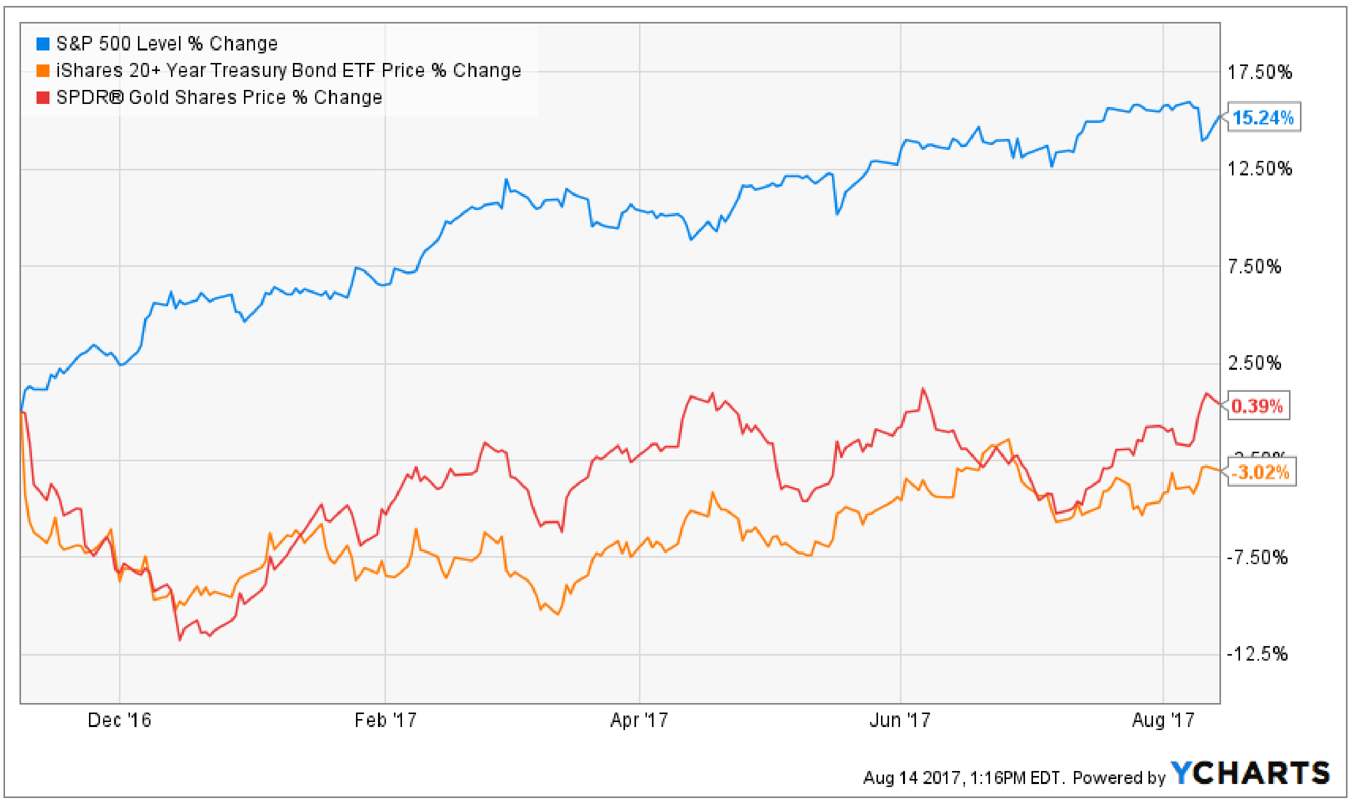
Market Update

August 14, 2017

Return of Volatility

Since last month's market update, the markets have been driven by corporate earnings and political events. The tensions between the U.S. and North Korea escalated and started to weigh on the markets at the end of last week. Market volatility jumped with the VIX rising sharply. The world unanimously voted for sanctions against the North Korean's which included votes from China and Russia. This morning China issued an order to implement these sanctions. Today the markets have started a relief rally and the VIX has declined significantly as pressure from Beijing on North Korea is welcome. The chart below which starts on November 8, 2016, shows the movements in the S&P 500 (Blue Line), Long Treasury Bonds (TLT, Orange Line) and Gold (GLD, Red Line). Both Gold and Treasuries rose in price since last month's update on these geopolitical tensions, however they are starting to show some reversal, as of today. The S&P 500 is mounting an attempt to recover as the chart reveals.



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

The latest yield curve (as of August 11, 2017) saw a small amount of flattening due to the tensions with North Korea, as the chart below shows. The yield curve remains normal in shape and with the relief rally today and China's engagement on North Korea we could see the curve shift back and become a bit steeper as fears of war subside further.

