Economic & Market Commentary

Market Update – December 2017

Global stocks (+1.6%) finished the year on a very strong note. Continued strength from emerging markets (+3.6%) pushed the asset class to a 37.3% gain during 2017! International stocks in aggregate led U.S. stocks over the course of 2017, helped by a weaker U.S. dollar. Aside from inflation-protected bonds (+0.9%), bonds were essentially flat during December to cap off a year of modest gains. Commodities also surged, up 3.0%, to end 2017 in positive territory.

Economy

- The final estimate of third quarter real GDP growth came in at an annualized rate of 3.2% - officially marking the second straight gain of 3.0% or greater.
- Core inflation (CPI less food and energy) dipped 0.1% to 1.7% on a year-over-year basis, but underlying components show potential for higher inflation.
- Consumer confidence cooled slightly from November's 17-year high, but still reflects optimism.
- Nonfarm payrolls revealed 148,000 jobs added in December, while U.S. unemployment remained at 4.1%.

Stocks

- The S&P 500 Index posted a 1.1% return in December, besting small cap stocks, but slightly behind large value's 1.3% pace.
- International stocks performed favorably once again with large caps gaining 1.6% and small caps up 2.8%.
- Emerging markets stocks jumped 3.6% due to outsized gains from South Africa, Indonesia, and Malaysia.

Bonds

- On December 13th, the Federal Reserve raised rates for a third time in 2017 to a range of 1.25%-1.50%.
- Prospects for inflation generated a 0.9% return for TIPS while other bond asset classes were essentially flat in December.

Alternatives

- Alternative asset classes were all positive, with commodities leading the way (+3.0%).
- Managed futures (+1.3%), global REITs (+1.2%), and reinsurance (+1.0%) posted softer, positive returns in December.

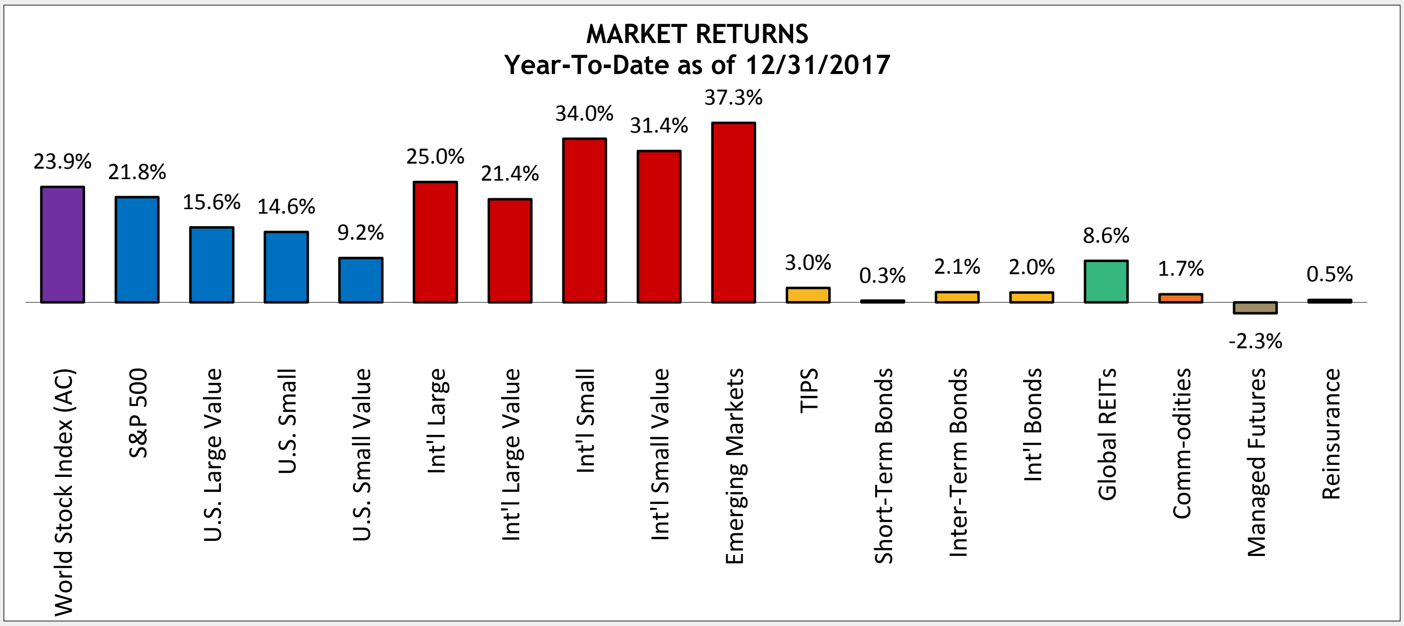
Sources: Bureau of Economic Analysis (BEA), Federal Reserve, Morningstar Direct, Standard and Poor's

