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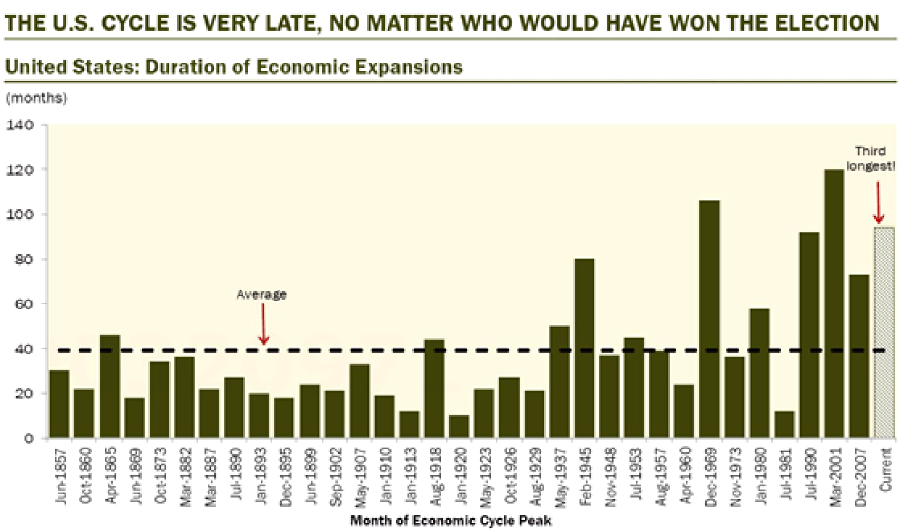
CLIENT BULLETIN: 3rd QUARTER 2017

<u>Economic Overview:</u> Goldilocks returns.

The longest economic expansion in US history was from 1991-2001. That period came to be known as the "Goldilocks economy," named after the popular children's book, *Goldilocks and the Three Bears*. During that period, the economy didn't grow too fast causing too much inflation, nor did it grow too slow causing a recession. It grew just right, allowing for significant job creation and stock market gains.

The current expansion has already lasted 95 months. This ranks as the third longest in U.S. history, across 33 business cycles going back to 1854. Although this expansion has resulted in slower growth and fewer new jobs than the 1990s boom, inflation has been well contained. The economy remains on solid-footing and may actually be getting a bit stronger. We do not anticipate an economic problem in 2017.



Source: National Bureau of Economic Research, Gluskin Sheff

First quarter GDP clocked in at a sub-par 1.4%. In recent years, Q1 has been the slowest growing quarter of the year and economists aren't sure why. Our best guess is that winter weather combined with some out-of-sync seasonal adjustments to the data creates the sluggish GDP figures. But the good news is that second quarter GDP tends to bounce back nicely. Economists are forecasting 2Q GDP in the area of 3.0%, driven by an uptick in consumer and government spending.

The Federal Reserve is still on track to increase interest rates at least one more time in 2017 and the economy appears to be ready for it. Positive news on the fiscal front, especially a tax cut, would also be a boost to economic growth.

<u>Fixed Income:</u> Cyclical vs. Secular.

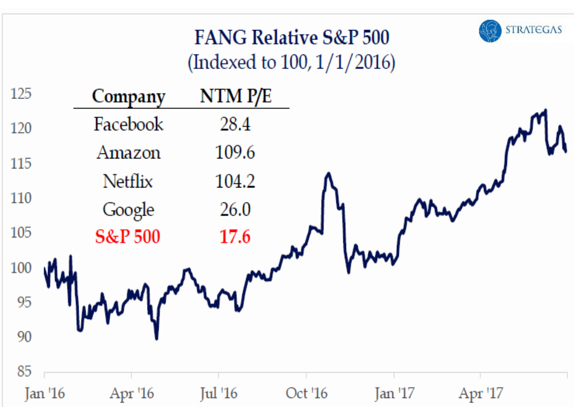
The cyclical forces of stronger economic growth are trying to push rates higher. Historically, accelerating economic growth would lead to much higher interest rates. But this is not happening. Why? Because the secular duo of debt and demographics are pulling rates down even as economic growth puts upward pressure on borrowing costs. By the end of 2016, global debt exceeded $217 trillion. Put another way, global debt exceeded 325% of global GDP in 2016. This tug-of-war will continue throughout 2017. As a result, we expect fixed income returns in the low single digits this year.

<u>Equity Markets:</u> Peak FANG?

