DeMarche
ASSOCIATES, INC.

# Capital Market Review

*September 30, 2017*

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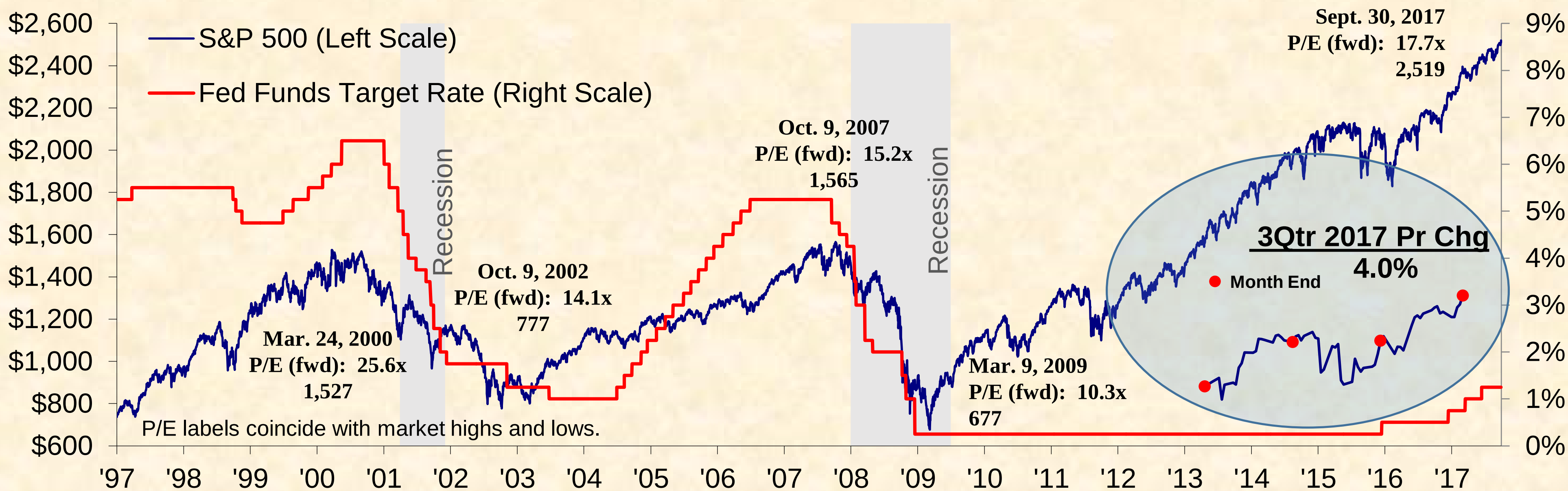
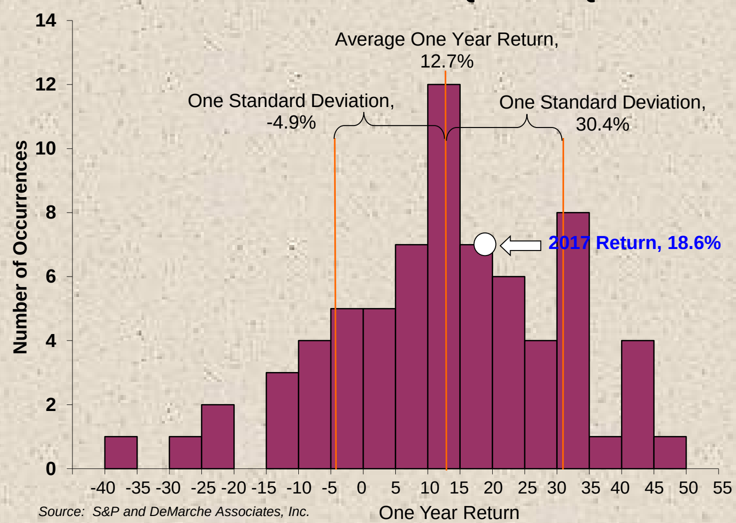
# The Bull Runs

