FOCUS – 3rd QUARTER 2017

While the pace of business tends to slow down in the summer as many of us make our annual pilgrimage to the beach or other vacation destination, with the portability of data and ease of access (just download the mobile app!), there is virtually no stoppage of all that drives markets. With the exception of some volatility in August, equity markets remained on trend (that is to say, moving up and in many cases reaching new highs). U.S. Treasury yields fell significantly during the early part of the summer based on the benign inflationary environment and dovish comments from the Federal Reserve. That trend reversed in September as we saw continuing proof of economic expansion and heard more hawkish rhetoric. While we saw some initial signs of rotation across markets (growth to value, large cap to small cap), large cap growth equities and emerging markets remained the best performing segments.

While we pay close attention to daily headlines, including the continuing process of Britain's exit from the Eurozone ("Brexit"), the Trump administration's push on its legislative agenda and the re-emergence of populist sentiment in Europe (the latest events in the Catalonia region of Spain), here are the major developments that took most of our focus during the quarter:

1) **The rebound of the U.S. dollar –** To our consternation, the U.S. dollar, as measured by the Bloomberg trade-weighted dollar index, had been weakening since the beginning of the year. However, after falling below a key support level in early September, the dollar reversed course. We can attribute this reversal to a number of reasons including hawkish rhetoric from the Fed, confirmation of the Fed's plan to finally reduce their bloated balance sheet, and improved GDP growth. We have maintained a pro dollar stance within our portfolios throughout the year, which has served as a headwind for performance relative to our benchmarks. We believe the dollar was oversold and will continue to rally from here, rewarding our patience.

2) **North Korea's saber rattling –** It seemed like North Korea dominated the summer news as it test-fired long-range missiles, conducted an underground nuclear test, and continued to escalate its threatening rhetoric. A look back at history shows that this is nothing new as the Kim regime tries to stay relevant on the world stage. However, world leaders must pay attention based on proof of North Korea's enhanced missile capabilities and its nuclear weapons program. Ultimately we believe there will be a diplomatic solution (most likely combined with economic incentives) to keep North Korea in check.

3) **The Fed's reversal of quantitative easing –** While the recent interest rate increases can be interpreted as the Federal Reserve's growing confidence in the U.S. economy, the Fed's confirmation of their plan to reduce their $4.5 trillion balance sheet is a definitive step toward normalization of central bank policy. Granted, the European Central Bank and the Bank of Japan are still buying massive quantities of bonds (and equities in the BOJ's case), but the Fed's intentions are proof that the Financial Crisis may finally be fading in the rearview mirror.

Furthermore, we are confident that the Fed will continue to take a measured approach to policy moves in order to limit disruption to the U.S. economy.

4) **The "fullness" of global equity prices –** Equity markets across the globe continue to hit record levels. Valuation measures such as Price-to-Earnings and Price-to-Book are above historical averages. A number of Wall Street analysts believe that global markets have peaked and are at risk of an impending correction. We continue to remain optimistic based on a number of considerations including growth in corporate earnings, broadening economic growth across regions, benign inflation, strong sentiment (both consumer and business), and the potential for U.S. tax reform. However, we do remain vigilant for signs of fatigue in the market rally and will not hesitate to reduce risk in portfolios in order to preserve client capital.

The purpose of this newsletter is to provide some timely insights into what occupied our focus as we considered market opportunities and how to position portfolios. We hope we have accomplished that and welcome questions and comments from our clients.

Wilde Capital Management, 60 Morris Turnpike, Summit, New Jersey, 07901 (866) 894-5332
www.wildecapitalmgmt.com contact@wildecapitalmgmt.com

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