

## Quarter in Review

As we look back over the past quarter and first half of the year, a few things stand out. Overall stock market volatility remained extremely low, despite significant domestic political uncertainty and unsettling global and geopolitical events. In stride, both risky assets (stocks) and defensive assets (core bonds) performed very well.

European stocks jumped 8.4%, while the broader developed foreign stock market was up 6.4%. Emerging-market and large-cap U.S. stocks gained 3.4% and 3.1 %, respectively. Bonds also delivered solid returns in the quarter, rising 1.5%.

### Investment Environment:

The S&P 500’s actual realized volatility recently fell to near its lowest level in the past fifty years, according to a recent Goldman Sachs report, while the S&P 500 Index continued to hit all-time highs. The U.S. stock market’s calm ascendance seems to fly in the face of ongoing political uncertainty and geopolitical tumult. Each day seems to bring a new headline concerning something else to worry about.

That said, maintaining a degree of composure is a valuable attribute of successful long-term investors. Global risks always exist and unexpected events inevitably happen, causing markets to fall no matter their valuation. The world and financial markets have faced numerous negative shocks over the decades, but the broad economic impacts have ultimately proved transitory. Over the long term, financial assets are priced and valued based on their underlying economic fundamentals—yields, earnings, growth—not on transitory macro events or who occupies the White House. Therefore, we believe it is beneficial for investors not to react to every domestic political development or geopolitical event with the urge to sell their stocks nor get overly excited and jump into the

market on some piece of news they view positively. We don’t think refraining from such short-term trades is complacency, as any changes must be supported by a sound decision-making framework. Having a disciplined investment process and a focus on the long term are essential in order to achieve your financial objectives.

### Recent Market Trends:

Several points worth highlighting given the reversal of market trends and consensus market views that were widely held at the start of the year:

- European stocks are beating U.S. stocks by a wide margin.
- The U.S. dollar is down (about 6%).
- Treasury yields are down.
- Oil prices have plunged 20% from their recent highs.
- Growth stock indexes are crushing value indexes.
- Larger caps are beating smaller caps.
- Emerging-market stocks are outperforming U.S. stocks.

<i>Asset Class</i>	<i>2Q</i>	<i>1 Year</i>	<i>5 Years</i>
U.S. Large-Cap	3.05%	17.74%	14.46%
U.S. Large Growth	4.59%	20.26%	15.08%
U.S. Large Value	1.30%	15.40%	13.71%
U.S. Small Blend	2.50%	24.44%	13.74%
Developed Int'l Stocks	6.37%	20.23%	9.12%
Emerging-Markets Stocks	3.44%	18.84%	3.33%
REITs	1.58%	-2.05%	9.14%
Investment-Grade Bonds	1.45%	-0.54%	2.02%
Municipal Bonds	1.96%	-0.49%	3.06%
High-Yield Bonds	2.14%	12.75%	6.91%
Global Bonds	2.89%	-4.14%	-0.20%

The recent market shifts only reinforce the audacity of “expert” market predictions. We don’t think anyone can consistently and accurately time short-term swings in markets or inflection points in market cycles. The false belief that they can be timed often leads to performance chasing, whipsawing in and out of markets (selling low and buying high), and ultimately disappointing investment results.

Most of the market reversals we've seen this year are consistent with, if not driven by, an unwinding of the so-called Trump trade. This is shorthand for the markets' almost knee-jerk reaction (which soon became consensus) that Trump's election and the Republican sweep of Congress would herald a period of inflationary, pro-growth fiscal, tax, and regulatory policies, unleashing the U.S. economy's animal spirits. Instead, the Trump administration has gotten bogged down in a myriad of other issues, with little progress on the economic front thus far.

In general, we agree with Warren Buffett who recently said, "If you mix your politics with your investment decisions, you're making a big mistake." We made no changes to our portfolio positioning when Trump was elected, and we highlighted the significant uncertainty around potential Trump policies. That's not to mention the highly uncertain *timing, implementation, and magnitude* of their *ultimate economic and financial market impacts*. Therefore, the unwinding of that narrative this year hasn't led us to make any portfolio changes.

### **Portfolio Positioning and Outlook:**

One of the most notable observations is how steadily markets have risen, despite ongoing political uncertainty and geopolitical tumult. Economic and corporate fundamentals largely still look solid, and investors are pricing in expectations that the second quarter earnings season will demonstrate a continuation of the strong growth trends exhibited so far in 2017. Inflation is lower, but still in the ballpark of the Federal Reserve's 2% target. And global central banks, including the Fed, are not seen as becoming too aggressive in raising rates and tightening monetary policy any time soon.

From a big picture perspective, we think the odds favor a continuation of the ongoing mild global economic recovery we've witnessed this year. That should be broadly supportive of riskier assets, such as stocks and corporate debt. In particular, we believe there is still more room to run for foreign stocks versus the U.S. market, given their more

attractive valuations and earnings growth potential, even after their strong performance in the first half of the year.

Ultimately, our asset class weightings rest on our assessment of the risk and return potential for each asset class as well as the objectives and risk threshold of each portfolio. These are our foremost considerations as we manage our portfolios and work with our clients to help achieve their goals. Within our portfolios, we look to bonds for protection, capital preservation, and/or a regular income stream to meet current and future spending needs based on our in-depth knowledge of each client's long term cash flow.

### **Putting It All Together**

Looking ahead, we don't expect a recession in the near term, but we remain alert and positioned to meet the high level of uncertainty that characterizes both global financial markets and the current geopolitical environment. We know there will inevitably be shorter-term market surprises, including negative ones. And given the high level of complacency we've witnessed in the markets so far this year, we understand stocks are particularly vulnerable to a negative surprise. This is why it's more important than ever to take a long-term investment view when it comes to positioning our portfolios. While there has been seemingly little need for diversified portfolios over the past eight years of a raging U.S. equity bull market, history tells us this cycle will turn, and the portfolio benefits of a well-diversified asset allocation will become extremely apparent. Moreover, market over-reactions to shorter-term news or outcomes can create compelling longer-term investment opportunities for us, provided we stick to our long-term investment philosophy.

As always, we appreciate your confidence and welcome questions about your individual portfolio or financial situation.

*-We thank you for your continued support!*