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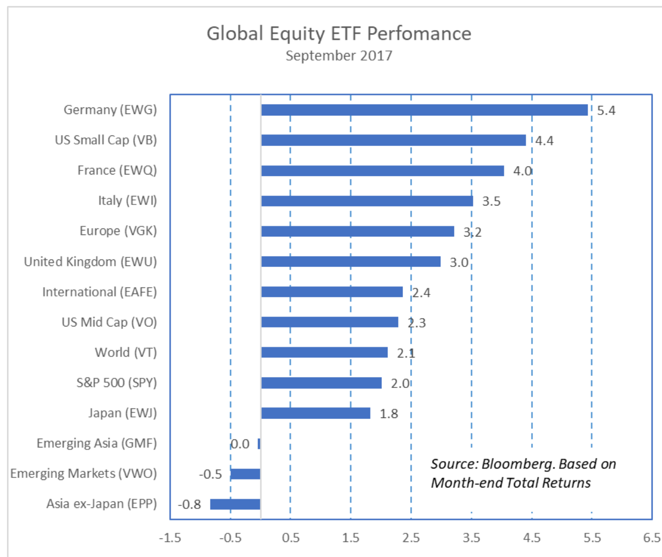
SEPTEMBER 2017 CAPITAL MARKET REVIEW

September saw several developed equity markets rally impressively with global stocks up 2.1%. Leadership was centered mostly in Europe with Germany, France and Italy - all posted impressive gains. Bond markets were mixed with some U. S. corporate credit instruments posting solid gains – notably High Yield, Convertibles, and Senior Loans - while many other U.S. fixed income sectors struggled. Dollar strength served as a major headwind for non-dollar fixed income markets.



Equity Markets*

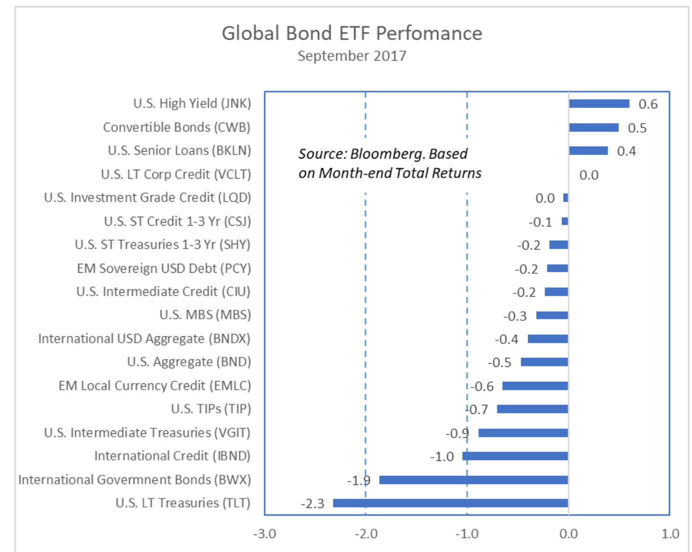
Europe led global equity markets, posting dollar-based returns of 3.2%. Germany and France were the clear leaders advancing 5.4% and 4.0%, respectively. Italian stocks continued their strong recovery, posting a 3.5% gain for the month.

Within the U.S., small cap stocks were among the strongest performers globally, advancing 4.4%, while mid caps and large caps also rallied, 2.3% and 2.0%, respectively. One area of disappointment centered on Asia and other Emerging Markets that all lagged in September.

Bond Markets*

Only select sectors of global bond markets advanced in September and it was concentrated in the U.S. U.S. High Yield, Convertible Bonds and Senior Loan segments rose modestly while nearly all other sectors contracted in price.

A combination of higher interest rates - the yield on benchmark U.S. 10-year treasury bond rose 21 basis points from 2.12% to 2.33% - and a stronger dollar - the Bloomberg dollar index climbed 0.65% - placed downward pressure on longer duration U.S. treasuries and non-dollar fixed income markets.



THE EURO VS. THE DOLLAR: *Where do we go from here?*

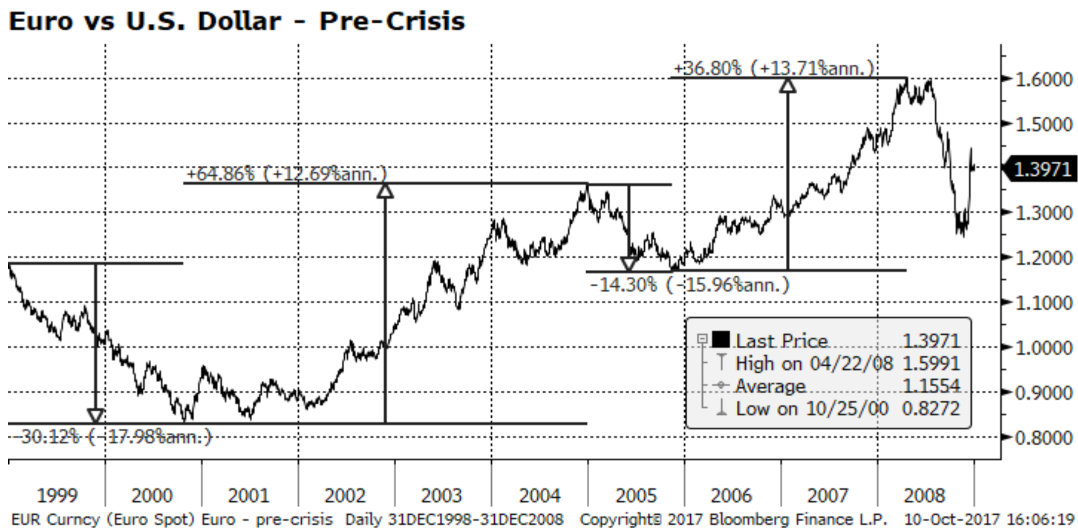
This year's weakness in the U.S. Dollar, at least until it began to firm up in recent weeks, has been surprising to many investors given relatively robust economic conditions in America compared to many of the OECD member nations. Yet economic readings, particularly in Europe, are improving which may explain why the Euro has strengthened by a considerable degree this year. The world's currency markets are notoriously difficult to predict both in the short and longer-term because there are so many factors involved – relative economic trends and interest rates, central bank activity, and sentiment are among the most commonly cited influences.

