Investment Commentary: 3/2017

U.S. stocks finished February on a high note. All major indexes rose, with larger-cap U.S. stocks (S&P 500) jumping nearly 4%. Gains were broad-based, but especially benefited the health care, financial, and technology sectors. Investor exuberance over the possibility that the Trump administration will create faster economic growth by following through on campaign promises to boost government spending, loosen regulations, and cut taxes helped propel stocks higher.

> Investor exuberance over the possibility that the Trump administration will power faster economic growth by following through on campaign promises to boost government spending, loosen regulations, and cut taxes appeared to help propel stocks higher.

Emerging-market stock ETFs have seen strong inflows this year, with equities buoyed by a softening of the Trump administration's rhetoric on reworking international trade agreements. Emerging markets finished the month with a 3.1% gain and are up 8.7% YTD. ***In Europe, continuing signs of economic resurgence, including pricing data, industrial activity, and largely strong 2016 corporate earnings results were balanced by the overhang of political risks from upcoming elections in at least three Eurozone countries.*** The MSCI EAFE finished the month with a 1.5% gain.

Fixed-income markets in the U.S. were somewhat muted and core bonds finished the month with a 0.7% gain. Foreign sovereign debt markets were more volatile in February. Yields on France's government bonds rose while German bund yields fell, and credit default swaps spreads on French and Italian sovereign debt rose—all reflecting increased risk aversion. Uncertainty related to potential political shocks from upcoming elections in the Netherlands, France, and Germany, as well as the looming specter of another Greek debt crisis, weighed on markets. Yields on the 10-year U.S. Treasury bounced around during the month—at one point spiking to 2.50%—before settling at 2.39% on February 28. That was down slightly from the start of the month. The volatility in Treasury yields had multiple drivers. They included data showing increases in the inflation rate, expectations the Trump administration's expansive fiscal policy agenda in concert with already solid economic growth will further stoke inflation, and a perceived higher probability of a Federal Reserve interest rate hike in March.

March's calendar includes the Fed's next rate-setting meeting as well as parliamentary elections in the Netherlands on March 15. The latest polls show incumbent Prime Minister Mark Rutte's Liberal party slightly ahead of populist frontrunner Geert Wilders and his anti-European Union, nationalist Dutch Freedom Party. While Trump's first official speech to Congress was generally well received and markets reacted positively, details continued to be sparse. ***Should Trump's fiscal proposals fall short of promises, the Fed surprise on rates, or an upset occur in European political races this spring, markets could reawaken to downside risks.***

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Bull Market Perspective

The current bull market, using a 3/9/09 start date, is on the cusp of being the longest ever and ranks as the fifth largest in terms of gain. (See Table 1)

Given the length and size of the bull market, it makes sense to take a look at the risk vs. reward at current levels. The reserch team at Leuthold did an interesting analysis of the median stock valuation in the S&P 500 based on several different valuation metrics. The table below (Table 2) shows the current valuation, as well as the highest and lowest valuation for each metric that we have seen since 1990. They then displayed the potential upside and downside if we were to reach the highest or lowest valuation, respectively. We share this analysis, not because we believe the market is headed for another crisis, but simply because ***we think it is a good time for investors to revisit their investment goals and risk tolerance.*** This is especially important for retired investors or those that have a shorter-time horizon. If you have any questions about your investment strategy and how well it fits with your goals, don't hesitate to give us a call.

