Investment Strategy Update April 5, 2017

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"If our crystal ball was any murkier it would be a muddy soccer ball."

Market Thoughts...

This year, emerging markets and international stocks are performing best. U.S. stocks are also doing well <u>and</u> sport expensive valuations compared to non-U.S. markets. Since we have exposure to global investments our equity returns are solid on both an absolute and risk adjusted basis. A sanguine view of the markets is not warranted because of geopolitical and economic uncertainties outlined below but there are reasons to be optimistic about returns this year.

The Promise: Thus far, U.S. stocks remain strong due to Trump's *promise* of tax cuts, deregulation, fiscal spending, and 3-4% GDP growth. Small business and consumer optimism has spiked on the belief that Trump will succeed. Other leading economic sentiment indicators are confirming this optimistic view and forthcoming actual data will reveal if the low growth we have experienced since 2009 is changing to higher sustainable growth. <u>If</u> that is confirmed, we expect that international markets will catch up to U.S. stock valuations. U.S. stocks already price in an optimistic/cheerful scenario and while they could continue upward, any negative surprises to Trump's growth narrative will be problematic.

(Part I) The Background: Walk with us, for a moment, down memory lane. The dot com bust was parlayed into the housing boom. The housing bust then incubated the current extraordinary experiment of government debt issuance. How will this play out? We have heard many pundits say there are no excesses in the financial system. We have opinions, working hypothesis, educated and informed guesses and over 25 years' worth of scar tissue from markets. We scoff at such certainty of predictions. President Trump has raised the probability of geopolitically driven market risk in a world teetering on unprecedented debt and low growth. Considering this new reality, risk management is paramount.

(Part II) Federal Reserve's Actions and Composition: Consensus expectations remain that the Fed will not raise interest rates if markets falter for any reason. All things equal, when the Fed can successfully rescue markets, valuations are less of a concern and stocks can remain expensive. This pattern of market support by the Fed is another reason for the current bull market to continue despite broadly accepted expectations for the Fed to hike its policy rate twice more this year.

President Trump will name replacements of the Fed's Board of Governors (including the chair and vice chair) over the next year and the potential for fiscal expansion at a time of full employment raises uncertainty about the Fed's future direction for monetary policy. Will the Fed hike more aggressively in response to inflationary pressures? Will they still be able to inspire confidence in their ability to backstop any market troubles? We think President Trump, as opposed to Candidate Trump, will want the Fed to remain accommodative to expansionary trends and market stability and will appoint replacements with the same vision. Thus, we don't expect any big surprises from the Fed. Business as usual should be supportive for US stocks.

Positioning: Our muddy soccer ball prediction for the remainder of 2017 is then; international stocks will perform better than U.S. stocks, U.S. stocks will perform ok but not great. Bonds will remain unattractive from a return perspective but attractive for risk management, and alternatives will finish somewhere in between stocks and bonds with both decent expected returns and attractive risk control. Should global growth pick up we expect mid to high single digit returns this year. If not, we will be glad to have a broad diversification of exposures.

Our Plan: Stick with diversified strategies and <u>control/manage</u> the only things we can - risk exposure and cost containment. More risk means more potential for higher returns and, of course, higher losses. Lower risk begets smaller losses and lower growth potential. Spreading portfolios over various types of risk allows us to balance risk exposure to meet each client's unique needs, wants and wishes. We will rebalance as needed and bias portfolios towards areas with attractive relative value – paying only what is required to obtain targeted exposures. A patient investor's reward is watching this process work regardless of the uncertainty of the times.

Thank you for your continued trust.

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