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MARKET INSIGHTS

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From RiverPoint Capital Management

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December Sound Bites on the Market and Economy

It has been a good year for equity investors. While the networks may be obsessing about the recent SPECULATIVE run in bitcoin, true INVESTORS in stocks have much to cheer about also as we close-out 2017. Few "experts" thought we would see a strong double digit advance in the S&P 500 this year, with international markets doing even better.

We're pleased to tell you that this was our base case...strong returns in 2017. We laid that out in our "Crystal Ball" Webinar at the beginning of the year in January. This consistent positive view was not broadly held by market participants and strategists going into either 2016 or 2017. Many were suggesting as early as during the 11 percent swoon in stock prices in January of 2016 that investors should abandon growth oriented stocks and run to defensive holdings or cash. Later that year the chorus was just as loud to retreat from equities due to fears about Brexit and potential fallout from results in the upcoming 2016 US Presidential election. Despite a post-election rally, skepticism continued into and throughout 2017 as folks questioned valuation, the ever lengthening age of this bull market, still perceived sub-par economic growth, the prospects of some bursting of a so-called "FANG" stock bubble and the low levels of volatility experienced in stock prices this year. They expressed concern for the GOP's inability to pass any kind of legislation to further stimulate economic growth and promoted the conclusion that the hoped-for tax cuts were already "baked-in" to stock prices. In fact, in all honesty, this entire bull market advance that started in March, 2009 has been doubted from day one. Investors have been net purchasers of trillions of dollars of bonds, yet have been net sellers of stocks during this time period. Often, the instinctive thought for individual investors has been to become more defensive after each pullback we have seen over the past few years of this secular advance. We felt 2016 and 2017 would be above average return years for equity markets, despite the negative headlines. This was based on our research and the data, not rose colored glasses thinking. While it is extremely fun to dialogue with you about whether Broadcom or Apple, for example, is the better investment, the greatest value-add (from an investment perspective) that we can provide is to help you avoid making emotional decisions at the wrong moments. That is… to keep you from chasing stocks at the top or abandoning them when they are close to the bottom. Data suggests these whiplash-like choices that high net worth individual investors tend to make on their own accord can cost their portfolios over 300 basis points in returns annually.** We so much appreciate the opportunity to work with you to keep you invested or to pare back as appropriate, based on the data… to help you avoid allowing feelings of greed or fear to consume and guide your investment choices. The focus in this year-end issue of Sound Bites is to discuss the value of our research-based asset allocation decisions. We'll also preview some thoughts in our upcoming 2018 Crystal Ball Webinar we will be hosting in early January of next year.

Asset Allocation—those high level decisions are key.

The adjacent chart illustrates the costs that individual investors have experienced by getting caught-up in the headlines and making emotional decisions and selling low and buying high over time. Specifically, the chart shows that the S&P 500 has returned roughly 8.2 percent annually over the last 20 years, yet the return of the average equity investor is a much lesser 4.7 percent, due to poor timing decisions…selling at the bottom, not getting back-in after selling, and buying at the top.

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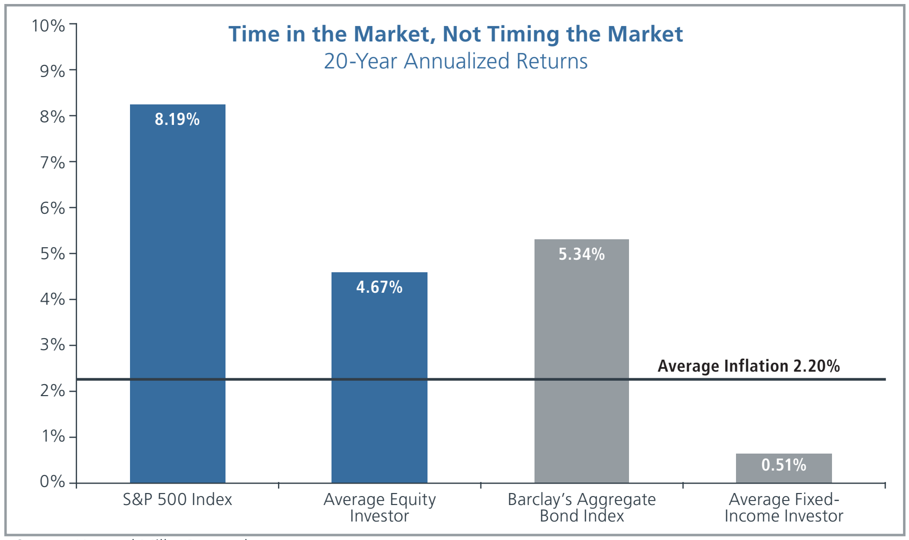
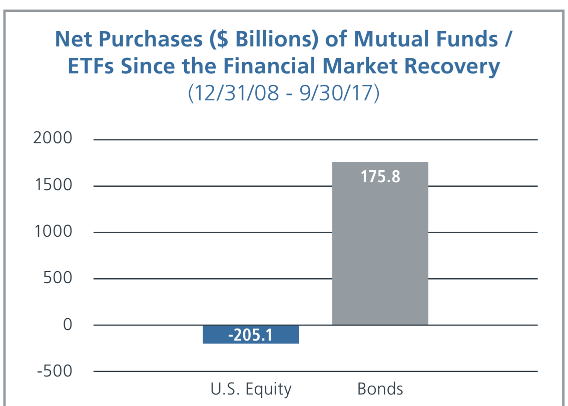
This is truly where our research and fact based decision making can help. We aren't perfect and we don't swing our client's asset allocation wildly from 100 percent stocks to 100 percent cash and try to time the market. It's not smart to aspire to be a hero in the market in this manner from our perspective. In fact, we would view such a strategy as reckless. What we do employ, however, is a disciplined approach to allocation, where we set targeted equity ranges for each of our clients based upon their wealth accumulation goals, their spending needs and their willingness to assume risk. We marry that with our assessment of the fundamentals (F's), valuation levels (V's) and technical (T's) price trends in the market. When we view these three levels of analysis as positive, we will be at the upper end of your specific targeted equity range. When we assess these factors as neutral, we'll be at the mid-point of your targeted equity range and when negative, we'll move to the lower end. So both the process to establish customized targets and the analysis for making tactical adjustments is disciplined, not based solely on headlines. When executed properly, we believe this process can make a significant difference in growing and protecting your wealth.