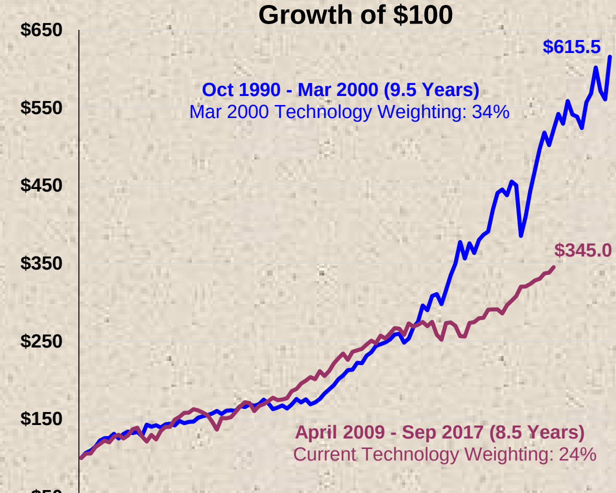



## Frequency Distribution of S&P 500
## One Year Total Returns 3Q1947 - 3Q2017




The solid economy and low volatility resulted in another good quarter for the markets. The last 12-month return of 18.6% for the S&P 500 is clearly better that the longer term average of 12.7%. However, while robust, there have been many 12-month returns that have outperformed since 1947. Similarly, technology has been leading the index upward, as it did in the 1990s but the market, while feeling frothy, is not as overvalued as it was in the "go-go tech bubble." Also somewhat tempering the enthusiasm, GDP growth is modest but steady and the Federal Reserve is implementing a draw down of its balance sheet and has been raising rates for almost a year now. It does stand to reason that stock returns may not be as robust in coming years.

## S&P 500 Bull Market Runs
## Growth of $100




Source: S&P 500, DeMarche, Stock Traders Almanac,CNBC cnbc.com/id/46399386

# BROAD MARKET OVERVIEW

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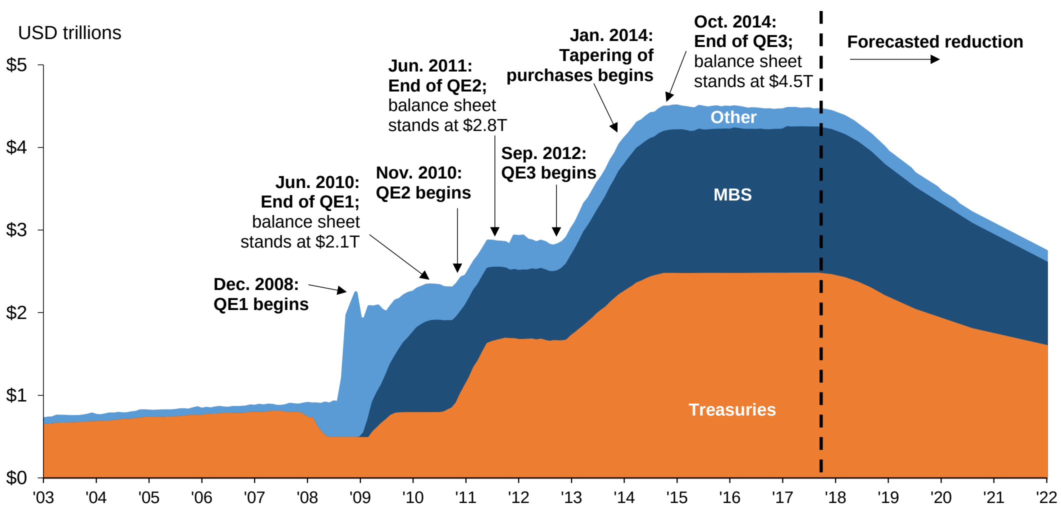
| INDEX | 3rd QTR | YTD | 1-YEAR | 3-YEAR | 5-YEAR | 10-YEAR |
|---|---|---|---|---|---|---|
| MSCI World | 4.8 | 16.0 | 18.2 | 7.7 | 11.0 | 4.2 |
| DeMarche World* | 4.7 | 17.3 | 19.3 | 7.7 | 10.7 | 4.2 |
| DeMarche 3000 | 4.8 | 14.3 | 17.9 | 8.6 | 11.9 | 5.7 |
| Russell 3000 | 4.6 | 13.9 | 18.7 | 10.7 | 14.2 | 7.6 |
| S&P 500 | 4.5 | 14.2 | 18.6 | 10.8 | 14.2 | 7.4 |
| DeMarche International | 4.4 | 20.5 | 20.4 | 7.0 | 9.4 | 2.4 |
| MSCI EAFE USD | 5.4 | 20.0 | 19.1 | 5.0 | 8.4 | 1.3 |
| BlmBarc Aggregate | 0.8 | 3.1 | 0.1 | 2.7 | 2.1 | 4.3 |
| Citigroup Non-U.S. Gov't Bond | 2.6 | 8.6 | -3.1 | 0.5 | -1.1 | 2.7 |
| BlmBarc Global Aggregate | 1.8 | 6.3 | -1.3 | 1.3 | 0.5 | 3.3 |
| NCREIF (Private RE) | 1.7 | 5.1 | 6.9 | 9.8 | 10.3 | 6.2 |
| Bloomberg Commodity | 2.5 | -2.9 | -0.3 | -10.4 | -10.5 | -6.8 |

