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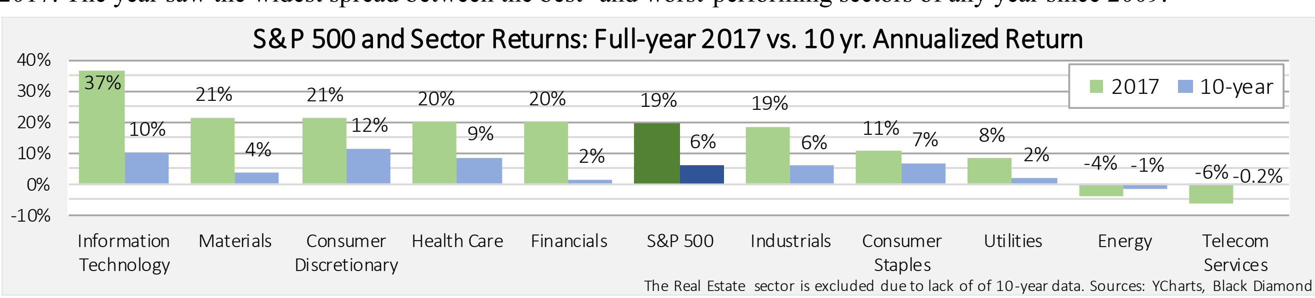
# FOURTH QUARTER 2017 MARKET & ECONOMIC REVIEW

## Major Equity Market Indexes & Commentary

| Index | Description | 9/30/17 | Low Close | High Close | 12/31/17 | QTD Return* |
|---|---|---|---|---|---|---|
| S&P 500 | A market-capitalization weighted index of 500 large U.S. companies. | 2,519.36 | 2,529.12 | 2,690.16 | 2,673.61 | 6.12% |
| DJIA | Dow Jones Industrial Average or "The Dow"; A price-weighted average of 30 major U.S. companies. | 22,405.09 | 22,557.60 | 24,837.51 | 24,719.22 | 10.33% |
| Nasdaq Composite Index | A market-capitalization weighted index comprised of over 3,000 companies, mostly in the technology and biotech industries. | 6,495.96 | 6,516.72 | 6,994.76 | 6,903.39 | 6.27% |
| NIKKEI 225 | A price-weighted index comprised of Japan's top 225 most established companies. | 20,356.28 | 20,400.78 | 22,938.73 | 22,764.94 | 11.83% |
| MSCI Emerging Markets | An index comprised of 23 MSCI indices from emerging economies including Brazil, China, India, Mexico, Russia, South Africa, and the UAE. | 1,081.72 | 1,082.97 | 1,158.45 | 1,158.45 | 7.09% |
| Stoxx Europe 600 | An index comprised of 600 companies based in one of 18 EU countries including Austria, Belgium, Denmark, France, Germany, Ireland, Spain, and the United Kingdom. | 388.16 | 381.96 | 396.77 | 389.18 | 0.26% |

* Excludes effects of dividends — Sources: YCharts, Wall Street Journal

- 2017 was an impressive year for equities across the world, and the fourth quarter was no exception. Developed and emerging economies, on the whole, continued to experience economic expansion that bolstered market returns.
- A comparison of the three U.S. indexes above illustrates two prevailing trends in 2017: the relative outperformance of large cap stocks and that of technology stocks versus the rest of the U.S. equity market. The Dow, a collection of large cap stocks, outperformed the more diverse S&P 500 during the quarter, as did the tech-heavy NASDAQ. During the year, the Dow and NASDAQ outperformed the S&P 500 by 5.7 percentage points and 8.8 percentage points, respectively.
- Given the high-flying nature of tech companies, it is not surprising that the sector outperformed the S&P 500. In fact, tech has outperformed the S&P 500 in each of the last 4 years (2014-2017). But before one jumps on the band wagon, note that the tech sector underperformed the S&P 500 in 5 of the 6 years prior to those (2008, 2010-2013), so past performance is truly no guarantee of future results. Therefore, GFC continues to focus on fundamentals and resists following the herd, no matter how tempting.
- The chart below illustrates 2017 and 10-year annualized return of each sector and the S&P 500. The outperformance of many sectors in 2017 versus their 10-year return shows just how robust 2017 really was. It also shows how lopsided sector performance was in 2017. The year saw the widest spread between the best- and worst-performing sectors of any year since 2009.




- Japanese equities experienced four unique quarters during the year: losing ground in the first quarter, experiencing modest gains in the second and third, and then hitting their stride in the fourth. The NIKKEI, interestingly, for the year was the most volatile (i.e., risky) of the above indexes, even when compared to the emerging markets index.
- Emerging markets were the top performing group in 2017, with the index topping 34.4% for the year. The rise in oil prices helped buoy some emerging economies, and Chinese and Indian equities continued to grow at blistering rates, 51% and 37% respectively.
- European stocks experienced a virtually flat quarter to end what was respectable year. The Stoxx Europe 600 grew 7.7% in 2017 after having lost 1.2% in 2016. The index has not yet recovered to its previous peak, sitting about 6% below the mark set in 2015.