2017: A Year of Risks That Weren't

There was certainly no shortage of potential market shocks in 2017. To start the year, the U.S. ushered in new leadership. The year also saw presidential elections in South Korea, India, Iran, Germany, and France – each of which had potential to impact markets. In March, the U.K. invoked Article 50 commencing Brexit negotiations that may last up to 730 days. Just months after major hurricanes pounded the Caribbean and southeastern United States, the largest wildfires in California history raged out west. Cryptocurrencies, or digital currencies, staged a rally greater than almost any asset in human history despite being backed only by a digital ledger and belief (by some) that it may be the future of currency. North Korea tested nuclear weapons and intercontinental ballistic missiles on several occasions and even threatened nuclear war.

Now take a deep breath. Despite all of these (and more) potential shocks, the U.S. and international markets proved unshakable in 2017. In fact, not only did markets dodge all of these bullets as if a character from 'The Matrix', but around the globe stocks generated robust returns with historically low volatility. The Sharpe Ratio, developed by Nobel Laureate William Sharpe, is a common measure used to compare risk-adjusted return for different assets. Since its inception in 1994, the MSCI All Country World Stock Index has returned 7.2% with a 15.1% standard deviation (volatility) – producing a historical Sharpe Ratio of 0.32 once the risk-free rate (the rate of return an investor could expect with absolutely zero risk – 30 Day U.S. T-Bills are used here) is backed out. But in 2017, a return of 24.0% with a 2.7% standard deviation generated an incredible Sharpe Ratio of 8.5 – the highest in the index's history! To put this in perspective, the index's second best calendar year Sharpe Ratio was *only* 2.8. Focusing on the S&P 500 Index, we have an even longer data history. Since 1926, the S&P 500 Index has had a Sharpe Ratio of 0.36. In 2017, a 21.8% return in combination with a 3.9% standard deviation generated a Sharpe Ratio of 5.3 – the 3rd highest for the S&P 500 since 1926!

In terms of risk-adjusted returns, 2017 was undoubtedly one of the best years of all time for stocks around the globe. But as we forge into 2018, we must not forget that geopolitical and macroeconomic risks remain which could add to volatility – making it as important as ever to maintain a portfolio globally diversified across stocks, bonds, and alternatives.



