WAYPOINT
ADVISORS

Fourth Quarter 2017

As part of our year-end review of the markets, we decided to have a little fun and create a quiz touching on some of the interesting stories of 2017. See how you do! You will find the answers embedded in our Market Perspectives below, and as well, on our website at www.waypointadvisors.net/waypoints.

1. **In what year did the S&P 500 have a record number of new highs?**
   A. 1928
   B. 1964
   C. 1995
   D. 2017

2. **Which equity class returned 38% in 2017?**
   A. U.S. Large Cap
   B. U.S. Small Cap
   C. International – Developed Markets
   D. International – Emerging Markets

3. **On November 11 – "Singles' Day" in China – how long did it take Chinese e-commerce platform provider, Alibaba, to equal U.S. Thanksgiving weekend retail sales?**
   A. 14 hours
   B. 1 day
   C. 3 days
   D. Did not reach U.S. Thanksgiving sales

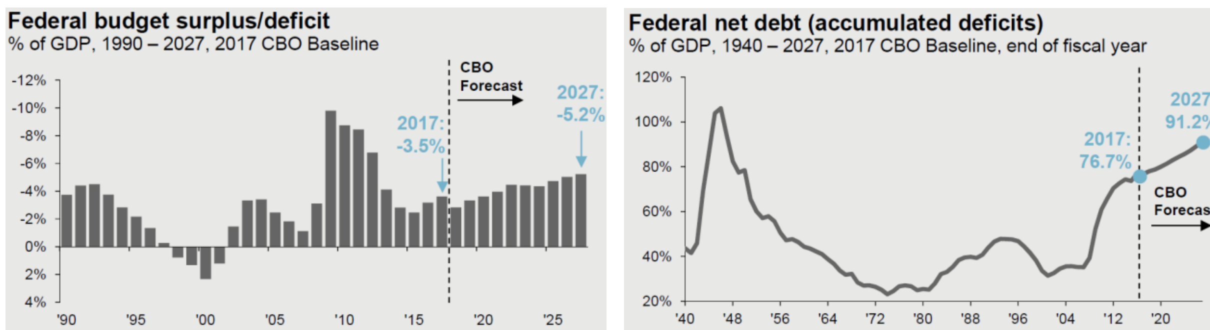
4. **How many times in 2017 did the Federal Reserve raise its benchmark interest rate?**
   A. One
   B. Two
   C. Three
   D. Four

5. **Which of these facts about North Korea is *FALSE*?**
   A. The nickname of North Korean leader Kim Jong Un's haircut is "Ambitious" and all male Koreans are "encouraged" to copy the style.
   B. North Korea is about the size of Delaware.
   C. On the 4th of July, the North Koreans announced that they had given President Trump a "gift" in the form of a successful ICBM launch in honor of U.S. Independence Day.
   D. The North Koreans formed their own time zone called Pyongyang Time.

The bull rages on!

The stream of good economic news continues to pour in from across the globe. Equity markets forge ahead, extending this bull run to nearly 9 years. 2017 recorded 62 highs for the S&P 500, tying it with 1964 for 2nd place behind the 77 highs of 1995. Many prognosticators are predicting the bull market will continue for a 10th year in 2018 – the longest positive run in history without a 20% market correction.

The anticipation of tax cuts supported the bull market of 2017 and the passage of the Tax Cuts and Jobs Act of 2017 is expected to boost the U.S. economy in 2018. While positive in the short run, there are risks. The fiscal stimulus could over-excite an economy at or near full employment, leading to wage inflation and lower profits. Also, the fiscal stimulus is expected to increase the federal deficit and add to the already high federal debt. Projections by the Congressional Budget Office (CBO) reflect this concern in their forecasts.



Source: JP Morgan Asset Management, CBO, BEA, Treasury Department

Seesaw

Last year at this time, we wrote about how great 2016 was for U.S. equities. We also noted the dissonance within the market with value managers outperforming growth managers by nearly 3:1. This dissonance reversed in 2017: growth returns were nearly double the return of value strategies.

