

MARKET REVIEW & COMMENTARY

JANUARY 2018



TELEMUS[®]

Diana Joseph, Co-Chief Investment Officer
Direct: (312) 870-1902 • djoseph@telemus.com

David Post, Co-Chief Investment Officer
Direct: (424) 281-1125 • dpost@telemus.com

Enrich your life. Enjoy your wealth.

MARKET REVIEW

JANUARY

2017's ebullient bull run continued into the first month of 2018. As well, large caps continued their outperformance over small caps. However, January cut short value's nascent resurgence and growth outperformed value by more than two-to-one in most cases. As well, U.S. stocks slightly outperformed international and emerging markets won the performance derby as in December. Most categories of fixed income experienced modestly negative returns as interest rates rose. Most alternatives and real assets sported positive returns, with real estate the only laggard.

Specifically, the S&P500 rose +5.73% while high dividend payers gained a lesser +3.86%. Large cap growth gained +7.08% while large cap value gained only +3.87%. Small cap growth advanced +3.90% while its value counterpart eked out only +1.23%. Emerging markets, the month's best performer, gained +8.33%, while frontier markets rose +5.73%. EAFE climbed +5.02% while Europe was up +5.40%.

Fixed income returns varied markedly but the theme was clear. The longer the duration, the worse the return. Corporates and municipals generally did better than Treasuries. Riskier and diversifying bonds were mostly positive. Thus, 10-20 year Treasuries dropped -2.66%, the Bloomberg Barclays long credit index lost -1.28%, 10 year municipals were down -1.53% and TIPS lost -0.86% in January. 3-5 year Treasuries lost -0.98%. 1-5 year credit lost -0.44% while T-bills gained a skinny +0.12% and 3 year municipals

eked out a +0.15% gain. World bonds garnered a +1.64% return and high yield paper rose +0.60%. Perhaps presaging an ugly February, emerging market bonds lost -0.50%.

Alternatives and real assets were generally up as returns spanned a wide range. The HFRX Global Hedge Fund Index gained +2.45%, global natural resources climbed +2.05%, the Bloomberg Commodity Index rose +1.99%, global real estate was up +0.57% and precious metals gained a modest +0.38%. The dollar continued to drop, losing -3.25% while U.S. real estate fell -2.87%.

World markets started 2018 like a rocket. Markets focused upon the economics, which are quite positive. Global growth remains synchronous, good and rising. Valuations remain toward the high-end in the historical record, but so does corporate earnings growth. The forward P/E ratio on the S&P 500 was 18.2x versus the 20 year average of 16.0x while earnings growth for the next 12 months is projected at 10.1% versus the 20 year average of 5.8%. February reminded us of our oft-stated longer term concerns – a global debt buildup, the implications of reduced quantitative easing and the possibility that growth is so good as to spur more interest rate increases than the markets will tolerate without reducing valuations. We have been banging the drum for investors to make sure that their asset allocations are appropriate for their risk tolerance and we have aggressively rebalanced portfolios as stocks rose over targets.

INDEX RETURNS AS OF 1/31/2018

BASIC INDEX RETURNS

	MONTH TO DATE RETURN	QUARTER TO DATE RETURN	YEAR TO DATE RETURN	LATEST 3 YEARS RETURN	LATEST 5 YEARS RETURN	LATEST 10 YEARS RETURN
BALANCED INDEX (25% ACWI, 60% US Gov. Cr 1-5, 5% HFRX, 5% commodity, 5% bill)	1.32%	1.32%	1.32%	10.72%	16.08%	31.25%
HFRX GLOBAL HEDGE FUND INDEX	2.45%	2.45%	2.45%	7.56%	11.34%	-0.25%
CPI - SEASONALLY ADJUSTED	0.00%	0.00%	0.00%	5.66%	7.25%	16.85%
S&P 500 COMPOSITE	5.73%	5.73%	5.73%	50.73%	107.13%	151.14%
LIPPER LARGE - CAP CORE	5.49%	5.49%	5.49%	46.64%	95.66%	129.38%
WISDOM TREE LARGE CAP DIVIDEND	3.86%	3.86%	3.86%	45.87%	94.80%	131.26%
MSCI ALL COUNTRY WORLD INDEX NET	5.64%	5.64%	5.64%	40.12%	67.40%	78.42%
MSCI EAFE NET	5.02%	5.02%	5.02%	30.90%	45.02%	38.08%
BLOOMBERG BARCLAYS MUNICIPAL BOND 5Y (4 - 6)	-0.23%	-0.23%	-0.23%	3.42%	8.69%	37.67%
BLOOMBERG BARCLAYS US AGGREGATE	-1.15%	-1.15%	-1.15%	3.47%	10.54%	43.69%
BANK OF AMERICA / MERRILL LYNCH US T - BILL 3MONTH	0.12%	0.12%	0.12%	1.36%	1.46%	3.62%

