Investment Manager Meetings Recap Commentary

This quarter, the Strategic Income Group Investment Committee met with the following companies: Fidelity Investments, Lord Abbett, First Eagle Investment Management, Goldman Sachs, New York Life/ MainStay Investments, MFS Investment Management, and Northern Trust/ FlexShares.

In addition to meeting with these companies, the committee reviewed research from many other companies and outputs from our technologies in order to determine the most appropriate investments and advice for our clients.

Strategic Income Group Current Views (Q4 2017)

		Bearish	Slightly Bearish	Neutral	Slightly Bullish	Bullish
Capital Market Outlook				X		
		Underweight	Slightly Underweight	Neutral	Slightly Overweight	Overweight
Equities	U.S. Large Cap			X		
	U.S. Mid Cap			X		
	U.S. Small Cap			X		
	International				X	
	Emerging Markets				X	
Fixed Income	U.S. Government		X			
	U.S. Investment Grade Corporate				X	
	U.S. High Yield		X			
	International			X		
Alternatives					X	
Cash				X		

Please Note: These are 12- to 18-month views from the published date of the applicable commentary. Arrows represent movement from Q3 '17.

Capital Market Outlook

Unlike last quarter where we had no changes in our views, this quarter we saw movement in our views in both the equity and the fixed income space.

A consistent message from the managers that we sat down with and independent research we read, gave us reason to favor international equities. In fact, all of the managers we met with believed international equites would outperform U.S. equities in the near-term as well as over half of the managers brought up the idea of investing in international small-cap companies, specifically.

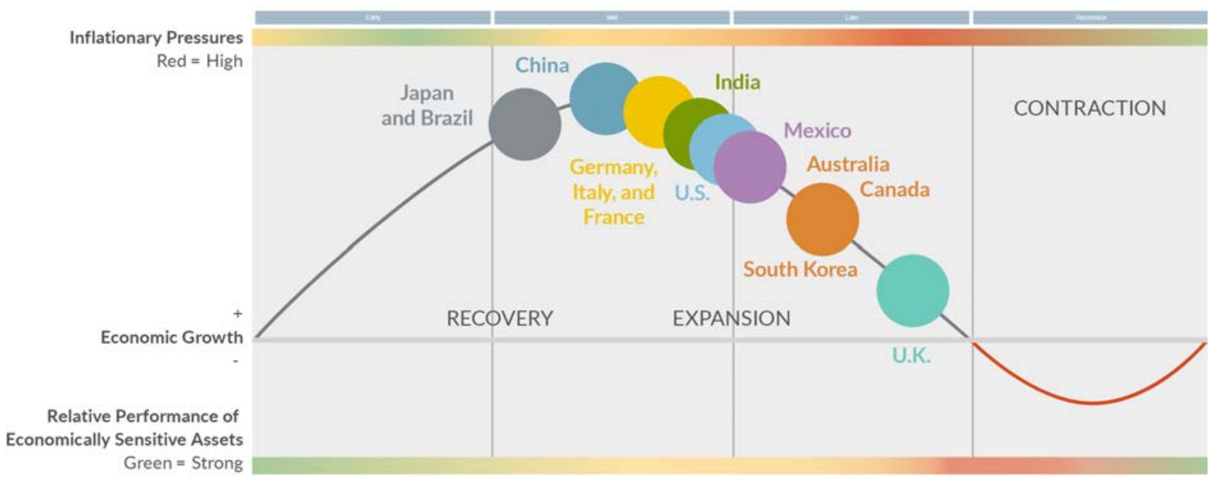
These viewpoints led us to move our international position from *neutral* to *slightly overweight*. While the committee does continue to see some political uncertainty in the European Union, the valuations and fundamentals in emerging markets, international small-cap companies, and even some international developed countries warrant this move.

On the fixed income front, U.S. high-yield junk bonds, are being moved from *neutral* to *slightly underweight*. Over the last several years, U.S. high-yield junk bonds delivered some great returns in both income and appreciation.

The long-term average spread of high-yields to the 10-year Treasury is 525 basis points. When the spread is lower than this number (meaning high-yield bonds have increased in value), high-yield bonds are much less attractive and present less of an opportunity moving forward.

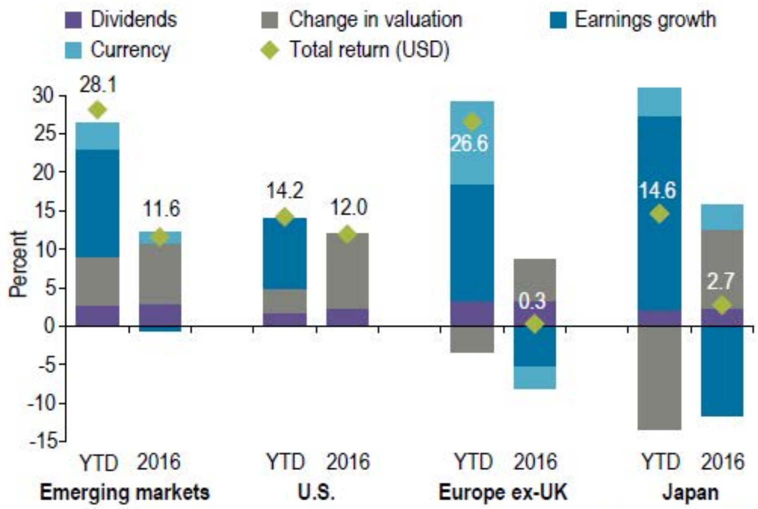
As of November 3, the spreads are at 352 basis points. We are happy with our return in these bonds and will be looking to trim this position in portfolios and will wait for those spreads to widen (high-yield bond values would fall) and then repurchase this position.

