ROUND TABLE
WEALTH MANAGEMENT

QUARTERLY REVIEW – THIRD QUARTER 2017

A *market* in motion stays in motion…unless acted upon by an unbalanced force.[1] We suspect this is how Sir Isaac Newton, as a 21st century market strategist, would view the current capital market trends. Global equity and fixed income markets continued their 2017 upward trajectory during the quarter. The markets did meet some resistance during August but by month-end Wall Street returned from vacation and the market's upward trend continued. And perhaps for good reason: Corporate earnings continue to grow, inflation remains below the Fed's 2% target threshold and interest rates are accommodative with Federal Reserve guidance managing rate expectations…the market remains *in motion*.

Our 21st century Newton's "unbalanced forces" are developments that can alter the market's path: lower earnings growth, rapid and unexpected inflation, rapidly rising interest rates, and of course the unknown unknowns. However, some unbalanced forces can favorably change the trajectory of the market such as tax reform. We endeavor to be the best wealth managers for you and your family and that includes being proactive risk managers. Our firm regularly debates the risk and rewards of the markets: those risks that are worth the potential reward and those that are not. As we move toward year-end, you will likely see portfolio rebalancing that is a mix of profit-taking, loss-harvesting and risk exposure management.

We are cautiously optimistic on the markets but are keen to be watchful of unbalanced forces.

Annualized Benchmark Returns through September 2017*

	1 Quarter	YTD	1 Year	2 Years	3 Years	5 Years	10 Years
S&P 500	4.5%	14.2%	18.6%	17.0%	10.8%	14.2%	7.4%
Russell 2000	5.7%	10.9%	20.7%	18.1%	12.2%	13.8%	7.8%
MSCI World Ex. US Index	5.7%	19.7%	19.3%	13.4%	5.1%	8.3%	1.8%
MSCI Emerging Markets	8.0%	28.1%	22.9%	20.0%	5.3%	4.4%	1.7%
Bloomberg Barclays U.S. Aggregate	0.8%	3.1%	0.1%	2.6%	2.7%	2.1%	4.3%
Bloomberg Barclays Municipal Bond	1.1%	4.7%	0.9%	3.2%	3.2%	3.0%	4.5%
Bloomberg Barclays U.S. High Yield	2.0%	7.0%	8.9%	10.8%	5.8%	6.4%	7.8%
FTSE Nareit All REITs	1.2%	6.7%	3.6%	11.8%	10.3%	9.9%	6.1%
Alerian MLP	-3.0%	-5.6%	-3.7%	4.2%	-12.9%	-0.6%	6.5%

*Source: Bloomberg   *Quarter return is not annualized.*

The Big Picture (for additional information, click HERE)

U.S. Real Gross Domestic Product increased at an annualized 3.1% rate in the second quarter, revised up from the Advanced Estimate of 3.0%. Manufacturing and consumer surveys continue to be optimistic, helping to drive the U.S. equity markets higher. This data is reflected in corporate earnings that are on track to grow at the fastest pace in several years. This year's market increase is largely due to earnings growth rather than multiple expansion.

[1] Newton's First Law of Physics actually reads: An object at rest stays at rest and an object in motion stays in motion with the same speed and in the same direction unless acted upon by an unbalanced force.

Despite the best attempt by the Federal Reserve to increase inflation in the U.S., the economic measure continues to remain below their targeted 2% level. This dynamic has helped keep real yields higher and is one of the reasons bond nominal yields remain relatively low despite increases to the Fed Funds Rate. We expect the Federal Reserve will raise interest rates at its December meeting and will begin in earnest to reduce its balance sheet of nearly $4.5 trillion of fixed income securities. It appears much of the Federal Reserve's actions have been accounted for in the fixed income markets and therefore any deviation by the Federal Reserve from its stated path would create higher volatility in the fixed income markets.

Volatility in the equity markets has been historically low for much of the past several years. We anticipate that this could increase in the near-term. The underlying reason for this is that earnings in 2017 are very strong after coming off a very poor earnings year in 2016. Comparable earnings growth for 2018 will be more challenging compared to 2017 based purely on the level from which earnings must grow. This could have an impact on equity prices given the high valuations investors must endure to remain in the market and could be a "repricing" catalyst in 2018.

Global economic fundamentals are also positive, helping to push non-U.S. developed and emerging markets to higher levels. We continue to be encouraged in those markets due to favorable fundamentals and the tailwind from global growth that should affect most economies, though we remain mindful of the implications of stronger foreign currencies relative to the U.S. Dollar.

