



3RD QUARTER END 2017

FINANCIAL & ECONOMIC REVIEW

The third quarter of 2017 came to a close with many of the same themes from Q2. Although the macroeconomic environment remains largely unchanged, the broader stock market continues to attain record high levels. One observation while stock indexes are reaching new highs, trading volumes and overall market volatility is approaching multi-decade lows. The CBOE Volatility Index has returned to the lowest level in 20 years. The daily average trading volume across the NY Stock Exchange and NASDAQ Composite is down 20% from this time last year. The S&P 500 alone hasn't had a day with a 1% drop in over a month. Several potential reasons for this observation can be surmised; lack of substantial market moving news, rising popularity of passive investments, investors' confidence so high they see no reason to sell. Additionally, the Federal Reserve has telegraphed its intentions fairly consistently and major market shaking events have been infrequent at best. What we do know is that substantial cash reserves remain on the sideline waiting for a market dip that simply hasn't occurred.

The Federal Reserve abstained from raising rates in Q3 and announced the beginning of what we consider to be an important policy shift regarding their balance sheet. They will not reinvest principal on bonds held once they come due, but rather allow them to "roll off" the balance sheet. This policy tightening measure in conjunction with additional Fed Funds rate increases may be a catalyst to bringing the market into correction territory early next year. Furthermore, as policies are tightening in the US, the Eurozone and Bank of Japan are continuing their bond buying stimulus.

Natural Resources and Technology were the best performing sectors in Q3, returning 8.4% and 8.1%. The worst performing equity sector returns were Energy Limited Partnership and Consumer Defensive returning -0.5% and 0.7% respectively. In fixed income, the U.S. Aggregate Bond index rose 0.9%, while the 10-year Treasury bond yield ended the quarter unchanged at 2.3%. The S&P 500, Dow Jones Industrial Average and NASDAQ Composite Index returned 4.5%, 5.6% and 6.1% in the third quarter respectively. Basic Materials, the most overvalued sector last quarter, continued to post gains, now approximately 1.37 price/fair value of Morningstar's coverage universe, or 37% above fair value. The most undervalued sector was Communication Services at 0.96 price/fair value respectively. The overall price/fair value of covered stocks in the Morningstar universe was 1.04¹ or 4% overvalued to end Q3. With the S&P 500 ending the quarter trading at a P/E ratio of about 18, compared to 15.7 for its historical average, we are as cautious as we've been in the last few quarters. Patience continues to remain a virtue as we navigate fully valued equity markets awaiting investment opportunities to present themselves.

We look forward to the final quarter of a prosperous investing year, while continuing to grow your investments, earn your business and your referrals throughout the final quarter of 2017.

Jack A. Kennedy
Chief Investment Officer



¹ Results referenced from Morningstar.com

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