

# Year-End Financial Market Review

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*A Market Analysis of 2017 with a  
look to Major Trends in 2018*



**GLEASON**  
**ADVISORS**

# Gleason Advisors Perspectives

## *Optimistic Investors Cheered 2017 Across the Globe, Tax Reform Sets the Stage for Strong Economic Growth in 2018*

While it seems like a lot happened in 2017, in retrospect we struggled to find any one event that defined the year... that is until Tax Reform passed. The Trump Presidency had its inaugural legislative success with the passing of Tax Reform in December. In our opinion, much of 2017's double digit stock market increases were hinged on expectations of a more business friendly environment in the United States under the Trump Administration. Now we start 2018 with a major legislative step towards realizing those expectations.

The U.S. wasn't alone in its market advance during 2017. In fact, financial markets across the globe were also up double digits. Strength across the global markets were the result of synchronized central bank easing, the return of global growth, and relatively benign international conflict. Going into 2018, many central bankers across the globe have laid the ground work for a return to normal monetary policy. This will likely result in rising global interest rates which in turn could put a crimp on market valuations. Stocks are currently at the second most expensive price-to-earnings ratio ever recorded, according to the Shiller PE ratio (first being pre-Great Recession).

U.S. mergers & acquisitions remained historically strong topping \$1.5 trillion in total value for the fourth year in a row. However, deal count has declined ~7% & 13% over the past two years after the boom years of 2014 & 2015. The private equity industry continues to be the main driver of sustained strength in M&A. In 2017, the private equity industry hit record numbers of U.S. investment firms (~1,800) and capital raised but yet to be deployed (\$820 billion – “dry powder”). The vast number of investment firms looking to deploy the massive amount of dry powder overhang with fewer transactions has resulted in increased valuations across all industries and company sizes. Add into the mix corporate balance sheets having more cash than ever before and the tax advantages of repatriation as part of Tax Reform, we expect private market M&A valuations to remain elevated in 2018.

In the face potential rising interest rates, elevated valuation levels, and a nine-year bull market, the majority of investors and economists remain optimistic about the financial and economic prospects for the United States going into 2018. Corporate and individual tax cuts are sure to be a boon for consumers and businesses alike. One of the next agenda items for the Trump administration is expected to be an infrastructure bill, which could further boost economic expansion.

Will this bull market turn 10-years old in 2018? In short, yes. Caveated with, we expect economic growth to be strong, the stock market to catch it's breath, and M&A to remain at elevated valuations with declining transaction volume.

# 2017 Market Moving Events

## *Major Events that Impacted Domestic and International Financial Markets*

### President Trump Inauguration

*"Investors have asked a lot of questions...about the incoming new Presidential administration. The optimism for positive change here at Bank of America and among our customers is palpable...We will have to see how these topics play out, but that we are optimistic.*

*– Brian Moynihan, CEO of Bank of America*

### Federal Reserve Balance Sheet Reduction

*If they begin to let the balance sheet roll off in an aggressive way, that's taking money out of the system, and that would be negative for equities...I think they're going to go slow, so I'm not too worried about it, but you never know...*

*– Byron Wien, Vice Chairman, Blackstone*

### North Korea Nuclear / ICBM Tests

*One measure of financial risk are the S. Korean sovereign credit default swap (CDS) spreads, [which] widened in July following North Korea's ICBM tests, and spiked up following North Korea's threat to attack Guam...a further widening would be a clear signal of rising investor anxiety.*

*– Rajiv Biswas, Chief Economist Asia Pacific, IHS Markit*

### Hurricanes Harvey & Irma Impact

*The storms [are] likely to have caused \$150 billion to \$200 billion in total damage to homes and furnishings, vehicles, commercial real estate, and public infrastructure. Nonetheless, we anticipate most of the rebuilding, save to damaged public infrastructure, to be completed by the end of 2018.*

*– Mark Zandi, Chief Economist, Moody's*

### Jerome Powell Appointed as Federal Reserve Chair

*We can split hairs on the nuances but bigger picture, he will practice a patient approach to policy which is identical to what is in place now...Our view is Powell is the G.O.P. version of Yellen, with the added kicker of wanting to reduce regulation*

