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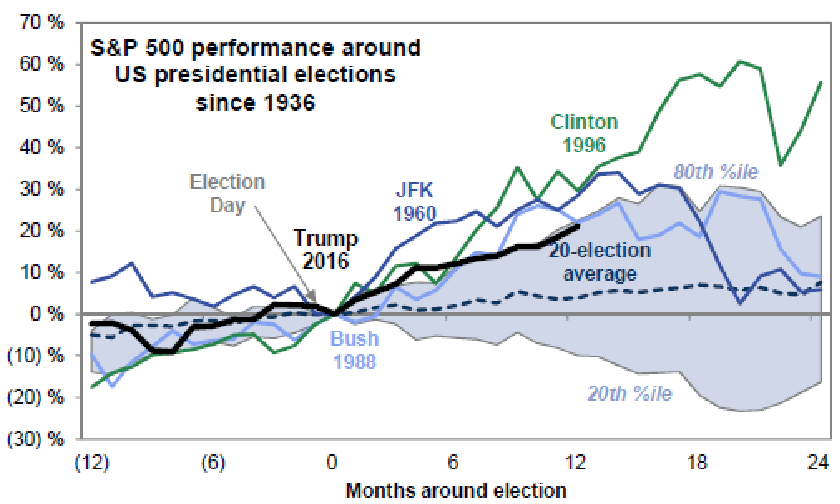
The synchronized economic global recovery continued in October, and global risk assets were the beneficiary. Developed and emerging market stocks were mostly higher for the month, with the S&P 500 returning 2.3%. Growth stocks in the U.S. continued their dominance over value, up 3.9% vs. 0.7%, while small-cap stocks finished the month up 0.9%. Emerging market stocks were up 3.5% and are now up a very strong 33% year to date. Foreign developed market stocks were up 1.5% in October and continue to outperform U.S. stocks year-to-date, up 22%. In the fixed-income markets, core bonds were flat, with the Barclays Aggregate Bond Index up 0.06%, while high-yield bonds were up modestly, up 0.42%.

> "The remaining months of 2017 will be an important time to review portfolio strategy, re-balance assets and check if risk is still within portfolio guidelines"

Overall, the global expansion remains relatively steady and synchronized across major economies. **In the U.S. steady and broad-based growth implies a low probability of recession, although the tightening U.S. labor market is a sign the business cycle is maturing.** The global financial markets have remained in a sweet spot amid steady growth, low inflation and heavily accommodative monetary policies. However, we be believe the world is the midst of a slow transition toward a less accommodative monetary policy stance, global economic activity is likely peaking, while asset valuations are elevated and geopolitical risks are rising. All of these factors suggest stock market returns will be more challenging going forward. **The remaining months of 2017 will be an important time to review portfolio strategy, re-balance assets and check if risk is still within portfolio guidelines.**

One Year into the New Presidential Cycle

As of November 3rd, the S&P 500 has returned 21% since the election of Donald Trump, which ranks at the fourth-highest gain following a presidential election since 1936. The following chart from Goldman Sachs, shows the Trump rally trailing only the election rallies of Bill Clinton (1996, 32%), John F. Kennedy (1960, 29%) and George H.W. Bush (1988, 23%). **Looking forward we believe the Republican tax plan has the potential to boost corporate earnings and the economy. However, it's important to recognize this bill has a long way to go before becoming legislation, and many changes are likely.** An initial review of the bill shows mostly tax cuts, not reforms, with the majority of benefits going to corporations and the wealthiest taxpayers. We expect the longer term impact to fiscal deficits to be hotly debated in the coming months. Political strategists we respect are placing a 65% likelihood on tax changes occurring early in 2018, stay tuned!



Source: FactSet, Goldman Sachs Global Investment Research.

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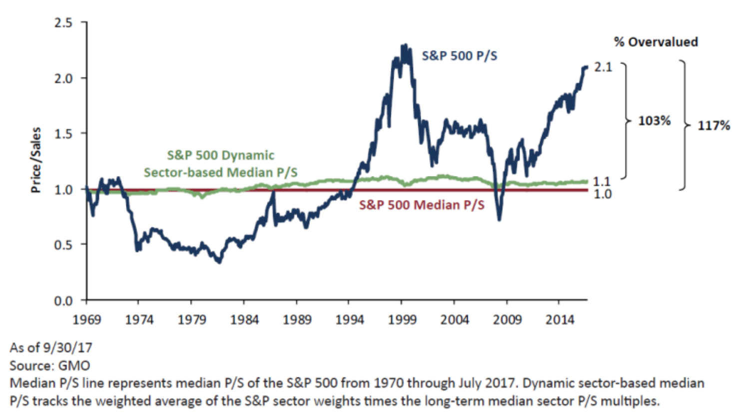
Stock Market Expected Returns

The investment industry exerts a lot of effort building models and algorithms in an attempt to predict future market returns. Most of these efforts are simply worthless, and are largely marketing attempts to attract money by convincing investors they've invented a better mouse-trap to predict returns. Investors would be well served to filter through the 'noise of Wall Street' and apply the principle of Occam's Razor. **Occam's Razor is a principle for logical decision making and states that among competing hypotheses, the one that is the simplest is usually the best. This can be applied to forecasting long-term U.S. stock market returns, with better results than most models we've seen.** At its simplest form stock market returns can be broken down as follows:

Expected stock returns = dividend yield + earnings growth +/- change in valuation (price/earnings ratio).

