

INVESTMENT SPOTLIGHT

“In the short run, the market is a voting machine, but in the long run, it is a weighing machine.”

– Benjamin Graham

Benjamin Graham, the “father of value investing” and author of the industry renowned book *Security Analysis*, first published in 1934, is credited with this (now paraphrased) quote that has guided the work of generations of investors. The point Graham and his followers (including Warren Buffett) have made over the years is that stock prices change far more rapidly than the underlying economic value of companies. After the short-term behaviors and biases of the market’s fickle investors ebb and flow over time, the true value of a stock comes down to the performance of the underlying business. At a time when investor exuberance is in full force sending equity prices further into record territory, this philosophy rings truer than ever to our investment team.

Investors continue to cast their votes by bidding up shares of U.S. equities while measures of volatility

and “fear” reach new all-time lows. At the time of this writing, the S&P 500 Index trades at a price to earnings multiple of 21.8x, well ahead of the 10 and 20-year averages of 17.2x and 19.5x respectively. The VIX index, which serves as a gauge of investor fear, stands at half of the long-run average. Earlier in the month the index closed at a record low, breaking through the previous trough set in 1993.

A short-term flight-to-quality temporarily boosted U.S. Treasuries during the quarter before quickly reversing course. Economic data was skewed by the devastating hurricanes making landfall in Texas, Florida, Puerto Rico, the Virgin Islands and several island nations in the Caribbean, but those data point impacts are expected to be just as short-term in nature. ■

Economic Review & Outlook

Hurricanes wreaked havoc during the final month of the quarter with the economic impact now showing up in various economic measures from industrial production, employment and wages to housing. Refinery capacity in the Gulf Coast region came back online relatively quickly; gasoline futures, followed by prices at the pump, have now normalized. The devastating impacts of human dislocation and rebuilding, however, will continue to take place well into the future.

The final estimate of Q2 GDP was revised upward to 3.1%, driven primarily by construction and inven-

tories. This is the strongest reading in two years, but it remains unclear if the uptick in growth is sustainable. Consumer confidence remains at historic highs, but with personal consumption a dominant factor to GDP results, consumers will need to follow through with increased spending to sustain economic expansion.

Retail sales reports were muted during the quarter followed by a spike in the final month, driven by storm-related impacts of auto replacements and spending on gasoline. Rebuilding efforts are likely to offer a favorable boost to year end growth figures.

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The employment situation remains strong in the U.S. with headline unemployment at a 16-year low reading of 4.2%. Wage growth blipped up to 2.9% after flat lining at 2.5%, however storm-related impacts (including utility worker overtime) were a temporary factor in the results.

Inflation remains benign with the Fed's preferred measure, Personal Consumption Expenditures (PCE), remaining at 1.4% on a year-on-year basis. The Core Consumer Price Index (CPI), excluding food and energy, was also flat at 1.7% despite a headline CPI figure of 2.1% led by a 13% increase in gasoline prices. ■

	Q3-2017	YTD-2017
Consumer Discretionary	0.84%	11.93%
Consumer Staples	-1.35%	6.57%
Energy	6.84%	-6.63%
Financials	5.24%	12.48%
Healthcare	3.65%	20.31%
Industrials	4.22%	14.13%
Information Technology	8.65%	27.36%
Materials	6.05%	15.82%
Telecommunications	6.78%	-4.69%
Utilities	2.87%	11.87%

Bond Review & Outlook

The yield on the 10-Year U.S. Treasury trended lower from the start of the third quarter into the first week of September based on subdued inflation reports and a short-lived flight-to-quality as test missiles from North Korea flew over Japan. The 10-Year bellwether reached a low of 2.04% during the quarter before rising in the final weeks to 2.33%. Stronger than usual hawkish Fed commentary lifted short rates to a nine year high in September with the 2-Year U.S. Treasury ending the quarter at 1.48%.

With the Fed now four rate increases into the current tightening cycle, they opted to leave rates unchanged in their September meeting, as widely expected. In a step we deem meaningfully more important, the FOMC announced the start of the much anticipated unwinding of the \$4.5 trillion balance sheet of mortgage and Treasury bonds to begin this month. The process of gradually and predictably removing artificial demand in the market by allowing bonds to mature without reinvestment (as opposed to outright selling) at a slow, measured pace has been well communicated to the market.

The release of minutes from the latest FOMC meeting revealed a lack of consensus on the current state of inflation within the Committee. Particularly hawkish comments from Janet Yellen, Chair of the Federal Reserve, weighed on traders. The implied probability of a Fed Funds Rate hike at the December meeting now stand at 73%, after being as low as 22% prior to the September meeting. Expect speculation on the appointment of Yellen's successor to top the list of topics for the market pundits in the coming weeks with her term expiring in February, 2018. Should a new figure other than Yellen be nominated, we may expect fixed income volatility to heighten as the new Chair's policy views undergo scrutiny and interpretation by traders. ■

	Q3-2017	YTD-2017
Cash:		
Citi 3 Mo. T-Bill Index	0.26%	0.56%
Taxable Fixed Income:		
Barclays US Agg. Bond	0.85%	3.14%
Barclays Govt./Credit Int.	0.60%	2.34%
Barclays Govt./Credit Long	1.53%	7.65%
BofAML High Yield Index	2.04%	7.05%
Tax Exempt Fixed Income:		
Barclays Muni. 5 Yr.	0.68%	3.87%
Barclays Muni. 7 Yr.	0.78%	4.72%
Barclays Muni. TR	1.06%	4.66%

