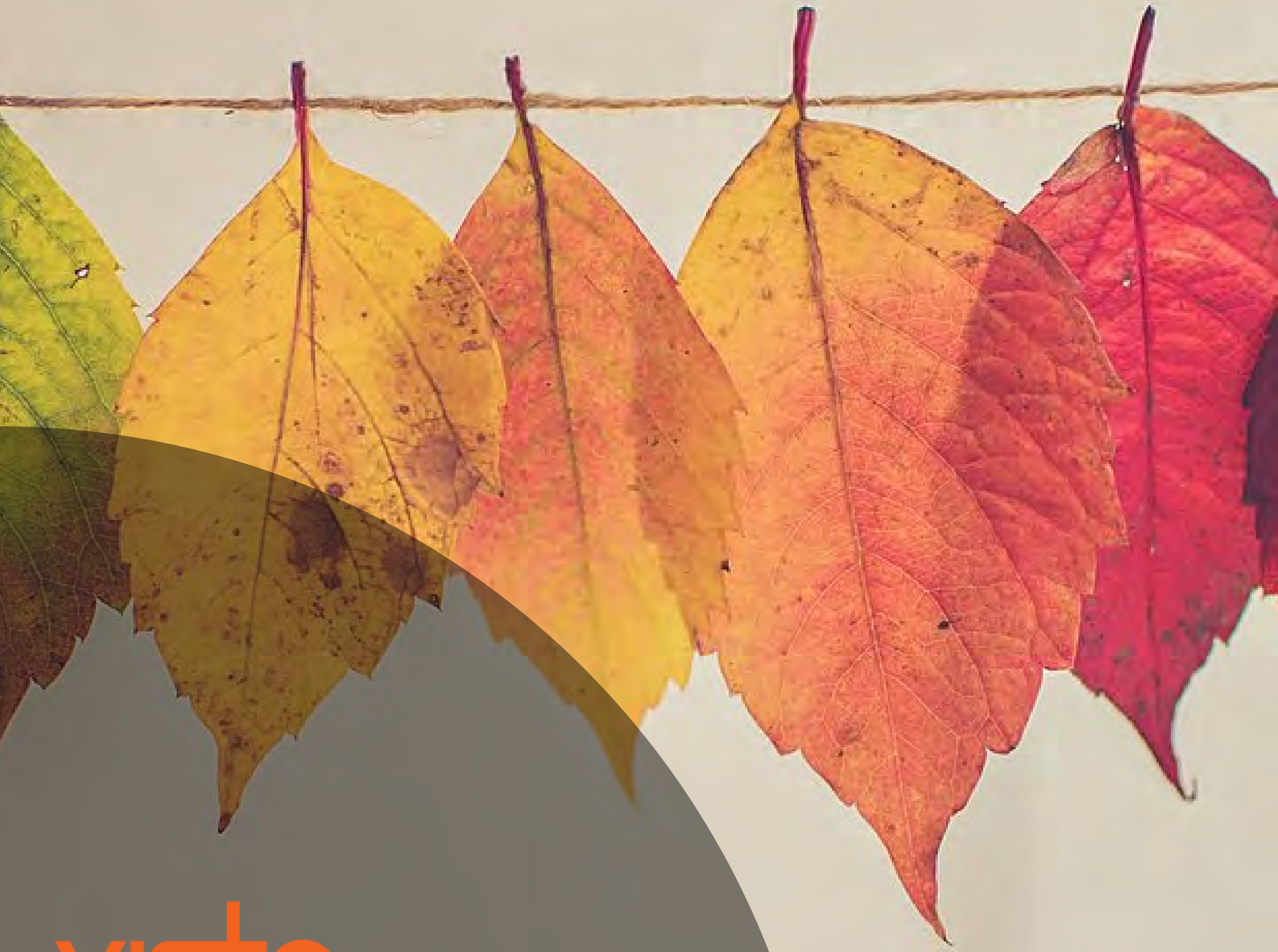

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Investment Briefing

Third Quarter 2017

Introduction

All major asset classes were up in the third quarter.

International stock markets (especially emerging markets) outperformed the U.S., continuing one of the themes this year. Looking out to longer periods, emerging markets have had the best returns over the last 12 months, while U.S. markets are still the highest for periods of five and ten years. Real estate securities and bonds also turned in positive returns for the quarter, although they were the group's laggards.

