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Financial Advisors

OCTOBER 16, 2017

QUARTERLY PERFORMANCE REVIEW — THIRD QUARTER 2017

Dear Client:

We have enclosed your third quarter 2017 Portfolio Performance Report. Please review the materials and insert them behind the green "Performance" tab in your "Planbook."

This table presents the 2017 third quarter returns of the benchmarks for selected asset classes.

Asset Class Returns

Asset Class	3rd Qtr 2017	YTD 2017	Benchmark Index
Domestic Fixed Income	0.60%	2.34%	Barclays Intermediate Gov't / Corp Bond
Domestic Inflation Protected	0.86%	1.72%	Barclays TIPS Index
International Fixed Income	0.64%	0.82%	JP Morgan – Global Gov't - Non US (hedged)
Domestic Equity (Large)	4.48%	14.24%	S&P 500 with Dividends
Domestic Equity (Large Value)	3.11%	7.92%	Russell 1000 Value Index
Domestic Equity (Small)	5.67%	10.94%	Russell 2000
Domestic Equity (Small Value)	5.11%	5.68%	Russell 2000 Value
International Equity	5.40%	19.96%	MSCI EAFE Equity Index with Dividends
Real Estate	1.11%	6.04%	FTSE NAREIT Equity
Precious Metals	3.29%	11.97%	Gold
Natural Resources	4.30%	-0.77%	Dow Jones UBS Commodity Index

Portfolio performance for the third quarter of 2017 was led by US large cap, US small cap, and international equity asset classes. Many other asset classes had positive performance as well. The markets continued to reach new highs during the quarter.

Many portfolios are benefitting from these positive results, yet clients are asking "when will the market go down?" We will try to provide our perspective in this seemingly "illogical" and "long-lived" rise in the markets. Read on!

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First of all, we think the question may be too simple. We think a better way to ask the question is to pose a group of questions.

- When is the next market downturn?
- How far will the market fall?
- How long will it take the market to recover from the fall?
- Based upon the above answers, what should I do with my portfolio?

There are two ways (at least!) to view the current bull market and form a response to these questions.

Q3 2017 Statistics:

- *Gold – 1 ounce $1284.80*
- *Crude Oil – barrel $51.67*
- *Federal Funds rate 1.25%*
- *Prime Rate 4.25%*
- *30 Year Mortgage 3.82%*
- *10 Year Treasury 2.34%*

\- *Source: Washington Post September 30, 2017*

The first is to rely upon all of the "soft" information available. That is to say, we all have access to information about the market from the internet, friends, neighbors, newspapers, television, magazines, email, social media, etc. We impose our own personal experience and investment attitudes when absorbing and assessing these data points to reach conclusions. Many of our conclusions are our "gut" telling us to do something.

Here is an interesting side note before continuing our thoughts. The 2017 Nobel Prize for Economics was just awarded to Richard Thaler of the University of Chicago. He has been one of the pioneers in the field of "behavioral economics." His work and conclusions are still being debated by the economics world, but he seems to have captured his peers' attention. He basically concludes that most investors act irrationally.

Many people seem to be having their "gut" tell them that the current bull market cannot last and now is the time to get out! Unfortunately, using only soft data and asking only one question, the other three questions go unanswered!

The second view is to look at "hard" information available. That is to say, we have access to historical information about the markets from economists, mutual fund companies, portfolio managers, professional investors (i.e., Warren Buffett), and independent third party market data analytics firms (i.e., Morningstar).

As we stated in our last quarterly letter, predicting when a correction will happen in any world market or any specific asset class is not possible. One indicator that is watched for US stocks is the average Forward Price to Earnings ratio (PE). The Forward PE is one measure used by market analysts and investors to assess how much they are willing to pay for a stock right now (price), based upon how much profit (earnings) they expect the company to produce in the next 12 months.

As of the end of the third quarter, the Forward PE ratio for the S&P 500 was 17.7. This is slightly higher than the 25-year average of 16 (highest was 27.2 and lowest was 10.3). A Forward PE ratio higher than long-term averages may signal that this class of investments is becoming overvalued.
Source: JP Morgan Guide to the Markets, Sept 30, 2017, Pages 4 & 5

Although this is one of many interesting statistics, it is not necessarily predictive of what will happen in the future. Sometimes overvaluation can lead to a correction. However, there are also many other factors that contribute to market behavior. Another market correction could occur at any time.

Financial "experts" try to use the "hard facts" to reach a conclusion about the future and what do to about it. Unfortunately, using hard data and asking only one question, the other three questions go unanswered.

We believe long-term investors are reaping the benefits of asset classes like the Dow and the S&P 500 reaching new record highs. We also believe that adjustments will inevitably occur. History has shown that when you average positive returns with negative returns over long periods of time, the positive is quite often the winner!

Therefore, here are our answers to the four questions:

- When is the next market downturn?
  - We don't know. It is unpredictable.
- How far will the market fall?
  - We don't know. It is unpredictable.
- How long will it take the market to recover from the fall?
  - We don't know. It is unpredictable.
- Based upon the above answers, what should I do with my portfolio?
  - We believe your individual circumstances are the best gauge of what actions may be appropriate. For long-term investors, little or no action has proven to be the best decision in similar circumstances in the past.

Our investment philosophy continues to advocate participation in the markets with a globally diversified portfolio as a prudent strategy for the long journey. We welcome your comments and value the relationship we have with each of you. Stay safe and enjoy the fall!

Regards,

Rembert Pendleton Jackson

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Quotable Quotes

Interviewer question:

How will you spend your $1.1M prize for winning the Nobel?

Richard Thaler response:

"This is quite a funny question. I will try to spend it as irrationally as possible."

- The New York Times, Binyamin Appelbaum October 9, 2017

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