2017 Weekly Portfolio Manager Commentary

December 1, 2017

ECONOMIC HIGHLIGHTS

The November U.S. Manufacturing Indices were quite strong, with Chicago PMI at 63.9, ISM at 58.2 and PMI at 53.9. Preliminary real third quarter GDP growth was also quite strong, at +3.3%. The GDP Price Index was also up nicely at +2.1% for the quarter (both figures annualized). New U.S. Single-Family Home Sales continue to be strong as well, coming in at an annualized rate of 685,000 units for October.

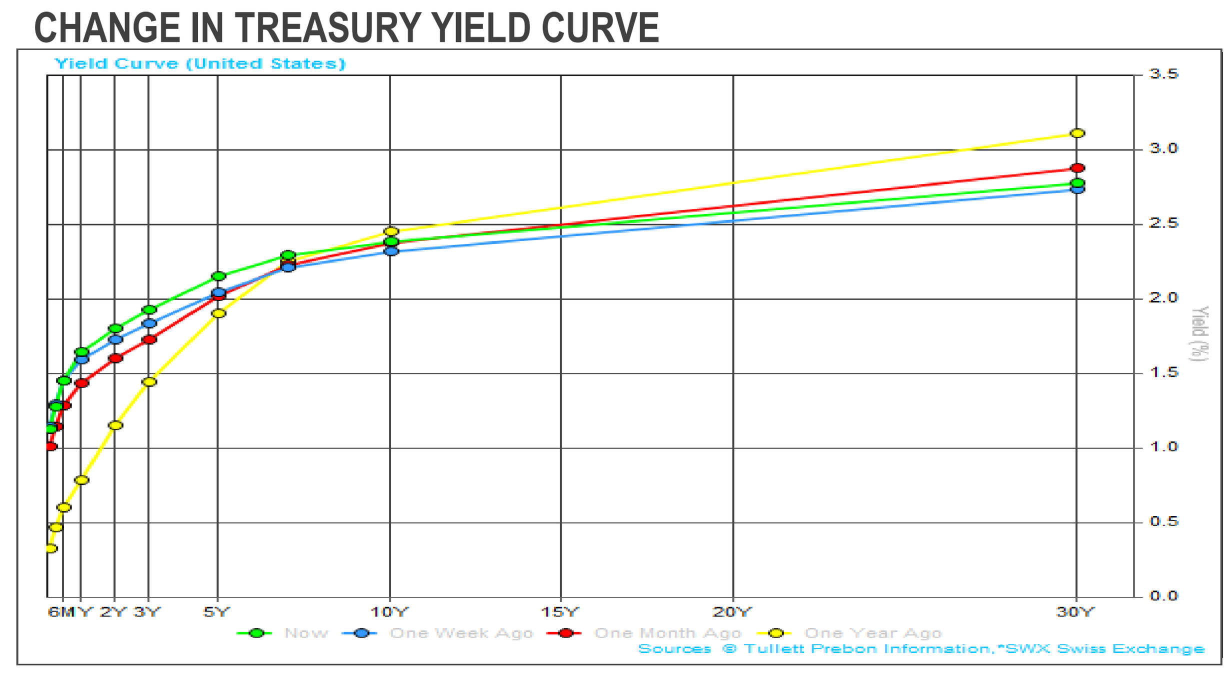
FIXED INCOME

Within a span of minutes Friday, bond traders had to put on the back burner just about everything they were focused on heading into the home stretch of 2017. Deliberations over how many times the Federal Reserve will tighten next year, and how many Republican Senators were on board with the GOP tax plan suddenly seemed irrelevant for Treasuries. The benchmark ten-year yield plunged almost 10 basis points on news that former National Security Advisor Michael Flynn pleaded guilty to lying to federal agents and is cooperating with Special Counsel Robert Mueller. "When the rules change, you put your hands in your pockets," said Glen Capelo, head of rates at Academy Securities. "Between now and year-end it's going to be very difficult to figure things out," with Flynn's plea adding to uncertainty surrounding the tax overhaul, the economic outlook and the Fed's path. Whether Friday's Treasuries rally will be a one-day wonder will hinge on the coming week's data. As soon as Monday, lawmakers may start the process of resolving the differences between the House and Senate tax bills, after the Senate passed its plan over the weekend. Traders will also get a slew of crucial U.S. data, highlighted by November's labor report, which is projected to show robust job growth. Confirmation of that expectation may push the ten-year yield to again test the key 2.40% technical level that some investors have called "the moment of truth" for bonds' bull run. After all, it was above that mark just minutes before the Flynn news struck. Should everything fall into place, it'll have significant implications for the Treasury market. Even with the market volatility around the Flynn news, the two-year yield, the coupon maturity that's most sensitive to Fed policy, was the least affected, falling about one basis point. The ten-year note pared its advance, ending Friday's trading at a 2.36% yield.