Using the above formula we can back into a reasonable expectation of stock market returns. We use a five year time horizon for returns, as we think it is a long enough to reflect a full stock market cycle, but not too long where the projections become useless to investors. The current dividend yield is 2%. A reasonable earnings growth rate would be 5%, a little below the long-term average, mainly due to slower economic growth and profit margins near all-time highs. The last part of the equation, change in valuation, is the trickiest, however with current valuations near all-time highs we think it is safe to assume they will decline overtime. A reasonable estimate is that valuations will decline by roughly 3% per year. Adding all of these factors together we arrive at an annual expected of roughly 4% per year. **Over the short-term we don't know if markets will be higher or lower, nor do we believe anyone else does, however over the next 5 or more years we think 4% is a good estimate for U.S. stock returns.** Here are a couple of charts that support the case that valuation is likely to have a negative impact on returns going forward.

Source: Y Charts



If you have any concerns about how a lower expected income will impact your retirement or portfolio strategy, please give us a call to discuss.

Play the Bounce

Tax-loss selling season, the period from November to December 31, is upon us! Tax-loss selling is when an investor sells a stock they are holding at a loss in order to shelter from taxation any capital gains they have

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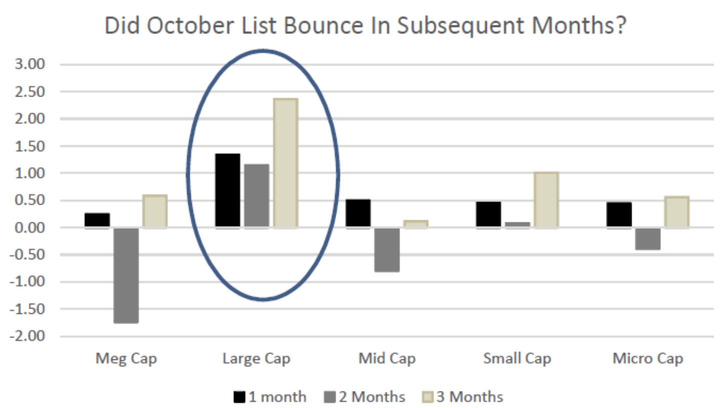
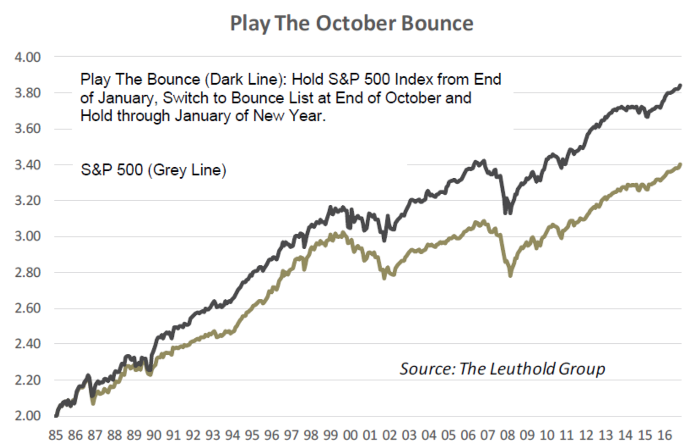
realized from other investments. **Unlike other types of selling, this usually has nothing to do with the underlying merits of the stocks involved and can artificially depresses stock prices at year-end. Which can lead to some to very attractive buying opportunities for stocks.** Since once the year-end selling pressure subsides, these stocks tend to bounce back. The Leuthold Group did a study to test the validity of this “bounce back effect” and the results confirmed what we intuitively already knew, the effect is real. Their study was based on a list of stocks in the Leuthold 3000 that had the largest decline from their peaks and have re-bounded the least from their lows as of October 31st of each year. The charts below highlight the results from the study and show how using this strategy has outperformed the S&P 500 over the past 33 years.





Given the strong performance in the stock market in 2017 and our expectation that mutual funds will distribute larger than normal capital gains this year, we anticipate the “bounce back effect” will be greater than usual. Mainly because investors are likely to scramble to find losses and will drive some stocks to extreme lows. **Over the next couple of months we will be actively looking for high-quality stocks with competitive advantages and reasonable valuations that we believe have been artifically depressed by tax-loss selling and have the potential to bounce back in 2018 and beyond.** As discussed above, we are likely in an extended period of lower stock market returns and one of the ways that investors can add value to their returns is to capitalize on periods when markets are “emotional” and get too extended to the upside or downside.

Give us a call if you would like to discuss any of the topics in this commentary or your investment strategy.

--AWM Investment Team (11/17)