*Notes: Data are presented as percent returns. All 3, 5 and 10-year returns are annualized. *Does not include Canada or Brazil.*

| Indicator Year Ending 9/30 | 2017 | 2016 | 2015 | 2014 | 50 Year Average |
|---|---|---|---|---|---|
| GDP Annual Growth Rate | 2.3 | 1.5 | 2.4 | 2.9 | 2.8 |
| Unemployment | 4.2 | 4.9 | 5.1 | 5.9 | 6.2 |
| Inflation (CPI) | 2.2 | 1.5 | 0.0 | 1.7 | 4.1 |
| 10-Year Interest Rates | 2.3 | 1.6 | 2.1 | 2.5 | 6.5 |

**The Federal Reserve Balance Sheet**




*Source: Federal Reserve, J.P. Morgan*

- The S&P 500 continues to chug along, notching its 8th straight quarterly advance. Investors continue to believe in the strength of the U.S. economy. Solid earnings and economic data continue to buoy stocks.

- Investors also see strength in the broader global economy. This marks the 3rd straight quarter (and 4 out of the last 5 quarters) that the broader international index has outperformed domestic stocks. Still, 3-year performance lags the broader domestic index, due primarily to stronger U.S. economic performance over that period.

- The dollar came into September having suffered six consecutive months of decline. By the end of September, the dollar began a rebound on renewed expectations of tighter Fed policy. The Fed met on September 19-20 and affirmed that the U.S. economy appears strong enough to warrant another rate increase by the end of the year.

- The Federal Reserve confirmed on September 20 that it will begin shrinking its portfolio by allowing $6 billion in Treasuries and $4 billion in mortgage-backed securities to mature every month without reinvesting principal. The plan is to gradually increase the amount to $30 billion and $20 billion a month, respectively. At the end of September, the Fed held $2.5 trillion in Treasuries and $1.8 trillion in mortgage-backed securities.

## DeFact

S&P 500 volatility usually picks up in September, except for this year. In fact, this September was the least volatile September in the past 50 years, averaging only 40 basis points intraday movement during the month. Volatility increases the chance of a negative return, so with less volatility during September, this is the first September in the past 5 years with a positive return for the S&P 500.

~ CNBC

# DOMESTIC EQUITIES

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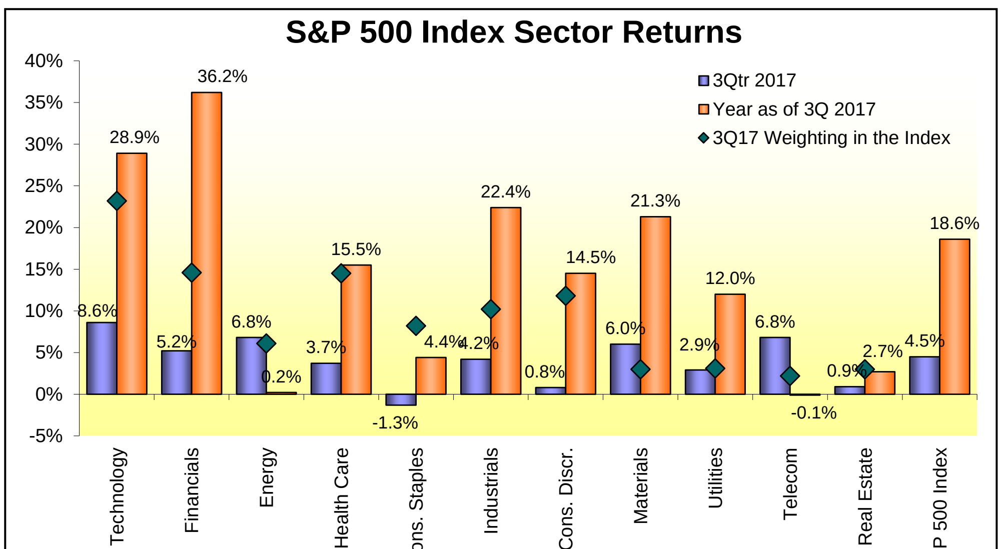
| INDEX | 3rd QTR | YTD | 1-YEAR | 3-YEAR | 5-YEAR | 10-YEAR |
|---|---|---|---|---|---|---|
| DeMarche Growth | 5.3 | 19.0 | 21.2 | 11.4 | 13.7 | 7.2 |
| DeMarche Value | 4.2 | 9.0 | 14.1 | 5.2 | 9.9 | 3.9 |
| DeMarche Aggressive | 8.2 | 10.8 | 15.6 | 3.3 | 11.0 | 3.4 |
| DeMarche Defensive | 4.6 | 14.7 | 18.1 | 9.1 | 11.9 | 5.8 |
| DeMarche Large Cap | 4.9 | 15.0 | 17.7 | 8.4 | 11.5 | 5.0 |
| Large Cap Growth | 5.5 | 20.3 | 21.4 | 11.7 | 13.8 | 6.8 |
| Large Cap Value | 4.1 | 9.2 | 13.6 | 4.6 | 9.0 | 2.8 |
| DeMarche Small Cap | 7.4 | 11.7 | 23.5 | 11.5 | 13.9 | 7.9 |
| Small Cap Growth | 7.6 | 14.5 | 25.6 | 11.5 | 12.8 | 6.7 |
| Small Cap Value | 7.2 | 9.4 | 21.8 | 11.4 | 14.6 | 8.6 |
| S&P 500 | 4.5 | 14.2 | 18.6 | 10.8 | 14.2 | 7.4 |
| S&P Mid-Cap 400 | 3.2 | 9.4 | 17.5 | 11.2 | 14.4 | 9.0 |
| S&P Small-Cap 600 | 6.0 | 8.9 | 21.1 | 14.1 | 15.6 | 9.3 |
| Russell 1000 | 4.5 | 14.2 | 18.5 | 10.6 | 14.3 | 7.5 |
| Russell 1000 Growth | 5.9 | 20.7 | 21.9 | 12.7 | 15.3 | 9.1 |
| Russell 1000 Value | 3.1 | 7.9 | 15.1 | 8.5 | 13.2 | 5.9 |
| Russell 2000 | 5.7 | 10.9 | 20.7 | 12.2 | 13.8 | 7.8 |
| Russell 2000 Growth | 6.2 | 16.8 | 21.0 | 12.2 | 14.3 | 8.5 |
| Russell 2000 Value | 5.1 | 5.7 | 20.5 | 12.1 | 13.3 | 7.1 |

