ROUND TABLE
WEALTH MANAGEMENT

QUARTERLY REVIEW - THIRD QUARTER 2016

Perhaps one thing that *we can all agree* on, and that which doesn't need *debating,* is the strong performance of risk assets during the last quarter. The S&P 500 was up 3.9%, non-U.S. developed markets were up 6.4%, and emerging markets were a top performer, up 9.2%. Not to be outdone, investment grade and high yield bonds also posted strong returns. This year's best performing asset classes were the absolute worst last year---markets remain cyclical. The overall market returns were in many ways surprising in the aftermath of "Brexit", a low to negative corporate earnings growth environment, a world of negative interest rates in other G7 countries and maybe…maybe… a step to higher interest rates in the U.S. Now with corporate interest rates so low and premium equity valuations in most equity sectors, investors are asking with Axel Rose-like energy, "Where do we go now?"

Patience. We continue to believe investment opportunities are available in the market. However, in this market cycle noted for investors "chasing yield" or buying equities as fixed income substitutes, we believe a higher level of caution is warranted. We discuss our forward-looking views below, but suffice it to say, holding some cash as "dry powder" for the intermediate term is reasonable, in that a modest allocation will not materially impact returns should the markets push higher, given the low-yield environment and low equity risk premiums currently available.

We do not think a 2008 redux is in the making, but as financial advisors our fiduciary role is to be cautious when return potential is limited and proactive when return potential is high. Markets will continue to be cyclical in nature and holding cash and safe haven assets today may provide the ability to capitalize on higher return opportunities tomorrow.

Annualized Benchmark Returns through September 2016*

	1 quarter	YTD	1 year	2 years	3 years	5 years	10 years
S&P 500	3.9%	7.8%	15.4%	7.1%	11.2%	16.4%	7.2%
Russell 2000	9.0%	11.5%	15.5%	8.1%	6.7%	15.8%	7.1%
MSCI World Ex. US Index	6.4%	3.6%	7.7%	-1.4%	0.8%	7.4%	2.4%
MSCI Emerging Markets	9.2%	16.4%	17.2%	-2.6%	-0.2%	3.4%	4.3%
Barclays U.S. Aggregate	0.5%	5.8%	5.2%	4.1%	4.0%	3.1%	4.8%
Barclays Municipal Bond	-0.3%	4.0%	5.6%	4.4%	5.5%	4.5%	4.7%
Barclays U.S. Corporate High Yield	5.6%	15.1%	12.7%	4.3%	5.3%	8.3%	7.7%
FTSE Nareit All REITs	-1.0%	12.6%	20.6%	13.8%	13.7%	15.7%	6.0%
Alerian MLP	1.1%	15.9%	12.7%	-17.2%	-4.8%	5.0%	9.0%

*Source: Zephyr Style Advisor   *Quarter and YTD returns are not annualized.*

The Big Picture (for additional information, click HERE)

The U.S. generated a revised second quarter real gross domestic product growth of 1.4%, up slightly from 1.1% in the government's second estimate. While positive, the economy's growth rate is somewhat underwhelming and likely played a role in the Federal Reserve deciding not to raise its target rate in September. The global growth outlook is modest according to the International Monetary Fund, which suggested that the global economy will grow about 3.4% in 2017, just slightly ahead of its 3.1% 2016 estimated growth rate. The IMF forecasts that developed countries may grow at 1.8%, while emerging and developing economies are expected to grow at 4.6%.

The U.S. continues to be the "best house in the global neighborhood" yet has a host of issues starting with the Presidential election. Regardless of who wins, we expect changes to the tax code and international trade deals. The latter is no small issue. The Trans-Pacific Partnership encompasses nearly 36% of global GDP and impacts existing trade deals such as the North American Free Trade Agreement. Combining that scenario with Brexit negotiations leads to a great deal of uncertainty within international investments. A negative scenario would likely include growing protectionist measures by the U.S. and its trading partners.

As suggested above, absolute low interest rate levels are influencing investor behavior. With several global central banks advocating negative interest rates, foreign investors are finding low interest rate U.S. bonds and premium priced equities downright enticing. In capital markets, "un-natural" holders of a security are those investors that under "normal" circumstances would not be an owner of a given security. Global central bank policies are creating nomadic, un-natural investors in fixed income and equity markets. While recent experience has pushed rates lower (higher prices) and equity valuations higher (again, higher prices), we as investors should remain cognizant of the recent drivers of market returns and never forget that markets are cyclical and nomadic investors may not become permanent.