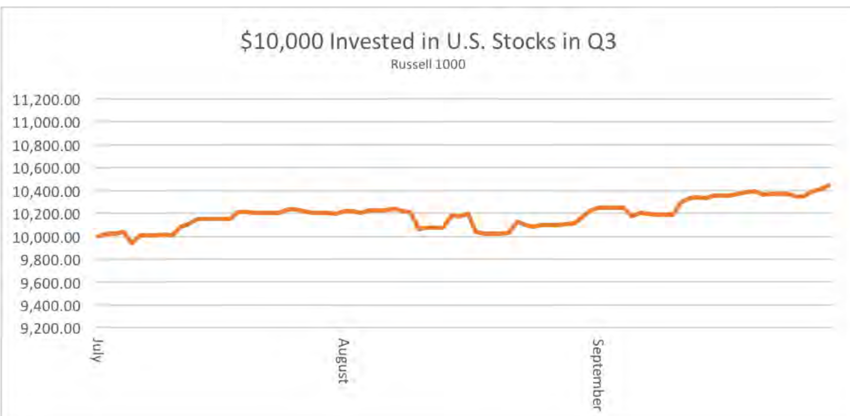
Asset Class[1]	3rd Quarter	12 Months	5 Years (annualized)	10 Years (annualized)
U.S. Stocks (Russell 3000)	4.57%	18.71%	14.23%	7.57%
International Developed (MSCI World ex U.S.)	5.62%	18.73%	7.81%	1.28%
Emerging Markets (MSCI EM)	7.8%	22.46%	3.99%	1.32%
Real Estate Investment Trusts (MSCI World REITs)	1.26%	-0.24%	7.14%	2.05%
Taxable Bonds (Barclays 1-5 Yr Gov)	0.29%	-0.06%	0.83%	2.38%
Municipal Bonds (Barclays Muni 1-5 Yr)	0.53%	1.16%	1.35%	2.81%

References

1. Return data and charts are from Morningstar Direct.

U.S. Stocks: Onward

Calm in the markets is defined as relatively small movements in daily prices.



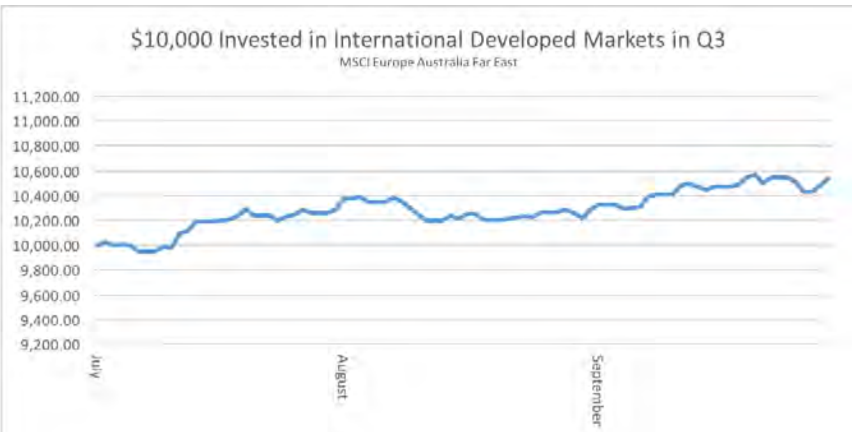
Like the persistence of a 1960's war protestor, U.S. stocks continued climbing. Growth was generally steady in U.S. stocks throughout the quarter. Looking more closely at the numbers, stocks of small companies (small caps) returned 5.7% for the quarter while large companies returned 4.5%. Growth stocks outpaced Value stocks in Q3, but by lower margins than in Q2.

As the market's rally continues, an increasing chorus of predictions are saying that we are due for a correction. Like a watch that's stopped and is therefore right twice a day, the stock prediction will inevitably come true at some time. Here's what to be aware of as time progresses:

- The price-to-earnings ratio of the S&P 500 has slowly climbed to 17.7, which is higher than it has been since 2004. While the P/E ratio is an unreliable short-term market gauge, an elevated P/E usually predicts lower future returns.
- The Federal Reserve continued talking about increasing interest rates and announced it would no longer replace the maturing bonds they purchased to stimulate the economy after the financial crisis (more about this in the bond discussion later).
- U.S. savings rates are down, which could indicate that consumers are feeling a little stretched. On a short-term basis, we'll see how retailers fare in the upcoming holidays, but sales could be slower than expected.
- On the positive side, employment is healthy and there is still a prospect of some tax stimulus coming from Washington. Corporate earnings have also been strong.
- American goods are now cheaper abroad given the relative decline in the value of the dollar. Theoretically, this should lead to more growth in our exports.

Despite the uncertainties it is always best to stay in the stock market with the allocation we recommended for your specific circumstances. Although we don't know when, we do know that stock prices will eventually drop and we've factored the probabilities into your planning. Always keep the long-term view in mind.

International Developed Stocks: It's Go-Go Time



Although we're definitely not in the 1960's, go-go is a fitting term to describe international markets this year with returns of almost 20% year-to-date. Developed markets, of which Europe comprises the largest block, have seen growth that now outpaces ours in the U.S. The Eurozone has now seen its highest rise in output in the last five years and its unemployment rate is lower than it was before the financial crisis.

International markets got two green lights this quarter as both growth and currency values continued to improve. There has been some concern that currencies like the euro and British pound have appreciated a bit too much, threatening to make their goods so expensive abroad that exports take a hit. While that could deal a blow to large exporters, like Germany, any change will be slow moving, subject to change at any time, and Europe's stock markets are still relatively inexpensive. This portends higher relative returns going forward when compared with others, like the U.S.

