ASPIRIANT

Market Snapshot

January 2018

MARKET SNAPSHOT
Fourth Quarter 2017

Happy New Year! We are delighted to be celebrating Aspiriant's 10th anniversary with our clients in 2018. Thank you for partnering with us through the years. We could not have built a leading independent wealth management firm without you. We're honored to have the opportunity to serve you, and we look forward to continuing to do so this year and beyond.

Major Index Performance
Periods Ending December 31, 2017

			Annualized Trailing Return		
FIXED INCOME	**Q4**	**1YR**	**3YR**	**5YR**	**10YR**
Bloomberg Barclays US Agg Bond TR	0.39	3.54	2.24	2.10	4.01
Bloomberg Barclays Municipal TR	0.75	5.45	2.98	3.02	4.46
Bloomberg Barclays HY Muni TR	1.83	9.69	4.77	4.35	5.25
DIVERSIFIERS					
Aspiriant Defensive Allocation Fund[1]	2.37	9.41	---	---	---
REAL ASSETS					
S&P GS Commodity Index TR	9.90	5.77	(7.52)	(12.16)	(10.16)
Wilshire Global Real Estate Securities Index TR	3.21	10.01	5.76	8.02	5.35
Alerian MLP TR	(0.95)	(6.52)	(9.33)	(0.06)	6.05
DEFENSIVE EQUITIES					
Aspiriant Risk-Managed Equity Allocation Fund[1,2]	5.58	21.78	8.28	N/A	N/A
GLOBAL EQUITIES					
S&P 500 TR	6.64	21.83	11.41	15.79	8.50
Russell 2000 TR	3.34	14.65	9.96	14.12	8.71
MSCI EAFE NR	4.23	25.03	7.80	7.90	1.94
MSCI Emerging Markets NR	7.44	37.28	9.10	4.35	1.68
MSCI All Country World NR	5.73	23.97	9.30	10.80	4.65

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.

[1] Current performance may be lower or higher than the performance information quoted. To obtain performance information current to the most recent month-end, please call 1.877.997.9971.
[2] The performance returns for the fund reflect a fee waiver in effect. In absence of such waiver, the returns would be reduced.

A good year for investors

By almost all measures, the last calendar year was a very good one for investors. A globally balanced portfolio invested 60% in the MSCI All Country World Index and 40% in the Bloomberg Barclays Municipal 1-15 Year Index produced a return of more than 15%, with returns for both equities and fixed income securities exceeding most expectations. Beyond the strong performance, 2017 will most likely be remembered for being the first year ever with 12 consecutive months of stock market gains. Throughout the year, the global stock markets marched higher, with just a few modest pull backs and very little volatility.

There was also very little volatility in the global bond markets as interest rates mostly stayed in a narrow range. Despite forecasts that faster economic growth — driven by less regulation and fiscal stimulus from Washington — would lead to higher interest rates, bond prices had limited movement and investors' returns came mostly from the coupon interest earned.

In this Market Snapshot, we review the market forces that affected investments in fixed income, real assets and global equities. And we look ahead to examine the potential impacts of inflation.

Fixed income

The Federal Reserve Bank increased the Fed Funds rate again in December — the third hike in 2017 — and signaled there would be three more increases in 2018. A result of the Fed's action, along with expectations for faster economic growth and higher inflation, was rising interest rates during the quarter. Interest rates rose for most bonds, but shorter-term bonds experienced the biggest yield increases. As a result, intermediate and longer-term bonds performed better than shorter bonds in the fourth quarter. The increase in short-term interest rates was also significant because it caused the yield on cash and money market investments to rise substantially. For the first time in several years, investors can now make some nominal return while holding cash.

Both core municipal bonds and core taxable bonds posted returns of less than 1% in the quarter. Municipal bonds experienced higher volatility as investors attempted to predict how the tax law changes would impact supply and demand for tax-exempt bonds. It was another good quarter for high-yield municipal bonds as their yield advantage allowed them to produce greater returns relative to those produced by investment-grade bonds.

