

CAPITAL MARKET REVIEW

Third Quarter 2017



The Economy

What could go wrong?

Last quarter we discussed the return of international leadership in the capital markets. It seems only right that in a quarter where emerging market stocks went up 8.04 percent that we maintain that focus.

China recently ended its 19th Party Congress. This is a once every five year event where the Chinese Communist Party sets policy goals and elects officials. Xi Jinping was re-elected President and many are saying he is now the most powerful Chinese leader since Mao Zedong. What will this mean? Of course it is yet to be known. It could be more of the same for China.

However, there is another possibility which investors cannot ignore. Economic freedom and political tyranny have never co-existed comfortably. The Soviet Union in their early years under Lenin tried something very similar to what China has become. It was known as NEP or New Economic Policy. Lenin described it as “state capitalism” and much like China today the free market was allowed to operate under state control. Then came Stalin, who supported NEP until he had consolidated power.

I had a professor in college who had now worthless Russian stock certificates framed and hanging in his office. We are not predicting that this is going to happen in China, we are simply reminding you that it could. There is no investing without risk, and history has taught us that political risk is one of the greatest risks of all.



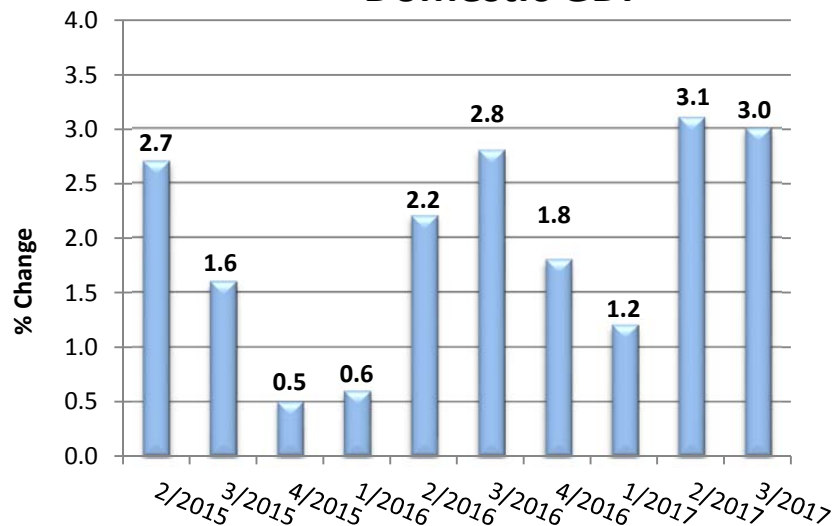
The Economy

The 3rd quarter 2017 GDP growth came in at 3.0 percent making it the second straight quarter of three percent or higher growth. Without some actual policy movement it is unlikely that this can continue. But if tax reform gets done then we could see a brighter future.

The official unemployment rate dropped to 4.2 percent in September. The labor market keeps improving and perhaps more importantly we are seeing wage growth of 2.9 percent. That is an encouraging sign.

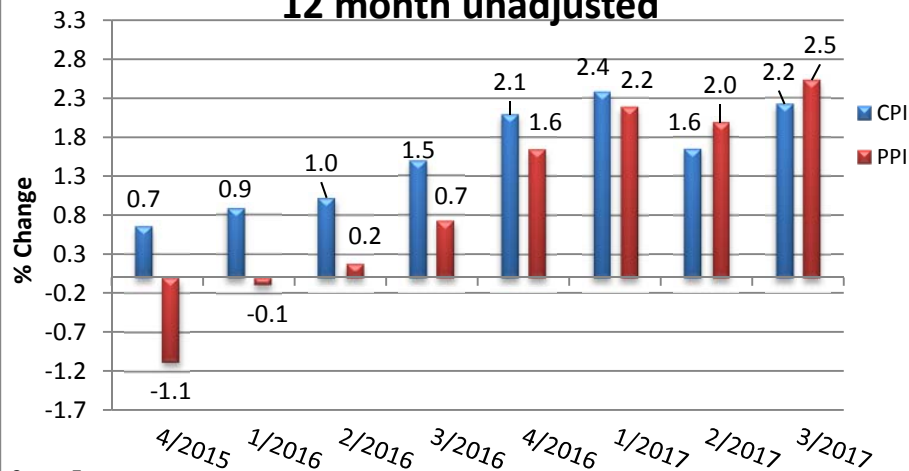
Inflation is at 2.2 percent based on the latest consumer price index report. This is slightly above the Fed's 2 percent target to continue its tightening.

Domestic GDP



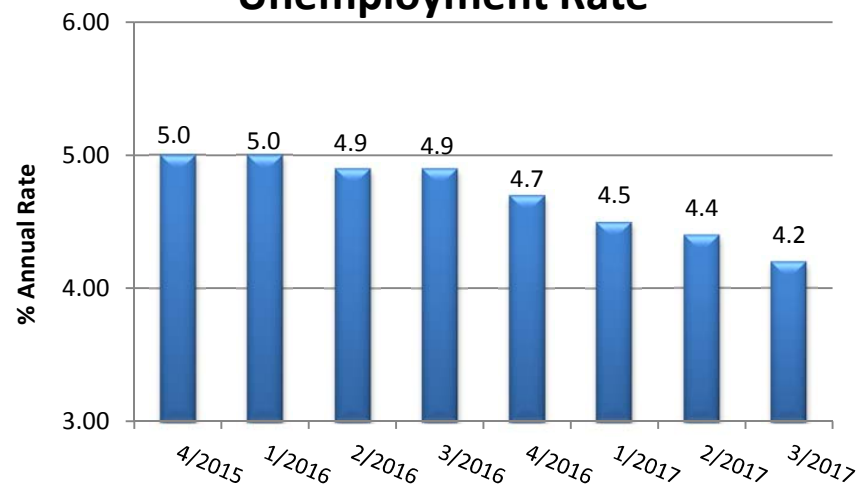
Source: Factset

Inflation Indicator 12 month unadjusted



Source: Factset

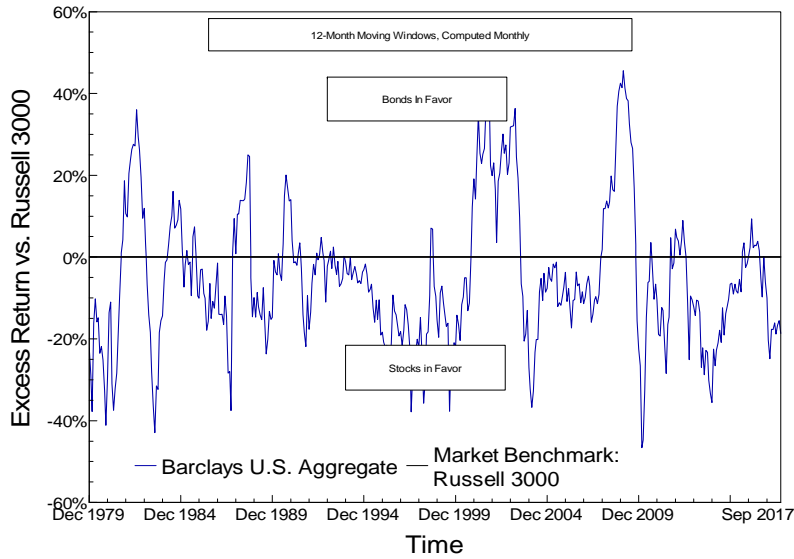
Unemployment Rate



Source: Factset

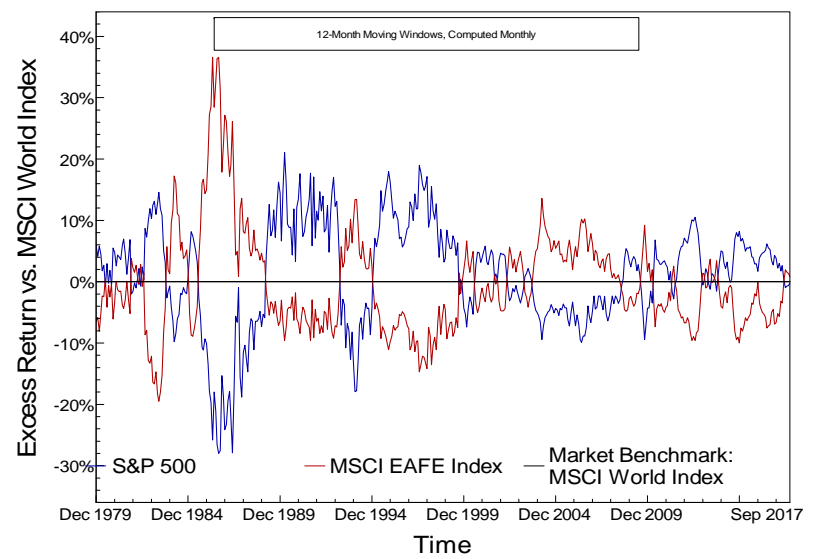
Bonds vs. Stocks

Zephyr StyleADVISOR: Iron Capital Advisors



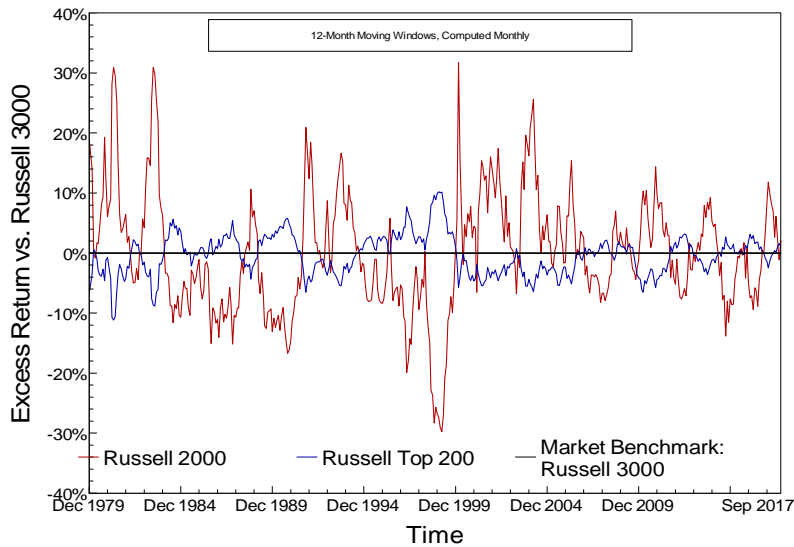
International Vs. Domestic

Zephyr StyleADVISOR: Iron Capital Advisors

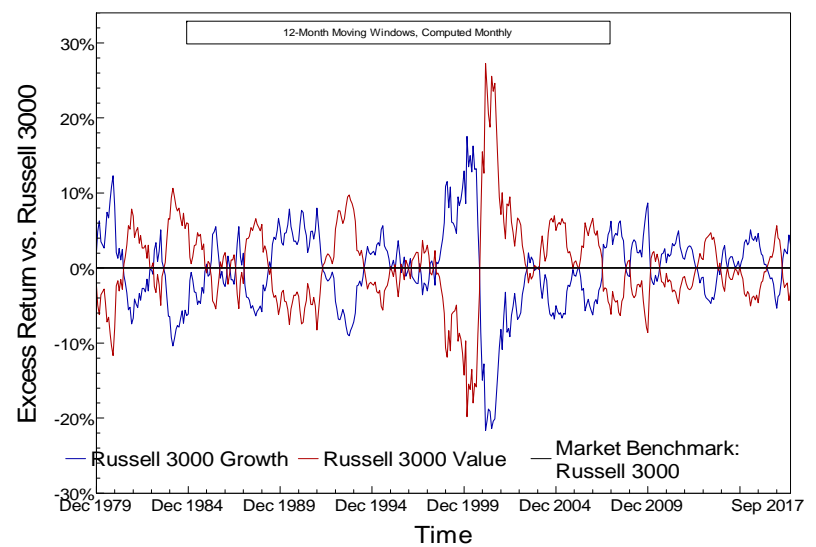


Large vs. Small

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Value vs. Growth



Domestic Equity Markets

We just keep climbing. For the quarter the S&P 500 was up 4.48 percent. Growth outpaced value for the third quarter in a row. The Russell 1000 Growth index finished up 5.90 percent, while its value counterpart was up 3.11 percent. Small companies held their own with the Russell 2000 index finishing up 5.67 percent.

