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Year End Market Update

Looking back, 2017 was a good year for investors. The S&P 500 had its best year since 2013, increasing nearly 22%. In addition to the strong performance in domestic markets, we witnessed a strong rebound in international markets as well, which were up almost 26% when measured by the MSCI EAFE. Fixed income markets, measured by the Barclay's US Aggregate Bond Index, continued their steady growth and finished the quarter up 3.5%. Echoing sentiment from our last note, while it is nice to see all the major asset classes having positive years, it is also important to remember to rebalance portfolios to keep allocations in line with what was designed for your financial plan.

A Positive Year in Financial Markets

Domestic markets, led by the S&P 500 had a strong year finishing up 22%. Most market pundits refer to the S&P 500 when discussing domestic markets. However, it is important to remember that there are further distinctions that make up the broader domestic markets; and while all were positive for the year, they did not all perform the same. Large Cap Growth stocks led the charge in 2017, increasing 30%; a significant out performance relative to Small Cap Value stocks, which ended the year up a modest 8%. These differences are important to keep in mind when considering rebalancing your portfolio.

The current bull market cycle, which started in 2009, is now one of the longest in the history of the S&P 500 and showed no signs of slowing in 2017. Over the year, we saw strong fundamental earnings reported from the S&P 500 constituents leading to analysts raising their expectations, which in turn propelled the stock market to all-time highs. Stocks benefited from the continued low interest rate environment and the now finalized tax reform bill. Even with the strong performance, the price-to-earnings valuation metric that many market participants use to determine if a stock is "cheap" or "expensive" remains at palatable levels. The forward P/E ratio of the S&P 500 at the end of the year was 18.2x relative to its 25 year average of 16x and remains within one standard deviation of this mean number. If companies were not reporting the strong earnings that they have been, and we did not see continued improvement in the labor market, it would be concerning, given the elevated valuations relative to their historical averages. However, that has not been the case and the strong corporate reports, coupled with a continually improving labor market, lead us to believe that 2018 could be another strong year for the S&P 500 and domestic markets. While we have expectations of 2018 being a positive year, we would caveat that comment with more modest expectations then the 22% we witnessed in 2017.

2017 was a refreshing year in international markets, which saw their first meaningful gains since 2013. Global markets have had a much slower recovery relative to domestic markets since the financial crisis in 2008. Since the market lows, the MSCI All Country World Index Ex US has increased a cumulative 127% or less than half the cumulative performance of the S&P 500's 295% gain. Given the lagging performance, the valuations in international markets remain slightly below their historical averages whereas domestic markets are above theirs; indicating they may be "cheaper" relative to the higher priced domestic markets. The European Central Bank is expected to maintain its accommodative stance in 2018, which should continue to bode well for international stocks; just as our market fared well under the quantitative easing programs introduced after the financial crisis. Given the relative valuations and an accommodative monetary policy we would expect international markets to continue to fair well going into 2018.

Rounding out the major asset classes, fixed income had a positive year as well; finishing up a modest 3.5%. Investors have been cautious in this space given expectations of a rising interest rate environment, which theoretically puts pressure on bond prices. As the stock market has different sectors, so does the bond market and short-term debt has faced more of this burden relative to long term bonds, which have benefited from a flattening yield curve. While this yield curve was beneficial, this asset class continues to face the undeniable headwind of increasing interest rates from the Federal Reserve.

Again, 2017 was a good year for investors and we remain optimistic for 2018. While we are constructive on the year to come, it is important to remember that markets do not always go up and volatility could come back if we do not get the earnings analysts expect or a geopolitical event spooks the markets. Given this, it is important that your allocation is in line with your goals, time horizons and risk tolerances in case something does throw a wrench in the seemingly steady growth we have seen over the last few years.

We are always ready to assist you and answer any questions regarding this newsletter or any other financial matter that may come up. If any changes to your situation have occurred, please contact us at your convenience.

	Closing Price: 9/30/2017	Closing Price: 12/31/2017	Q4 2017 Return %	CY 2017 Return
S&P 500 TR USD	2,519.36	2,673.61	6.64%	21.79%
MSCI EAFE NR USD	1,973.81	2,050.79	4.23%	25.03%
Barclays US Aggregate Bond TR	2,038.46	2,046.37	0.39 %	3.54%

Written by Finity Group

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