



QUARTERLY NEWSLETTER [3Q 2018]

Positives:

US Stocks Posted New Record Highs. US stocks surged in the third quarter, with all three major indices hitting new all-time highs. Gains were again fueled by solid economic data and strong corporate earnings, as the S&P 500 rose to have its strongest quarter since 4Q 2013. Healthcare was the strongest sector, but all market areas posted gains as volatility dropped dramatically from earlier this year.

Economic Conditions Remain Strong. Corporate profits among S&P 500 companies jumped 25% from last year's 2Q, with over 75% of firms beating analyst expectations. The market easily absorbed another Fed rate hike in September (the third this year) as second quarter GDP growth was 4.2%, the best growth rate since 2014. Even better, on the last day of the quarter, Canada signed onto a new trade accord with the US and Mexico, relieving investor fears about the ongoing global trade war.

Negatives:

Lagging Small/Medium Size Company Stocks Reveal Potential Market Divergence. After leading the charge last quarter, small company stocks, seen in the Russell 2000 index, slumped in September. While the asset class still slightly leads large caps YTD, some analysts are concerned as small caps would typically lead the market if the economy is as strong as the recent data indicates. Lagging returns for small/medium company stocks reinforce worries that the US market gains are being driven by a small group of large, highly valued technology stocks rather than by a majority of companies.

International Stocks Still Trailing US Markets. After a rough second quarter, international stocks saw slightly better results in 3Q. Developed markets, seen in the MSCI EAFE index, added +1.4% this quarter (now -1.4% YTD) but this was well behind US market results; concerns remain about slow economic growth and bank stability in Europe. Emerging markets, measured by the MSCI Emerging Markets index, are still reeling from US dollar gains and the potential for tariffs to hurt Chinese companies. After a big drop last quarter, this index only slipped -1.1% in 3Q, but is down -7.7% YTD compared to robust US market gains.

Portfolio Diversification Not Helping. So far in 2018, the investment adage to keep diversified is not adding gains (unlike last year). With the Fed still raising interest rates, bonds are down (Barclays US Aggregate investment grade index is -1.6% YTD) to slightly up (Barclays US Corporate High Yield index is +2.6% YTD). Real estate, measured by the Dow Jones US REIT index, is up just +2.6% YTD after dropping in September. Commodity prices, seen in Barclays Commodity index, slipped -2% in 3Q despite rising oil prices. Typically, strong economic conditions would lead to rising commodity prices, but recent slowing in China has led to lower prices for copper and other industrial commodities, a sign that the global economic growth story may be ending.

What We Are Doing For You:

Getting Ready For Year-End. Over the next two months, we will be busy analyzing clients' taxable accounts to determine any tax loss harvesting that might be available to limit capital gains in these accounts. We are also spending time reviewing portfolio allocations (and specific mutual fund managers) to reposition client accounts for what we anticipate might take place in the markets over the next year.

On a personal note

Bernie Jenny started her final quarter at Cal Poly SLO and, while studying, continues to earn some spending money dog sitting on Rover.com. She loves the feeling that she is getting paid to 'rent a pet' and feels like she should be paying the dog owners for the privilege. As fall begins, Jody started up again at UC Berkeley in the Tang Medical Center. Bernie and Jody are looking forward to spending Jenny's 22nd birthday with her and her boyfriend, Austin. Jenny's final symphony orchestra concert will occur in December, when she graduates.

Damien Damien and his family were able to do a nice trip to Boulder, CO just before school started for Nicky in August. They enjoyed hiking the Flatirons in Chautauqua Park, located right in Boulder, and also hiked and explored Rocky Mountain National Park. They also toured the University of Colorado, Boulder with Nicky so he could check it out as a possible college destination. He really liked it and Damien was ready to go back to college too! In September the big day came for Lynn and Damien when they moved Natalie into the dorms at UCLA. She seems to be really enjoying the college experience so far and is having too much fun to be homesick. Meanwhile back at the homestead Damien, Lynn and Nicky are trying to get used to life with only three at home.

Debbie Debbie and Dave returned safely (and tired!) from their trip on the southern part of the John Muir Trail ending with summiting 14,500' Mt. Whitney. Because it is so hard to get permits to do just Mt. Whitney, they had to start 40 miles north of this peak, and backpacked southbound to it. In October, they are celebrating their 26th wedding anniversary by going to Pismo for a few days to stare at the ocean.

Zack Zack has been staying busy with family and friends. Zack loves to fish, and currently the west coast of California is experiencing the fall season Chinook Salmon run. He has been taking the time to catch as many Salmon as possible. Another hobby that Zack has been enjoying is Barbequing with family and friends. Some of his favorite things to cook are smoked ribs as well as grilling Santa Maria style tri-tips. Given the great weather lately, this has been a great way to get loved-ones together. Zack is also looking forward to Fall and Winter approaching. It is always an exciting time for Zack to catch-up with family during the Holidays.

We appreciate your continued trust and confidence. Do you have any questions or concerns?
Please feel free to contact us any time.



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S&P 500 - A capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The Russell 2000 is a stock-market index measuring the performance of 2000 small-capitalization stocks. It represents the 2000 smallest companies in the Russell 3000 Index, which in turn represents the 3000 largest companies in the U.S. Thus, the Russell 2000 is a barometer of small-cap stocks. Though small, the companies represented by the Russell 2000 are not the smallest of the small as they are not penny stocks. The Russell 2000 is weighted by the market capitalization of the stocks. MSCI EAFE - Designed to measure the equity market performance of developed markets (Europe, Australasia, Far East) excluding the U.S. and Canada. The Index is market-capitalization weighted. MSCI Emerging Markets - Designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index. MSCI Emerging Markets - Designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index. The U.S. Corporate High-Yield Index measures the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below, excluding emerging market debt.

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