***Notes: Data are presented as percent returns. All 3, 5 and 10-year returns are annualized.***




*Source: S&P 500, DeMarche Associates, Inc.*

- Small cap stocks led large cap stocks in the quarter after underperforming large cap stocks in the second quarter. Small cap stocks now lead large cap in the one-year and the three-year time frames and are on par in longer periods.

- Growth stocks continue to outperform value stocks in all time frames in both large cap and small cap equities. Large cap growth stocks led with a return of 8.6% for technology stocks in the quarter. While in the 2nd quarter, small cap healthcare led, in the 3rd quarter, small cap stocks were led by technology.

- Large Cap value stocks, conversely, were led by financial stocks, which posted a 5.2% return in the quarter. Financial stocks, negative for the quarter until the middle of September, staged a strong rally as the prospects for higher interest rates increased. Conversely, dividend stocks tailed off at the same time. For example, utilities and REITs stocks fell flat by the end of the month.

- The chart at the bottom left shows third quarter returns for sectors as compared to annual returns. The strong performance of technology continues to drive the index forward (and primarily the growth indexes). The rebound in energy in the quarter is largely due to disruption from the Gulf Coast hurricanes.

## DeFact

Technology stocks led the S&P 500 again for the quarter with an 8.6% return. However, this quarter, only the F and the N of the FAANG stocks led the index. Apple, Amazon and Google, all posted relatively lower or negative returns for the quarter at 7.2%, 0.6% and -6.1%, respectively. Facebook was up 14.2% and Netflix was up 21.1%. In fact, the equal-weighted technology index outperformed the cap weighted index by 100 basis points.