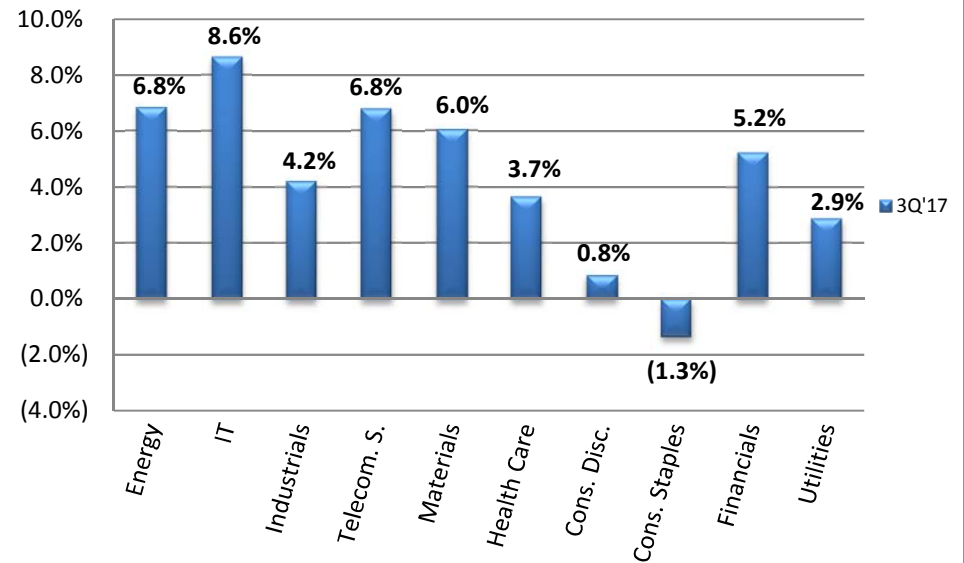
Technology was the best place to be followed by telecom and energy. There seemed to be more optimism as the quarter went on that tax reform might happen and this boosted stocks.

Consumer stocks were the laggards, although this is somewhat misleading. It is really traditional brick and mortar retail that is struggling. Many of the companies in the technology sector are really consumer discretionary companies. This reflects more on the changing taste and buying habits of consumers as opposed to a weak consumer.

Domestic Indices Three Months Ending September 30, 2017

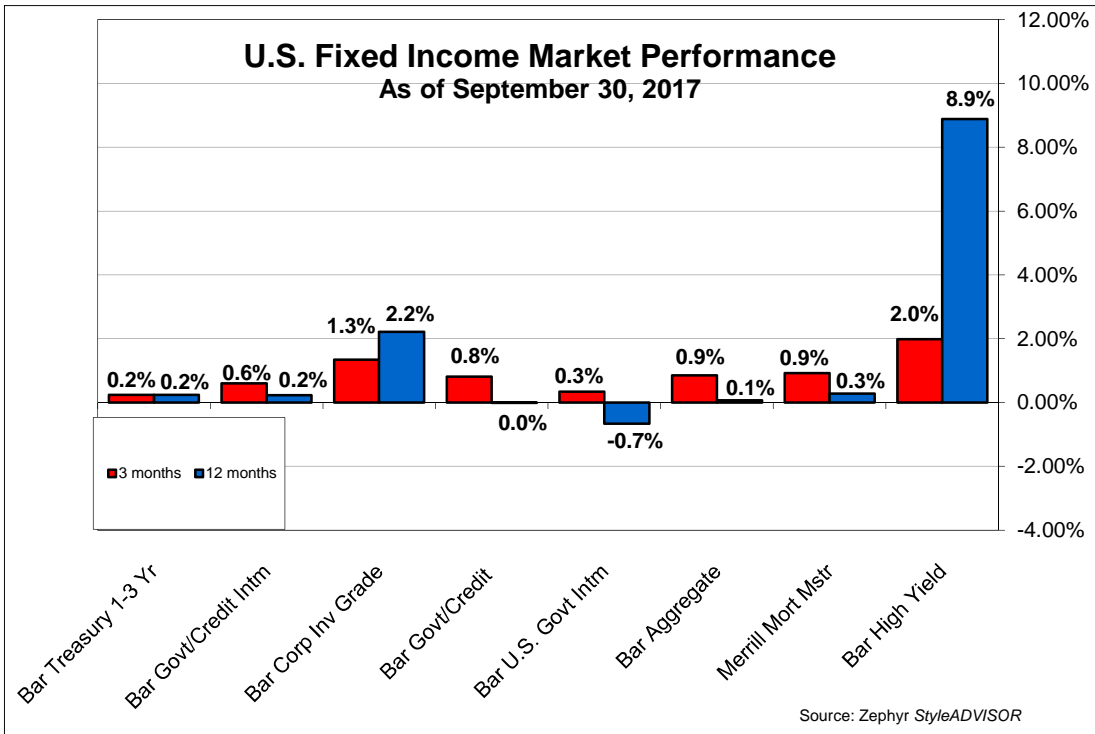
	Yield	Price/Earnings	Price/Book
S&P 500	1.85%	22.0	3.13
Russell 1000 Gr	1.28%	26.3	6.64
Russell 1000 Val	2.31%	19.7	2.00
Russell Midcap	1.60%	25.3	2.72
Russell 2000 Gr	0.65%	65.3	4.57
Russell 2000 Va	1.81%	34.6	1.55

