SPRINGWATER
WEALTH MANAGEMENT

Third Quarter 2017 Market Commentary

For the US stock market, the third quarter was yet another step on a seemingly unstoppable move upward. It was the eighth consecutive quarter with a positive return – meaning that the last negative quarter occurred in Q3 2015.

Domestic stock prices were supported by a wide range of factors during the third quarter, including a better-than-anticipated result for the Q2 earnings season. This gave weight to the bulls' argument that corporate earnings support the relatively high valuations investors are beginning to worry about. A strong labor market also supported the positive sentiment. Finally, the hope that Congress would pass the Trump administration's business-friendly tax reform framework lifted the market.

The Federal Reserve appears committed to a disciplined approach to raising interest rates. One consequence of this commitment is a weaker dollar. Reduced fiscal stimulus in the US, combined with stronger economic growth overseas, has led the dollar to weaken relative to other major currencies.

Across Europe, economic growth has continued to improve. Consumer spending has recovered, as the stronger labor market has supported consumer confidence. In response to the better economic data, the European Central Bank has indicated that it will begin to reduce its program of "quantitative easing". Less easing from the ECB and a shrinking US Fed balance sheet could push bond prices down and yields up.

In the UK, the news continues to be dominated by the increasingly contentious Brexit negotiations. The European commission has taken a firm stand, arguing that only when the "Article 50" talks have made progress – on issues like the rights of EU citizens in Britain, and Britain's financial obligation to the EU – will they be willing to discuss future trade relations. British prime minister Theresa May's position was severely weakened by the poor election results for her Conservative party, and the political outlook in the UK remains very uncertain. The economic outlook is also cloudy. While unemployment is low, consumer confidence is weak and the London housing market is showing signs of weakness. Despite this, the Bank of England appears committed to an interest rate rise this year. Expectations of a rate rise and a transitional agreement with the EU supported the pound sterling during the quarter, but the stronger currency also explained the relatively poor performance of UK equities when compared to other equity markets in local currency terms.

In Japan, stocks performed well, as the pick-up in global economic growth increased exports 18% year-on-year.

Emerging markets stocks rose over 6% in the third quarter, pushing their year to date returns to roughly 25%. If this level holds for the remainder of the year it would be the best annual return since the bounce-back 75% return in 2009. The MSCI Emerging Markets index has yet to experience any significant pull-backs this year, which is unusual for such a volatile asset class. The strong performance is a reflection of continued corporate earnings growth, a weakening US dollar, and accommodative global monetary policy by the major central banks.

In the fixed income markets, the benchmark 10-year US Treasury note recorded its first positive quarterly result of the year. Consumer prices rose slightly during the period, reinforcing the notion that inflation may finally be moving in the direction of the Fed's 2% target. Yields in the government bond market are now suggesting that investors are expecting inflation will average about 1.8% over the next five years, approaching the 2% goal.

Benchmark Returns

For comparative purposes, the S&P 500 index (a proxy for large US stocks) returned +16.2% for the twelve months to September 30, and rose +4.0% in the third quarter.

The Russell 2000 (a proxy for small US stocks) returned +20.7% for the twelve months to September 30, and rose +5.7% in the third quarter.

The Wilshire 5000 index (a proxy for the broad US stock market) returned +18.6% for the twelve months to September 30, and rose +4.5% in the third quarter.

The MCSI EAFE index (a proxy for large international stocks) returned +16.0% for the twelve months to September 30, and rose +4.8% in the third quarter, as measured in USD. Measured in euros, the performance was worse: +10.3% for the year and +1.1% for the third quarter.

Finally, the MSCI Emerging markets index returned +19.7% for the twelve months to September 30, and rose +7.0% in the third quarter.

In the fixed income segment, the Bloomberg Barclays US Aggregate Bond Index returned +0.1% for the twelve months to September 30 and +0.8% for the third quarter.

Looking Forward

We remain cautiously pessimistic about expected returns in the short- to medium-term. The stock market is now well into an unprecedented eighth year of recovery after the 2008-09 crisis. Stock market valuations – in which current prices are expressed as a multiple of either past or projected earnings – remain relatively high, especially in the US. It is not unrealistic – or overly "bearish" – to expect a correction very soon. The problem with not having a crystal ball with

which to see the future is that we do not know when the correction will come, how severe it will be, or how long it will last.

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.

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