Given that our economy has continued to grow robustly and optimism is high, it makes sense that growth strategies would outperform. When things are good, speculation seems less risky and growth investors are often more willing to pay a premium for the prospects of greater return. Value investors on the other hand, who look to buy good companies at a low price, have had few opportunities this past year to shop for bargains. However, drawing comfort in the knowledge that, if historical patterns repeat, they will win in the long run by losing less when the market reverses, value managers are patiently waiting for the time when pessimism once again replaces exuberance.

U.S.	2016		2017	
Equities	**Value**	**Growth**	**Value**	**Growth**
Large Cap	17.3	7.1	13.7	30.2
Mid Cap	20.0	7.3	13.3	25.3
Small Cap	31.7	11.3	11.3	22.2

Here, there and everywhere

International equities, coming off a disappointing 2016, recovered strongly in 2017 at 25.6%, handily outpacing excellent U.S. equity returns of 21.1%.[1] Global economies continue to strengthen with emerging markets leading the pack at 37.8% (the highest performing asset class), bolstered by growing middle classes and increased consumerism. (Consider that the Chinese company, Alibaba, sold more merchandise in 14 hours on "Singles' Day" in China than was sold in the U.S. over the entire Thanksgiving weekend!)

	2016		2017
U.S.	12.0		21.1
International	1.5		25.6
Emerging Mkts	11.6		37.8

While it was a banner year for global equities, other asset classes also had a respectable 2017. Even hedge fund performance improved, returning 7.7% in 2017 vs. 0.5% in 2016.[2] And considering that 3 rate hikes in 2017 by the Fed could have negatively impacted certain bond portfolios, investors with diversified fixed income holdings enjoyed modest gains.

	2016		2017
Hedge FOF	0.5		7.9
Bonds	2.7		3.5

Let the good times roll (but don't forget the brakes)

The frothy bull market and strong economic environment will almost certainly encourage excessive risk taking in the coming months. We were beginning to experience this in late 2017, when even our more conservative clients began asking us about crypto-currency names such as Bitcoin. Since "euphoria" tends to set in at the last stages of a bull market when investors are more tempted to make emotional short-term decisions, it is a good time to step back and try to look at the big, long-term picture.

At the other end of the spectrum, too much of a good thing can make investors wary. Few predicted the extent to which equities would outperform last year and, while there is almost universal agreement that in 2018 the market will continue its bull run, we find that the same nagging question haunts us as it did at this time last year, "With stock valuations so high, can this bull market really continue? And how should we be investing?"

To answer that question, **it is important to understand the risks that can stymie a bull market.** We mentioned some of these risks at the beginning of this report. While we are generally optimistic about the likelihood that the market will continue its upward climb, one risk that we will watch closely is the ability of central banks in the U.S. and across the globe to manage the delicate task of tightening interest rates after so many years of unprecedented quantitative easing. Also, an inflation spike could lead to larger and faster rate hikes which would likely cause expansion to contract. Geopolitical risk is

[1] Returns measured using the following indices: emerging markets – MSCI Emerging Markets, developed markets – MSCI EAFE, U.S. markets – Russell 3000.

[2] Source: Morningstar, Hedge Fund Research, Inc. Indices representing the various categories are as follows: Large Cap – S&P 500, Small Cap – Russell 2000, Small Value – Russell 2000 Value, Small Growth – Russell 2000 Growth, Developed Markets – MSCI EAFE, Emerging Markets – MSCI Emerging Markets, Hedge Funds – HFRI Fund of Funds Composite Index.

also ever present – with North Korea, a country the size of Pennsylvania, providing an unpredictable global quandary. Other risks that could create headwinds this year are oil price increases that could lead to inflation and Chinese policymaker missteps that could damage emerging market growth.

Let's hear it for diversification!

As always, we believe that diversification across all asset classes is the best way to take advantage of strong growth spurts as well as protect portfolios when markets flip flop. When times are good, investors must be careful not to compare the returns of their portfolios with an index that was a high flyer the previous year. Instead, focusing on long term goals and taking advantage of the rebalancing opportunity presented by over or underperformance of different asset classes helps to remove the risk of last year's winner becoming this year's laggard.

With that said, we also believe the current economic environment is a "Goldilocks" scenario with low interest rates, low inflation, and solid economic growth across developed and emerging economies. Enjoy the ride.

We wish you all a wonderful 2018.