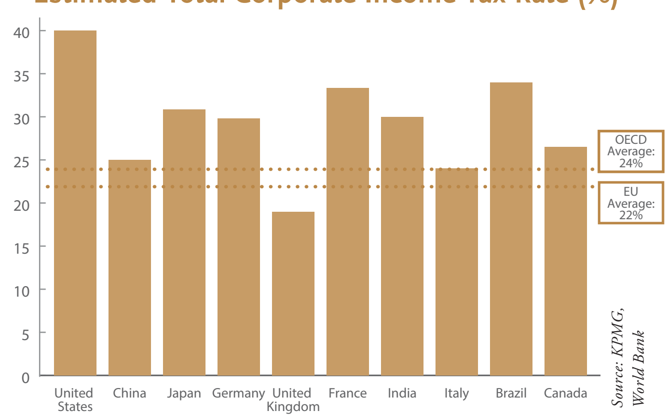
JULY 2017

ARE WE THERE YET? EVIDENCE POINTS TO NO

With the summer road-trip season under way, drivers are hearing the familiar question "Are we there yet?" from the backseat of their automobiles. The same question is being asked about the stock market as indices are at record highs and returns in the first half of 2017 have been good. Unlike a summer road trip to a national park, campground, or cabin, the stock market does not have a known destination so it is difficult to identify when the market is at a peak. But there are signs to help investors understand where we are in the market cycle. As we look at these signs, we see potential for additional market upside.

In the first six months of year, the S&P 500 Index (S&P 500) hit 24 new all-time highs and increased 9.3%. Small cap stocks as measured by the Russell 2000 Index (Russell 2000) hit 9 new all-time highs and increased 5.0% during the same period. Breaking down the S&P 500's year-to-date returns shows that the market returns have been driven more by multiple expansion (2017 price/earnings ratio up 9.6%) than by earnings revisions (declined 1.2%) or dividends (1.1%). However, this doesn't mean that earnings growth is weak. In fact, as noted by FactSet, the total earnings of the S&P 500 are expected to increase 10% in 2017 (over 2016) and another 11% in 2018 (over 2017). If favorable stock market returns were driven only by higher valuations, we would be more concerned. But with corporate earnings growing at a double-digit rate, this suggests a healthy economic backdrop.

Estimated Total Corporate Income Tax Rate (%)



Perhaps the biggest wild card right now is corporate tax reform as U.S. corporate tax rates are among the highest in the developed world. U.S. companies typically realize some profits from outside the U.S., reducing their overall effective tax rate somewhat from the estimated rate shown in the chart on the right. But a reduction in the U.S. federal corporate tax from the existing 35% level could lead to higher corporate earnings, likely a tailwind for U.S. stock prices.

Also giving us confidence in our positive outlook is the relatively low probability of a recession in the near term. Admittedly the U.S. is not in the early part of the business cycle as the U.S. has had only two quarters of negative real GDP growth over the last eight years, including none in the last three years. Looking forward, however, popular

Kopp
Investment Advisors
8400 Normandale
Lake Boulevard
Suite 1450
Bloomington, MN
55437

measures of recession likelihood from the New York Fed and academia put the chance of a recession in the next year at less than 10%. If the likelihood of recession is low and earnings growth is accelerating, we believe the odds favor new highs in the equity markets despite a bull market that seems long in the tooth. As an old Wall Street adage says, "Bull markets don't die of old age."

We believe the market has further room to run, but we also need to be mindful of the risks to our positive outlook. The U.S. Federal Reserve has raised interest rates twice already this year and plans to gradually reduce the size of its balance sheet beginning later this year. In our view, the Fed's actions have been prudent. But the Fed or other central banks tightening too much or too soon would not be favorable for asset prices. Other risks to our positive outlook would include escalating global tensions. Overall, we have had a strong start to the year and are pleased to have delivered strong performance for our clients. As we enter the second half of the year, the signs we monitor suggest the potential for additional gains ahead.

—Dan Garofalo
Senior Portfolio Manager

CLIENT SERVICE CONTACT

Portfolio Manager Dan Garofalo is the best contact for any client service needs you may have.

You can reach our office at 800-333-9128. Dan can also be reached at 952-841-0457.

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.

REMINDER Kopp Investment Advisors is an investment adviser, not a financial planner or financial consultant. We manage your account for long-term capital appreciation primarily through investing in emerging growth companies in the health care sector. Assets allocated to our AccruHealth strategy should represent the aggressive equity portion of your overall portfolio. Our investment style involves risk, including liquidity risk and market risk. This 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 our investment strategy for you or the manner in which we manage your account. We rely on you to keep us up-to-date.

 July 17, 2017