*– Tom Porcelli, Chief Economist, RBC Capital Markets*

### Tax Reform

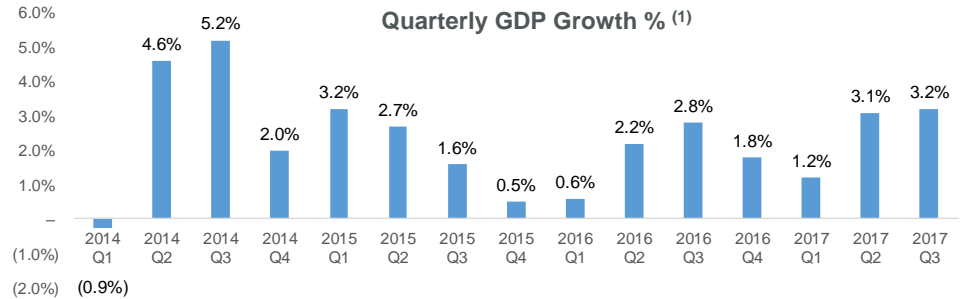
*The enactment of a comprehensive overhaul – complete with a lower corporate tax rate – will ignite our economy with levels of growth not seen in generations...driven by greater investment, capital stock, business formation, and productivity – all of which will yield more jobs and higher wages.*

*– 137 Economists Letter to Congress In Support of Tax Reform*

# Key Economic Indicators

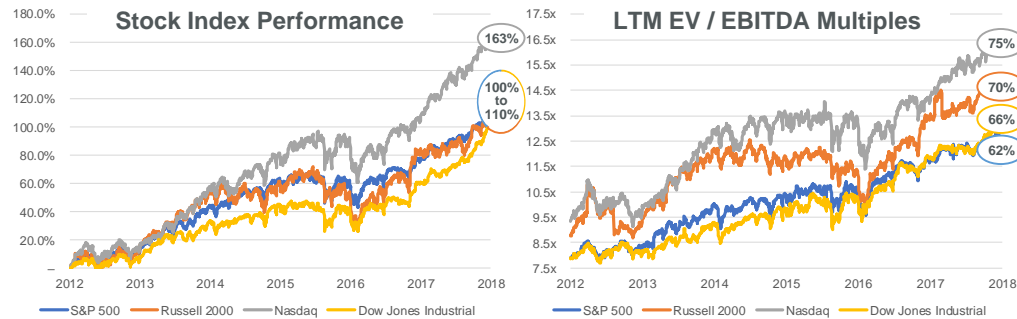
## Macro U.S. Performance

- U.S. GDP grew over 3.0% in consecutive quarters for the first time since 2014
- GDP beat expectations in the 3<sup>rd</sup> quarter, even with the devastating impacts of the hurricanes in Texas and Florida
- Consumer spending, and business & government investment were the main drivers for the beat on expectations
- Excluding inventory build-up, GDP grew at a less impressive 2.5%



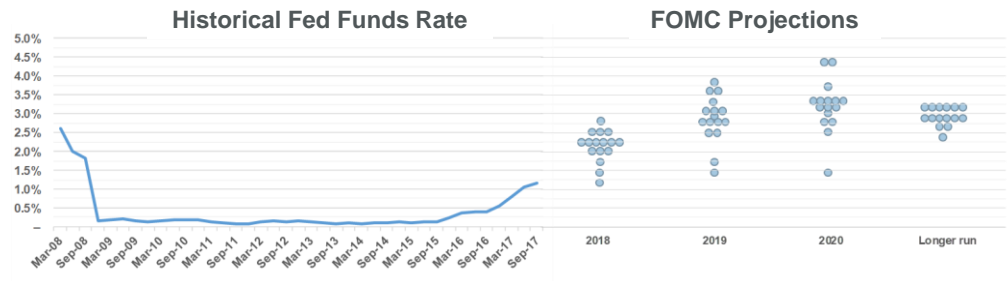
## U.S. Stock Markets (2)

- The Nasdaq has been the best performer of the major stock indices, increasing 163% since January 2012
- EBITDA Multiple increases from January 2012 to the present have accounted for roughly half of the stock market increases across all indices
- According to Goldman Sachs, stocks have been more expensive only 11% of the time since tracking



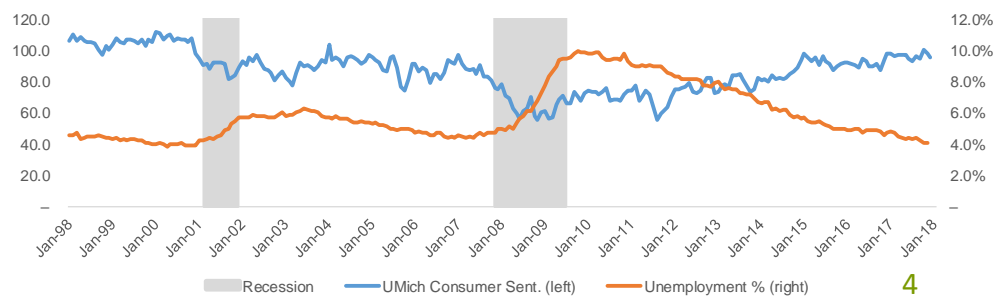
## Interest Rates / Federal Reserve (3)