There was also plenty of good news for these markets. Portugal, one of the sicker countries of the EU after the downturn, regained an investment-grade rating on its bonds. Italy saw its employment rate grow to the highest level in 10 years. But not everything was rosy (it never is). In France, thousands marched against some of Macron's proposed rules for labor and Britain is struggling through the Brexit talks.

Looking at Asia, Japan is still bogged down in deflation but a lower yen should help with exports. Earnings of Japanese companies have also been coming in stronger than in the U.S. In all, it seems that there are still fewer headwinds for international stocks than there are for the U.S. and that will hopefully lead to continuing strength in their stock prices.

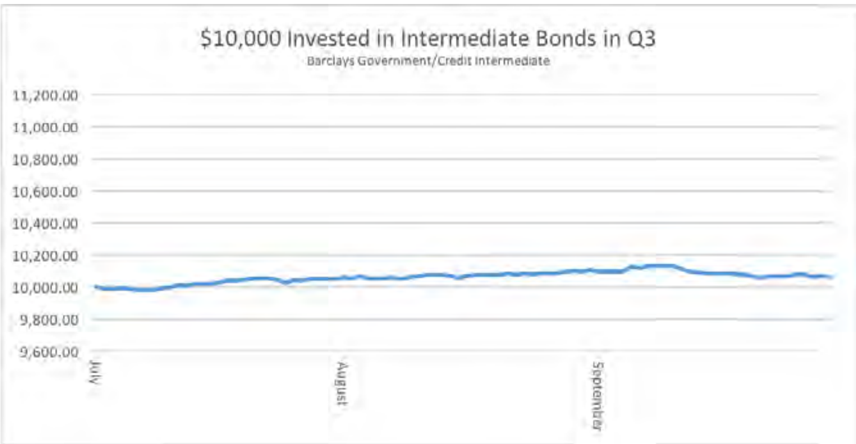
Emerging Markets: The Mod Markets

Emerging markets enjoyed another good quarter, with the MSCI index up almost 8%, bringing its year-to-date growth to almost 28%. A number of factors contributed to this strong rise:

- The best performing emerging country this year has been Poland, followed by China. Each of their markets has been up over 40% so far this year. Reasons cited are usually surprises in economic growth rates or, in China's case, increasing exports.
- India is benefiting from lower commodity prices which in turn have lowered domestic inflation. Steady growth is forecast for India by the International Monetary Fund since switching its cash to battle corruption is now completed.
- Russia appears to be coming out of its two-year recession and has increased demand for its goods and commodities, both internally and for its exports.
- Despite Brazil's ongoing corruption, its economy is coming out of recession because of strong export growth and benign inflation. Brazil's stock market was the best performer in Q3, up almost 24%.

As we’ve seen, emerging market stocks are typically more volatile than others. We always like volatility when it involves positive returns and it always concerns us when returns are volatile and negative. This year is proving the advantage of sticking with a volatile investment through bad times.

Bonds: Modesty Prevails



No bell bottoms, miniskirts and rock and roll for bonds this quarter, although returns were positive. Those returns were well received given the drumbeat coming from the Federal Reserve. Increasing interest rates and reducing other stimulus continued to be hot topics in the Fed's meetings.

More specifically, the Fed increased the target rate for lending between banks and said that they believe one more increase will be made before year-end. This was consistent with market expectations and appears to have already been priced into bonds.

In addition, the Fed also announced their plan for decreasing their balance sheet. As you will recall from previous letters, the Fed aggressively bought bonds during the downturn (what was referred to as Quantitative Easing). Those bonds ballooned the Fed's holdings from about $800 billion in 2008 to about $4.4 trillion today. The issue now isn't so much the size of those holdings but the changes in them going forward.

Rapidly reducing the holdings by selling the bonds back to the banks they came from could pull too much money out of the economy too fast. Instead, the Fed has decided to just let the bonds mature without replacing them. The Fed actually stopped buying bonds a few years ago, but as the bonds it held matured, they would replace them by buying new bonds and that action will now stop. What this means is there will be a very gradual reduction of the bonds the Fed holds and they firmly believe that will happen quietly in the background with minimal effect on economic growth.

Summary: It Isn't the Sixties, But It's Still a Good Dance

With just about all major markets having positive returns over the last four quarters, we continue to be cautious when setting expectations.

It has generally been a very quiet and positive year for both global stocks and bonds. At some point, we know that the quiet will end.

Those uncertainties have been taken into account when we designed your portfolio and recommended it based on your specific financial plan. It's always prudent to keep the downturns in mind even though, hopefully, the rock and roll will continue its beat.

Thanks

We hope this briefing brings a little more light to the numbers in your reports. As always, we look forward to any questions you may have. Thank you for your trust in Vista.

Your Vista Wealth Management Team

Source of all charts and data: Morningstar Direct

Additional Disclosures

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