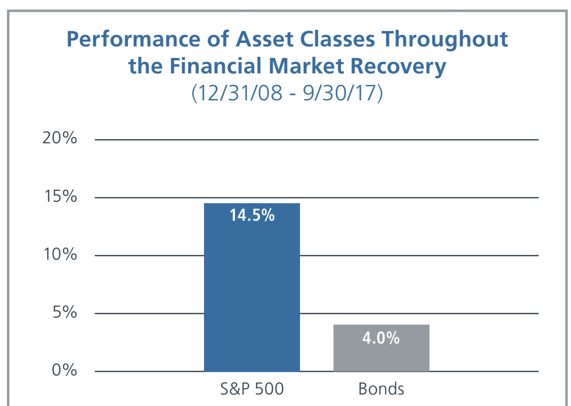
Source: Howard Miller Research

Back in 2009, clients understandably were stunned to witness the fallout from the housing bust. Arguments to remain defensive and heavily weighted in cash included fears about the increased government spending and growing fiscal deficit required to jump start an economic recovery, concerns about likely over-regulation of industries etc., etc. Headlines suggested that consumers were so in debt that they would NEVER spend again in the US. In the midst of these more recent negative headlines, we suggested that our clients should move to the upper end of the range of their equity targets. Why? Because we saw the improving trends in the economy…job losses getting less bad; cost cuts on the part of companies such that break-even levels were far reduced, to name a few. This is what a recovery is…metrics shift from horrible to less-worse, to stable and eventually to quite good, like we see today. When this trend is evolving in a positive way, you want to be moving your equity allocation towards the higher end of the range. The data drives such convictions. That turned out to be good advice, but again, it was based on the data. And, guess what the best performing S&P 500 sector has been post financial crisis—Consumer Discretionary! Wasn't the consumer supposed to stay in a cave, deleverage, and never spend again? Be careful what you read.

Fast forward to 2016/2017 and the headlines were almost equally negative. But when we looked at the substance of the arguments in the headlines…Brexit, potential fallout from Presidential election, perceived high valuation, false conclusions about concentrated leadership in only the "FANG" stocks…we found them to be toothless, our call to stay at the upper end of the range in equities, and, in fact, to be invested in the more growth-oriented US stocks as well as increase international stocks. This was our high conviction call while much of the population was cheering a move to defensive stocks or to cash. We are pleased that we stayed with our discipline of focusing on the data and keeping you invested. The second charts shows that most investors have been doing the opposite….note that investors have purchased over $1.6 trillion in bonds since 2007 to the present while they have sold over $200 billion in stocks.



Source: Strategas Research Partners



Source: Strategas Research Partners

Check out the returns…stocks have outperformed bonds during this period. So, while we always strive to provide the best individual stock selection that we can—the Broadcom versus Apple decision—these decisions are indeed swamped by these asset allocation calls with regard to the contribution to your wealth accumulation outcome!

Crystal Ball for 2018:

So, now we approach that time of year to transition from reflection on what's happened this calendar year to our outlook on what is to come in the New Year. While our views on the market are really an ongoing conversation and the market never really rests, this is a time to pause and reset expectations for the upcoming calendar year…this has become an annual "Crystal Ball" event that we enjoy sharing with you every

January. While we don't want to advertise what our thoughts are in detail in this writing, since we will do that in our January webinar, suffice it to say that we do remain positive on the equity markets for 2018, but with significant nuance versus how we felt going into 2017. A couple of snippets include:

- Going into 2017, we assigned an 85 percent probability to a double digit return for US stocks with risks to the upside, if earnings came in as strong as we thought they could. And indeed they did. For 2018, we assign a lesser (but still high) 65 percent probability to positive US equity returns, but we believe high single-digit returns are much more likely than double-digit gains for US stocks. And, risk of disappointment is higher than in 2017.

- Even if the economy remains strong, tax cuts happen, and earnings are strong, we will be watching trends in interest rates VERY closely this year. If the market advances swiftly in the early innings of 2018 while rates rise more rapidly than expected, look for us to trim your equity holdings back to the lower end of your targeted equity range.

- Ah, and bitcoin. Yes, we will comment on this in our outlook. The quick summary here is that it is too early to call this a developed asset class, a currency, or even an "investment". Cryptocurrencies currently are speculative in our mind, and we see many parallels to dot-com stocks in the late 1990's.

As always we thank you for your trust and confidence and the privilege to serve you. We wish you Happy Holidays and look forward to talking with you early in the New Year to discuss our 2018 outlook with you in detail!

Thanks,
RiverPoint Capital Management