- In December, the Federal Reserve raised the Fed Funds Rate to a target range of 1.25-1.50%, the 3<sup>rd</sup> time the Fed raised in 2017
- Jerome Powell, the new Federal Reserve Chairman, begins his oversight in February 2018
- The yield curve has continued to flatten throughout 2017, as longer dated government bonds have remained unchanged as the Fed has increased short-term rates



## US Consumer (4)

- The University of Michigan Consumer sentiment is at an almost 14 year high as of the latest reading
- Unemployment dropped to 4.1%, the lowest figure since March '01
- Wage growth, sluggish since the recession, grew 2.5% over the last twelve months, nominally ahead of the 2.0% inflation reading



## Footnotes

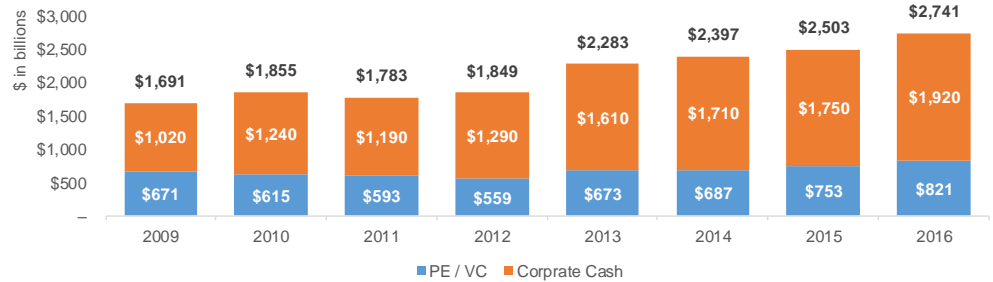
- Nominal GDP – Bureau of Economic Analysis
- S&P Capital IQ
- FederalReserve.gov
- University of Michigan / Bureau of Labor Statistics

# Current M&A Environment

## Cause

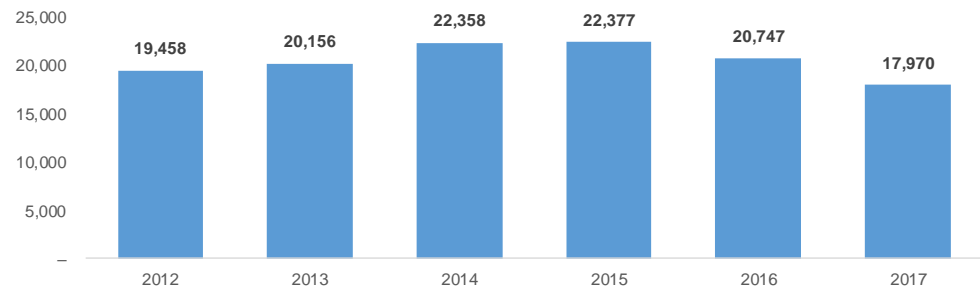
### PE / VC Dry Powder & Corporate Cash <sup>(1)</sup>

- \$1.9 trillion of cash is on U.S. corporations balance sheets and private investment firms are waiting to deploy \$821 billion of capital, for a record \$2.7 trillion combined
- Investment firms typically have mandates to deploy their capital in a 5-year period
- Many expect the Tax Holiday on repatriation of cash to be deployed for M&A purposes



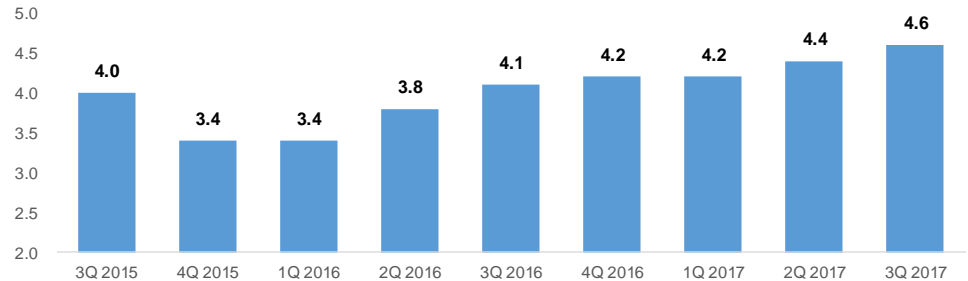
### North American M&A Transaction Volume <sup>(2)</sup>

- 2017 saw the lowest amount of M&A deals transacted over the past 6 years, however still relatively strong relative to historical levels
- Since 2012, total transaction value of M&A has exceeded \$1.0 trillion every year (only 2015 exceed \$2.0 trillion)
- B2B, Information Technology, and Healthcare amounted for 40% of total transaction volume. Energy & B2C were down relatively to historical levels