The FANG stocks (**F**acebook, **A**mazon, **N**etflix, and **G**oogle) are today's stock market darlings. In a world starved for growth, these companies have grown exponentially and they have been rewarded for that growth. From the start of 2015 through May 2017, the FANGs returned almost 50% per annum, while the other 496 companies in the S&P 500 averaged less than 5%. Through May alone, the FANGs are up over 30% on average, while the rest of the market has returned slightly more than 5%. Fortunately, this year Apple and Microsoft also joined the FANG party, with Apple returning 32% through May and Microsoft returning 12%.

But nothing goes up forever and we believe a change in stock market leadership may be at hand. Amazon trades at a Price-to-Earnings ratio of 110, Netflix at 105, Facebook at 28 and Google at 26. By comparison, the S&P 500 trades at a more reasonable 18 times earnings. We believe Amazon's acquisition of Whole Foods may be its toughest integration to date. Grocery stores already operate on razor thin margins (1%-2%) and shipping produce is not as easy as shipping clothes or household cleaning products. In addition, this acquisition will result in the loss of many jobs. Job losses and market share dominance may put Amazon in the crosshairs of local politicians and anti-trust authorities at the Federal Trade Commission (FTC).

Roger McNamee, a pioneer in the field of venture capital and technology investing said this on CNBC's Squawk Alley: "Google, Facebook, Amazon are increasingly just super-monopolies, especially Google and Facebook. The share of the markets they operate in is literally on the same scale that Standard Oil had…more than 100 years ago – with the big differences that their reach is now global not just within a single country." According to the latest PriceWaterhouse-Coopers Entertainment and Media Global Outlook, "Google's ad revenue is roughly the same as all print ad revenue globally and Facebook's ad revenue topples all radio ad revenue globally." According to the report, nearly 50% of all ad dollars flow to the duopoly. (Strategas Research - July 3, 2017).

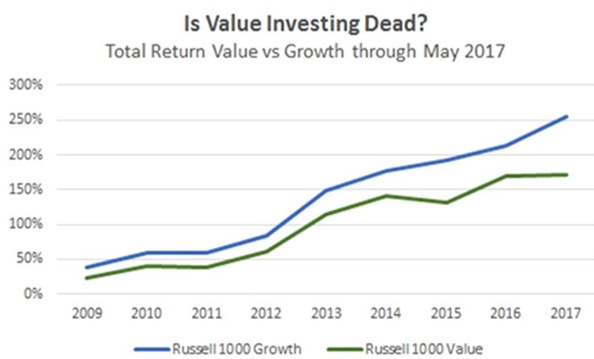


Netflix is facing an onslaught of competition from the likes of Amazon's streaming service and Google's YouTube. At the same time, its production costs on original programming are soaring. Add in to the mix a President who is not a friend of "Big Tech" and not just because of his immigration policies. He has had a Twitter feud with the Washington Post, owned by Amazon CEO Jeff Bezos, and was snubbed at his business roundtable by Facebook CEO Mark Zuckerberg.

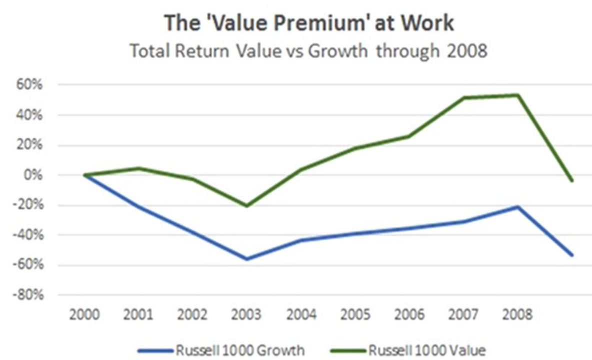
<u>Equity Markets:</u> Peak FANG? Cont'd.

Big Tech and Solar Energy were the darlings of the last administration. This administration has been reducing regulations on the financial services industry and working to increase energy production within the United States. As you might expect Financials and Energy have been two of the most unloved sectors in the market. Financials and Energy make up over 36% of the Russell 1000 Value Index. Conversely, the Russell 1000 Growth index owns about 4% in these sectors. Because these sectors have not kept pace with the market, they tend to have higher dividend yields than the S&P 500 index. Financials are already growing dividends at an above average rate and if oil prices stabilize and maybe even go higher, then Energy companies can begin growing their dividends again.

The accompanying charts indicate that growth and value take turns in leading the stock market. Growth has been the leader since the market bottom in 2009. From the 2000 market top until 2009, value easily bested growth. Looking back even further you would see a similar pattern.



Source: FTSE Russell



Source: FTSE Russell

Now may be the time when value begins a long period of outperformance. In addition to being less expensive than their growth counterparts, value stocks are expected to being growing earnings at a faster clip than growth stocks in the second half of 2017. If value is to resume leadership, then Financials and Energy should enjoy above average stock appreciation.