EXTENDED INDEX RETURNS

	MONTH TO DATE RETURN	QUARTER TO DATE RETURN	YEAR TO DATE RETURN	LATEST 3 YEARS RETURN	LATEST 5 YEARS RETURN	LATEST 10 YEARS RETURN
RUSSELL 1000 GROWTH	7.08%	7.08%	7.08%	60.21%	125.90%	197.25%
RUSSELL 1000 VALUE	3.87%	3.87%	3.87%	38.77%	86.34%	111.91%
RUSSELL MIDCAP GROWTH	5.66%	5.66%	5.66%	44.19%	100.83%	167.76%
RUSSELL MIDCAP VALUE	2.30%	2.30%	2.30%	34.41%	87.31%	150.33%
RUSSELL SMALL CAP COMP GROWTH	5.25%	5.25%	5.25%	45.73%	106.17%	183.64%
RUSSELL SMALL CAP COMP VALUE	1.33%	1.33%	1.33%	34.81%	73.86%	130.67%
MSCI EM (EMERGING MARKETS) NET	8.33%	8.33%	8.33%	39.86%	31.74%	42.17%
BLOOMBERG BARCLAYS US TREASURY BILL 6 MONTH	0.12%	0.12%	0.12%	2.01%	2.33%	6.77%
BLOOMBERG BARCLAYS US AGENCY	-0.73%	-0.73%	-0.73%	2.19%	6.43%	28.62%
JP MORGAN EMERGING MARKET BOND INDEX(EMBI) + COMPOSITE	-0.50%	-0.50%	-0.50%	19.59%	19.49%	90.43%
CITI GROUP WORLD GOVERNMENT BOND	1.64%	1.64%	1.64%	7.34%	3.79%	27.29%
BLOOMBERG COMMODITY	1.99%	1.99%	1.99%	-9.64%	-36.17%	-51.14%
PHILADELPHIA STOCK EXCHANGE GOLD / SILVER	2.80%	2.80%	2.80%	10.40%	-42.31%	-52.52%
LIPPER GLOBL NAT RES	2.05%	2.05%	2.05%	16.24%	1.75%	-13.97%
LIPPER PRECIOUS METAL FUND	0.38%	0.38%	0.38%	10.87%	-36.40%	-36.67%
MSCI WORLD REAL ESTATE	0.57%	0.57%	0.57%	13.63%	35.32%	42.59%
LIPPER REAL ESTATE FUND	-2.97%	-2.97%	-2.97%	8.06%	36.94%	59.93%

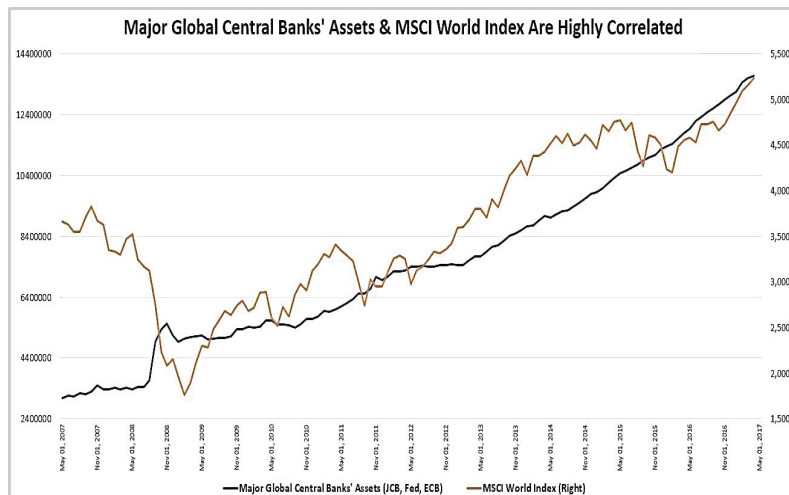
MARKET REVIEW

dis-pas-sion-ate *adjective*

Not influenced by strong emotion, and so able to be rational and impartial.

For over a year, (in numerous publications), we have been advising that the reduction in the growth of global Central Bank money-printing would reintroduce volatility into global markets heretofore soothed by flowing oceans of liquidity.

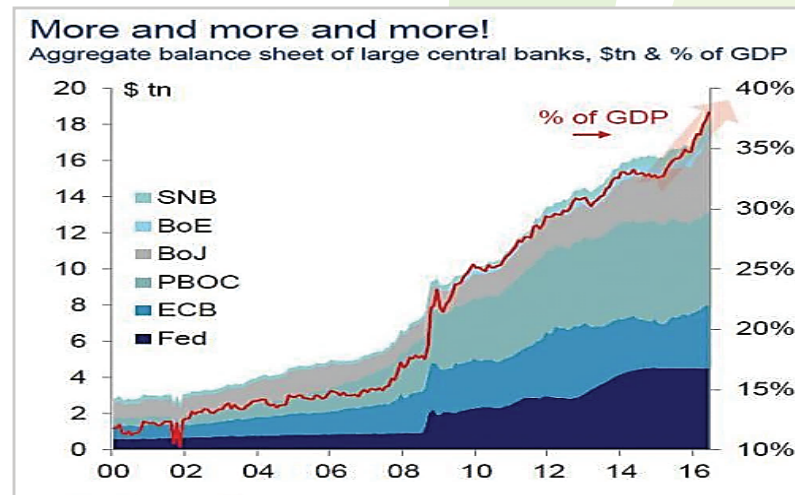
Central Banks Have Supported Markets



[Source: Time Money, Bull Market Ending with Balance Sheet Unwinding?, July 6, 2017.]