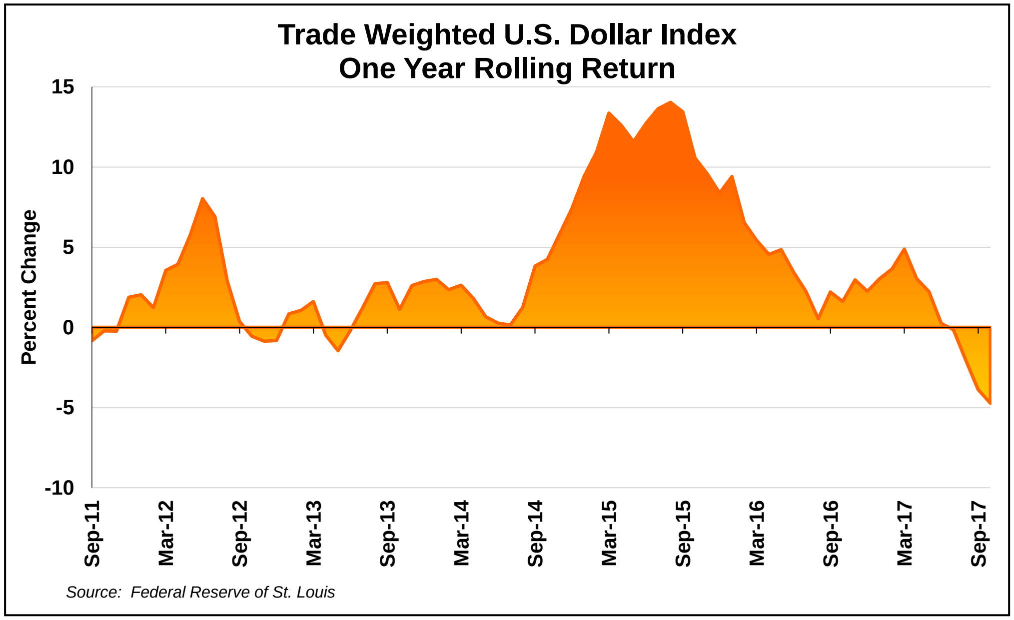
~ DeMarche, Yahoo Finance, Guggenheim

# International Equities

DeMarche ASSOCIATES, INC.

| INDEX | 3rd QTR | YTD | 1-YEAR | 3-YEAR | 5-YEAR | 10-YEAR |
|---|---|---|---|---|---|---|
| DeMarche Int'l | 4.4 | 20.5 | 20.4 | 7.0 | 9.4 | 2.4 |
| Growth | 3.6 | 22.6 | 17.5 | 7.1 | 7.8 | 2.3 |
| Value | 5.7 | 19.1 | 24.0 | 5.4 | 9.7 | 2.1 |
| DeMarche Int'l Small Cap | 3.1 | 21.1 | 23.0 | 8.7 | 11.2 | 5.1 |
| DeMarche EM | 6.1 | 23.1 | 22.1 | 6.0 | 5.4 | 1.4 |
| MSCI EAFE Local | 3.4 | 11.2 | 19.0 | 7.9 | 12.3 | 2.6 |
| MSCI EAFE USD | 5.4 | 20.0 | 19.1 | 5.0 | 8.4 | 1.3 |
| Growth | 4.9 | 22.4 | 15.7 | 6.5 | 8.9 | 2.1 |
| Value | 5.9 | 17.6 | 22.5 | 3.5 | 7.8 | 0.5 |
| MSCI Japan | 4.0 | 14.3 | 14.1 | 7.7 | 10.6 | 1.7 |
| MSCI AC Asia-ex Japan | 6.6 | 30.9 | 22.7 | 7.9 | 7.4 | 3.1 |
| MSCI Germany | 7.7 | 24.2 | 26.1 | 7.7 | 9.9 | 2.0 |
| MSCI France | 8.4 | 26.8 | 30.6 | 7.7 | 10.9 | 1.0 |
| MSCI U.K. | 5.2 | 15.7 | 14.6 | 0.8 | 4.9 | 0.7 |
| MSCI EAFE Small Cap | 7.5 | 25.4 | 21.8 | 11.1 | 12.8 | 4.6 |
| MSCI EM | 7.9 | 27.8 | 22.5 | 4.9 | 4.0 | 1.3 |
| MSCI All Country-ex U.S. | 6.2 | 21.1 | 19.6 | 4.7 | 7.0 | 1.3 |

***Notes:** Data are presented as percent returns. All 3, 5 and 10-year returns are annualized.*




- As the dollar has weakened during the year, international stocks have outperformed domestic stocks and now one-year dollar returns are on par with local currency returns. In addition, growth has stabilized in Europe as the political disruption of the past few years has subsided.
- Emerging market stocks have particularly benefitted from the translation of local returns into dollars. But emerging market stocks also are being powered by strong earnings and lower multiples. One-year returns still significantly outperform longer-term returns.
- Asian stocks have also posted strong one-year returns. As in the U.S., tech stocks are leading the way. Tech makes up over 27% of the Emerging Market index, up from 2% in 1995. Leading tech stocks exist in Asia, led by giants Alibaba, Tencent and Samsung which make up a combined 13.2% of the index and returned a weighted-average 61.3% for the past 12 months.
- The chart at the bottom left shows the trade-weighted dollar exchange rate. Since late 2015, the dollar has weakened, especially losing steam in 2017. International returns are positively impacted by a weakening dollar. A weaker dollar will also tend to increase the price of imported products, thereby leading to higher inflation.

