PAUL R. RIED FINANCIAL GROUP, LLC
SECURITY FOR YOUR FUTURE

# August 2017 Market Commentary

August 23, 2017

Dear Clients,

It has been a very strong year so far for a broad range of asset classes. Through the first eight months of the year many asset classes have either matched or surpassed their full year returns from last year. International stocks, having trailed US stocks for multiple years, are currently experiencing their best year since 2009.

What is most interesting is how little volatility stocks have experienced year-to-date. In fact, US and International stocks haven't even experienced a pullback that reached 3%. If markets remained this calm for the rest of the year it would be the smallest intra-year pullback experienced for US stocks since 1995. For international stocks, you would have to go back to 1985 for a calmer year.

It would be hard to find a reason for this market to be calm. The dysfunction in DC appears quite extreme, with political discourse more closely resembling social interactions one might witness roaming the halls of a high school (although we don't want to put down your average high school).

**"It always puzzled me that markets are blasé about political risk until the very last moment"**

-- Ben Bernanke, Former U.S. Federal Reserve Chairman

The above quote comes from a speech Bernanke gave a few months ago. So far, markets have been willing to overlook the political risks, whether that be uncertainty caused by an inability to come to consensus on healthcare, the delay in tax cuts and infrastructure spending, the ongoing and deepening investigations into the Trump campaign, or the re-escalation of the North Korea situation.

Fortunately, markets are more than satisfied that global growth has continued its steady upward trajectory and have happily followed suit.

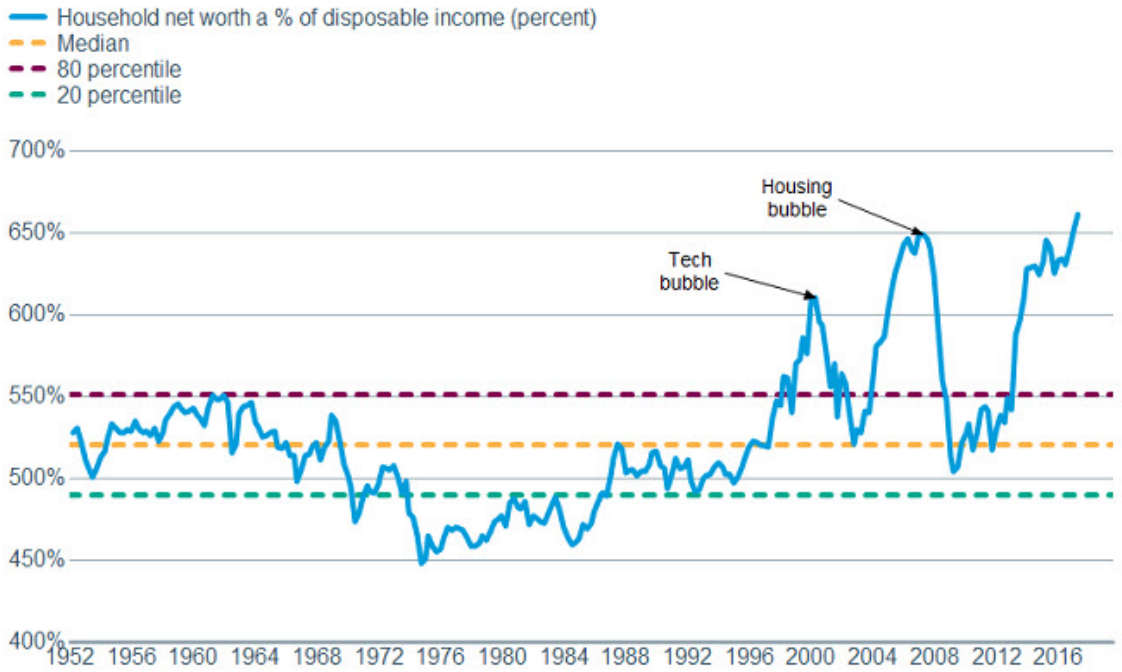
## The Wealth Effect

The response by central banks around the world in the wake of the 2008 financial crisis was to lower rates to zero (or even negative rates in some cases) and flood economies with cheap money. This was for the explicit purpose of increasing asset values and creating what they term the "wealth effect". This was described by Ben Bernanke in a 2010 Op-Ed which he wrote explaining the reasoning behind their policies of low interest rates and asset purchases by the Federal Reserve.

10801 Main Street, Suite 201, Bellevue, WA 98004
425.646.6777 425.451.2453 paulr@paulried.com www.paulried.com

*"Easier financial conditions will promote economic growth. For example, lower mortgage rates will make housing more affordable and allow more homeowners to refinance. Lower corporate bond rates will encourage investment. And higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending." – Ben Bernanke, 2010*

The primary problem with this approach is not that easy financial conditions haven't had the intended effect on asset prices. In fact, they have indeed helped boost asset prices in past cycles as well as today. However, the problem is that history has shown that economic expansions based on this outsized "wealth effect" have not been sustainable. The below chart shows the historical relationship of household net worth as a percentage of disposable income.




Source: Schwab, FactSet, Federal Reserve Bank, Strategas Research as of July 18, 2017

Household net worth is made up of many components including real estate, stocks, bonds, checking accounts, etc. It is important to realize that stocks, on a price-to-earnings basis, may not be as expensive as they were in the 2000 tech bubble. Also, housing, on a price-to-income basis, may not yet be as expensive as it was in 2007. But on an aggregate basis, asset prices are the most inflated that they have been for over 65 years.

Is it possible that lax policies of central banks could make this relationship the new norm? That is a possibility and the answer will only be known in hindsight.…However, in the meantime we think caution is certainly prudent.

**Staying Disciplined**

Investors should remember that the time it takes for something to go from risk to reality is short. However, it's also important to remember that many "risks" are never realized. Investing on a reactionary basis is a losing proposition and can lead to emotionally driven mistakes.

In your portfolio, we employ a research driven process oriented approach that reflects your objectives and the “season” of the economic cycle. We have structured your portfolios to incorporate a variety of complimentary active management teams. If your long-term goals and objectives have not changed then the only real “reactionary” response investors should have to their overall portfolio involves simple old-fashioned rebalancing.

The key to a successful investment experience is not to dwell on uncertainty but to expect constant uncertainty….and invest relying on the time tested principles of asset allocation, diversification and discipline.

As always, we are here to serve you. Should you have any questions or concerns, please do not hesitate to contact us.

**Paul R. Ried, MBA, CFP®**
President / CEO
Registered Principal*

**Timothy R. Kimmel, CFP®**
Personal Financial Advisor*
Registered Representative*

**Adam Jordan, CIMA®, AAMS®**
Director of Investment Research & Management
Registered Principal*

**Kelly Kolstad, J.D., CFP®**
Personal Financial Advisor*
Registered Representative*

Prepared By:
Adam Jordan, CIMA®, AAMS®
Director, Investment Research and Management
Registered Principal*