Chart 1: Leuthold

Bull Markets In The DJIA, 1900 To Date

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Dates	Gain (%)	Duration (Mos.)
August 24, 1921 - August 30, 1929	495.2 %	96
July 8, 1932 - March 10, 1937	371.6	56
October 11, 1990 - July 17, 1998	294.8	93
August 12, 1982 - August 25, 1987	250.4	60
March 9, 2009 - March 1, 2017	**222.5**	**96**
June 13, 1949 - April 6, 1956	222.4	82
November 9, 1903 - January 19, 1906	144.3	26
April 28, 1942 - May 29, 1946	128.7	49
July 30, 1914 - November 21, 1916	110.5	28
October 9, 2002 - October 9, 2007	94.4	60
November 15, 1907 - November 19, 1909	89.6	24
June 26, 1962 - February 9, 1966	85.7	44
December 19, 1917 - November 3, 1919	81.4	22
December 6, 1974 - September 21, 1976	75.7	21
October 22, 1957 - December 13, 1961	75.1	52
October 19, 1987 - July 16, 1990	72.5	33
May 26, 1970 - January 11, 1973	66.6	32
March 31, 1938 - November 12, 1938	60.1	7
August 31, 1998 - January 14, 2000	55.5	16
September 24, 1900 - June 17, 1901	47.8	9
February 28, 1978 - April 27, 1981	38.0	38
October 7, 1966 - December 3, 1968	32.4	26
September 25, 1911 - September 30, 1912	29.1	12
AVERAGE	**136.7 %**	**43**
MEDIAN	**85.7 %**	**33**

Chart 2: Leuthold

S&P 500 Median Stock: Reward/Risk Analysis

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S&P 500 Median:	Feb17 Close	1990-To-Date High	1990-To-Date Low
Trailing P/E	22.5x	24.7x	9.7x
Normalized P/E	25.8x	31.5x	11.8x
Price/Cash Flow	13.9x	15.1x	5.6x
Price-to-Book	3.31x	3.54x	1.33x
Average Upside/Downside To 1990-To-Date Valuation Highs & Lows		+11.9%	-57.6%

The Allure of IPO Investing

Often investors are so eager to chase the next 'big thing' they will pay almost any price to get a piece of it, often without understanding what they are buying. Here's a great example, when Snapchat announced its IPO in early February, investors eagerly started to buy a company called Snap Interactive, driving it up over 122% in a few weeks. The only problem is it has no relationship to Snapchat!

In the past two years, according to the Financial Times, there have been 217 IPOs, excluding companies valued at less than $100m and penny stocks. Of those 217, 152 are now trading below the price they opened for purchase on the public exchanges, leaving many investors with major losses. Giving evidence that the current IPO environment may be more of a sellers-market and investors should be cautious before jumping in. With

Snapchat having no earnings and trading at roughly 90 times its revenue we'd suggest a wait-and-see approach before jumping in!

Buffett on investment fees

In late February, Warren Buffett delivered his annual letter to Berkshire Hathaway's shareholders. For shareholders and avid investors, his letters are a must-read source of investing wisdom. In this year's letter Buffett gave extra attention to the topic of investment fees.

Of particular interest, Buffett called out the hedge fund industry and railed against the folly of paying their "two and twenty" fee structure. Many hedge-fund manager charges an annual 2% of assets, plus 20% of profits earned. Highlighting, his long-held thesis that, over time, highly paid hedge-fund hotshots will underperform an inexpensive index fund, Buffett updated the results of a bet he made nine years ago with Protégé Partners. The bet pitted his pick- a low cost S&P 500 index fund managed by Vanguard against a basket of five hedge funds selected by Protégé Partners. After nine years of the 10-year bet, the index fund was up 85.4 percent and the average of the hedge funds was up 22 percent, a bet he seems certain to win, easily!

In the shareholder letter Buffett did not mince words on his disdain that so-called elite managers can register such mediocre returns while raking in steep fees. ***"I'm certain in almost all cases the managers at both levels were honest and intelligent people. But the results for their investors were dismal, really dismal. And alas, the huge fixed fees charged by all of the funds and funds-of-funds involved—were such that their managers were showered with compensation over the nine years that have passed."*** We couldn't agree more with Warren's assessment of Wall Street and fees, and believe any investor looking to improve long-term performance should start with a look at fees. If you are not sure what you are paying your current advisor in fees, give us a call, and we would be happy to do a complimentary fee analysis and let you know.

--AWM Investment Team (3/17)