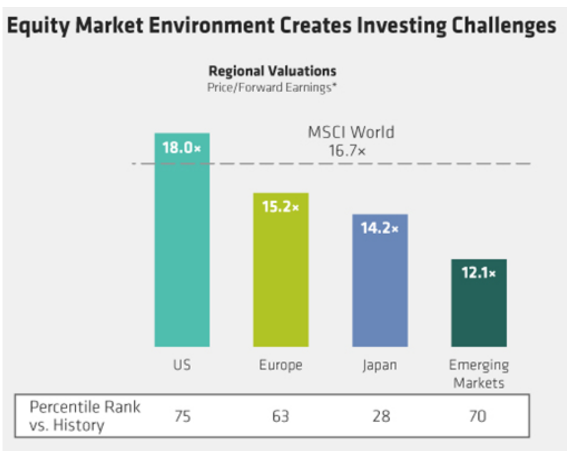
<u>Financial Market Scoreboard</u>
<u>2nd Quarter 2017</u>

<u>Equity Indices</u>	
S & P 500:	+3.1%
Dow Jones:	+4.0%
Nasdaq Composite:	+4.2%
<u>Fixed Income Indices</u>	
Long Term Treasury ETF:	+4.3%
Barclay's Govt/Credit:	+1.7%

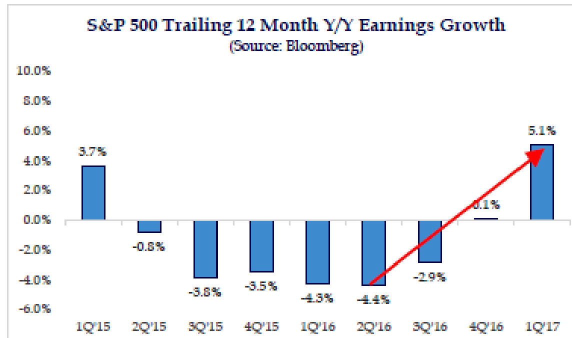
Source: CNBC.com

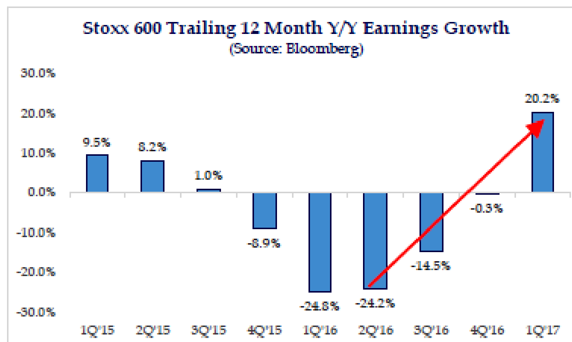
<u>Investment Outlook:</u> Finding Value in Value.

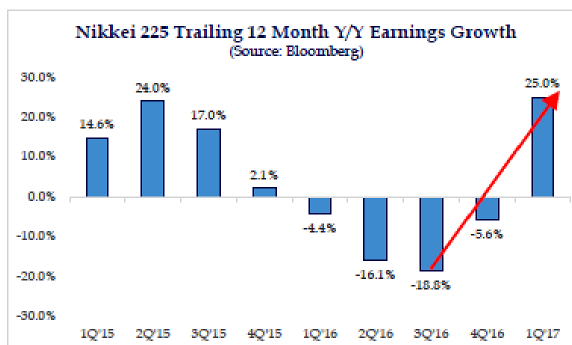
The majority of changes to client accounts took place in the equity portfolio. Microsoft and Apple were pared back due to price appreciation in most accounts. Also, in most accounts, we added and/or initiated exposure to international markets. In the last bulletin we highlighted the favorable attributes of international stocks versus US stocks: 1) lower valuations, 2) earlier in the economic cycle and 3) earnings growing more quickly than the US. We expect to add to our international exposure via individual securities and/or ETFs as opportunities arise.



As of June 30, 2017
Source: Bloomberg, CBOE, FactSet, MSCI, S&P and AB







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Currently, our research is focusing on the Financial, Energy, and Consumer cyclical sectors. These areas have been laggards this year. In some cases, the underperformance is justified. In others, it is an opportunity for outsized gains.

<u>Disclaimer:</u> Any projections, outlooks, or assumptions should not be construed to be indicative of the actual events which will occur. Discussions, market conditions, objectives, and strategies set forth herein are specifically subject to change if market conditions change, or if the Adviser believes in its discretion, changes and/or modifications are warranted accordingly. July 2017