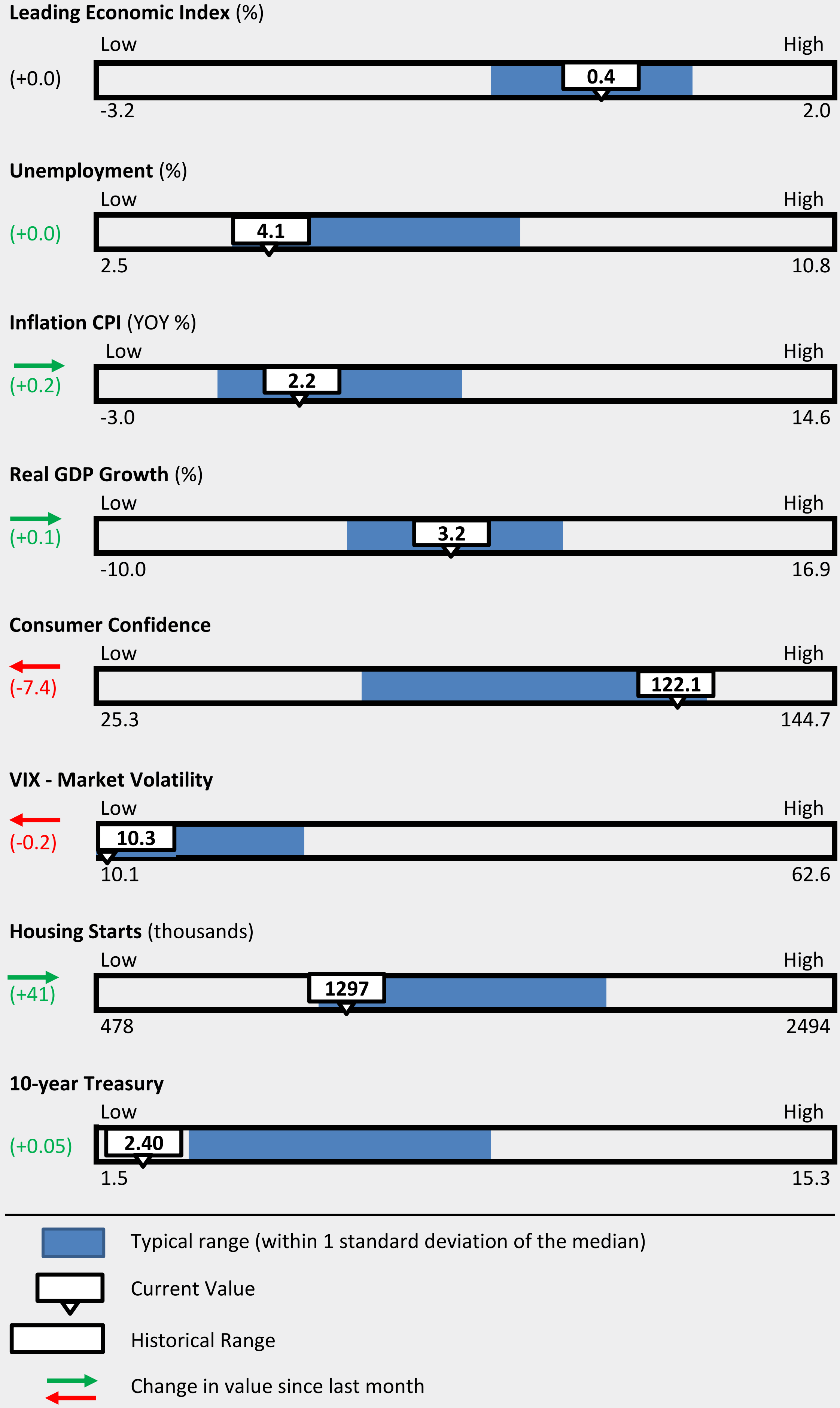
MARKET RETURNS - Longer Term Annualized as of 12/31/2017

	1 Month	YTD	1 Year	3 Years	5 Years	10 Years	15 Years
EQUITIES							
S&P 500	1.1%	21.8%	21.8%	11.4%	15.8%	8.5%	9.9%
U.S. Large Value	1.3%	15.6%	15.6%	10.1%	14.7%	7.3%	9.7%
U.S. Small	-0.4%	14.6%	14.6%	10.0%	14.1%	8.7%	11.2%
U.S. Small Value	-0.2%	9.2%	9.2%	9.8%	13.7%	9.1%	11.4%
Int'l Large	1.6%	25.0%	25.0%	7.8%	7.9%	1.9%	8.1%
Int'l Large Value	1.5%	21.4%	21.4%	6.4%	7.0%	1.1%	8.0%
Int'l Small	2.8%	34.0%	34.0%	14.1%	13.1%	5.6%	12.3%
Int'l Small Value	2.9%	31.4%	31.4%	14.1%	13.4%	5.8%	12.9%
Emerging Mkts	3.6%	37.3%	37.3%	9.1%	4.4%	1.7%	12.3%
World Stock Index (AC)	1.6%	23.9%	23.9%	9.5%	11.0%	5.0%	9.4%
FIXED INCOME							
TIPS	0.9%	3.0%	3.0%	2.1%	0.1%	3.5%	4.4%
Short-Term Bonds	0.0%	0.3%	0.3%	0.2%	0.2%	0.7%	1.4%
Interm-Term Bonds	0.1%	2.1%	2.1%	1.8%	1.5%	3.3%	3.6%
International Bonds	-0.1%	2.0%	2.0%	3.0%	4.0%	4.4%	4.3%
ALTERNATIVES							
Global REITs	1.2%	8.6%	8.6%	5.3%	8.1%	5.3%	10.1%
Commodities	3.0%	1.7%	1.7%	-5.0%	-8.5%	-6.8%	-0.3%
Managed Futures	1.3%	-2.3%	-2.3%	1.8%	5.6%	4.1%	6.6%
Reinsurance	1.0%	0.5%	0.5%	3.8%	5.6%	6.8%	7.4%

