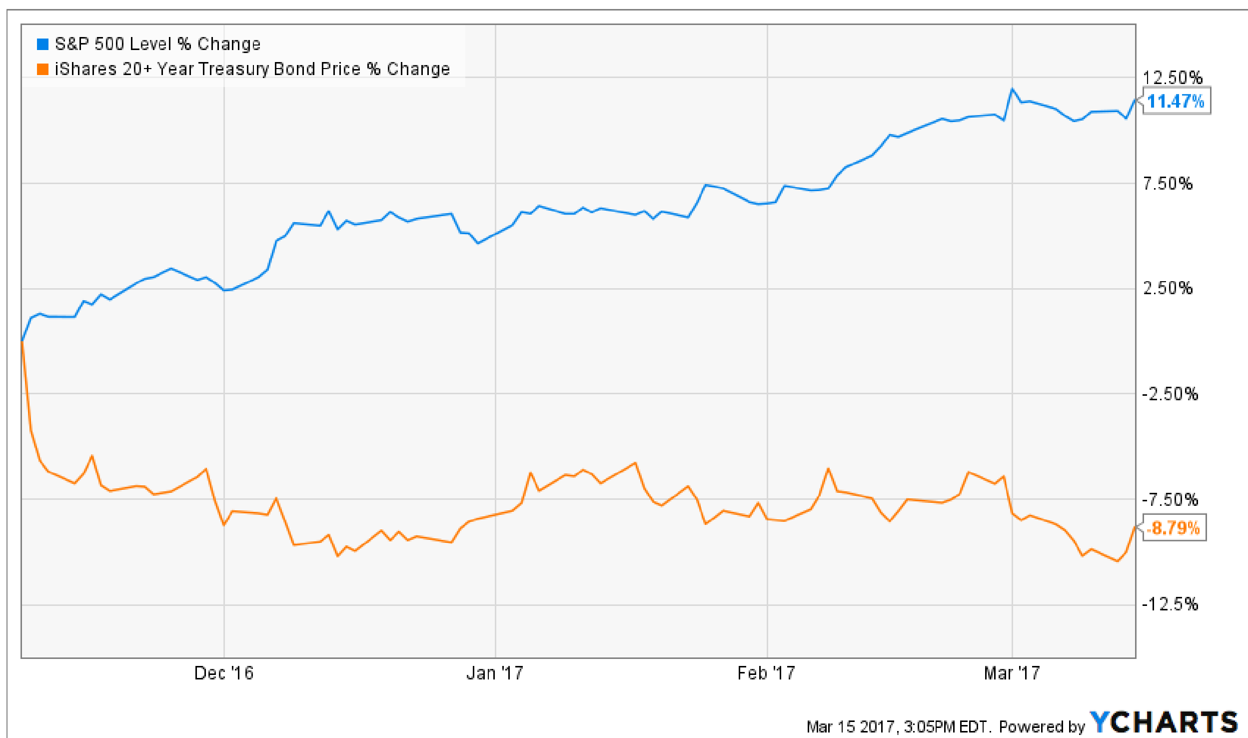
Market Update

March 15, 2017

The Path to Normalization

Today, as I write this market update, Janet Yellen, The Federal Reserve Chair Woman is discussing this morning's Federal Reserve decision to increase the Federal Funds rate by 0.25%. The Federal Reserve is making it's interest rate policy decisions based on an evaluation of economic conditions and is not on a preset course in making those decisions. What is clear, is that based on better economic data coming in, such as better unemployment numbers, higher labor force participation rates, modest rising inflationary indicators and the overall continued stabilization of the economic environment here in the U.S., the Federal Reserve is on a path to normalization of interest rates. What this means is that they intend on becoming less and less accommodative on interest rates as the economy continues to strengthen. This is important because should the Fed remain overly accommodative, the risk of asset price bubbles increases, as does the potential for uncontrolled inflation which ultimately would have a negative impact on the economy and markets.

The Ten Year Treasury rate continues to hover around 2.5%. The TLT, a proxy for long term U.S. Treasury bonds, had traded down a bit since last month's update but has come back to its current level. The S&P 500 has continued its upward path, as the blue line in the chart below indicates its percent gain since November 8, 2016.



Information in this chart above was taken from sources we believe to be reliable; however we do not guarantee its accuracy or completeness.

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Prior to this morning's Federal Reserve announcement, there were indications that the rally in U.S. equities was getting a little tired after the DOW broke through 21,000 earlier in the month. One area that has been particularly hard hit is REITs (Real Estate Investment Trusts). Some of this has to do with interest rate increase anticipation, as REITs are very sensitive to changes in interest rates. Another reason is that there are some indications that commercial real estate investments are in the later innings of their cycle. One area particularly hard hit that tends to be part of large REIT portfolios are Mall operators. As more and more retail businesses shut down their brick and mortar facilities and large anchor tenants for malls such as Macy's and JC Penny show earnings' disappointments. Due to lighter brick and mortar traffic, this segment of the REIT market has seen a pull back. One other area we have seen some significant declines in the short term after a run up, is in Gold and precious metals. This tends to indicate that investors are still comfortable in taking on the risk of owning stocks and bonds. One other reason that metals (not necessarily precious metals) and other commodities may continue to see price increases is due to higher demand for them as raw materials, from the growth in economies both here and abroad.

We are expecting that equity markets will experience a normal market pull back of 5% or more at some point this year. If this happens, our current view is that it would be a buying opportunity for new money to enter the market and ride it out with the current investments owned, not a time to sell.

Our current view on the markets has not changed all too much. We still prefer domestic equities over international equites, however, the prospects for better international markets is showing positive signals. Mostly all of our portfolios hold a percentage of their assets in international investments, which should benefit from improved economic indications globally. We will continuously monitor the U.S. and Global economic environment for signs that indicate a reason to be more favorable toward International Equities. We continue to look at ways to lower the risk of a rising interest rate environment and have recently made some changes to further reduce duration risk in our fixed income holdings. Maintaining a low duration/shorter maturity outlook for bonds and fixed income is our view for the foreseeable future. Based on the current environment, we feel it is prudent to maintain the lowest duration and shortest maturities possible specific to investors individual needs.

If you have questions or would like to discuss this further with regard to your personal portfolio please contact me at 310-433-5378.

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