I. Market Recap and Outlook

Economic indicators going into 2018 are extremely positive and reflect not only a healthy domestic economy but a healthy global economy. Some of our favorite highlights:

- Consumer confidence is at 17 year highs, reflecting very high optimism among average Americans.

- The unemployment rate dropped to 4.1% in November. In the last 30 years it has only reached this level once, reflecting increasingly tight labor markets. While wages have unexpectedly not tightened as much as the labor force, we think this may change in 2018 as the surplus labor pool continues to dwindle.
• Despite tight labor markets, the Federal Reserve Open Market Committee expects inflation to be muted over the coming years, largely due to a similarly muted long-run GDP forecast.

<table>
<thead>
<tr>
<th>FOMC December 2017 forecasts</th>
<th>Percent</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>Long run</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in real GDP, 4Q to 4Q</td>
<td>2.5</td>
<td>2.5</td>
<td>2.1</td>
<td>2.0</td>
<td>1.8</td>
<td></td>
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<tr>
<td>Unemployment rate, 4Q</td>
<td>4.1</td>
<td>3.9</td>
<td>3.9</td>
<td>4.0</td>
<td>4.6</td>
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<tr>
<td>PCE inflation, 4Q to 4Q</td>
<td>1.7</td>
<td>1.9</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td></td>
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</tbody>
</table>

Source: JPMorgan Asset Management, Federal Reserve

Equities: Growth vs. Value

Growth had another extraordinary year relative to Value equities in all market capitalization ranges. We have maintained a slight overweight to growth funds over the last several years relative to our benchmarks, which has proven to be a successful asset allocation decision. This chart shows the dispersion in US markets in 2017 – a trend that was largely mirrored in international markets.

We have also maintained an overweight to mid-cap and small cap equities relative to our benchmarks. While these have not proven as profitable as large cap stocks in recent years, history and our asset allocation model suggest they remain a wise counterbalance to the concentration of mega-cap firms that dominate market weighted indices.

We will be carefully monitoring our growth vs. value allocations in 2018. As growth continues to rally, a tact back to core and value may make sense to help balance portfolios.

Source: JPMorgan Asset Management, Federal Reserve
Thought Topic – Market Timing

It has been exactly 10 years since the start of 2008 – a year that has become synonymous with investment pain and self-examination in capital markets. The S&P 500 peaked in October 2007, began its downward trend in Jan 2008, accelerated into a full-scale crash in August 2008, and bottomed in March 2009.

Despite this, from 12/31/2007 through 12/31/2017, the S&P 500 Total Return index (i.e. with dividends reinvested) returned 126%, or 8.50% annualized over that time period. In other words, if you had chosen to invest in arguably one of the worst times in history, or in other words, had terrible market timing, you still would have more than doubled your money if you had been able to bear the volatility in 2008 and early 2009 and held onto your stock investments.

It is an oft-cited statistic that the business cycle in the United States typically runs for 5-8 years¹, and this has produced many predictions that we must certainly now be approaching another recession. However, the market rarely behaves in the manner you think it might. For example, another developed Westernized country with a similar economic profile to the US – Australia – has gone 25 years without a recession.² This defies conventional wisdom of the business cycle, particularly in light of the commodities bust of recent several years in a commodity heavy economy such as Australia.

It is always tempting to be “right” about the direction of the markets in a big way especially, and far more exciting than being in a balanced, diversified and global portfolio. However, most comprehensive market studies³ have roundly rejected market timing. We say, don’t be tempted.

Volatility was at record lows in 2017. Don’t expect that to continue. There will be days, weeks and months where it will be uncomfortable to own securities. That said, the past decade has demonstrated that staying true to your risk-tolerance and process, investing for the long term, and leave market timing alone can lead to impressive investment results even in the most challenging of markets.

Sources:

https://fred.stlouisfed.org/

¹ http://www.nber.org/cycles/cyclesmain.html