We have also discussed the market risks of the world economy beginning to grow on its own as Central Banks reduced the crutch of too much liquidity. That time is here.

Stimulus Withdrawal Could Hurt



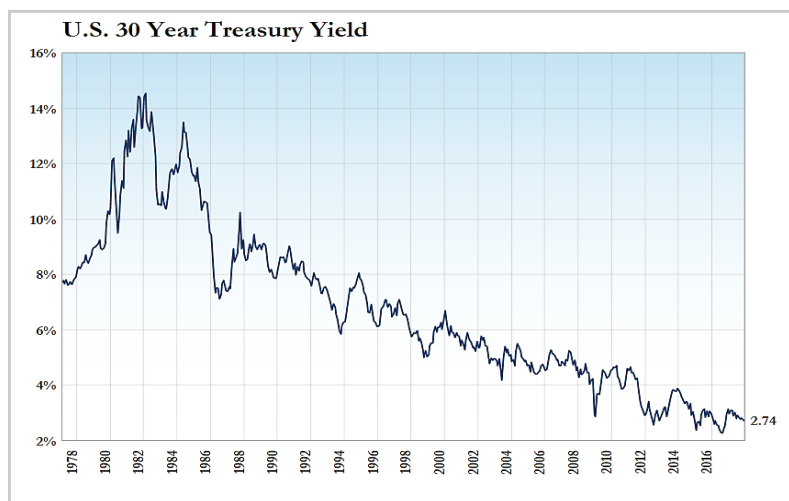
[Source: Citi Research, Haver, July 2017.]

MARKET REVIEW

Stocks closed January on a strong note although the end of month witnessed the reappearance of the concerns we note above in the form of rising interest rates, a very strong jobs report and average hourly earnings increases of 2.9% year-over-year. These concerns were reflected in mostly negative bond returns. Interest rates rose, but not evenly as the long end saw larger increases, slightly reducing the flattening we have seen in the past months.

We have been here before, it's just been a long time since economic news has been so good. We may be back at that

Has Been Declining For Years



[Source: Thomson Reuters Datastream]
Data Through 01/26/2018

stage of cycle when good news is bad news – it is a bit too soon to tell. This paradoxical dynamic can cause the things that are good for the economy to be difficult for the markets – i.e., reduced Central Bank money printing, and Central Banks continuing to raise rates. Both things have been in process over a year but this might be the time when the tug-of-war gets bolder.

Accordingly, below are a few observations that we are keeping in mind in the current market environment:

10 Year Yield Climbing



[Source: Macrotrends]
Data Through 02/05/2018

MARKET REVIEW

- The global economy appears to be on solid footing, but the more evidence we get that the labor market may be overheating the more likely we are to get labor pricing pressure. Given that this is the largest component of inflation, the Fed may become progressively more hawkish in terms of raising interest rates.
- The Fed has the herculean yet nuanced task of unwinding a balance sheet that at \$4.6 trillion is five times larger than it was in 2008. The Fed has plans to reduce their balance sheet by nearly one trillion dollars over the next 12-18 months. At the same time the Federal deficit will likely be at least \$1 trillion for the foreseeable future. The nuanced effort comes into play as the Fed is selling bonds to pay for the deficit and selling bonds to shrink its balance sheet. The supply of U.S. bonds on the market might put upward pressure on interest rates. However, since U.S. rates are much higher than rates of other developed countries it could be that incremental demand could temper any rise. Finally, although the Central Banks do not have a mandate to keep stock markets up, they have hastened printing when global markets headed south before.
- To the extent that global synchronized growth is real, and can stand on its own feet without the aid of Central Banks, there will be a tug of war between strong economics and less liquidity/higher rates. As we have been saying, we expect heightened volatility, in all markets as the interplay works itself out.
- Do not be deterred from your long-term plan by market gyrations. As in many volatile times, gyrations have been amplified by what is now called 'algorithmic trading' and what used to be called 'program trading' (1987 Crash). Also, when institutions' VAR (Value-at-Risk) programs are triggered they must all sell until the equation is leveled again. Use the volatility to add to positions which become attractive and continue to rebalance out of positions which reach fair valuation targets. In this disciplined exercise it is not necessary (because it is not possible) to know the outcome and its timing.



TELEMUS[®]

Enrich your life. Enjoy your wealth.

PAST PERFORMANCE IS NOT A GUARANTEE OF FUTURE RESULTS. This market commentary is a matter of opinion and is for informational purposes only. It is not intended as investment advice and does not address or account for individual investor circumstances. Investment decisions should always be made based on the client's specific financial needs, goals and objectives, time horizon and risk tolerance. The statements contained herein are based solely upon the opinions of Telemus Capital, LLC. All opinions and views constitute our judgments as of the date of writing and are subject to change at any time without notice. Information was obtained from third party sources, which we believe to be reliable, but not guaranteed.