Guiding you towards your financial goals

AMERICAN RETIREMENT & Investment Strategies, LLC

4th Quarter 2017

Moving into the last Quarter of 2017

The third quarter of 2017 saw a solid equity market, while fixed-income experienced continued volatility — the 10-year and 30-year Treasury bonds saw their lows of the year at 2.04% and 2.66%. Our decision to take some risk off the table (along with nice gains) was implemented at the peak of these robust gains and currently we are keeping that stand. We think that geopolitical risks both domestic and international (i.e., tax reforms within the US, with North Korea abroad) could still affect the performance of the market. We might revert to full equity exposure if we see these risks fading in the next few weeks. Having said that, we will also keep our eyes on economic data and so-far we like what we see.

The Fed took a much-anticipated break from raising short-term interest rates after it had increased rates a quarter point at each of the past three quarterly meetings, indicating that another short-term interest rate is likely at year-end and maybe twice next year. Furthermore, the Fed stressed wanting to normalize its balance sheet and announced their "unwinding process" (meaning no more purchasing securities as they did during their "Quantitative Easing" era). Their view on business investment was positive, stating that growth in business investment has picked up in recent quarters. Other comments in the Fed statement acknowledged that job gains remain solid and that the inflation outlook remains unchanged. All of this translates in the fact that from now the US economy would have to rely solely on its own strength and that the Fed has finally (after 9 years) started the process going back to normal times.

As we explained last quarter, for us investors, it's important that we keep the long term horizon in mind. In the US we are starting to see a re-acceleration of industrial production and small businesses posting more sales. These economic data points are important because they lead to higher employment which means higher income and a higher consumer confidence, translating ultimately in a higher spending. Let's remind ourselves how the US economy is 70% consumer spending dependent!! All these indicators are pointing higher. Let's see if the geopolitical risks discussed above will diminish moving forward, enabling the consumer confidence/spending to really permeate within the US.

Fixed Income and International Markets

Although global markets were up nicely during the third quarter, one segment of the market looks literally on fire: emerging markets. We highlighted last quarter our bullish sentiment for these markets after years of suffering and now they are roaring back. We think this bullishness for emerging markets could last for a few years and therefore we remain very positive toward this asset class. As far as developed international countries, the economic growth is gaining strength everywhere, inflation is no longer posing a serious threat for Europe and the conditions seem mature for these markets to continue doing better. Some international sectors (i.e., banks) still have a lot of ground to cover before they catch up to their US counterparts and they could be the sweet spot for many investors.

Within the fixed income world, we continue to favor convertible securities and floating rates. We also see emerging market bonds (not just equities) offering the most attractive value in fixed income for global bond investors who seek potential total returns. Overall, we think the long-term Treasury rates will remain low for the foreseeable future and send a message to the Fed to proceed with caution.

Final Thoughts

More and more people claim that the stock market valuation is too high. Our view instead is that these valuations can be sustained or climb further, as long as corporate profits and earnings keep rising (earnings are the mother milk of stock prices). In addition, if the Fed raises rates for good reasons (i.e., the economy is accelerating) we should continue seeing a healthy market. On the contrary, if the Fed raises rates for the wrong reason (i.e., inflation is too high), then we will see a correction. Given the current economic data from the US and abroad (not to be confused with geopolitical risks), and the fact that we are about to enter traditionally one of the best quarters of the year, we believe the global economy should continue to accelerate, providing a great environment for corporate earnings, profits and equity prices. We could re-enter the full positions (as at the beginning of the third quarter) with equities at any time and enjoy a nice Christmas Season.

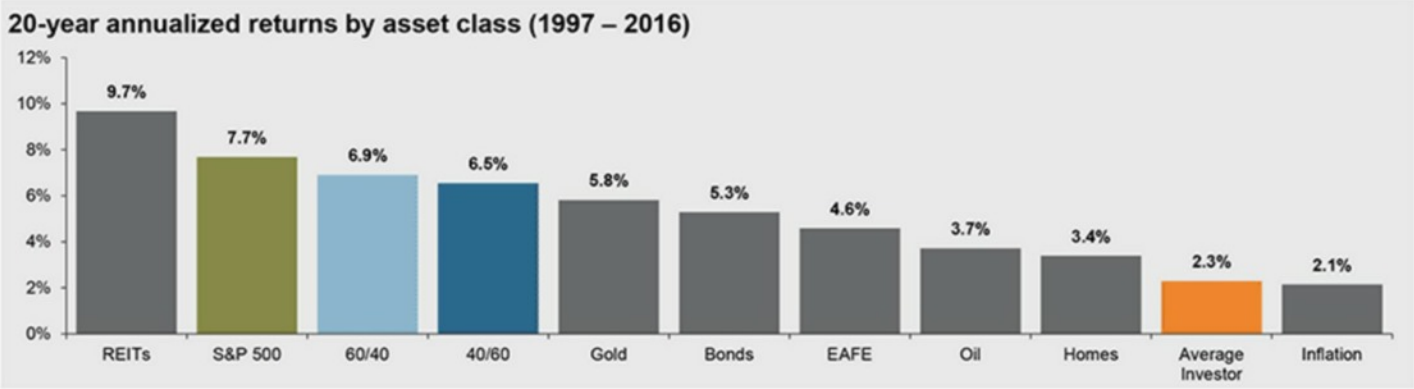
The Dynamic Portfolio

Our Dynamic Portfolio showed a brilliant third quarter, even after we decided to migrate for the time being half of its equities into very conservative buckets and wait for Washington to show us signs of real reforms and how it manages North Korea's crisis. The best stocks for the quarter were Alibaba (BABA) +22%, Netflix (NFLX) with +21%, Caterpillar (CAT) with +16% and Biogen (BIIB) with +15% (this last company was added together with Lockheed Martin just last quarter). The underperformers were Walt Disney (DIS) with -6% and Philip Morris with -4%.

As we start preparing ourselves for 2018, we remain keen on the fact that higher rates are already affecting real estate stocks, telecoms, and utilities companies as these remain highly sensitive to interest rates hikes. For the time being we are also keeping half of the Dynamic Portfolio in conservative funds but this might change depending on tax-reforms and geopolitical events.

Final Thoughts ...Did You Know?

That over a 20 year period the average investor under performs most major asset classes (See chart below). The main reason is that they let their emotions overtake any strategy. Remember to ignore the daily noise and stay focused on your long term goals.



Source: J.P. Morgan Asset Management; (Top) Barclays, FactSet, Standard & Poor's; (Bottom) Dalbar Inc.
Indexes used are as follows: REITS: NAREIT Equity REIT Index, EAFE: MSCI EAFE, Oil: WTI Index, Bonds: Barclays U.S. Aggregate Index, Homes: median sale price of existing single-family homes, Gold: USD/troy oz, Inflation: CPI. 60/40: A balanced portfolio with 60% invested in S&P 500 Index and 40% invested in high quality U.S. fixed income, represented by the Barclays U.S. Aggregate Index. The portfolio is rebalanced annually. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and represent the 20-year period ending 12/31/16 to match Dalbar's most recent analysis.
Guide to the Markets – U.S. Data are as of August 31, 2017.

J.P.Morgan
Asset Management

Thank you for continuing to put your trust in our firm.
All the best,

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