### Leveraged Lending Environment (1-5 Scale) <sup>(3)</sup>

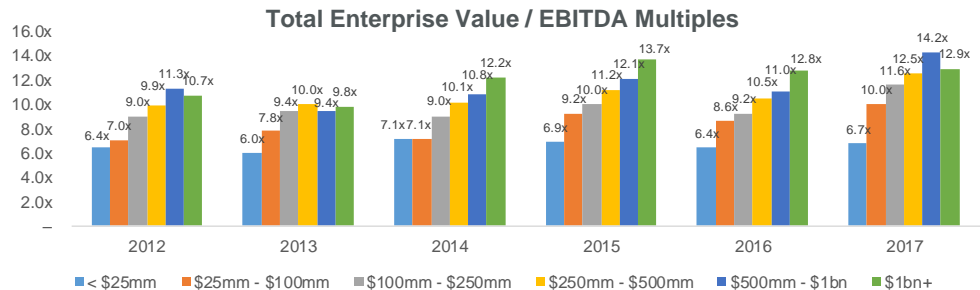
- William Blair's 3Q lender survey reported no lender tightening terms or pricing in the latest quarter
- Lenders reported total leverage of 5.2x for middle market leveraged financing packages over the observed period (not pictured)
- 98% of lenders expect the next year to continue to be more borrower friendly than lender friendly



## Effect

### M&A Transaction Multiples <sup>(4)</sup>

- The aggressive lending environment and well capitalized acquirers have both contributed to the increase in valuation multiples since 2012
- Acquirers are placing a premium on size, however we see acquirers moving down market which should pressure multiples higher in the lower middle market



## Footnotes

1. S&P Global Ratings, Preqin









2. S&P Capital IQ

3. William Blair

4. S&P Capital IQ (excludes empty values)

# Gleason Advisors 2018 Expectations

## *Economic Growth Catches Up With Extended Financial Markets*

Item	2018 Trend	Commentary
GDP		We believe Tax Reform will lead to consumer and business confidence that will spur spending and investment and drive economic expansion. Our expectation is 3.0%+ for the year, barring weather, political or other unforeseen events.
Short-Term Interest Rates		The new Fed will continue rate hikes to keep pace with economic growth. We expect short-term rates in the 2.0-2.5% range by the end of 2018.
Long-Term Interest Rates		Irrespective of the increase in short term rates, we expect long term yields to stay relatively unchanged, resulting in a flattening of the yield curve. We expect the 20-Year Treasury Rate to finish the year at no greater than 3.0%.
U.S. Stock Market		We don't expect the U.S. stock market to see gains similar to 2017. We believe the Nasdaq will lead the major indices at a 10% increase. Increasing rates, and an exogenous event will cause investors to have pause on valuation.
M&A Market		The large amount of dry powder will counteract the limited availability of investment opportunities. Valuation multiples will remain high but M&A transaction volume will continue to decline. Venture Capital outperforms M&A.
Capital Expenditures		The new tax plan has a strong incentivize for corporates to invest in capex. That said, we believe corporates will use their cash coffers with a balance between share buybacks & capital investment.
International Tensions		2018 will have the same players continue to put stability at risk. North Korea threatening with its nuclear arsenal, uprisings in Iran, and the stance of Russia & China will create on-going, but manageable challenges in 2018.
Disruptive Technology		Artificial intelligence and blockchain technology have become household terms and will continue to see greater adoption and use cases in 2018.

# Gleason Advisors Service Offering

*Gleason Advisors provides strategic & financial advisory services to middle market companies through the following offerings*

## Investment Banking\*

### Sell-Side

- Run the marketing process for the sale of a business
- Approximate financial criteria
  - Revenue: \$5 - \$150 million
  - EBITDA: \$2 – \$10 million
- Industry Agnostic

### Buy-Side

- Investment thesis origination
- Prospective target outreach
- Arrange acquisition financing
- No size criteria for target

### Capital Raise

- Growth Equity
- Venture Capital
- Business plan development

## Strategic Consulting

### Business Valuation

- Auction value expectations, along with textbook valuations (DCF, precedent transactions, etc.)
- Intellectual Property valuations
- 409A Valuations
- Estate and Gift Valuations

### Strategic Financial Advisory

- Financial modeling
- Unit level product economics and detailed customer analysis
- Debt capacity and lending covenant analysis
- Exit planning strategy and timeline
- Profit improvement strategy
- Cap table management

## Restructuring

### Out-of-Court Services

- Operational assessments
- Refinancings, asset sales, capital infusions
- Liquidity management
- Valuation (liquidation, asset sale, auction)
- Litigation support and expert testimony

### Bankruptcy

- Run §363 sales
- Court appointed trustee / receiver
- Prepackaged Chapter 11 plans
- Arrange DIP financing

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One Gateway Center, Suite 525  
420 Ft. Duquesne Blvd  
Pittsburgh, PA 15222  
(412) 391-9010  
[www.gleasonexperts.com](http://www.gleasonexperts.com)