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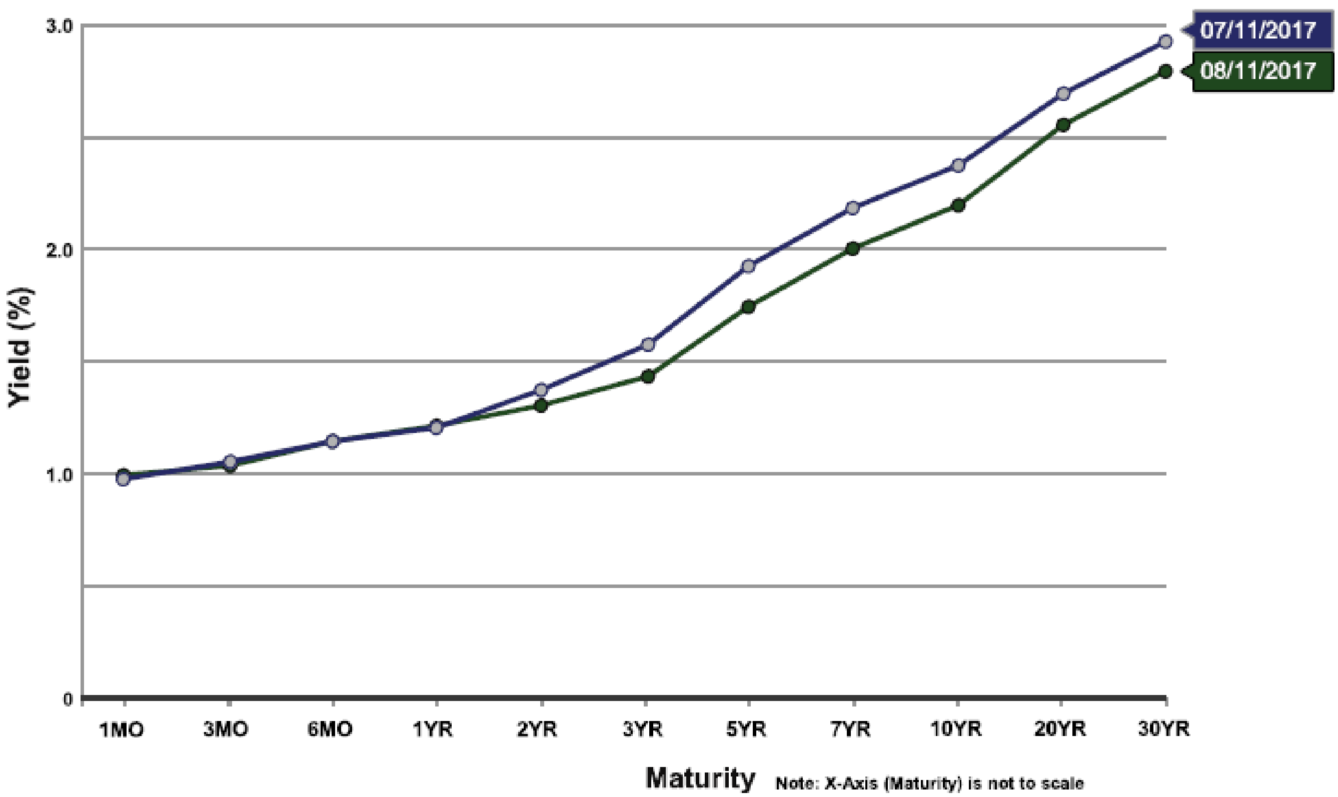

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Source: https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/Historic-Yield-Data-Visualization.aspx

A steep yield curve showing short term rates lower than long term rates tend to be indicative of a good economy. As mentioned last month, we are watching the yield curve as one of many indicators that the economy remains healthy and that investors have confidence. In times of more uncertainty, especially with the threat of war, it is natural to see investors take a more risk off approach and buy treasuries and gold. Once those fears subside or return to previous levels, equities tend to rally a bit, and gold and treasuries tend to be sold, until other reasons to buy them come to the fore-front.

One issue I have spoken about many times is the overall lack of a 5% or greater pull back in the markets that tend to be normal and healthy in bull markets. Corporate earnings have been coming in at or above expectations in many cases, which continues to fuel the equities markets. I do believe that the markets are set to pause as prices and valuations in the equity markets are getting high. This does not mean a major correction will necessarily occur, but it may be difficult to find significantly more return in equities without a catalyst. I believe the next catalyst could be tax reform and repatriation of overseas profits, if congress can get together and pass a bill. Also, an infrastructure bill would be another potential positive that can greatly improve an already strong economy.

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We are watching geo-politics and continue to look for opportunities to reduce equity risk (beta and standard deviation) through changes to the equity holdings inside client's allocations. We still prefer domestic equities over international equites, however, international markets especially developed international markets look attractive. 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. As we stated before, we continue to look at ways to lower the risk of a rising interest rate environment and continue to make needed changes to further reduce duration risk in our fixed income holdings where appropriate. Maintaining a low duration/shorter maturity outlook for bonds and fixed income remains 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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