SPRINGWATER
WEALTH MANAGEMENT

Second Quarter 2017 Market Commentary

US stocks concluded the first half of the year on a relatively strong note, raising new concerns about the sustainability of the current bull market, which is now into its eighth year.

The benchmark S&P 500 index rose 8% in the first six months of the year, while the tech-heavy NASDAQ climbed 14%. This is the best start for the S&P 500 since 2013, and for the NASDAQ since 2009.

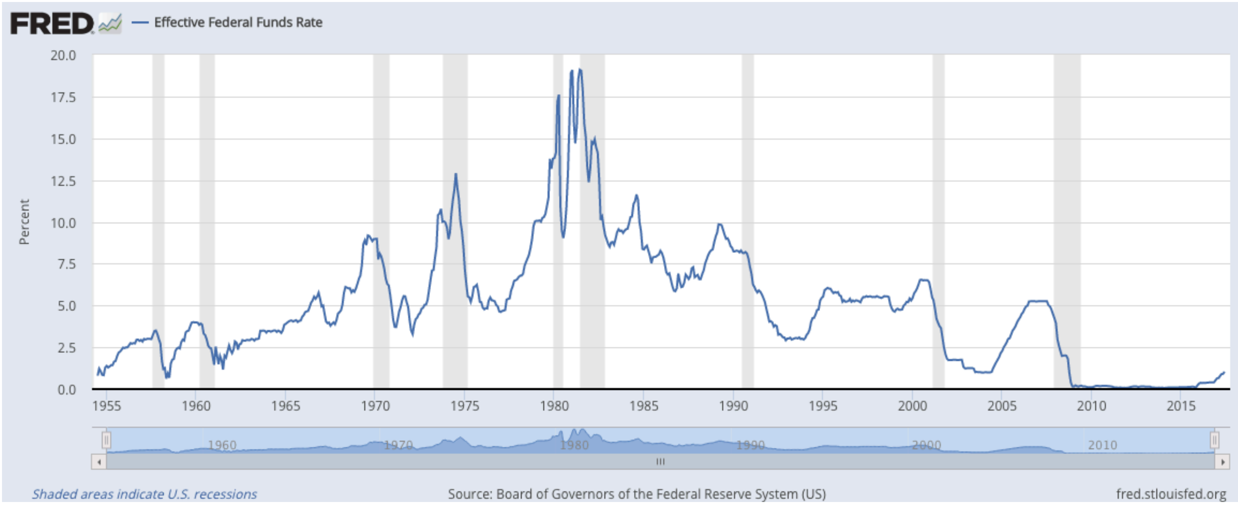
The rally that started in November 2016 on the expectation that the Trump administration would deliver substantive policy changes affecting corporate taxes and infrastructure spending. While those expectations have dimmed significantly, the markets have continued to be driven forward by positive news about corporate earnings and rising consumer confidence. US job growth also remains steady.

The strong start to the year is in marked contrast to the same period in 2016, when the US markets retreated due to worries about the impact on the US economy of slowdowns in Europe and China. This year, improvements in both regions have given investors something to be encouraged about.

Not all stocks have been rising. The US telecoms sector is down over 12% for the year, and the energy sector – which includes oil and gas companies – is down about 14%, as US oil prices have fallen by nearly 16%. The November 2016 OPEC agreement to cut oil output did not have the desired impact on inventories. In May 2017 OPEC decided to extend cuts a further 9 months to March 2018. The global oil market is still in a state of excess supply, with relatively large inventories, rising US production and weak domestic gasoline demand all contributing to the downward pressure on prices.

And the stock market rally will be tested fairly soon, when companies begin to report Q2 earnings. If earnings reports exceed expectations, it's reasonable to expect the run-up to continue. But if earnings disappoint, some investors may view current stock prices as unjustifiably high.

Companies have continued to benefit from the historically low interest rate environment. While the US Federal Reserve has raised its benchmark interest rate twice this year, it remains at a very low level.



Long-term interest rates are also still low, which means that corporations can borrow money inexpensively. The low yields on bonds also mean that it is unlikely that investors will pivot away from stocks to bonds in a meaningful way anytime soon.

Even as US inflation figures remain low, US central bank officials appear committed to the argument that falling unemployment will eventually drive up price growth (read: inflation), and that very gradual tightening (read: interest rate increases) remains appropriate.

Overseas, the impact of efforts to unwind the quantitative easing of 2008-10 was evident as central bank officials in the Euro region and the UK faced a bond market sell-off. Investors are expecting Eurozone bonds to suffer in the coming months as the European Central Bank starts to cut back on its massive purchases of debt, and to end its policy of negative interest rates.

<u>Benchmark Returns</u>
For comparative purposes, the S&P 500 index (a proxy for large US stocks) returned +18.7% for the twelve months to June 30, and rose +3.1% in the second quarter.

The Russell 2000 (a proxy for small US stocks) returned +24.6% for the twelve months to June 30, and rose +2.5% in the second quarter.

The Wilshire 5000 index (a proxy for the broad US stock market) returned +18.7% for the twelve months to June 30, and rose +3.0% in the second quarter.

The MCSI EAFE index (a proxy for large international stocks) returned +17.1% for the twelve months to June 30, and rose +5.0% in the second quarter, as measured in USD. Measured in Euros, the performance was worse: +14.0% for the year and -1.5% for the second quarter.

Finally, the MSCI Emerging markets index returned +21.2% for the twelve months to June 30, and rose +5.5% in the second quarter.

In the fixed income segment, the Bloomberg Barclays US Aggregate Bond Index returned -0.3% for the twelve months to June 30 and +1.45% for the second quarter.

Looking Forward

It seems common sense to understand that "what goes up, must come down", which in investing lexicon is known as "reversion to the mean". Since the last market low of March 2009, investors have experienced returns well in excess of their long-term historical averages. This can obviously not go on forever. Yes, of course, once might say. But aren't these returns just recouping what was lost in the 2008-09 correction? Well, yes and no. One could argue that there has been a pattern over the past 25 years:

1992-99: rally (to excess?)
2000-02: correction (to excess?)
2003-07: rally (to excess!)
2008-09: correction (to excess?)
2010-?: rally (to excess?)

At Springwater, we continue to advocate a prudent, proven investment approach that is focused on controlling what can be controlled – asset allocation, diversification, taxes, expenses and, most importantly, emotions. Over the long-term, investors have historically been rewarded for taking stock market risk with higher returns. We see no reason to expect that this will not continue.

As always, we remain available to answer any questions or comments you may have, and committed to helping you navigate the periodically choppy seas of successful long-term investing.

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For those of you that are not already doing so, we encourage you to follow us on Twitter (at @SpringwaterWM) and/or on Facebook (at https://facebook.com/SpringwaterWealth/). We're conscious of the "information overload" that everyone faces these days, and by using social media we can share with you our thoughts, observations and ideas in the least intrusive manner possible.