ASPIRIANT

Market Snapshot

October 2017

MARKET SNAPSHOT
Third Quarter 2017

The world economy and financial markets continue along a remarkably tranquil path. Ironically, this rare consistency in the market's movement is happening side-by-side with global risks such as escalating tensions with North Korea, the Federal Reserve's tightening monetary policy, and the destructive storms throughout the Caribbean, Florida and Texas. Overall, investment portfolios posted significant gains from international and U.S. equities. Stocks most often classified as "growth stocks" (such as technology and healthcare) outperformed those known as "value stocks" (such as financials and energy). With markets mostly moving up this year, our portfolios are capturing nearly all the positive return relative to our benchmark, while poised to protect capital in the event of a market correction. In our view, this is the most prudent long-term strategy in a market priced for perfection, which is to say a market that expects only more good news.

Major Index & Currency Performance
Periods Ending September 30, 2017

			Annualized Trailing Return		
EQUITIES	**Q3**	**1YR**	**3YR**	**5YR**	**10YR**
S&P 500 TR	4.48	18.62	10.81	14.23	7.44
Russell 2000 TR	5.67	20.76	12.17	13.79	7.85
MSCI EAFE NR	5.40	19.12	5.03	8.38	1.34
MSCI Emerging Markets NR	7.89	22.48	4.90	3.99	1.32
MSCI All Country World NR	5.18	18.66	7.43	10.20	3.88
FIXED INCOME					
Bloomberg Barclays US Agg Bond TR	0.85	0.07	2.71	2.06	4.27
Bloomberg Barclays Municipal TR	1.06	0.87	3.19	3.01	4.52
Bloomberg Barclays HY Muni TR	1.50	1.43	4.56	4.74	4.74
CURRENCIES					
Euro (EUR vs. USD)	3.65	5.20	(2.19)	(1.68)	(1.83)
Pound (GBP vs. USD)	3.29	3.28	(6.11)	(3.64)	(4.09)
Yen (JPY vs. USD)	(0.18)	(10.04)	(0.86)	(7.12)	0.22
REAL ASSETS					
S&P GS Commodity Index TR	7.22	1.79	(19.55)	(14.38)	(10.02)
Wilshire Global Real Estate Securities Index TR	1.35	2.46	7.70	8.42	3.74
Alerian MLP TR	(3.05)	(3.70)	(12.92)	(0.57)	6.49

Source: Morningstar. Indices are unmanaged and have no fees. An investment may not be made directly in an index. Index returns shown are based in U.S. dollars.

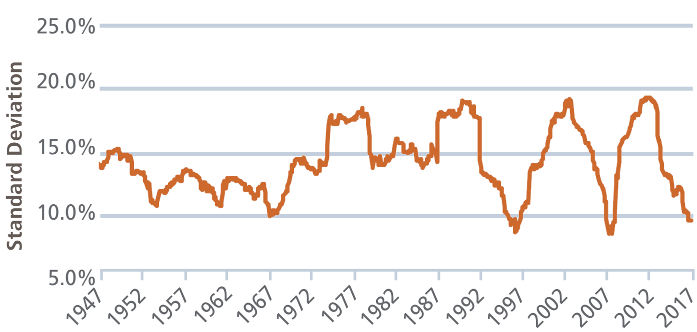
Equities — These days will not last forever

Equity markets have benefited from stable profit margins and a lack of negative economic surprises. Last quarter, we explained what's been driving strong returns and outlined our concerns why and how this dynamic could change over the next cycle. In the graph on the next page, we focus on volatility (swings in security prices) and historical return patterns. The takeaway is the low volatility of the last few years will not stick around forever.

For markets to continue the current low volatility pattern, a knowledgeable observer would have to believe investors have forever overcome fear- and greed-based investing behaviors and have embraced the elimination of economic cycles. And that's not likely.

This isn't the first time volatility has vanished from the investment scene, and it won't be the last. The below chart shows five-year volatility of the S&P 500 back to 1947, and you can see several instances where volatility was noticeably low. Needless to say, we don't expect volatility to remain subdued. And unfortunately for investors, history suggests an increase in volatility is often associated with lower returns.

S&P 500 Five-Year Volatility



Data as of Oct. 1 for each year shown.
Sources: World Federation of Exchanges, Bloomberg and Aspiriant.

Not only is volatility low, but the domestic equity markets continue to set and closely hug new record highs. Amazingly, the S&P 500 has had 11 straight months of positive returns; the first time this has happened since the 1950s. While we do not know how long the cycle will last, maintaining a long-term perspective on the market is especially important at this stage in the cycle.

Currency fluctuations — A give-and-take relationship

The ebb and flow of the U.S. dollar relative to other currencies exerts a significant impact on investment returns for U.S. investors holding international equities. Over the last five years, U.S. investors have been on the wrong side of this dynamic. In fact, the impact of currency fluctuations has accounted for a larger part of international equity underperformance than the underlying fundamentals of the companies. From 2012 through 2016, U.S. investors lost one half of the return from international developed markets due to currency fluctuations.

Entering 2017, many believed this effect would continue. The conventional wisdom was the dollar would remain strong

International Stock Returns

Through 12/31/2016	3 YR	5 YR
MSCI EAFE* (local currency)	5.5%	11.8%
MSCI EAFE* (in U.S. Dollars)	(1.6%)	6.5%
Cumulative cost of currency	22.2%	37.8%

*Europe, Australasia and Far East. Source: MSCI EAFE Index.

from fiscal policy expansion proposals such as increased infrastructure spending, potential trade tariffs and broad tax reform. The Federal Reserve's plan to further raise interest rates would add to the dollar's strength. As is often the case with conventional wisdom and especially economic theory, it just isn't that easy. Fast forward nine months and the dollar weakened against major currencies.

Through September, a weaker U.S. dollar has provided an 8.8% bump to performance for developed international equities and 4.2% for emerging market equities. Although the Federal Reserve increased short-term interest rates twice and discussed other measures that could push interest rates higher, longer-term interest rates, which are less influenced by Fed policy, have fallen slightly in the U.S. The combination of lower long-term rates and a stronger-than-expected international economy have helped weaken the dollar.

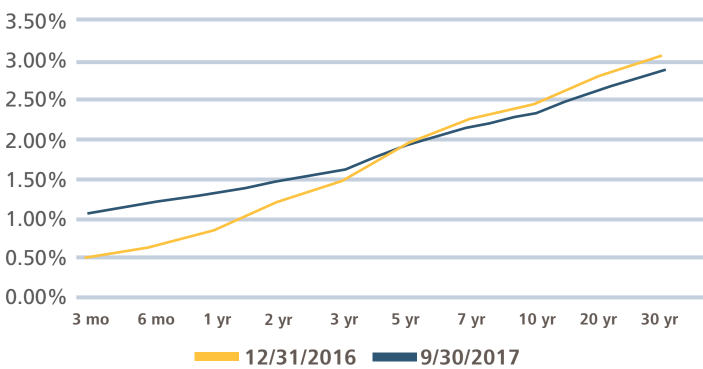
Fixed income — The focus is on the Fed

Given the attention on the Federal Reserve's actions this year, the rational reaction we have seen from the bond market is startling. Year-to-date short-term interest rates, which are directly controlled by the Federal Reserve, are 0.5% higher while intermediate- and long-term rates remain below year-end yields. With little in the way of shocks from the Fed and the economy, we're not surprised by the decline in long-term rates. In this relatively stable interest rate environment, longer-term bonds have outperformed short-term bonds and, overall, investment-grade bonds have performed well. The conventional wisdom that bonds don't do well in rising interest rate environments has not held true.

Looking ahead, the market's focus on the Fed for the remainder of the year will revolve around the balance sheet, continued interest rate hikes, and who will oversee the central bank in 2018 and beyond. Currently, our focus is on the potential market reaction to the Federal Reserve reducing its balance sheet by reinvesting a smaller amount of maturing bonds. By not fully reinvesting the proceeds from maturing bonds, the Fed is removing demand from the marketplace and placing upward pressure on long-term interest rates. The Fed signaled the beginning of this process over the summer and officially announced a plan to normalize the balance sheet and reverse the impact of Quantitative Easing (QE) at the September meeting.

The signaled change in policy did increase interest rate volatility during the two weeks leading up to the September meeting through the end of the quarter. The 10-year Treasury yield increased by 0.30%, a significant three-week move. Uncertainty surrounds how the market will ultimately react to the actual implementation of reduced purchases going forward. Using history as a guide, interest rates decreased leading up to and shortly after announcement of each phase of QE. However, once the purchases began, interest rates started to head higher — the opposite direction of the intended consequences.

Treasury Yield Curve



Source: Federal Reserve.

The market expectation from a smaller Fed balance sheet is higher long-term rates. And we have seen an increase in interest rates leading up to and shortly after the announcement. Could the market's response to normalizing the Fed's balance sheet be complete? The market is forward-looking and should be able to anticipate the changes in purchases ahead of time given the proper guidance.