S&P GICS Sector Returns



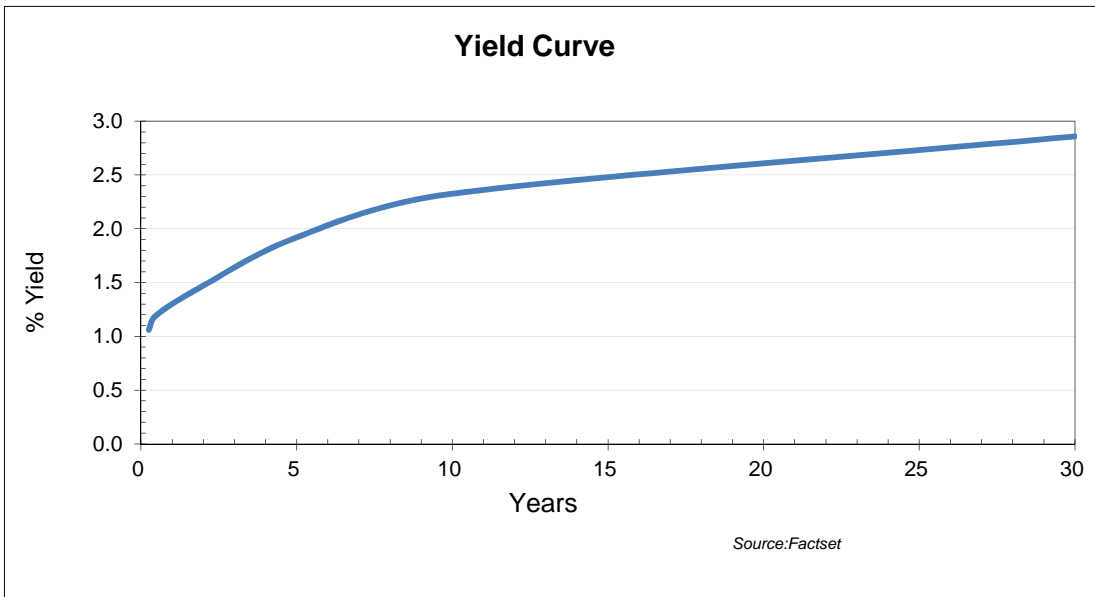
Source: Factset

DOMESTIC FIXED INCOME MARKET



Bonds rose slightly during the quarter. The Barclays US Aggregate Bond index ended up 0.85 percent. High yield bonds ended the quarter up 2.04 percent.

Bond yields dipped then came back. The ten year Treasury ended up within 3 basis points of where it started. It's the same old story of low rates and low expectations.



Yield Curve as of September 30, 2017

Time to Maturity	Interest Rate
3 Month	1.06
6 Month	1.20
2 Year	1.47
5 Year	1.92
10 Year	2.33
30 Year	2.86

INTERNATIONAL MARKETS

International stocks led the way. The EAFE index finished up 5.47 percent and the MSCI Emerging Markets index ended the quarter up 8.04 percent.

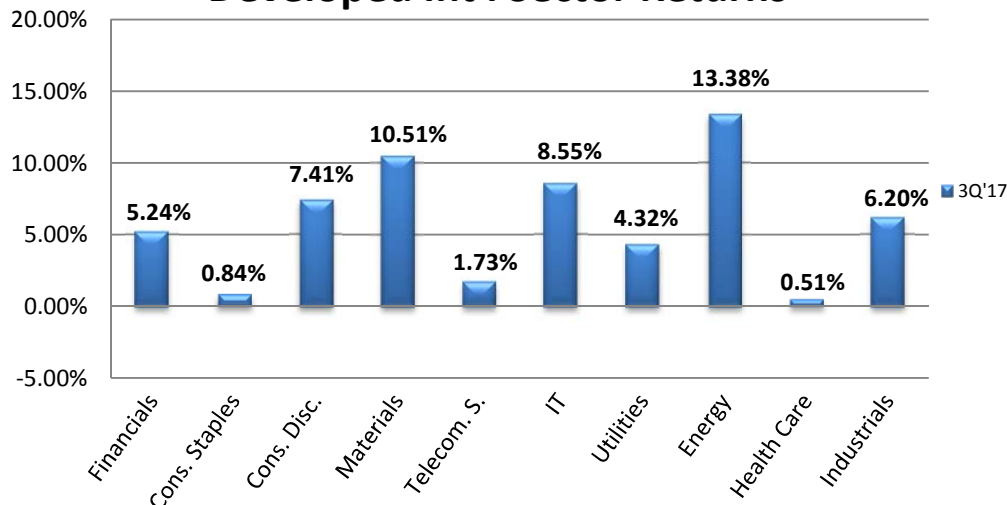
A weakening dollar plus an improving global economy makes for good international investing. Europe was up 3.49 percent in local terms but US investors got to add another 3 percent thanks to the strength of the Euro.

We did not get the same boost in developing markets but we also did not need it. It appears we are still in the early stages of an emerging bull market. The biggest risk to that assessment is political risk. Of course that is why they are referred to as emerging markets.

MSCI Country Returns Three Months Ending September 30, 2017

	Return US\$ (%)	Return Local Currency (%)	Currency Effect(%)
Austria	12.81%	8.83%	3.98%
Belgium	9.27%	5.42%	3.85%
Denmark	7.84%	4.13%	3.71%
Finland	3.30%	-0.34%	3.64%
France	8.42%	4.60%	3.82%
Germany	7.74%	3.95%	3.79%
Ireland	6.14%	2.40%	3.74%
Italy	13.85%	9.84%	4.01%
Netherlands	9.36%	5.84%	3.52%
Norway	19.28%	13.35%	5.93%
Portugal	13.36%	9.37%	3.99%
Spain	4.35%	0.67%	3.68%
Sweden	5.49%	2.08%	3.41%
Switzerland	2.00%	3.06%	-1.06%
UK	5.18%	1.83%	3.35%
Europe Total	6.49%	3.49%	3.00%
Australia	3.17%	0.86%	2.31%
Hong Kong	5.11%	5.16%	-0.05%
Japan	4.13%	4.32%	-0.19%
New Zealand	0.24%	1.53%	-1.29%
Singapore	3.12%	1.72%	1.40%
Pacific Total	3.97%	3.58%	0.39%
Brazil	23.00%	17.43%	5.57%
Canada	8.10%	4.10%	4.00%
China	14.76%	14.81%	-0.05%
Greece	-12.10%	-15.19%	3.09%
Hungary	9.56%	6.23%	3.33%
India	2.95%	4.04%	-1.09%
Indonesia	-1.04%	0.02%	-1.06%
Korea	2.71%	2.82%	-0.11%
Mexico	1.50%	1.83%	-0.33%
Poland	9.55%	7.65%	1.90%
Russia	18.07%	15.28%	2.79%
Thailand	10.62%	8.60%	2.02%
Emerging Markets	8.04%	7.72%	0.32%

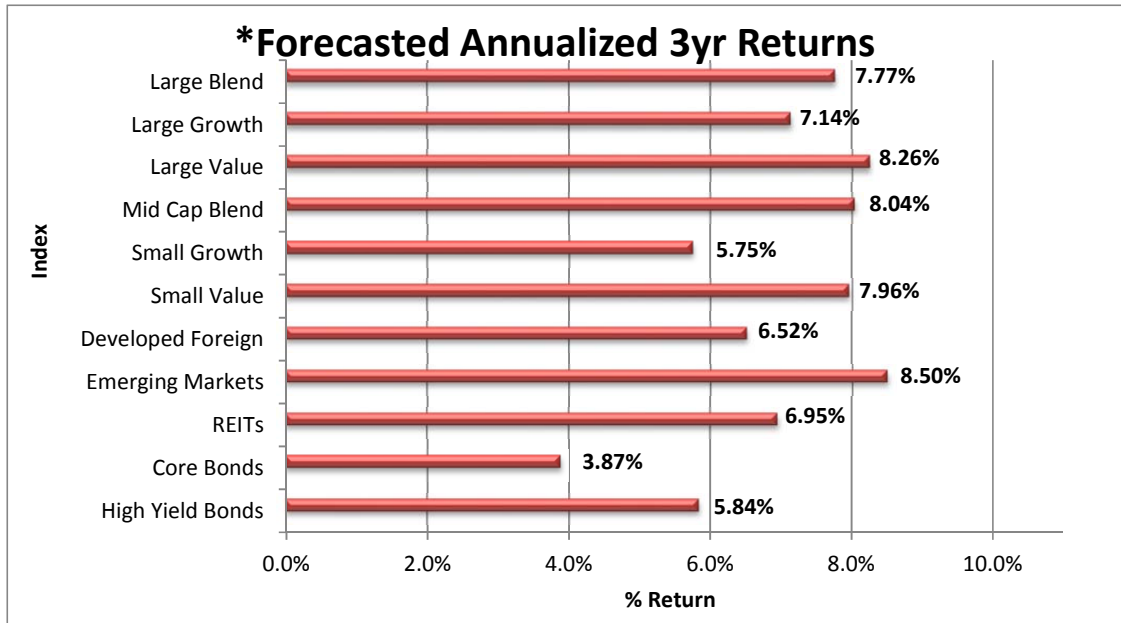
Developed Int'l Sector Returns*



Source: Harbor Capital

* MSCI EAFE Index

Market Forecast



We have been calling for a pause and continue to do so. The question mark is what comes out of Congress on taxes? If some tax reform gets done then the rally is likely back on and the beneficiaries are likely value stocks and small company stocks.

Emerging markets still look attractive and the rally in international stocks should have more legs.

Bonds remain our biggest concern over the long term and will until the yield on the 10 year treasury exceeds 3 percent. High yield remains the best place within the bond universe.

Indices Three Months Ending September 30, 2017

	Yield	Frwd Earnings Yield	**Hist. Return	***Hist. Risk Prem. + RF Rate
Large Blend	1.85%	7.46%	9.95%	5.99%
Large Growth	1.28%	6.12%	9.64%	5.99%
Large Value	2.31%	8.58%	10.09%	5.99%
Mid Cap Blend	1.60%	7.09%	11.36%	5.99%
Small Growth	0.65%	3.51%	7.49%	6.99%
Small Value	1.81%	6.96%	10.27%	6.99%
Developed Foreign	2.73%	9.48%	4.97%	4.12%
Emerging Markets	1.91%	9.89%	9.52%	5.62%
REITs	3.73%	5.75%	10.95%	4.56%
Core Bonds	2.56%	2.56%	6.61%	2.89%
High Yield Bonds	5.45%	5.45%	8.13%	4.06%

* Weighted average using 40% earnings yield, 30% historic return and 30% historic risk premium + RF rate

**Annualized 28 Yr return

***Hist. risk premium of domestic and international equity as defined by Zephyr Style Advisor's GFD Long Term Index database except for REITs and High Yield which are based on average 20 year rolling returns of the NAREIT Equity REIT Index and the Barclays Corporate High Yield Index minus the average 20 year rolling returns of the 3-month T-Bill and scaled using proprietary data. The Current 3-month T-Bill yield (as of 09-30-2017) is added back to each risk premium.

