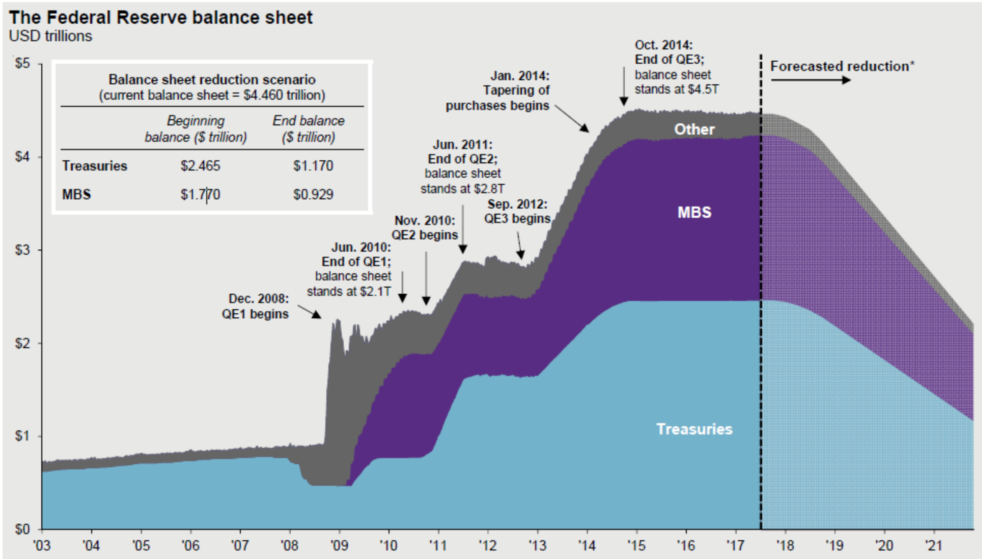
STRATEGIC
INVESTMENT
PARTNERS

Monthly Newsletter
August 2017

COMMENTARY

The Federal Open Market Committee (FOMC) had their fourth out of eight meetings for the year announcement in July and although this announcement didn't provide a Federal Funds Rate Target level hike (currently targeting 1.00 to 1.25%), it did set the stage for some interesting meeting announcements for the third and fourth quarter this year. With five months to go before the end of the year, the FOMC is still looking to raise the target rate at least one more time by 25 bps and start unwinding the balance sheet. As it stands, the market is pricing in about a 45.5% chance we see a rate hike in December, but very limited chance we see one before then. Inflation has been the main hiccup in the economy so far as the last two months of data has been softer than expected. The Fed is targeting a 2.0% year-over-year (YoY) inflation number, and although both the Core and Headline Producer Price Index (PPI) came in at 2.0% YoY, Core and Headline Consumer Price Index (CPI) fell well short (headline 1.6% and core 1.7%). The last few months could all turn out to be a small road bump and will be forgotten in a few months. The Fed thinks so, as they pointed to massive one-time declines in cell phone plans (price war between cell providers?) and prescription drugs (expiring patents?). With unemployment around record lows (4.4%), the Fed expects wage growth to push inflation higher (based on the Phillips curve), but it hasn't happened yet; a slow increase is expected to continue after this minor bump in the road.



Let's turn towards the almost $4.5 trillion balance sheet the Fed plans to start unwinding "relatively soon." The chart above provided by J.P. Morgan Asset Management is their current forecast of how the balance sheet will be reduced over the next four years. The plan is to start letting $6 billion per month of treasuries and $4 billion per month of mortgage-backed securities (MBS) mature and roll off the balance sheet by not reinvesting the proceeds. Every subsequent quarter, the FOMC would increase the amount of treasuries and MBS it will let roll off without reinvesting until it has reached $30 billion per month in treasuries and $20 billion per month in

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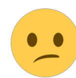
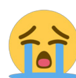
ECONOMIC HIGHLIGHTS

S&P 500	2,470.30
DJIA	21,891.12
NASDAQ	6,348.12
OIL	$49.18/barrel
GOLD	$1,273.40/ounce
10-YEAR TREASURY YIELD	2.29%
UNEMPLOYMENT	4.4%
GDP	2.6% (Q2 first estimate)
CONSUMER PRICE INDEX (CPI)	+0.0% / 12 month change: +1.6%
CORE CPI	+0.1% / 12 month change: +1.7%

Production/New Orders: ISM manufacturing continues to produce outstanding numbers and private sector output is also showing great strength.



U.S. Dollar: The U.S. Dollar Index has been falling since the first of the year after reaching a 14-year high. Much was expected from "Trump trade" and the idea it was going to boost the U.S. economy. But the weak dollar has helped U.S. large caps, especially U.S. technology stocks, as they get more revenue from foreign markets than small cap stocks do.



Inflation: CPI, PPI and PCE are all showing weakness over the last few months. Hopefully this is a small bump in the road and not a major indicator of something under the surface that will disrupt the economy.

(cont'd.) MBS. The most likely FOMC meeting dates that could change the balance unwind from "relatively soon" to "starting" are September 20 and December 13, we believe the edge is going to September 20. By going with September, the Fed will have the flexibility to increase the target rate in December and not hit investors with both pieces of fiscal tightening news on the same meeting announcement. Quantitative Easing (or fiscal loosening) helped lower long-term rates when the economy was going through the housing crisis back in 2008-2009. The Fed is going to try not to cause any market shocks as they reduce the balance sheet, but the Fed has been a major liquidity provider and to think there won't be some effect to the treasury and/or MBS market doesn't equate. We are in the process of researching how this will play out and how it could impact our fixed income portfolio.

Overall, the long-term view of the economy is strong, with many indicators pointing to a bullish economy and strong stock market. U.S. Large-Cap stocks have been performing well the last two years and we expect this to continue but also believe that Small- and Mid-Caps are positioned to take the lead as risk appetite increases. With our shift to more exposure in Small-Caps, we believe this should benefit the portfolio over the next three to five years as an improving economy and strong balance sheets for U.S. consumers and businesses should continue to drive the economy forward. As investors' risk appetites grow, we believe this will also benefit Small-Caps. Emerging Markets have been preforming 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 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, but 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 tend to do better in a rising interest rate environment; we believe this is still the best positioning, as we think rates have more room to increase. 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. 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	3.09	17.90	9.61	14.63
MSCI EAFE	6.37	20.83	1.61	9.18
BARCAP AGG BOND	1.45	-0.31	2.48	2.21

Data as of 7/31/2017. Investments cannot be made directly into an index.

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