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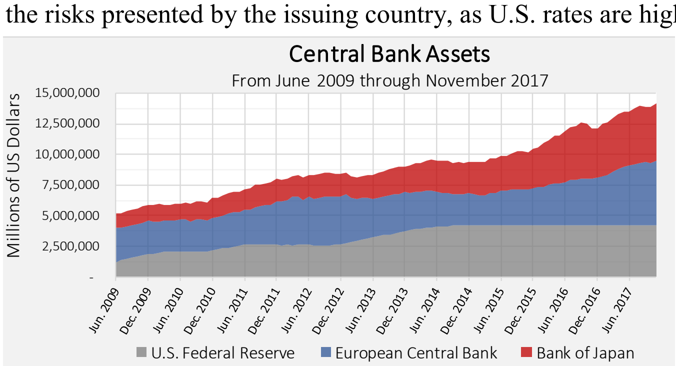
# FOURTH QUARTER 2017 MARKET & ECONOMIC REVIEW

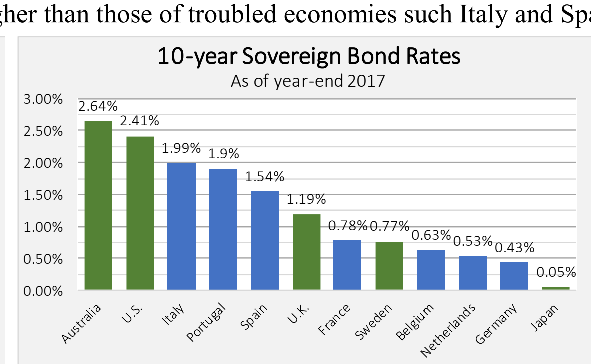
## Fixed Income Rates & Commentary

| Description | 9/30/17 | 12/31/17 | QTD Change in Basis Points* | Description | 12/31/17 | 52-Week Range Low | 52-Week Range High |
|---|---|---|---|---|---|---|---|
| 90 Day Treasury Bill | 1.06% | 1.39% | ↑ 33 | Federal Funds Rate Target | 1.25%-1.50% | 0.25%-0.50% | 1.25%-1.50% |
| 10 Yr. Treasury Note | 2.33% | 2.40% | ↑ 7 | Prime Rate (U.S.) | 4.50% | 3.75% | 4.50% |
| 30 Yr. Treasury Bond | 2.86% | 2.74% | ↓ -12 | LIBOR (3-Month) | 1.69% | 1.00% | 1.69% |
| 15 Yr. Mortgage Rate | 3.16% | 3.37% | ↑ 21 | 5-Year CD | 1.48% | 1.19% | 1.50% |
| 30 Yr. Mortgage Rate | 3.90% | 3.92% | ↑ 2 | New-car Loan (48mo) | 3.29% | 2.85% | 3.36% |

* One basis point is equal to 1/100th of 1%, or 0.01% — Sources: YCharts, Wall Street Journal

- The Federal Open Markets Committee of the U.S. Federal Reserve voted during its mid-December meeting to raise the Fed Funds Target Rate range by 25 bps to 1.25% to 1.50%. The fixed income markets had been expecting such a decision.
- President Trump nominated Jerome Powell for the chairmanship of the Federal Reserve. The appointment is awaiting Senate confirmation. Mr. Powell is a current member of the Federal Reserve Board of Governors, appointed by President Obama in 2012.
- The difference between short-term and long-term U.S. Treasury yields has again narrowed (a.k.a., "flattened"), as evidenced by the increase in the 90-day rate and the decrease in the 30-year rate. In practical terms, this means that investors are receiving relatively less compensation for tying up money for longer periods than before. In a normal economic environment (i.e., one with much less central bank intervention), this would be a concerning development. Typically, investors see a flattening yield curve as a sign that expectations of future growth have become muted. However, in this instance of flattening, the cause is more complex.
- Short-term yields are more sensitive to the Fed funds rate than are long-term yields. As the U.S. economy heats up and the Fed raises rates to keep that growth from overheating, short-term rates will naturally begin to tick upwards. Global economics, though, are weighing on long-term bond rates, such that we find they are not the indicators of future growth they once were.
- The charts below show two important data sets that inform our interpretation of long-term rates. The chart to the left shows that while the Federal Reserve has begun to unwind its balance sheet, the other two major central banks in the developed world, those of Europe and Japan, continue to buy assets. This is keeping global rates low by creating extraordinary demand for bonds.
- Low rates abroad translate to lower rates at home. Yield-hungry global investors may be buying a greater volume of higher-yielding U.S. Teasurys than usual, keeping domestic rates from rising to levels commensurate with current economic growth.
- The chart on the right shows just how low rates are across the world. Fortunately, 10-year government bond rates are no longer negative, but they are still quite low. The buying activity of central banks has also led to sovereign bond yields to be disconnected from the risks presented by the issuing country, as U.S. rates are higher than those of troubled economies such Italy and Spain.




- Goodman Financial continues to prefer corporate bonds maturing within the next five years. Shorter maturities means less exposure to interest rate risk. This also means that the invested capital will become available sooner and hopefully in a higher interest rate environment.