CURRENT GENERIC BONDS YIELDS

TREAURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	1.24%	3 mo	1.32%	3 mo	1.59%	3 mo	1.21%
6 mo	1.44%	6 mo	1.37%	6 mo	1.68%	6 mo	1.29%
1 yr	1.61%	1 yr	1.55%	1 yr	1.78%	1 yr	1.37%
2 yr	1.77%	2 yr	1.81%	2 yr	2.04%	2 yr	1.53%
5 yr	2.11%	5 yr	2.04%	5 yr	2.51%	5 yr	1.85%
10 yr	2.36%	10 yr	2.73%	10 yr	3.10%	10 yr	2.34%
30 yr	2.76%	30 yr		30 yr	3.72%	30 yr	3.25%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	3.00%	25.49%
S&P 500 (Large Cap)	1.60%	20.25%
S&P 400 (Mid Cap)	1.96%	15.69%
Russell 2000 (Small Cap)	1.21%	14.57%
NASDAQ Composite	-0.58%	28.59%
MSCI EAFE (International)	-0.73%	22.93%
iShares Real Estate	-0.46%	9.65%

Nine of the eleven major sector groups rose over the past week – with Financials leading the way with a 5% gain. One interesting note is the Technology group finished lower, down -1.5%. Tech has been the clear market leader this year, so if this trend continues it could prove to be a troublesome sign. Any time leading sectors begin to falter when the market is at price highs, it makes us pay attention.

Stocks ended November with positive returns for the 13th straight month setting a new record for the longest streak on record going back to 1928. This mark eclipsed a twelve month span in 1935-1936 and another twelve month streak in 1949-1950.

So far this year, the Technology sector is up over 30% - almost twice as much as the next best performing sector. According to a report from Bespoke which goes back to 1940, the average change for the Tech sector in the year after it gained at least 20% or more has been +14.69%. That number may seem high, but it is in line with the average gain of 14.27% for the Tech sector in all years since 1940.

On Tuesday, the latest report from the Conference Board's Consumer Confidence Index increased last week to 129.50 in November. That mark was the fifth straight month of increase and a new 17-year high.

For the week ahead there are lots of economic releases on the calendar – on the slate are releases of unemployment rate, ADP employment, Non-farm productivity, and factory orders. The only corporate earnings releases of note are Autozone and First Solar on Tuesday. Then on Wednesday Brown-Foreman and Pfizer are due to release results. Also of note is the continued wrangling around the proposed tax bill in Washington.

Moving into December, we are watching the following support levels – 2570, 2545, 2490, and 2435. The index closed last week at 2642.

ASSET ALLOCATION

CURRENT SENTIMENT	
Cash	Neutral
Short Fixed Income	Neutral
Intermediate Fixed Income	Neutral
Inflation-Adjusted Fixed Income	Unfavorable
High Yield Fixed Income	Neutral
International Fixed Income	Neutral
Equity Income	Favorable
Large Cap Equity	Favorable
Mid Cap Equity	Favorable
Small Cap Equity	Neutral
International Equity	Neutral
Emerging Markets Equity	Favorable
Real Estate	Favorable
Commodities	Unfavorable

Below is a summery of our current stance on most asset classes:

Cash - Holding as little as possible given the miniscule yields in money market instruments. Any exposure is for defensive positioning.
Short Term Bonds - Relative to Intermediate Bonds, the reduced duration is preferable given the outlook for higher interest rates.
Intermediate Term Bonds - The current trading range of intermediate bonds warrants a neutral position with limited upside potential. Some opportunities still remain present in spread products.
Inflation-Adjusted Bonds - Low inflation expected in near-term providing zero real return.
High Yield Bonds - Spreads have tightened; however, still remain attractive versus Treasuries.
International Bonds - Emerging market bonds offer good diversification qualities while providing higher yield opportunities relative to domestic fixed income.
Equity Income - High quality and higher-dividend-paying companies remain attractive for long-term investors given their favorable risk-adjusted profile and current yield curves.
Large Cap Stocks - A favorable weighting is recommended. Growth has reemerged as a more favorable style and should be overweighed versus Value.
Mid Cap Stocks - Mid cap exposure along with a value tilt is preferred. Mid cap stocks continue to provide the "sweet spot" of market capitalization - large enough to provide stability, but small enough to be more nimble.
Small Cap Stocks - In broad market corrections, small cap stocks will suffer most with increased volatility. However, a recent divergence of relative strength between small caps and large caps warrants a neutral exposure.
International Stocks - Given most foreign investment is in developed markets and European countries, until sovereign debt concerns are alleviated, an underweight to neutral weight is recommended.
Emerging Market Stocks - Stronger balance sheets, less debt, and better growth potential make emerging markets more fundamentally attractive than developed countries longer-term. Recent relative performance versus developed markets support the stronger fundamental backdrop and positions have been added.
Real Estate - Pricing has stabilized and long-term valuations appear attractive. Real Estate has performed well of late and should continue to be a strong alternative to other asset classes.
Commodities - Global demand should support higher prices if the global recovery remains on track. Although, volatility will be higher and commodities will be susceptible to short-term price shocks, if used in conjunction with other asset classes, risk can be reduced substantially to a diversified portfolio. However, used alone is not recommended as the short-term outlook is not favorable.