Investment Commentary: 2/2017

Investor's shrugged off any concerns about political uncertainty and pushed the major stock indices to multiple highs in January and early February. The S&P 500 returned 1.9% for the month and was led by a return to favor of growth stocks. Growth stocks finished the month up 3.4% compared to value stocks 0.7% gains. Optimism in foreign stock markets was even greater with foreign developed market stocks up 2.9% and emerging market stocks up 5.5% for the month. The positive results can be attributed to rekindled animal spirits on the part of investors. Investor optimism has ramped up on the prospects of improving economic growth and corporate earnings, as well as the anticipation of fiscal stimulus in the U.S.

As we move further into 2017, we believe the push and pull between the market forces of growing political uncertainty around the world and improving corporate fundamentals will continue to keep investors on edge.

Investment grade bonds finished the month relatively flat, up only 0.2%. The 10-year Treasury yield was at 2.45%, up slightly from where it started the month. Gold finished the month up 3.7%. The U.S. dollar pulled back after climbing throughout 2016. The weakening dollar contributed to the outperformance of emerging market bonds, which finished the month up 2.3%. As we move further into 2017, we believe the push and pull between the market forces of growing political uncertainty around the world and improving corporate fundamentals will continue to keep investors on edge. **We view investor's concern about political uncertainty here and abroad as a potential positive for the markets. We are reminded of legendary John Templeton's famous quote, "bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria." Our biggest concern, and what we will be watching, is if investor euphoria becomes prevalent.**

Investment thoughts on our mind

Risk assets in the U.S. have been in an extended economic sweet-spot. Slow and steady growth has reduced the threat of deflation, but has not been strong enough to increase inflation to a level that would cause the Fed and central bankers around the world to remove the monetary "punchbowl." In our opinion, we may stay in this economic sweet-spot for a while longer. However, we have to recognize that stock market valuations have become overvalued and the market is getting ready to undertake some transitions that will increase uncertainty in 2017. **Here are some of the transitions we are watching to determine if they will positively or negatively impact the financial markets: a switch from monetary-led policy to fiscal-led policy; a shift from dis-inflation to reflation; and the increase in populism or globalization to de-globalization.** Depending how well these transitions are handled will determine the direction of financial markets. In our opinion, there is substantial optimism surrounding the Trump administration's economic policies, and the markets have granted a grace-period while they formulate policy. At some point, the markets will shift from expectations to results, and we sincerely hope all of our publicly elected officials come together to implement policies in the best interest of our country.

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Fiduciary vs Suitability Standard for Advisors

President Trump recently delayed the implementation of the Department of Labor's (DOL) fiduciary investment-advice rule by six months. The rule was intended to protect investor's retirement savings and simply required brokers who work with retirement savings accounts to work in the best interest of their clients and not their own. **It's mind-boggling to us that some brokers are allowed to not work in their client's best interests, and that clients would consider working with someone who doesn't put their interest ahead of their own! In case you're wondering, AWM acts as a fiduciary and always puts our client's interests first.** Regardless of the final outcome for the DOL rule, we believe "the cat is out of the bag" and investors are moving their money away from conflicted brokers to low-cost investment advisors that will work in their best interest. Here is a surprising statistic, the Vanguard investment group has grown its assets by $3 trillion dollars since the financial crisis and now manages over $4 trillion dollars. Many of these assets have come from high commission annuities and over-priced mutual funds. We think this is big step in the right direction!

It's mind-boggling to us that some brokers are allowed to not work in their client's best interests and that clients would consider working with someone who doesn't put their interest ahead of their own!

Goldman Sach's S&P 500 Beige Book

One of our favorite research reports to read each quarter is Goldman Sach's S&P 500 Beige Book. The report gathers anecdotal evidence of fundamental and thematic trends that S&P 500 companies are discussing in their earnings reports. It's a good way to take the pulse of the market, this quarter the focus was on the four key pillars of the Trump Administration's agenda: tax reform, regulation, fiscal-spending and trade policy. Here are their findings:

- **Tax reform:** Management teams are optimistic about potential corporate tax reform, but are concerned about the controversial border-adjusted tax.
- **Regulation:** Hope for widespread deregulation and improved regulatory clarity is increasing confidence among some management teams.
- **Fiscal spending:** Managers of industrial firms are enthusiastic about potential infrastructure spending and a possible end to the defense sequester.
- **Trade policy:** Management views are mixed on whether President Trump's trade proposals will be constructive or will lead to damaging retaliation from U.S. trade partners.

The above items are just a few of the topics we are watching closely and wanted to highlight in this commentary. It's impossible to list them all! If there is an investing topic on your mind you would like to discuss or have us write about in the future, don't hesitate to give us a call. Thank you for your support and confidence.

--AWM Investment Team (2/17)