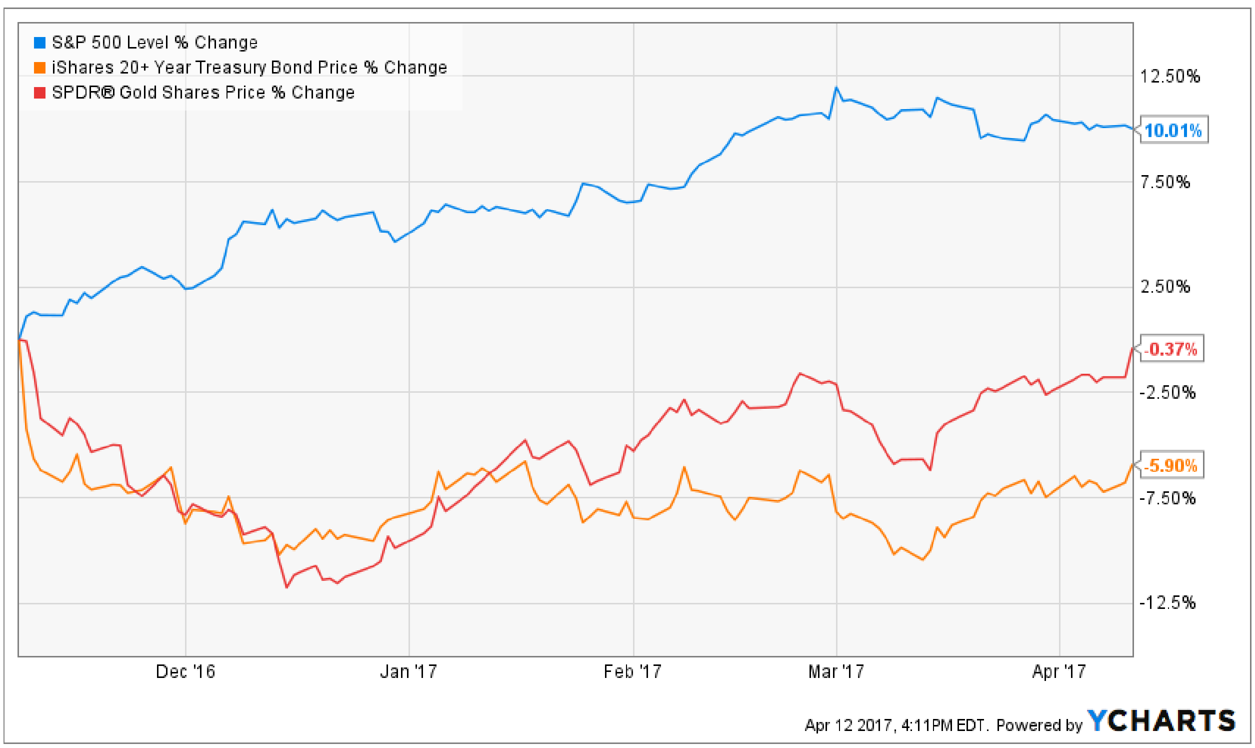
Market Update

April 12, 2017

Geo-Politics and the Markets

It is incredible what a month of changing geo-political issues can do. Since my last market update, the U.S. has changed its stance on conflicts in the Middle East, Russia and has gotten significantly more aggressive with its intentions toward North Korea. While this has unfolded, the U.S. has held very high level talks with world leaders, which have the initial appearance that they have gone well, but not necessarily perfect. The most important of all of those talks was with the leadership of China. While holding talks with Chinese leadership, the United States reacted militarily to the horrific chemical weapons attack by Assad's regime in Syria. Markets certainly take notice when the United States conducts airstrikes as the world awaits the further responses and direction both politically and militarily.

Although the markets reaction was not drastic, it has been slow. However, to some degree they have been predictable in response to these new developments. The stock markets sold off a little bit, the bond markets rallied, yields have dropped and gold has rallied as well. This would make sense due to greater concern arising regarding military actions. The chart below shows the percent change in the S&P 500, TLT (proxy for long term bonds) and GLD (a proxy for gold) since the election through April 11, 2017. The blue line represents the S&P 500, orange line TLT and red line GLD.



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

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We can see from the chart above that the change in gold and long term bonds are very highly correlated with gold receiving more of a recent bump from the geo-political atmosphere. Stocks are off their all-time highs, the S&P is about 2.3% off its recent all time high and the DOW is off about 2.7%. This is roughly half of the low end of the 5% or more correction that I have been discussing in my recent market updates.

It does not appear that the U.S. government is intent on getting into a broad scale war on multiple fronts. However, the rhetoric out of the White House is very strong and seems to be designed to get two of the worlds major powers in Russia and China to the negotiating table in order to effect regime change in Syria and the reduction of North Koreas nuclear ambitions. As of this week, Secretary of State Rex Tillerson has had meetings with Russian leadership and China has signaled it will work with the U.S. on a diplomatic resolution to the North Korean aggression and nuclear ambitions.

The market's pull back has been slow and continues, however it is important to mention a few things that can be the next catalysts for a continuation of the markets rally since the election. First, we are starting earnings season and with recent unemployment reports continuing to show more and more positive developments, earnings season could help the valuation equation for stocks. Equities under the previous administration had seen multiple expansions in the Price to Earnings calculation. This has recently gotten tired and the S&P 500 sits north of 18 times forward earnings, which is approaching historical high ranges. It is also one of the reasons for the back-off in the markets. If the continued labor market improvement leads to increases in consumer spending, along with the reduced regulation the administration has embarked on then we could be in for earnings expansion, which is the other part of the equation. This could lead to more upside for stocks. The other catalysts would be the continuation of regulatory reforms that the markets like, a potential surprise of getting a health care bill done and tax reform. As of now, there are negotiations going on regarding health care. If this does get done it will lead to a better environment to getting tax reform done. These are all things the markets want to see and are waiting for. Tax reform could potentially still get done without health care, but it is known that getting health care done first will make tax reform easier. For now, the markets wait in anticipation as the excitement of the possibilities of these happening has apparently worn off.

Our current view on the markets has changed a small amount. We are watching geo-politics and are ready to look for opportunities to reduce equity risk (beta and standard deviation) through some small changes to the equity holdings inside client's allocations. We still prefer domestic equities over international equites, however, the prospects for better international markets is showing positive signals. Most 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. Although bond prices have rallied, 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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