Stock Market Review & Outlook

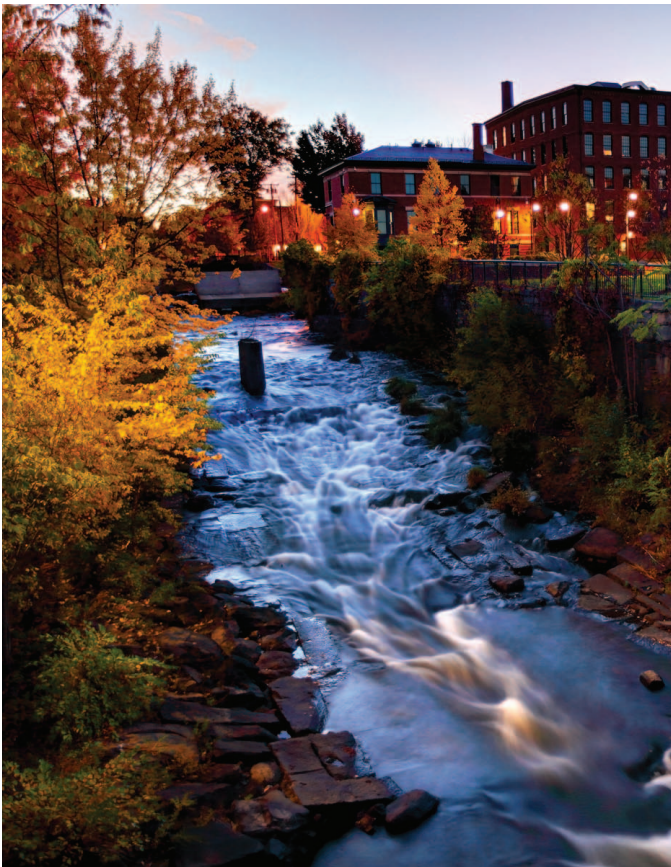
U.S. equities continued their march further into record territory. Improved corporate earnings and steady economic data allowed the S&P 500 Index to methodically grind to continued new highs despite severe weather and threats being exchanged with North Korea. Second quarter corporate earnings averaged a solid 10.3% following an equally strong first quarter. This is the first stretch of double digit earnings growth in back-to-back quarters since 2011. The S&P 500 and Dow Jones Industrial Average have now advanced for eight consecutive quarters. This is the best streak in 20 years for the Dow average of blue chip companies. The current bull market, which began in 2009, is now the longest on record, edging past the 266% gain recorded in the bull run from 1949-1956.

The methodical drive of the S&P 500 Index into new record territory has been accomplished with remark-

ably low levels of volatility. The average daily change in the index level during the third quarter was the lowest since 1968. There have been no daily moves of greater than 2% thus far in calendar year 2017. Investors must look back to 2005 for a similar year of such muted volatility. There is no other year in the recorded history of the index with a lower peak to trough drawdown than 2017. Long-term investors who believe in reversion to the mean and that markets move in cycles as we do, are justified in taking pause over these record breaking statistics.

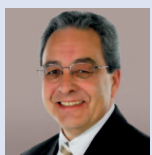
Technology companies continued their strong run over the last quarter pulling the NASDAQ index to new record highs as well. The NASDAQ has made a whopping 50 new record highs this year. Biotech stocks have continued to recover from the significant decline experienced in 2015, further contributing to NASDAQ strength. The Telecommunications sector partially recovered losses incurred earlier in the year. Energy stocks also made back some previous losses on rising oil prices. Consumer Staples was the only sector to post a decline during the quarter.

Returns for equities outside of the U.S. continued to be strong and provide opportunity for added diversification to equity portfolios at more favorable valuations. Developed economies continue to follow the U.S. with talks of tapering quantitative easing. Emerging markets countries continue to lead the charge during “risk on” periods lead by Latin American markets. ■

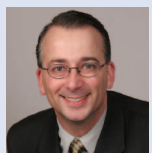


	Q3-2017	YTD-2017
DJIA Index	5.58%	15.45%
S&P 500 Index	4.48%	14.24%
Russell 2000 Index	5.67%	10.94%
MSCI EAFE Index	5.47%	20.47%

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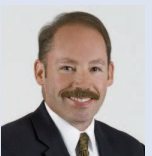


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Closing Thoughts

Renewed talk of tax reform out of Washington and a debt ceiling deal being struck in September are both positive developments for financial markets. We are however, encouraged to hear investor discussions begin to shift away from referencing fiscal stimulus as a main source of optimism. When more quantifiable measures such as corporate earnings and economic factors are focused on, we believe investors' "votes" are more informed.

We will continue to carefully weigh the decisions made with respect to allocation across major and sub-asset classes. We strive to deploy capital on behalf of our trusted partners into securities offering the most attractive risk and return profile. As always, we will continue to monitor economic and market conditions to ensure timely and appropriate investment action. If we can be of assistance, please do not hesitate to call us at the numbers provided. ■



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