SELECTED INDEX RETURNS - PERIODS ENDING September 30, 2017

	Quarter	Year-to-Date	One Year	Three Years	Five Years	Ten Years
US EQUITIES						
Broad Stock Market - Russell 3000	4.57%	13.91%	18.71%	10.74%	14.23%	7.57%
Large Stocks - S&P 500	4.48%	14.24%	18.61%	10.81%	14.22%	7.44%
Dow Jones Industrial Average	5.58%	15.45%	25.45%	12.35%	13.57%	7.72%
Medium-Size Stocks - Russell Mid-Cap	3.47%	11.74%	15.32%	9.54%	14.26%	8.08%
Small Stocks - Russell 2000	5.67%	10.94%	20.74%	12.18%	13.79%	7.85%
Small Value Stocks- Russell 2000 Value	5.11%	5.68%	20.55%	12.12%	13.27%	7.14%
Small Growth Stocks- Russell 2000 Growth	6.22%	16.81%	20.98%	12.17%	14.28%	8.47%
Large Value Stocks - Russell 1000 Value	3.11%	7.92%	15.12%	8.53%	13.20%	5.92%
Large Growth Stocks - Russell 1000 Growth	5.90%	20.72%	21.94%	12.69%	15.26%	9.08%
US FIXED INCOME						
1-3 Yr Treasury (Gov't) Bonds - Barclays Capital	0.24%	0.70%	0.24%	0.77%	0.64%	1.72%
US Government Bonds Int - Barclays Capital	0.34%	1.55%	-0.66%	1.58%	1.01%	3.08%
US Corporate Inv Grade Bonds - Barclays Capital	1.34%	5.18%	2.21%	4.10%	3.46%	5.74%
Government/Credit (Corp) Bonds - Barclays Capital	0.81%	3.49%	-0.01%	2.83%	2.10%	4.34%
Int Govt/Credit (Corp) Bond - Barclays Capital	0.60%	2.34%	0.23%	2.13%	1.61%	3.64%
US Aggregate Bond Market - Barclays Capital	0.85%	3.14%	0.07%	2.71%	2.06%	4.27%
Mortgage Master - Merrill Lynch	0.92%	2.31%	0.28%	2.41%	1.94%	4.14%
US Corp High Yield Bonds - Barclays Capital	1.98%	7.00%	8.88%	5.83%	6.36%	7.84%
INTERNATIONAL (Measured in US Dollars)						
Non-US Stocks - MSCI EAFE	5.47%	20.47%	19.65%	5.53%	8.87%	1.82%
World Stocks (includes US) - MSCI World	4.96%	16.53%	18.83%	8.30%	11.62%	4.81%
European Stocks - MSCI Europe	6.49%	23.45%	23.01%	4.96%	8.97%	1.69%
Japanese Stocks - MSCI Japan	4.10%	14.63%	14.46%	8.10%	10.91%	1.91%
Asian Stocks (Ex-Japan) - MSCI Pacific ex-Japan	3.69%	17.74%	14.59%	4.71%	5.41%	2.91%
Chinese Stocks - MSCI China	14.76%	43.41%	33.27%	12.81%	11.22%	2.06%
Indian Stocks - MSCI India	2.95%	24.09%	14.18%	4.48%	6.57%	1.48%
Emerging Markets - MSCI EM	8.04%	28.14%	22.91%	5.28%	4.36%	1.65%
Int'l Gov't Bonds -Citi World Gov't Bond (Non USD)	2.57%	8.63%	-3.14%	0.47%	-1.07%	2.67%
REAL ESTATE						
FTSE NAREIT Equity-Reits Index	0.94%	3.67%	0.67%	9.86%	9.69%	5.83%
SHORT TERM INTEREST RATES						
T-Bills	0.26%	0.56%	0.64%	0.29%	0.19%	0.42%

Note: Returns for periods longer than 12 months are annualized.