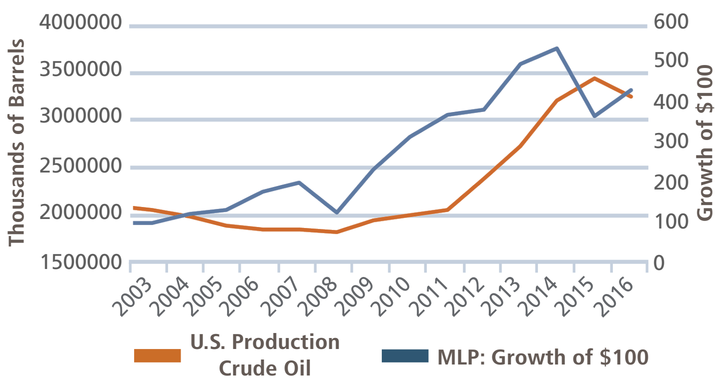
On that score, the Fed has been very transparent with their intentions, so there may be little need for the market to react as the plan is implemented. In a rational market, a further change in long-term interest rates should only occur if the Fed makes an unexpected change from the current plan. But markets aren't always rational, so we will be watching the market reaction as the Fed takes the next steps to resize its balance sheet.

Oil prices and MLPs

The debate about master limited partnerships (MLPs) rages on. The view over the last few years has been MLPs move in tandem with oil or natural gas prices. Historically, MLP returns have a low correlation to oil price changes. The more significant connection is with crude oil production, which drives demand for energy infrastructure projects.

Master Limited Partnerships

Crude Oil Production and MLP Performance



Data as of Jan. 1 for each year shown.
Sources: U.S. Energy Information Association and Bloomberg.

Strong MLP performance from 2011 through late 2014 can be tied to a significant increase in production while oil prices remained flat. It's true the correlation of MLPs to oil price changes has increased over time. However, MLP cash flow has not shown this same relationship. Many MLPs have been able to maintain or increase dividend distributions with oil prices down significantly from the 2014 highs.

Unfortunately, the volatility for MLPs has persisted this year. The market was unnerved when a couple major components of the Alerian MLP Infrastructure Index cut distributions to protect and improve their balance sheets during the quarter. Meanwhile, the majority of companies in the Alerian index continue to increase distributions. Additionally, improvements are being seen with IPOs testing the market and sizeable infrastructure development occurring during September. Despite the recent travails, the benefits of diversification and low valuations compared to the broader market make a small investment in MLPs prudent for a diversified portfolio.

Looking to the future

We can all revel in the strong returns the market has provided over the last eight-and-a-half years, and especially over the last year. As we contemplate future returns, we counsel caution about expecting the recent performance to continue into the future. Understanding where returns come from helps us put the future in context. Our approach of breaking equity returns down between long-term fair value returns (growth and dividends) and market cycle returns (changes in valuation) provides us with this context.

If you have any comments or questions about how the Market Snapshot relates to your personal investment portfolio, please reach out to your client service team.

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Important disclosures: *Past performance is no guarantee of future performance. All investments can lose value. Indices are unmanaged and it is impossible to invest directly in an index. The volatility of any index may be materially different than that of a model.*

Equities. *The S&P 500 is a market-capitalization weighted index that includes the 500 most widely held companies chosen with respect to market size, liquidity and industry. The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. It is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. The MSCI EAFE Index (Europe, Australasia, and Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The MSCI ACWI Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets.*

Fixed Income. *The Barclays U.S. Aggregate Index represents securities that are SEC-registered, taxable and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis. The Barclays Municipal Bond Index is a rules-based, market-value-weighted index engineered for the long-term tax-exempt bond market. The index has four main sectors: general obligation bonds,revenue bonds, insured bonds and pre-refunded bonds. The Barclays High Yield Municipal Bond Index is an unmanaged index composed of municipal bonds rated below BBB/Baa.*

Real Assets. *The S&P GSCI® is a composite index of commodity sector returns representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities. The returns are calculated on a fully collateralized basis with full reinvestment. Wilshire Global RESI is a broad measure of the performance of publicly traded global real estate securities, such as Real Estate Investment Trusts (REITs) and Real Estate Operating Companies (REOCs). The index is capitalization-weighted. The Alerian MLP Index is a gauge of large and mid-cap energy Master Limited Partnerships (MLPs). The float-adjusted, capitalization-weighted index includes 50 prominent companies and captures approximately 75% of the available market capitalization.*