Summary of Allocation Recommendations

Asset Class	**Recommendation**	**Comment**	**Asset Class Summary Link**
U.S. Large Cap	Neutral/Underweight	Earnings remain strong, but YoY comparable growth will be challenged in 2018	*U.S. Large Cap Review*
U.S. Small & Mid Cap	Neutral/Underweight	Premium valuation with little growth premium, Tax Reform "hope" propelled market higher in 3Q	*U.S. Small Cap Review*
Non-U.S. Developed	Overweight	Attractive relative valuations and improving macro and corporate fundamentals	*International Equity Review*
Emerging Markets	Overweight	Economic and earnings growth continue to improve, focused on Asia	*International Equity Review*
Fixed Income	Neutral	Maintain safe haven assets for volatility and floating rate loans to alleviate interest rate risk, shorter duration given flat yield curve	*Fixed Income Market Review*
Tactical	Neutral	Master limited partnerships, financials, pharmaceuticals, robotics and cyber security	*Tactical Investments Review*
Alternative	Hedge Funds & Private Equity	For appropriate allocations	Contact your Wealth Advisor

The Outlook

We continue to recommend a neutral/underweight allocation to U.S. Large Cap Equites as upside is likely modest in the near-term. The market appears to have priced in much of the potential future earnings growth. For example, as companies meet or exceed quarterly earnings estimates, their respective stock prices move only slightly, whereas those companies that miss earnings expectations sell-off. Companies will need to continue strong earnings growth, and this could be challenging in the year ahead given the current level of earnings.

We also continue to recommend a neutral/underweight to U.S. SMID Cap Equities. Small cap experienced a strong rally during the third quarter on earnings growth and the potential for Tax Reform. SMID Caps on average pay a 32% corporate income tax rate[2] and Tax Reform would reduce that rate and improve free cash flow. Due to the uncertain outlook for Tax Reform, we are hesitant to overweight the asset class at this time.

Our positioning in non-US developed markets remains an overweight allocation. Various economic surveys continue to point to sustained growth, and corporate earnings continue to improve. Currency played a large role in year-to-date returns, helping U.S. investors by about 5.5%. We suspect this tailwind will be less impactful going forward but believe valuation and strong fundamentals should support these markets.

We are raising our recommendation of emerging markets from neutral to a slight overweight. Economic fundamentals and corporate earnings continue to improve in the asset class, alleviating concerns reflected in our last letter. Within emerging markets, Asia continues to stand out for continued growth and reasonable valuations.

Regarding fixed income, our recommendation is for a neutral allocation to moderate portfolio risk. Higher-grade corporate credit is favored over high-grade municipals that are trading at premiums. We continue to include floating rate loans in allocations to alleviate interest rate risk.

Our Tactical recommendations include Master Limited Partnerships (MLPs) and specific sector ETFs. MLPs have been highly correlated to oil prices, which despite driving gains towards quarter end, has been a headwind for the asset class on the year. We are reducing this allocation within client portfolios. We are maintaining exposure to both Pharmaceuticals and Financials. Both generated reasonable returns year to date and we will look to harvest gains upon reaching long-term status. Two new tactical sector investments have been added to our recommended list: Robotics and Cyber Security. Please see our Tactical Investment Review for more information on this new recommendation.

Tax and Financial Planning News

Tax reform has been a mystery since the election, but we can now start looking at what aspects Congress may prioritize. The biggest changes we've known about for some time – a collapse of personal rates from seven brackets down to three at 12%, 25%, and 35% (with a possibility for a fourth). The standard deduction, which was $6,300 for single and $12,600 for married couples filing jointly, might be increased to $12,000 and $24,000, respectively. In addition to raising the standard deduction, most itemized deductions (exceptions: mortgage interest and charitable contributions) may be eliminated. These two moves aim to reduce the number of taxpayers who itemize their deductions and should simplify filing next April.

With respect to taxes on business entities, Trump's tax reform plans to reduce corporate rates from 35% to 20%, and establish a top marginal rate of 25% for pass-through entities (LLCs, S-Corps, partnerships) which are currently taxed at the owner's individual marginal rate. A one-time 10% tax on repatriating stockpiled foreign profits was proposed with the intention of bringing that capital stateside.

[2] Source: Goldman Sachs Market Know How – Q4 2017

The other major proposed changes come in the form of repeal. The tax plan would eliminate the alternative minimum tax ("AMT"), which was enacted to ensure households cannot excessively take advantage of the use of certain deductions. It would also eliminate the estate tax, which is currently 40% and is levied against estates in excess of $5.49mm(single)/$10.98(married) in 2017.

Firm News

Please join us in congratulating Taylor and Larissa Thomas on the birth of their daughter, Emma-Jane Thomas.

Respectfully submitted,
Round Table Wealth Management