Real assets

Both Master Limited Partnerships (MLPs) and Real Estate Investment Trusts (REITs) should continue to benefit from the recently passed Tax Cuts and Jobs Act, which created deductions for some pass-through businesses. The change was partly responsible for the improved performance in these assets in the second half of the quarter.

Although they rallied a bit in December, MLPs were one of the few asset classes that lost money in the fourth quarter. While MLP fundamentals remain solid, and have improved somewhat thanks to higher oil prices, the sector has been hurt by some MLPs cutting their distributions and shifting towards retaining more cash to fund growth internally instead of having to issue new debt or equity. This shift in strategy has taken some investors by surprise and led to selling pressure.

REIT investments — both U.S.-based and international — climbed further in the quarter, but they did not keep pace with the broader equity markets in 2017. In the U.S., the real estate sector produced modest returns during the fourth quarter. As was the case throughout the year, REITs underperformed stocks as investors gravitated towards sectors with better growth potential such as Technology and Consumer Discretionary. Outside the U.S., returns from real estate investments were much stronger, thanks to faster economic growth in Europe and parts of Asia.

Global equity

Led by the U.S. and emerging markets, the MSCI All Country World Index returned a robust 5.7% during the quarter. Both U.S. and international stocks finished the year strongly as investors remained optimistic about global economic growth and fat corporate profits. Some of the gains produced by international stocks — in both developed countries and emerging markets — resulted from continued weakness in the U.S. dollar. For the year, the dollar dropped more than 10% versus a basket of foreign currencies.

Throughout the year in the U.S., larger growth-oriented stocks were the best performers, while smaller value-oriented stocks lagged. In 2017, the Russell 1000 Growth index gained 30.2% versus just 7.8% for value stocks. While large-growth stocks have been the best performing asset class recently, we expect the pendulum to swing back over time, and small-cap value stocks (which we do not currently favor) will get their turn to be the leaders at some point in the future.

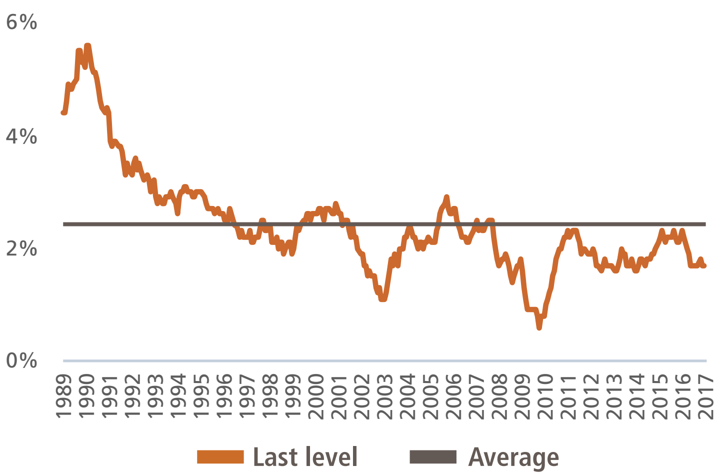
We have written in past quarters about the relative attractiveness of international and emerging market stocks, so it was satisfying to see these asset classes perform well in 2017. Emerging market stocks were the best performers in the fourth quarter and for the entire year. Developed market international equities also finished the year strong. The performance of both developed international and emerging market equities was boosted by the decline in the U.S. dollar in 2017. After appreciating in 2016, the dollar fell against all major currencies last year, making investments outside the U.S. more profitable.

Will inflation return?

While we enjoyed the strong investment returns produced in the fourth quarter of 2017, we realize that we cannot expect these types of gains to be repeated each quarter. Based on our analysis, it appears that most asset classes are expensive at this time and investments made today are expected to produce relatively low returns over the next seven years.