## DeFact

Overseas pension funds are dialing up the risk as the developed world's population rapidly ages. Ultra-low interest rates have left pension plans grappling with deficits just as retiree numbers begin to swell. Typically, international pension plans were dominated by government bonds. Now plans are allocating to corporate investment grade and high yield credit, real estate and infrastructure to generate income.

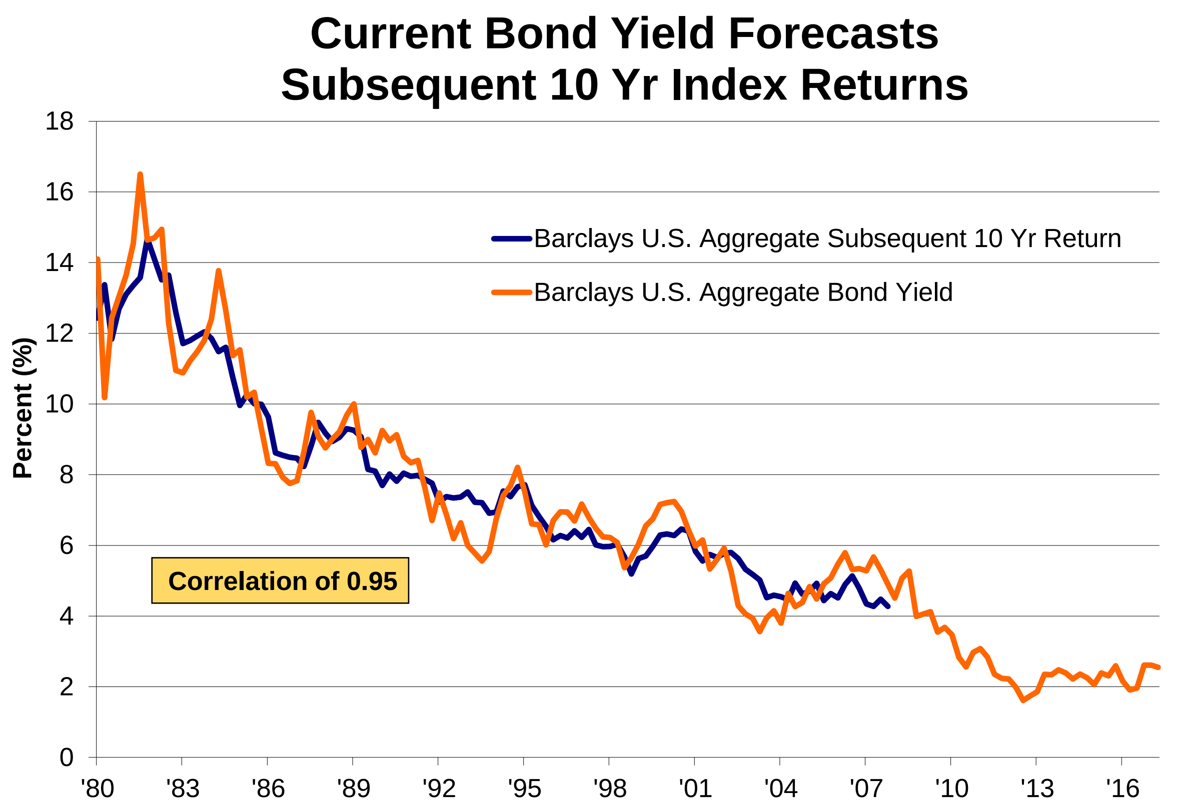
~ WSJ

# FIXED INCOME

DeMarche ASSOCIATES, INC.

| INDEX | 3rd QTR | YTD | 1-YEAR | 3-YEAR | 5-YEAR | 10-YEAR |
|---|---|---|---|---|---|---|
| BlmBarc U.S. TIPS | 0.9 | 1.7 | -0.7 | 1.6 | 0.0 | 3.9 |
| BlmBarc Aggregate | 0.8 | 3.1 | 0.1 | 2.7 | 2.1 | 4.3 |
| BlmBarc Gov Credit Long | 1.5 | 7.7 | -0.8 | 5.5 | 3.9 | 7.4 |
| Merrill Lynch High Yield | 2.0 | 7.1 | 9.1 | 5.9 | 6.4 | 7.7 |
| CSFB Leveraged Loan | 1.1 | 3.0 | 5.4 | 4.0 | 4.4 | 4.4 |
| JPM Emerging Mkt Debt Global | 2.4 | 8.7 | 4.2 | 6.1 | 4.3 | 7.3 |

