cox, leading to the resignation of Attorney General Elliot Richardson. The recent FBI raid on the office of Trump's personal attorney Michael Cohen has led the New Yorker to opine that the end of the Trump Presidency is in sight. There is nothing in all this that is positive for markets. The consensus is growing that the Democrats will take the House in the upcoming election, bolstered by the retirement of almost 40 Republican House members including Speaker Paul Ryan. If the Democrats do take the House, that will at best usher in gridlock and more likely lead to increased rancor and governmental dysfunction.

If the political outlook is darkening ominously, why am I constructive on the equity market? It goes back to those "underlying conditions." Earnings estimates continue to rise, with first quarter numbers expected to be up as much as 25%, which follows the fourth quarter's strong 15% growth. Dividends in the first quarter grew a solid 9%. Balance sheets are strong, as are corporate cash flows. Profit margins are at records, as are corporate profits, gross domestic product, and household net worth. Unemployment is at cycle lows and inflation is quiescent. The earnings multiple of the S&P 500 Index is under 17x, which is hardly demanding compared to 10-year Treasuries at 2.82%, over 30x for a return that cannot grow.

The 10% correction already experienced seems to me to adequately discount the visible risks noted above, leaving the market poised to go up if these risks either dissipate or fail to morph into more serious troubles. The path of least resistance remains higher.

Bill Miller, CFA

April 15, 2018

S&P 500 2656.30

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The **S&P 500 Index** is a market capitalization-weighted index of 500 widely held common stocks. **CBOE Volatility Index** is a measure of the stock market's expectation of volatility implied by S&P 500 index options. It is not possible to invest directly in an index. **Cash flow** is the total amount of money transferred in and out of a business.

Earnings growth is not representative of the Funds' future performance.

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