



ASPIRIANT

Market Snapshot



July 2017

MARKET SNAPSHOT Second Quarter 2017

The second quarter completed a strong first half of 2017 for equity and fixed income markets. The markets have continued to rally despite no action in U.S. fiscal policy surrounding taxes and infrastructure spending, and the Federal Reserve's moves toward tighter monetary policy through higher interest rates. Importantly, investment portfolios benefited from significant outperformance from international equities, especially emerging markets, over U.S. equities; while the value style of investing weighed on returns.

Major Index & Currency Performance Periods Ending June 30, 2017

EQUITIES	Q2	1YR	Annualized Trailing Return		
			3YR	5YR	10YR
S&P 500 TR	3.09	17.90	9.61	14.63	7.18
Russell 2000 TR	2.46	24.60	7.36	13.70	6.92
MSCI EAFE NR	6.12	20.27	1.15	8.69	1.03
MSCI Emerging Markets NR	6.27	23.75	1.07	3.96	1.91
MSCI All Country World NR	4.27	18.78	4.82	10.54	3.71
FIXED INCOME					
Bloomberg Barclays US Agg Bond TR	1.45	(0.31)	2.48	2.21	4.48
Bloomberg Barclays Municipal TR	1.96	(0.49)	3.33	3.26	4.60
Bloomberg Barclays HY Muni TR	1.99	1.22	5.62	5.22	4.46
CURRENCIES					
Euro (EUR vs. USD)	6.64	2.66	(5.91)	(2.11)	(1.68)
Pound (GBP vs. USD)	3.88	(2.83)	(8.75)	(3.70)	(4.25)
Yen (JPY vs. USD)	(0.83)	(8.70)	(3.39)	(6.62)	0.95
REAL ASSETS					
S&P GS Commodity Index TR	(5.46)	(9.01)	(24.82)	(13.70)	(9.67)
Wilshire Global Real Estate Securities Index TR	2.92	1.13	5.85	9.05	3.64
Alerian MLP TR	(6.35)	0.40	(11.23)	1.77	5.74

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.

Source: Morningstar

Fixed income — Contrarian long-term bonds

Fixed income provided solid returns for the quarter despite the Federal Reserve raising the fed funds rate for the second time in 2017. The strong quarter brought year-to-date returns up to 2.3% for the Bloomberg Barclays US Aggregate taxable bond index and 3.5% for the Bloomberg Barclays Municipal index. Contrary to popular expectations, yields on longer-term bonds

fell during the first half of the year, even as the Fed lifted the short-term fed funds rate. Lower yields for longer-term bonds helped produce strong fixed income returns as bond prices move in the opposite direction from yields. Continued optimism for the economy and the search for more income remains a positive for high-yield bonds. We continue to monitor the

credit spread — or difference in interest rates between high-yield bonds and investment-grade bonds — as the narrowing of that spread over the last 18 months has reduced the benefit of holding high-yield bonds.

Equities — Supported by low interest rates, stock buybacks

Equity markets have also benefited from low long-term interest rates. The Fed has acknowledged high valuations and suggested that these lofty valuations should be tied to long-term interest rates. Meanwhile, it signaled a plan to cut back the amount of bond assets it owns, also called normalizing the Fed balance sheet. Generally speaking, a decrease in Fed purchases lowers demand for bonds. And this reduction in demand could lead to lower bond prices and higher yields, which if done too abruptly may unnerve the market. So, the Fed is telegraphing the change in purchases well in advance and is planning to move at a measured pace to provide the market ample time to absorb the adjustment.

In addition, equity markets have seen a strong increase in earnings over the last year. S&P 500 second-quarter earnings are estimated to have increased by 20% over the prior year. Much of that increase came from improving profit margins, which are back to near-record highs of 10%. While high profit margins are great, increasing future earnings through further improvement to profit margins becomes more difficult. This creates a scenario where future earnings growth will need to come from revenue growth (more consumers buying your product or service), which is difficult when real economic growth is only 2% or so. Going forward, high current margins increase the odds of a negative surprise.

Company stock buybacks have also driven increased earnings and stock market returns. Buybacks have two impacts on the market. First, they create more demand for the stock, pushing the current price higher. Second, the company is reducing the number of shares outstanding, which increases the amount of earnings per share, even when the company is not seeing an increase in total earnings. Earnings per share, not total earnings, is the number used when the market evaluates earnings growth. We have started to see the amount of buybacks fall from the 2016 highs as some measures of corporate debt have grown to levels last seen in 2007. The upshot is corporations have reduced capacity to increase earnings through additional stock buybacks.

We remain cautious as high valuations lead to a greater likelihood of a negative surprise rather than missing out on

a positive surprise. While very few people are calling for a recession in the near term, investors need to be reminded that down markets come before the beginning of a recession. It is nearly impossible to consistently predict the direction of the market over the short-term, one- to three-year period. However, valuations provide a much better predictor of future long-term returns.

European elections stabilize the union and economy

Meanwhile, good results from European elections have put an end to talk of the European Monetary Union's demise. Dutch and French voters proclaimed their desire for the Netherlands and France to remain part of a unified Europe and stopped, or at least slowed down, the insurgency of populist nationalism throughout the world. Emmanuel Macron's victory over Marine Le Pen for the French presidency is important to the stability of the European region. Macron is a centrist with free-market tendencies who believes it is important for France to restructure its economy and stay within the euro.

While continental Europe has seen improved economic stability, the U.K. continues to produce surprises and is grappling with uncertainty. A recent snap election in Britain indicates the British may be having regret over the Brexit vote. Prime Minister Theresa May's Conservative Party suffered an embarrassing setback and was denied the majority of seats in the Parliament necessary to provide May the mandate she sought to strengthen her Brexit negotiating position. This unexpected result creates more ambiguity for Brexit and the U.K. economy.

Along with favorable election results, the Eurozone economy has benefited from rising confidence and pent-up demand. Germany is leading the way but Italy, France and Spain have also seen a considerable increase in manufacturing activity over the last year. These regions have also seen a healthy increase in inflation and a reduced level of unemployment. The economic data and the election outcomes have provided a good environment for the euro to appreciate against the dollar and as a catalyst for these markets to outperform domestic equities.

Falling oil prices impact MLPs

Oil prices continue to exert a significant impact on market prices for MLPs, even though their actual impact on corporate

cash flow is not as significant as the volatility would lead you to believe.

Oil prices fell 9% during the second quarter and 14% in the first half of the year. Meanwhile, MLPs returned -3% during the first half of the year; still 30% higher than the lows seen in 2016.

We continue to believe an oil price range of \$40 to \$60 per barrel is reasonable, and prices are now toward the bottom of that range. Moreover, new technology continues to lower the cost of extracting oil, allowing the energy sector to operate profitably in this price range. MLP fundamentals would deteriorate if energy prices were dropping because of lower demand, but we are not seeing that in the market. Lower oil prices are due to increased supply. Therefore, we continue to believe it is prudent to maintain a small investment in MLPs to further diversify the portfolios.

Remaining defensive

The current environment leads us to continue our defensive posture. However, low interest rates mean we can't maximize our fixed income position and must use defensive strategies and defensive equities to lower the risk in portfolios. These are the days when we have to remember the first part of Warren Buffett's famous quote, "Be fearful when others are greedy. Be greedy when others are fearful."

While fear may be too strong of a word at this point, caution is prudent. We also know from Buffett that, "Successful investing takes time, discipline and patience." At Aspiriant, we are privileged to work with so many people who understand the enduring importance of these behavioral traits.

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.