***Notes: Data are presented as percent returns. All 3, 5 and 10-year returns are annualized.***




*Source: DeMarche Associates, Inc.*

- Longer-term rates exhibited some variance in the quarter but basically ended the quarter where they began. The 10-year Treasury opened the quarter at 2.31% and ended at 2.33%. Longer-term returns were driven by the coupon earned.
- Corporate bond spreads remained tight to Treasuries during the quarter. Very little change in yield and in spreads meant that investors earned the coupon in their corporate bond holdings. High yield bonds exhibited the same effect.
- The continued weakening of the dollar in the quarter helped emerging market debt returns. Debt denominated in dollars is easier to repay as the dollar weakens as compared to other currencies. In addition, emerging market debt has experienced spread tightening (as with other bond sectors), positively influencing longer term returns.
- The chart at the bottom left shows how closely long-term bond returns track current yields. If the trend holds, bond returns, as measured by the Bloomberg Barclays Aggregate, will measure about 2% over the next ten years. The chart shows that this trend began in 2013 and does not look to end anytime soon.

## DeFact

Not only is stock market volatility at long-term low levels, 10-year Treasury note volatility is also at historical low levels. In the past ten years, volatility has only been this low twice - in May 2013, at the beginning of the "taper tantrum" and in October 2016, right before the "reflation" spike in rates just after the U.S. election. In both instances, rates subsequently increased in a short amount of time.

~ CBOE, Forbes, DeMarche

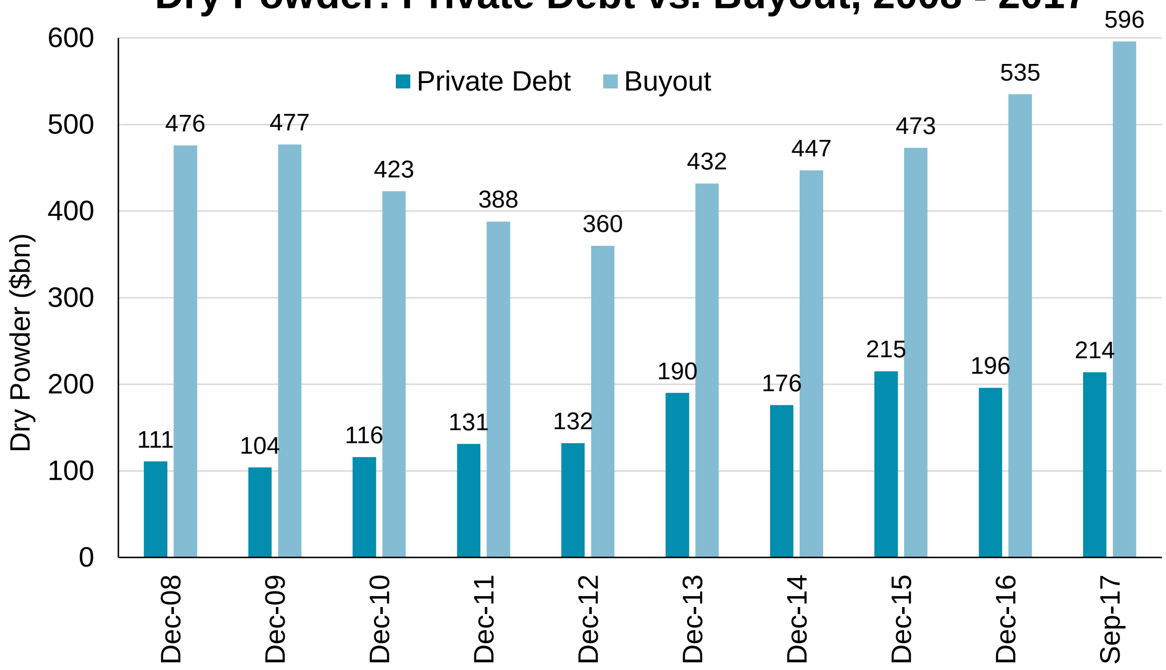
# LESS LIQUID STRATEGIES

DeMarche ASSOCIATES, INC.

| INDEX | 3rd QTR | YTD | 1-YEAR | 3-YEAR | 5-YEAR | 10-YEAR |
|---|---|---|---|---|---|---|
| NCREIF Property (Private RE) | 1.7 | 5.1 | 6.9 | 9.8 | 10.3 | 6.2 |
| Apartment | 1.7 | 4.5 | 6.2 | 8.9 | 9.5 | 6.1 |
| Industrial | 3.3 | 9.5 | 12.8 | 13.6 | 13.0 | 7.1 |
| Office | 1.4 | 4.3 | 5.7 | 8.7 | 9.3 | 5.2 |
| Retail | 1.2 | 4.3 | 6.1 | 10.4 | 11.5 | 7.8 |
| NAREIT (Public RE) | 1.2 | 6.7 | 3.6 | 10.3 | 9.9 | 6.1 |
| NCREIF Timberland | 0.6 | 2.1 | 3.3 | 5.2 | 7.1 | 5.2 |
| HFR FOF Composite | 2.3 | 5.6 | 6.5 | 2.2 | 3.8 | 1.1 |
| Conservative | 1.2 | 2.8 | 4.5 | 1.8 | 3.5 | 1.0 |
| Diversified | 2.4 | 4.7 | 5.9 | 2.0 | 3.7 | 1.1 |
| Strategic | 2.9 | 8.6 | 8.9 | 2.9 | 4.5 | 1.1 |
| Bloomberg Commodities | 2.5 | -2.9 | -0.3 | -10.4 | -10.5 | -6.8 |

