JOHN D. DOVICH
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Market Update — Third Quarter 2017

During the 1992 presidential election, Bill Clinton's campaign coined the phrase "It's the economy, stupid!" when they successfully ran against George H.W. Bush. While the phrase earned an iconic legacy within our culture, it now defines the continued strength in the financial markets today. The Fed's accommodative monetary policies have been a significant contributor to this bull market's advance since 2009. With the Fed gradually tightening monetary policy, in the form of balance sheet reduction and higher interest rates, economic growth plays an increasingly important role in providing continued upside for the stock market. In late September, the final reading for the second quarter GDP (Gross Domestic Product) showed an increase of 3.1%, the fastest pace of growth since early 2015. Why did the financial markets perform well this quarter? Well, do you remember the 1992 rallying cry of Mr. Clinton's? It really is all about the economy!

Third Quarter 2017 Review

Index	Total Return 3Q17	Total Return YTD
S&P 500 (large cap US stocks)	4.5%	14.2%
Russell Mid Cap	3.5%	11.7%
Russell 2000 (small cap US stocks)	5.7%	10.9%
MSCI EAFE (large cap foreign)	5.4%	20.0%
MSCI Emerging Markets	7.9%	27.8%
MSCI ACWI All Cap (global stocks)	5.3%	17.3%
Barclays US Aggregate Bond	0.9%	3.1%

Despite two Category 4 hurricanes making landfall in the US during the third quarter, heightened geopolitical tensions with North Korea and drama within the "Beltway," this was another quarter of strong investment results. All major asset classes exhibited positive returns. Emerging markets posted the strongest returns with a 7.9% gain in the third quarter and a 27.8% gain for the first three quarters. A weakening U.S. dollar has been a strong catalyst for resurgent emerging market stocks after they significantly underperformed U.S. stocks from 2013-2015. U.S. small cap stocks rallied late in the quarter on renewed hope of tax cuts/reform presented by President Trump. Bonds posted a strong gain of 0.9%, overcoming concerns that interest rate hikes by the Fed would be a headwind for the bond market.

The Federal Reserve

The Federal Reserve maintained level interest rates during the September meeting, but another 25-basis point (0.25%) increase for December remains on the table. They now expect to raise rates three more times next year, two times in 2019 and once in 2020. The Fed also announced its intention to begin shedding its $4.5 trillion balance sheet in October by allowing $10 billion in monthly bond maturities to "roll off," rather than reinvesting the proceeds. The Fed will increase this amount quarterly by $10 billion to a maximum of $50 billion by October 2018. Due to the financial crisis of 2008-2009, the Fed lowered interest rates and purchased bonds for its balance sheet to provide liquidity to the financial system. Since the economy is performing well, the Fed believes these financial emergency measures are no longer needed.

We continue to believe one of the greatest risks to the financial markets, besides any unforeseen geopolitical risk, is how the Fed handles normalizing monetary policy. The Fed's balance sheet has never been this big, so there is no historical precedent for balance sheet reduction. This risk is amplified as President Trump interviews candidates for the expiration of Fed Chair Janet Yellen's term in early February 2018. While this does not mean Fed Chair Yellen is out, it does mean any change in this extremely important appointed position may bring uncertainty to the financial markets.

Economy

Global economic growth continued to improve during the third quarter. In fact, European economies are improving at a faster pace than in the U.S., albeit from a lower level of growth. This is challenging the European Central Bank to consider when they will begin to increase interest rates and follow the path the Federal Reserve has taken to gradually end its accommodative monetary policies. With economic activity improving globally in most countries, a recession does not appear likely at this time.

Conclusion

While any number of events can occur that may lead to a market selloff, we remain cautiously optimistic about the U.S. economy and financial markets. Even though short-term volatility in the markets may occur from time to time, it is important to remain focused on your long-term financial goals.

All of us at John D. Dovich & Associates, LLC thank you for the opportunity to serve you and your family. We look forward to discussing any financial issues you may have and wish you a happy autumn!

Definitions

S&P 500: Standard & Poor's (S&P) 500 Index. The S&P 500 Index is an unmanaged, capitalization-weighted index designed to measure the performance of the broad U.S. economy through changes in the aggregate market value of 500 stocks representing all major industries.

Russell Midcap® Index: The Russell Midcap Index is an unmanaged, market-capitalization-weighted index designed to measure the performance of the mid-cap segment of the U.S. equity universe.

Russell 2000® Index: The Russell 2000 Index is an unmanaged, market-capitalization-weighted index designed to measure the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000 Index.

MSCI EAFE Index (Europe, Australasia, Far East): The MSCI EAFE Index is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed international markets, excluding the US & Canada.

MSCI Emerging Markets Index: The MSCI EM Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

MSCI ACWI All Cap Index: The MSCI ACWI All Cap Index is a free float-adjusted index that is designed to measure the equity market performance of the global equity markets representing over 14,000 securities including large, mid, small and micro-cap segments of developed markets together with large, mid and small cap segments of emerging markets.

Barclays Capital U.S. Aggregate Bond Index: The Barclays Capital U.S. Aggregate Bond Index is an unmanaged index consisting of U.S. dollar-denominated, fixed-rate, taxable bonds. The U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS.