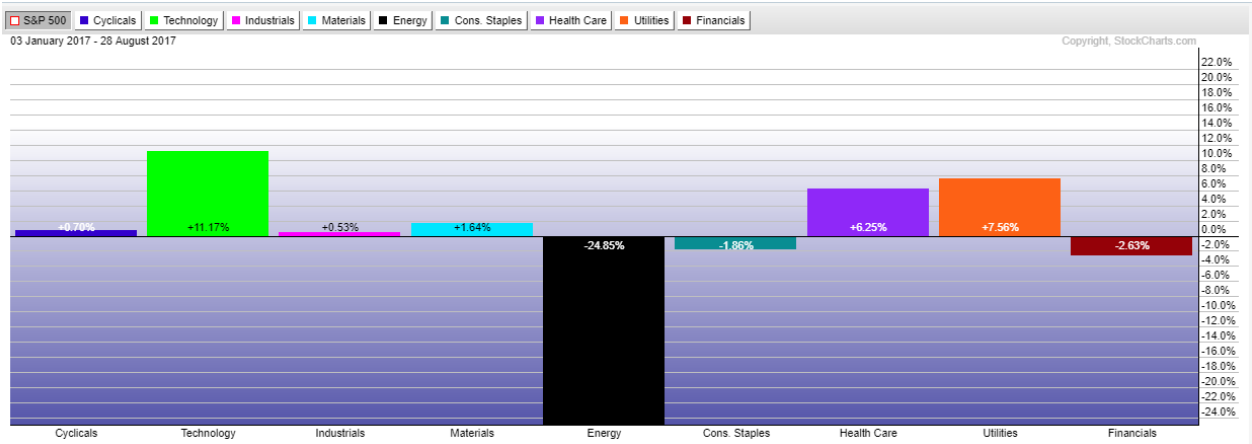
STRATEGIC INVESTMENT PARTNERS

Monthly Newsletter
September 2017

COMMENTARY

There is quite a lot of headline news that investors are tracking – Hurricane Harvey, missile testing by North Korea, Congress facing debt limits, and a possible government shutdown. For all of this, stocks have held up fairly well, with the S&P 500 dipping 3.0 percent from its all-time high on August 8th (2490.87) down to August 21st low (2417.35). For the month, the S&P ended up 0.31 percent, and it's up 11.93 percent year-to-date (YTD). Growth stocks have continued to lead the way with small caps lagging. So what's the case against small caps? We think the major detractor is the lack of implementation from the Trump administration on pro-business policies. Early after the election, the market had started pricing in possible tax reforms that would have benefited small caps more than large caps, but as the Trump administration has failed to bring a change to the healthcare system, the market is pricing in more and more that the government is not going to be able to work together and bring much of what Trump campaigned on, even with a super majority. If we see any hints that there could be some tax reform, we would expect to see small caps rally. We think the best play is to use the weakness in small caps as a buying opportunity, and there are many reasons we still believe small caps will outperform over the next few years: the US economy is very strong, with unemployment at low levels; increased business optimism; and growing consumer confidence are a few. Also, we are still bullish on the technology and financial sector, both of which are heavily weighted in the small cap sector. (YTD sector price performance can be seen in the graph above.) When investor risk appetite does start to increase, we believe they'll be turning towards small caps.



The economic numbers reported in August were very solid, outside of inflation. The ISM Manufacturing Index, which is based on surveys of more than 300 manufacturing firms, reported another strong report for July: a consistent theme for the year. The U.S. added 209,000 nonfarm payroll jobs and help pushed down the unemployment rate to 4.3 percent from 4.4 percent even as the participation rate increased to 62.9 percent from 62.8 percent. July's retail sales report also indicated that consumers were back in the stores

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ECONOMIC HIGHLIGHTS

S&P 500	2,471.65
DJIA	21,910.50
NASDAQ	6,428.66
OIL	$47.23/barrel
GOLD	$1,322.20/ounce
10-YEAR TREASURY YIELD	2.12%
UNEMPLOYMENT	4.3%
GDP	3.0% (Q2 second estimate)
CONSUMER PRICE INDEX (CPI)	+0.1% / 12 month change: +1.7%
CORE CPI	+0.1% / 12 month change: +1.7%

Gross Domestic Product (GDP): The second estimate for the second quarter was revised 0.4 percent higher and estimates now are for 3.0 percent annualized rate. This last estimate is

Housing: New and existing home sales were weak for July and housing starts were on the low end of consensus. For most of the year the market has been very strong, which has benefited sellers, but the recent weakness could help out first-time homebuyers.

Inflation: CPI, PPI and PCE are all tracking below the Fed's target rate of 2.0 percent. Month-over-month number from PPI actually showed disinflation (inflation decreased by 0.1 percent) which would be a major concern if it persists into the future.

(cont'd.) as retail sales were up 0.6 percent month-over-month. We'll see how the August numbers come in, but expectations are strong as August is known for back-to school shopping. Second-quarter GDP was solid, coming in at 3.0% in the second estimate. Inflation continues to be a weak spot in the economic data. Consumer Price Index (CPI), Producer Price Index (PPI) and Personal Consumption Expenditures (PCE) are all tracking below the target the Fed target rate of 2.0 percent. We're still waiting to see if wage growth can help boost inflation and we'll see how the Fed reacts in the last two meetings this year (Sept. & Dec.). On the company front, second quarter earnings were strong. As of August 19, 95% of the companies in the S&P 500 have reported their earnings. According to FactSet, 71% of the companies reporting have earnings above the mean estimate and 54% reporting have sales above the mean estimate.

Overall, the long-term view of the economy is strong, with many indicators pointing to a bullish economy and strong stock market. An improving economy and strong balance sheets for U.S. consumers and businesses should continue to drive the economy forward which should lead to an increase in investors' risk appetite. Emerging Markets have been performing very well this year and valuations still look very attractive. We do believe there will be an opportunity to benefit from these valuations, but as with all moves, we need to find a spot to underweight in the portfolio to add to the emerging market position. We also are maintaining our defensive position in International Developed markets, although economic data and stock market behavior are turning positive. The downside risk is still present as Brexit negotiations are still cloudy, although we haven't heard much news out of the negations. If economic data continues to improve, it might offset the downside that is present—stay tuned. Our Fixed Income positions have been weighted towards low duration, which historically tends to do better in a rising interest rate environment; we believe being on the shorter side of duration is the best positioning. As we analyze the impact of the Fed's reduction of the balance sheet, we continue to be tactically underweight to government treasuries and overweight to corporate, high-yield, floating rate, and global bonds. Our research team is currently evaluating our positioning in agency-Mortgage-Back Securities (MBS), non-agency MBS and commercial MBS to stay in front of possible impact the Fed could have on the MBS market. Stay tuned for communication on possible moves in the near future. With our daily monitoring and proactive trading, we will continue to rebalance models when they fall outside their target threshold.

MARKET TRACKER

Index	3 Mo	1 Yr	3 Yr	5 Yr
S & P 500	3.01	16.23	9.54	14.34
MSCI EAFE	2.71	18.19	3.30	8.97
BARCAP AGG BOND	1.23	0.49	2.64	2.19

Data as of 8/31/2017. Investments cannot be made directly into an index.

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