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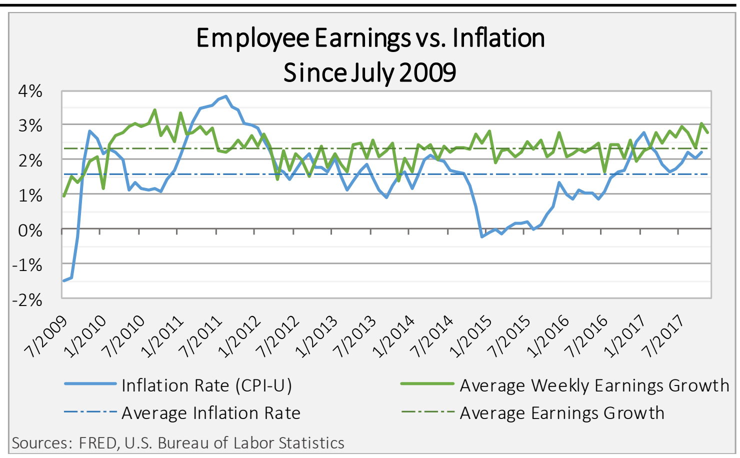
## Economic Indicators

| Unemployment Rate | Description | 9/30/17 | 12/31/17 | QTD Change |
|---|---|---|---|---|
| Average Weekly Initial Claims for Unemployment Insurance | The number of new filings for unemployment insurance benefits. **Claims decreased due to recovery from active hurricane season, economic growth.** *Most economists believe claims below 300,000 indicate a healthy labor market environment.* | 267,000 | 241,750 | ↓ -9.5% |
| Unemployment Rate | The percentage of total labor force that is unemployed but actively seeking employment. **The unemployment rate remains below 5% and is the lowest since early 2001.** *The U.S. Federal Reserve targets a long-run unemployment rate of between 4.5% and 5%.* | 4.2% | 4.1% | ↓ -10 bps |
| Average Weekly Earnings | The average weekly salary earned by private, nonfarm employees. **Wages increased during the quarter, likely as a result of a tightening labor market. This suggests more disposable income for consumers.** | $912.63 | $918.74 | ↑ 0.67% |
| Index of Consumer Sentiment | This index reflects consumer attitudes towards the state of the economy. **Consumer confidence rose slightly, nearer to its post-recession high of 98.5.** | 95.1 | 95.9 | ↑ 0.84% |
| Manufacturers' New Orders for Consumer Goods and Materials (Millions) * | The number of new orders placed for consumer goods. **New orders increased, indicating higher demand for U.S.-produced consumer goods and validating high consumer confidence and lower unemployment.** | $199,456 | $205,175 | ↑ 2.87% |
| Manufacturers' New Orders for Nondefense Capital Goods, Excluding Aircraft (Millions) * | This index is the producer's counterpart of new orders of consumer goods and materials. **New orders for nondefense capital goods increased during the quarter, suggesting increased business confidence in the economy.** | $66,656 | $67,066 | ↑ 0.62% |
| US Capacity Utilization: Manufacturing * | The ratio of production capacity being used to produce finished products compared to the total capacity available. **Capacity utilization increased, with Gulf Coast refineries recovering from hurricanes.** | 75.8% | 76.9% | ↑ 117bps |

*These items are as of 11/30/17, the date of the most recently published statistics  Sources: YCharts, Federal Reserve Bank of St. Louis, The University of Michigan, U.S. Census Bureau, U.S Department of Labor

## U.S. Economic Health

2017 continued the trend of modest but positive growth in the U.S. The chart to the right compares two closely watched economic measures important to American households: earnings growth and inflation. The time scale is since the end of the Great Recession, the end of the second quarter of 2009.




Inflation, which has been struggling to meet the Fed's target rate of 2%, appears to be finding some footing around that level. This is an important development as inflation around 2% is typically seen as incentivizing businesses and individuals to make capital investments without being so high as to be destabilizing to households. Without some amount of inflation, businesses and individuals may put off investment today in the hopes of better prices tomorrow.

Higher inflation also means higher borrowing rates, a boon for fixed income investors. Given that higher rates would still be low in historical terms, higher rates—within reason—are not seen by us as a damper on growth but as an affirmation of economic stability.

The increase in wages is similarly a mixed blessing that we see, on balance, as a positive. The downside is that higher wages are a drain on corporate margins. However, putting dollars into consumers' pockets is hard to dislike. Having consumers and businesses drive the economic bus would be a welcomed change from having central bankers, bureaucrats, and legislators at the helm, as has been the case for the past few years.

Seeing employees' earnings growth regularly outpace inflation, even as inflation appears to firm around 2%, results in "real" wage growth, which is great for American consumers. With headline unemployment at 4.1% and so-called "real" unemployment (i.e., U-6 unemployment) back at pre-recession lows, it is hard to argue that there will not be continued real wage growth. High consumer sentiment and growing manufacturers orders signal real economic growth, which is foundational to a strong labor market.