U.S. in the Seventh Inning of a Nine-Inning Game . . . Again?



It is a common analogy in financial services to use innings of a baseball game for where the U.S. economy is in the business cycle. What is interesting, however, is that we have now been in the seventh inning for over 12 months. Corporate earnings are the largest contributor toward this.

As you can see from the chart below, the increase of equity prices in 2016 were almost 100% attributed to valuation increasing. Last year, the U.S. market was flat for the year until the election, which then propelled the market forward, not on fundamentals, but more on optimism.



Source: FactSet, MSCI, J.P. Morgan Asset Management. Returns shown are for MSCI gross return indices except for U.S., which represents the S&P 500 index return. Past performance is not necessarily a reliable indicator for current and future performance. Data as of September 30, 2017.

This chart also shows how the market has continued to push higher in 2017. However, it is now due more to corporate earnings and fundamentals. This is a good sign moving forward for the U.S. The Committee feels that the fundamentals of earnings and valuations as well as policies such as the tax reform will have the largest impact on whether the U.S. stays on track for more positive returns in the next few years. It is also likely that the U.S. economy might stay in the seventh inning for the foreseeable future.

How Long Will It Last?

November marks the 101st month of sustained economic growth in the U.S. This is the third longest economic expansion in U.S. history. To become the second longest, we would need to see monthly growth through April 2018 (just five more months). To have the prize of being the longest expansion in U.S. history, we would need to have month-over-month positive growth for 120 months or until June 2019.

Source: Goldman Sachs Global Investment Research, National Bureau of Economic Research, and GSAM.

JPMorgan has told the Committee that they believe this will become the longest in history. Investors are reminded, however, that the economy and the markets are two completely separate things. While the direction of the economy is crucial, the markets are great about overshooting in both the positive and negative direction.

In Closing

In general, the Committee believes that U.S. equities are slightly overvalued presenting a lower annualized rate of return over the next five years. International equities present some additional upside and opportunity.

With incredibly low interest rates and narrow spreads, fixed income is not overly attractive from a return standpoint. The largest reason to own fixed income in this environment is to generate some income as well as to reduce potential risk in the portfolio.

As always, if you do not have a meeting set up with your advisor, please contact our office at (480) 466-7070 to get something on the calendar.

Interesting Facts

- Investment managers are now using big data for portfolio management (for example, 74 billion credit card transactions every year to forecast corporate sales growth up to two weeks prior to earnings announcements). (Goldman Sachs)
- Currently, in the 101st month in economic recovery, at 106 months, we will be in the second longest. If we hit 120 months, that would be the longest. (New York Life/MainStay Investments)
- Airbnb now has a similar market cap to Marriott. However, Airbnb only has 1,200 employees vs. Marriott's 300,000 employees. (MFS Investment Management)
- Uber now has a similar market cap to General Motors. However, Uber only has a fraction of the employees. (MFS Investment Management)
- Since this time last year, the S&P 500 has gained more than 21% in price — the third highest for all presidents since WWII. Only President John F. Kennedy (27.0%) and President George H. W. Bush (22.2%) had higher first-year results. (CFRA Research)

Interesting Facts (Continued)

- On average, the S&P 500 continued sailing along for another year after the conclusion of a president's first year since being elected before slipping into a new decline of 10% or more. The shortest time was only 36 calendar days after the conclusion of JFK's first year when the S&P 500 slipped into a new bear market. The longest stretch was 1,435 days, or nearly four years, after President Bill Clinton was voted into office. (CFRA Research)
- It has generally taken longer to slip into a meaningful decline during bull markets that were already long in the tooth. Indeed, the S&P 500 continued to rise an average of nearly 600 days beyond the first anniversary when bull markets were at least 1,000 days old, versus a lifespan of 380 days for shorter bull markets. Therefore, should history repeat, and there is no guarantee it will, this bull could continue to surprise investors with its resiliency. (CFRA Research)

Announcing Certified Fiduciary Services

Strategic Income Group is pleased to announce its new, wholly-owned subsidiary company, Certified Fiduciary Services, Inc.

Certified Fiduciary Services provides a variety of estate and trust administration services that complement Strategic Income Group's offerings. Clients will now enjoy more seamless financial services with the two companies working together.

Visit CFSArizona.com to learn more today!

Strategic Tax, LLC Is Coming for 2017 Taxes

You read that right.

In an effort to constantly improve as an organization, we are establishing a tax planning and tax preparation practice within our firm.

Now it will be even easier for clients as you will be able to have your taxes done at our office allowing us to provide you with even more comprehensive financial planning solutions.

What Are Investment Manager Meetings?

At Strategic Income Group, we believe in reviewing detailed investment research. Every 90 days we set aside a week during which around 7 to 10 investment managers give us recommendations on our current portfolios as well as share their firms' current views on the market and economy. This recap is our commentary on the most recent meetings.

Did You Know?

Strategic Income Group has an official financial planning process called "The Three Phases of Wealth" designed to help you wherever you're at in your financial journey.

Visit http://strategicincomegroup.com/start/ to learn and set some financial goals!

Join Our Team

Strategic Income Group is hiring for receptionist and CPA positions.

If you or someone you know would be a good fit for our team, you can contact us or learn more at http://strategicincomegroup.com/join-our-team/.

Questions?

If you have any questions whatsoever regarding our investment manager meetings or any of the notes, give us a phone call or stop by our office:

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