***Notes: Data are presented as percent returns. All 3, 5 and 10-year returns are annualized.***

**Dry Powder: Private Debt vs. Buyout, 2008 - 2017**




*Source: Preqin*

- REITs posted positive returns during the quarter, but lag small cap value stocks in the past one, three and five years. Over the longer term, REITs tend to produce returns more closely to that of real estate than to other small cap stocks.
- Commodities produced a positive return for the 3rd quarter, primarily due to the increase in energy prices brought about by disruption from the Gulf Coast hurricanes. Energy returns of the index were up almost 12% for the quarter.
- Hedge funds continued their steady performance this quarter. The composite has now notched 11 straight months of positive returns, the longest streak since 2003. Drivers of performance have shifted during the year as technology, healthcare and energy switched leadership.
- The chart to the left shows the amount of "dry powder" piling up. So called "dry powder" is the money that private equity and debt managers have raised but have not yet invested. A little amount of funds sitting on the sidelines can be a good thing if the managers are being picky about finding attractive deals. However, an excess amount means that those funds are sitting in cash and earning next to nothing in return.

## DeFact

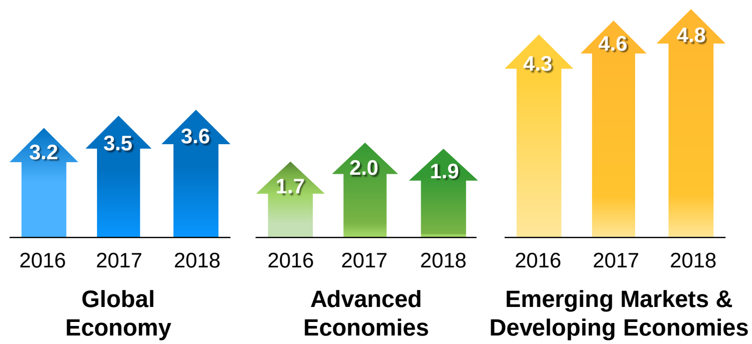
China is closing the gap with the U.S. on minting $1 billion startups. This year, 12 of the 33 new $1 billion startups have been based in China. Since mid-2015, the country has produced 34 of these companies while the U.S. has produced 39.

~ The Economist

# Implications from 2017 Client Conference: "The Elephant in the Room"

In today's environment, lower expected growth rates in advanced economies lead to questions:

- How much higher will stocks go?
- Are there any other investment strategies we should consider?

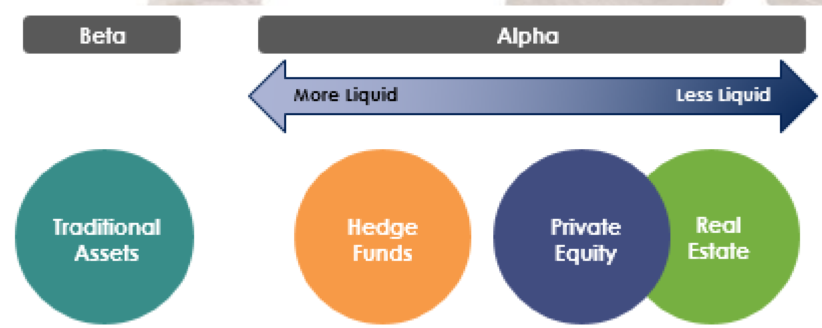



Source: *International Monetary Fund – www.IMF.org*

- Add a diverse blend of alternatives with moderate liquidity, such as private real estate, hedge funds, commodities, energy infrastructure, and REITs.
- Add liquidity premium to your portfolio by including private equity and private debt, considering your unique capital liquidity needs.

Given our modest return assumptions, client action may be necessary to best align investment objectives with risks and return opportunities, including:

- Diversify further to include additional less-traditional asset types, such as US mid cap stocks, emerging markets equity & debt, and bank loans.




**2017 Asset Class Return Assumptions**
**Short Term vs. Long Term**