Summary of Allocation Recommendations

Asset Class	Recommendation	Comment	Asset Class Summary Link
U.S. Large Cap	Neutral	Maintain high quality, earnings growth and valuations in focus	U.S. Large Cap Review
U.S. Small & Mid Cap	Neutral	Valuation risk; stronger earnings growth potential	U.S. Small Cap Review
Non-U.S. Developed	Underweight	Economic growth challenges Negative interest rates remain	International Equity Review
Emerging Markets	Underweight	Impact of higher U.S. rates on currencies	International Equity Review
Fixed Income	Overweight	Government and investment grade bonds to fend off market volatility	Fixed Income Market Review
Tactical	Neutral	Income with appreciation opportunities Profit taking potential	Tactical Investments Review
Alternative	Hedge Funds & Private Equity	For appropriate allocations	Contact your Wealth Advisor

The Outlook

We continue to recommend a neutral allocation to U.S. large cap equities on the basis that the expected return over the next year is in-line with long-term market expectations. Year-to-date the S&P 500 is up 7.8% and our 2016 projection called for mid-to upper-single-digit total returns. Our view for the remainder of 2016 has not changed from that stated in our 2Q 2016 Quarterly Letter. "The U.S. large cap market's upside may be challenging for the remainder of the year with higher bouts of volatility. We recommend seeking higher quality companies with reasonable valuations and/or meaningful dividends. In addition, we recommend active management as select industry sectors and companies with these characteristics have experienced dramatic valuation multiple expansion." As a case in point, the utility and telecommunication sectors were the best performers in the first half of 2016, but valuations in these sectors became stretched. During the third quarter these sectors were the worst performing across the S&P 500. Looking forward we believe the divergence between earnings growth and the S&P 500 Index level cannot continue indefinitely, leaving the door open for multiple contraction.

We are tempering our 2Q 2016 modest overweight recommendation in SMID cap equities to a neutral allocation. SMID cap equities have enjoyed a strong run since June and valuations have increased accordingly. Earnings growth estimates remain higher than U.S. large cap equities though the gap relative to history is smaller. Increasing costs have limited profit margin expansion and thus sales growth is a key focus for 2017. Reductions to allocations should be conducted on a tax aware basis to efficiently harvest profits.

We are recommending an underweight allocation to developed market equities and an underweight to emerging markets. Our developed market underweight continues to be driven by Europe. Economic growth in the European Union was negative in the second quarter and negative interest rates set by the European Central Bank suggest challenges remain. With respect to the markets, valuations within Europe are elevated relative to their historical averages, while earnings growth has been muted. Investor sentiment is negative as demonstrated by meaningful capital outflows since the start of the year.

Despite the very strong returns in emerging markets this year, we remain underweight the asset class. Most of the return was due to favorable currency movements relative to the U.S. Dollar. Should the Federal Reserve decide to raise its target rate in December, we would expect downward pressure on EM investments. Emerging market valuations relative to developed markets are at a historical premium. These high valuations combined with the potential impact of U.S. rate policy, U.S. elections and continued risk in China lead us to reduced allocations in emerging markets.

We maintain our overweight recommendation to fixed income. Similar to last quarter, we advocate clients to have a larger portion invested in "safe haven" fixed income assets given the potential for bouts of market volatility. A refinement of this recommendation includes shortening duration. During the quarter, the U.S. Treasury yield curve has witnessed longer-term bond yields fall as inflation expectations declined. As a consequence, potential rate increases by the Federal Reserve may likely have a more parallel impact on the yield curve (all maturities equally impacted by a rate rise) rather than a greater impact on short term maturities versus long term maturities. Such a development would lead to greater price declines for longer term maturities leading us to advocate shortening bond portfolio duration.

We are tempering our recommendation from an overweight to a broadly neutral allocation to tactical investments. Energy master limited partnerships, non-energy high yield bonds, floating rate loans and convertible bonds have performed admirably this year and in some cases valuations are closer to fair value than at the start of the year. We are not advocating a wholesale liquidation of these investments, and believe some profit taking to be appropriate.

Tax and Financial Planning News

As the Presidential election nears – less than a month away at the time of this writing – it is a good time to reflect on various planning issues that would require action before year-end. Should Hillary Clinton win the election in November, those who have not yet utilized their lifetime gift and estate tax exemption may want to revisit the issue. (Trump proposes eliminating the estate tax.)

As part of the tax proposals on Clinton's platform, she would raise revenue generally by increasing taxes on the wealthiest families, but one issue in particular that she will attempt to change is the gift and estate tax exemption, which currently stands at $5.45 million per taxpayer in 2016 (indexed for inflation). Secretary Clinton's proposal is to reduce that exemption to $3.5 million and raise the top estate tax rate to as high as 65% for very large estates, where it is currently 40% (see: www.hillaryclinton.com/briefings/factsheets). In all likelihood, any changes to the exemption and/or tax rate would not begin until tax year 2017 at the earliest – perhaps even retroactively to January 1 – as Congress has done in the past. Therefore, in order to take advantage of the ability to move assets out of one's estate (and any future appreciation thereon), you might consider gifting any remaining exemption before year-end.

For a broader look at the issues under both candidates' proposals, please see our recent whitepaper entitled "She Said/He Said: The Clinton and Trump Race to the White House" available at THIS link.

Firm News

Please join us in congratulating Adam Sabban for passing Level III of the Chartered Financial Analyst exam.

Ushir Shah (Partner, COO), Steven Saunders, CFA, CAIA (Portfolio Advisor) and Michael Fischer, CFP (Wealth Advisor) all celebrated their fifth-year anniversary with Round Table.

Respectfully submitted,

Round Table Wealth Management