RYAN
Financial Group

Market Update – November 2017

2017: A Perfect Year for Equities?

- Stocks yet again moved higher in November on the heels of solid economic data and what appeared to be significant progress on tax reform. Global equities (as defined by the *MSCI ACWI Index*) ended the month up +2.0%, bringing year-to-date gains to a very impressive 22.6%[1].

- Similar to last month, US stocks outperformed Developed International peers in November, despite a weakening US Dollar (most indices and international funds do not hedge currencies, so foreign currency appreciation boosts returns). The US Dollar has declined relative to most other currencies in 2017, adding approximately +8% to the return of unhedged international stocks. Emerging Markets sold off modestly, but remain the top performer around the globe this year, up over +32%[1].

- Equity market strength was broad-based from a sector standpoint, but gains were particularly strong in the Consumer sectors. Even brick and mortar retail names, which were battered earlier in the year, bounced back sharply in November as results were not quite as bad as many feared. Further, initial reports suggest that US consumers are spending more than expected this Holiday season, likely owed to strong confidence, low unemployment levels, robust equity markets, and income gains.

- From a stylistic standpoint, growth-oriented sectors and stocks have significantly outpaced their value counterparts this year, but we witnessed a fairly dramatic rotation in the last few trading days in November, as investors seemed to move out the better performing sectors (Technology, for example) and into this year's laggards (and more value-oriented market segments) such as Telecommunications, Financials, and Energy.

- Bonds posted modest losses in November, as interest rates moved higher, especially on the shorter end of the yield curve, and credit spreads moved a bit wider. Interestingly, rates on the long end of the yield curve (20-30 year maturities) fell marginally due to continued strong demand (from investors in the US and foreign investors) and continued low levels of inflation[1]. As we have been saying for a while, the risk/return outlook for traditional fixed income is unattractive, as it only takes a modest increase in interest rates to more than offset what the bonds are paying in yield.

- The Trump Administration appointed Jerome Powell as the next Fed Chair in early November. He will take the reins from Janet Yellen, whose four-year term will end in early February of 2018. The market continues to take this in stride, as he is widely expected to employ similar policies and philosophies as Ms. Yellen. The Fed very recently hiked rates by 0.25%, and is still calling for three additional rate hikes in 2018. Despite this, the market remains skeptical due to stubbornly low inflation, and currently expects just about two hikes, according to *CNBC*.

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[1] *Market and index data throughout the Market Update is sourced from Morningstar*

Market Environment & Portfolio Positioning:

It's certainly a most wonderful time of the year, especially for equity investors. According to an analysis by *Charles Schwab*, should the *MSCI ACWI Index* post positive returns in December, 2017 would be the first year in history in which the index had no negative months – a perfect year! Heading into 2017, not many prognosticators predicted this calm and steady march higher. Anything could happen in December, but historically speaking, the odds are in the favor of the bulls, as we tend to experience a "Santa Clause rally" more often than not. In fact, the average monthly return for the S&P 500 Index has been +1.4%[2].

As is typical, we have checked in recently with many of the investment managers to which we allocate client capital. While most have not made any drastic portfolio changes as of late, many seem to be at least somewhat concerned with the lack of market volatility and ever-richening valuations. The managers that have more of a "growth" style are more bullish, at least from a bottom-up standpoint, as there are many industries and companies benefitting from accelerating secular trends. Broadly speaking, these growth-oriented investors are also typically less focused on near-term valuation figures and are used to paying up for companies experiencing higher levels of growth. Value managers, on the other hand, are more sanguine about the market's near-term prospects and would welcome at least a little market volatility. We recently spent a few hours in the office of a value-oriented manager we hold in high regard. This firm has an intentionally small fishing pond – it focuses on 250 high quality companies in the US. Based on the team's proprietary earnings models, in aggregate, valuations for these companies are now more expensive than prior to the Financial Crisis of 2008. This team is particularly patient (and not afraid to look different than the benchmark), and will only buy stocks trading at a discount to its fair value estimate. As a result, the Fund is holding close to 25% in cash – the maximum allowed by its internal guidelines.

While we would not put ourselves in the bearish camp, we have made some portfolio adjustments in the past few months that should enable better protection in the event of heightened market volatility. Additionally, we have modestly increased cash levels in recent days, and made some more meaningful changes within Fixed Income structures for non-taxable portfolios, in order to optimize both risk and return. We would be happy to discuss the changes and our rationale in much greater detail (we can't think of a more enjoyable topic to discuss at Holiday parties!), but here is the summary:

- Trimmed exposure to our Core Plus manager; while this tends to be the better performer in periods of market shocks, there is more exposure to rising interest rates and the yield is unexciting to say the least.
- Fully exited a manager with considerable High Yield exposure; we do not believe defaults will spike anytime soon, but spreads (the yield difference versus treasury bonds) are at historically low levels, and we just don't love the return per unit of risk at these levels.
- Increased exposure to a boutique, under the radar manager with significant exposure to residential mortgage-backed securities ("RMBS"); this particular manager employs a conservative strategy in what believe to be a compelling space, and the Fund's modest asset base allows it to buy bonds that the bigger players cannot. The portfolio offers an attractive yield and approximately ~75% of the Fund is floating rate in nature – making it less susceptible to rising interest rates.

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[2] *Yardeni Research, Inc.*

As always, please don't hesitate to shoot us an email or give us a call if you have any questions or comments. In the meantime, we at Ryan Financial Group wish you all a very Merry Christmas and Happy Holidays!

Best regards,

Ryan Financial Group