One important data point that we are looking at is the rate of inflation, and especially how inflation expectations impact interest rates. Despite very easy monetary policy globally, including quantitative easing and still historically low interest rates, we have not seen a meaningful increase in inflation since the end of the Great Financial Crisis (GFC). As shown in the chart below, it has been almost a decade since the Federal Reserve Bank's target of 2% inflation was last achieved.

U.S. Consumer Price Index (Core)



Source: Bloomberg.

Because inflation has yet to rise, interest rates and bond yields have remained low as well. These low interest rates have contributed to the strong stock market returns we've experienced over the last nine years. The value of an investment goes up when interest rates go down because all future cash flows are worth more. Moreover, low interest rates offered by safe investments such as bonds has made investing in stocks look more attractive, which has helped boost equity returns.

So why hasn't inflation picked up and put pressure on interest rates to rise? And when will inflation increase? These are very difficult questions to answer and we would say that no one knows for sure. Many economists and investors have expected inflation to rise over the past several years, yet it has remained subdued. Despite the lack of certainty, we continue to look for answers. According to well-established economic theory, we expect to see inflation increase as the unemployment rate declines. However, even as the unemployment rate plunged — it's remained below 5% since October 2016 — wage growth (until recently) has been stagnant, helping to keep inflation below the Federal Reserve's 2% target. Despite central banks providing more than $10 trillion of liquidity to the economy through asset purchases and holding interest rates close to (or even below) zero, monetary largess has not yet produced any noticeable increase in inflation.

There are many theories for this. Some say that technological advances have kept inflation low. There's some truth that technology enables us to produce goods and services at lower costs now than ever before. Others point to globalization, which has provided consumers with access to products built more cheaply in countries where costs are lower. It's also said that the decline in labor unions has resulted in slower wage gains, and it has been noted that businesses have been reluctant to make capital expenditures due to uncertainty following the GFC. Another theory is that increasing income inequality could tamp down inflation because more of the income going to the wealthy is likely to be saved, while almost all income earned by the lower and middle class gets quickly recycled in the economy through consumption. Finally, some believe that low inflation reflects demographic shifts that we're experiencing here and in other countries. As baby boomers move into retirement, they tend to consume less, which lowers demand and helps keep prices from rising quickly.

All of these explanations are plausible, but history has shown that inflation is cyclical, and we expect this period of low inflation to end at some point. We don't expect anything like the hyper-inflation of the 1970s, but even inflation that is consistently between 2% and 3% could mean that investments that have been successful in the past could be replaced with new ones in the future. Higher inflation would almost certainly lead to higher interest rates, which would make investing in core bonds more challenging. Higher interest rates might also reduce the appeal of investing in bond-like equities, such as utilities that offer higher dividend yields but less growth potential. The prospect of such a scenario is one of the reasons we introduced defensive strategies as an investment solution in 2016.

A return to higher inflation may lead to a renewed interest in commodities and real assets, such as investments in real estate investment trusts, energy-related companies and infrastructure. Returns for these types of investments have not kept pace with the top-performing growth stock sectors over the past decade, but commodity prices usually rise when inflation picks up. Some of the stocks in these categories may also benefit from the new tax law changes. We also think that the Trump administration is likely to implement policies that will be favorable to the domestic energy and real estate sectors, and this could lead to higher returns in these areas.

More generally, the tax cuts should provide the economy with at least a short-term boost to corporate profits and increase the chance that we will see higher inflation going forward. Additionally, further fiscal policy, such as an infrastructure spending plan, could also boost the economy and increase GDP. All of this, at a time when unemployment is extremely low and spare capacity is limited, leads us to believe that rising inflation is a risk that we need to prepare for going forward.

Tax law changes

We know that many of you have questions about how the recently passed tax reform will affect you and your finances. A full discussion of the tax law changes is beyond the scope of this Snapshot, but we have published a summary of the changes and a Market Perspective on our blog, *fathom*. We would also be happy to discuss the details of the bill with you individually.

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

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