Source: Morningstar Direct. Indices used in above graphs: S&P 500 Index, U.S. Large Value-MSCI U.S. Prime Market Value Index, U.S. Small-Russell 2000 Index, U.S. Small Value-MSCI U.S. Small Value Index, Int'l Large-MSCI EAFE Index, Int'l Large Value-MSCI EAFE Value Index, Int'l Small-S&P EPAC Small Index, Int'l Small Value-S&P EPAC Small Value Index, Emerging Mkts-MSCI Emerging Markets Index, World Stock Index-MSCI All Country World IMI Index, TIPS-Barclays Gbl Infl Linked US TIPS Index, Short-Term Bonds-Ibbotson 1 Yr Treasury Const Mty Index, Interm-Term Bonds-Barclays Interm-Term Govt/Credit Index, International Bonds-JPM GBI Global Ex US Hdg, Global REITs-S&P Global REIT Index, Commodities-Bloomberg Commodity Index, Managed Futures-Credit Suisse Mgd Futures Liquid Index, Reinsurance-SwissRe Global Cat Bond Index.

Past performance is historical and does not guarantee or indicate future results. Index returns assume reinvestment of all distributions and unlike mutual funds, do not reflect fees or expenses. It is not possible to invest directly in an index. This report is not intended to provide personalized investment advice. Some information has been produced by unaffiliated third parties, and while it is deemed reliable, the advisor does not guarantee its accuracy or completeness.

Economic Indicators



**See appendix for sources and data ranges*

Appendix

Leading Economic Index
The Leading Economic Index is composed of 10 indicators used to forecast the direction of the economy. A fall in the index over three consecutive months is seen as a sign of a recession. *(Data Source: The Conference Board. Monthly data since 1/1/1959)*

Unemployment
The unemployment rate measures the percentage of workers that are out of work in the U.S. labor force. *(Data Source: U.S. Bureau of Labor Statistics. Monthly data since 1/1/1948)*

Inflation CPI (YOY)
The Consumer Price Index (CPI) measures the change in the price level for a broad basket of goods in the U.S. economy. The value shown represents the percent change in the index from a year ago. *(Data Source: U.S. Bureau of Labor Statistics. Monthly data since 1/1/1948)*

Real GDP Growth

Real GDP Growth represents the change in the market value of all output in the U.S. economy. It is an annualized quarterly measure. *(Data Source: U.S. Bureau of Economic Analysis. Quarterly data since 4/1/1947)*

Consumer Confidence

The Consumer Confidence Index measures the level of optimism among U.S. consumers on the economy and their overall financial situation. *(Data Source: The Conference Board. Monthly data since 1/31/1991)*

VIX
The CBOE Volatility Index (VIX) measures the volatility of the S&P 500 index. An increase in the index level represents a spike in market volatility. Conversely, a decrease in the index represents a move towards stability. *(Data Source: Chicago Board Options Exchange. Daily data since 1/2/1990)*

Housing Starts
The number of housing starts (new construction) in the U.S. each year. *(Data Source: U.S. Bureau of the Census. Monthly data since 1/1/1959)*

10-year Treasury
The annualized return that would be realized for holding a 10-year Treasury bond to maturity. The 10-year Treasury yield is the primary benchmark for measuring interest rate movements. *(Data Source: U.S. Board of Governors of the Federal Reserve System. Daily data since 1/2/1962)*

Disclosure

For informational purposes only. Not intended to be personalized investment advice.