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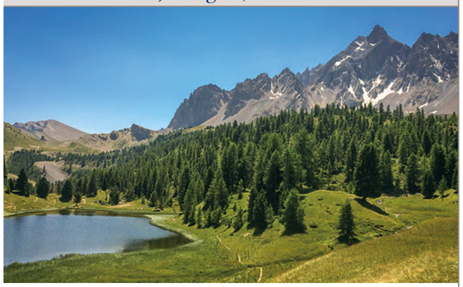
market update

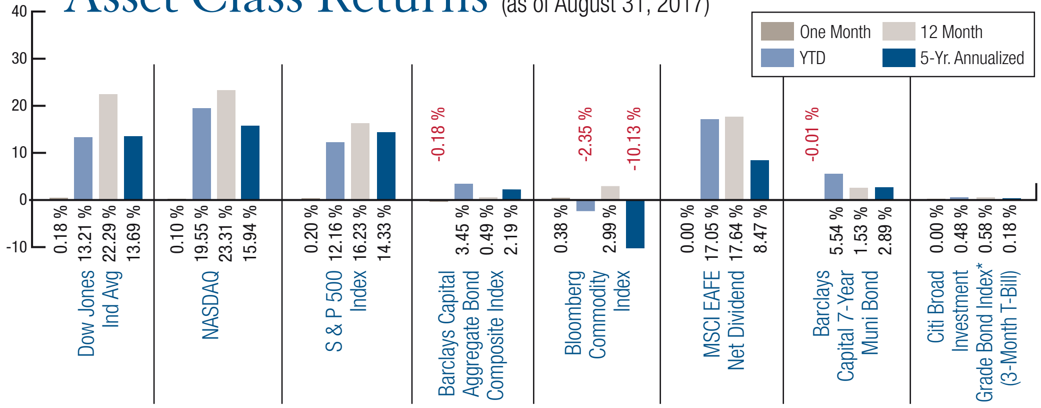
From the Office of:
Jeff Sgroi, CFP®



"Reversion to the mean is the iron rule of the financial markets."

– John Bogle

Asset Class Returns (as of August 31, 2017)



Market/Economic Synopsis

- Texas and Florida work toward rebuilding after Hurricanes Harvey and Irma blast coastal regions
- Global equities continue to show resilience despite ongoing geopolitical concerns, particularly in North Korea
- U.S. dollar weakness continues through 2017
- West Texas Intermediate (WTI) crude prices trade over $50/barrel for the first time since early August
- U.S. stock market volatility reaches historic lows, as VIX dips below 10
- Economist's consensus expectation for an additional Fed Funds rate hike before year end is at 50% probability
- Amazon expands its shopping footprint with recent acquisition of Whole Foods
- Growth continues to outperform value strategies in U.S. equity markets for 2017 YTD
- In Washington D.C., all eyes are on the debt ceiling, which must be raised by end of September to avoid U.S. debt default
- Struggles continue for brick and mortar retail sector as Toys 'R' Us files for bankruptcy

Market Outlook

Despite U.S. equity markets touching all-time highs recently, it is not the only asset class with reasonable performance over the past few years. Fixed income strategies of all categories, including Treasuries, corporate debt, municipal bonds, high yield and global sovereign debt have posted favorable returns during the current, eight year, equity bull market. All the while, bonds have done so as a low correlation asset to traditional equity investments with a lower risk profile.

Due to our fundamental belief in a "reversion to the mean" of asset class performance, does this translate into an inevitable correction (or worse yet, a bear market) in the fixed income space? For a high level outlook on this issue, I share insight from Raymond James' Senior Strategist in the Fixed Income Research Department, Mr. Doug Drabik. The following five considerations provided by Mr. Drabik offer a perspective shared by our office.

- The month of August saw yields drop across the curve. Year-to-date, the short-end of the Treasury yield curve remains higher, fueled largely by the two interest rate hikes levied by the Federal Open Market Committee (FOMC).
- This yearly trend in interest rates falls into the general declining interest rate environment that has been occurring for nearly 36 years (10-year peaked at 15.84% 9/30/81).

- The phrase "returning to the norm" has been used to describe interest rates moving from the current low levels to higher historic rates; however, nothing about today's global environment and geopolitical circumstances are remotely close to anything in the past. Furthermore, as with most statistics, choice of data time frame can produce very different conclusions. Are today's rates actually normal and the 1990's more the aberration?

(continued)

- Geopolitical issues are not going away. This month highlighted the fiery exchange of words and continued provocation from North Korea, which seems intent on getting Japan, South Korea and/or the United States involved in a skirmish. Any resulting flight-to-quality may push interest rates down quicker than the slow drift that 2017 has seen in the intermediate and long-term ranges of the Treasury yield curve.
- The "bond market bubble" vernacular has surfaced once again. A bubble often refers to exuberant investor behavior hastily driving the price up, absent supporting fundamentals. Bursting this bubble occurs when a more fundamental, logical or justified price ensues, creating major losses for investors still holding the asset. Unlike other asset classes that have been in a bubble (the dot com market from 1997-2000 or real estate bubble from 2007-2009), bonds have maturities. Investors have the option to hold their investment to maturity, in essence eradicating the effects of any interest rate or price volatility experienced during the holding period. An individual bond is about as precise as it gets with defined and known parameters of cash flow, income and date when face value is returned.
- Reasons that low interest rates could persist include global interest rate disparity is keeping demand for U.S. securities strong. Although the Fed discontinued quantitative easing (QE) programs in 2015, several major central bank QE programs are ongoing and creating money. All the global central banks combined have monetized over $19 trillion (the approximate GDP of the United States).

Our takeaway from Mr. Drabik's fixed income analysis is that it continues to be an important asset class for many client portfolios. With interest rates as low as they are, the risks cannot be overlooked, though. Many longer maturity bonds pay a yield barely exceeding inflation rates. High yield appears richly valued, as there has been a yield grab in recent years in this low interest rate environment. Municipal bonds have performed well relative to comparable corporate bonds with maturities up to seven years, to the point we could make a case for full valuation. As always, we will continue to seek the optimal risk/reward scenario for your specific objectives and income needs.

From the Homefront

Autumn marks the return to school for many families, including our own. Stella started second grade, while Lily and Hannah returned to preschool for one more year (first day back to school photo is below). Stella's favorite class is math (for the time being….), while "the littles" are still working on playground etiquette!

As a family, we hope to squeeze a couple more camping trips in before storing our pop-up camper away for the winter. With the first sign of snow in the mountains over this past weekend, and Moab and other great desert locations only a few hours away, we will likely be headed West from here on out.

One of our dear friends celebrated her 40th birthday recently. It was a great reminder to enjoy personal milestones and significant dates in our friends, our families, and our own lives.

If you prefer to receive this newsletter via email, please notify us at jeff.sgroi@raymondjames.com.

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