Over the past decade and even longer, the Euro/Dollar relationship has seen periods of pronounced strength and weakness. Different factors contributed to each episode of momentum. We provide some historical context regarding the relationship between this currency pairing in the pre-crisis and post-crisis periods.

The Pre-Crisis Period

As the chart below shows, upon the advent of the Euro in early 1999, its value immediately began to decline, ultimately settling at a level over 30% lower against the Dollar by the end of 2000. A large factor in the decline may have been European hubris that the currency *had* to be priced at a level higher than parity to the dollar because a "united" Europe had many well-cited advantages compared to the U.S.

The Euro strengthened 64% over the following four years as the kinks of the single currency began to work themselves out. Throughout 2005, it weakened relative to the Dollar. From there, it rocketed 36%, reaching an all-time high of 160 as we approached the beginning of the financial crisis.



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The Post-Crisis Period

Since the crisis, the Euro has been trading in a series of ranges that have been stepping down. The lower/high – lower/low trading ranges likely were due to uncertainty about the viability of the current roster of member nations. Lower Euro levels coincided with a series of national crises from one peripheral member country to the next and even included France at one point.

In contrast, until this year, the Dollar has been unusually strong, particularly versus the Euro. And only in recent months has the Euro been able to break out of a trading range relative to the Dollar since early 2015. Now at 117, the Euro is about 1% above the top of the recent range; from the bottom in late 2016, it is up nearly 12%.

So what does all of this mean? The Euro's all-time high was 160, the all-time low was 82. The average since the introduction of the common currency is 120, which is fairly close to where we are today. Our sense is that a steady state range (if you could call it that) is 120-140; or it could be narrower, 125-135, but that would mean a lot less volatility than we have seen over the past two decades.

Longer term, in our opinion, the probability that the Euro heads towards 130-135 is a reasonable expectation due to the signs of economic recovery in the region – the worst is over at least for the time being. Shorter-term expectations are more challenging – a case can be made for further strengthening or consolidation. Nonetheless, this is a key relationship that we continue to monitor as we consider non-U.S. positioning within portfolios.

See the WCM website for more market commentary or contact us with any questions.

**The returns cited on the prior pages reflect total return performance of exchange traded funds listed in the corresponding bar charts.*

> *"September saw several developed equity markets rally impressively. Leadership was centered mostly in Europe with Germany, France and Italy posting impressive gains. Bond markets were mixed with some U. S. corporate credit sectors posting solid gains while many other U.S. segments struggled. After weakening throughout the year, the U.S. Dollar finally showed signs of a reversal."*

PORTFOLIO POSITIONING

In terms of overall positioning, we continue to maintain a preference for the U.S. across equities and fixed income. We also have a favorable view of the Eurozone, Asia ex-Japan and the emerging markets. Our overweights to these equity markets are primarily funded from non-U.S. bonds. Within fixed income, our exposure to U.S. corporate credit is substantially higher than our benchmark. Our portfolios maintain lower duration than the benchmark and broad exposure to non-U.S. bonds at weights below our benchmark. We have no emerging market debt at this time.

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RISK OUTLOOK

Economic activity generally remains robust both home and abroad. Consumer and business sentiment indicators remain bullish, corporate earnings growth is robust, while inflation remains in check. Fiscal policy in the developed world will most likely continue to be expansionary and monetary policy, on balance, should remain accommodative. Political risk across Europe dissipated through the election cycle (although we have seen a recent re-emergence in Spain). All of these developments are constructive for global risk assets.

As expected, the Federal Reserve has raised interest rates twice this year but another hike by year end may be in doubt due to subdued inflation. The Fed's confirmation of their plan to shrink their $4.5 balance sheet is a sign of their confidence in the economy by may create volatility upon initiation. The continuing tensions with North Korea regarding its nuclear ambitions may be pure brinksmanship but demand continued monitoring. Another significant risk continues to be the Trump administration's ability to execute on policy. Healthcare legislation has stalled and the success of tax reform is in doubt. With the ongoing special investigation regarding Russian influence with the Trump presidential campaign, many market participants fear that the legislative agenda could be delayed for an extended period of time.

KEY EVENTS IN OCTOBER

Week 1

- 10/1 Japan Nikkei Mfg PMI (Sept.)
- 10/2 Markit Mfg PMI (U.S., U.K., Eurozone)
- 10/3 Japan Consumer Confidence
- 10/5 Eurozone ECB account of the monetary policy meeting
- 10/6 U.S. Employment Rate

Week 2

- 10/11 U.S. FOMC Meeting Minutes
- 10/12-10/13 U.S. Price Index Surveys

Week 3

- 10/15 China Price Index Surveys
- 10/17 U.K. Price Index Surveys
- 10/17 Eurozone ZEW Expectation Survey
- 10/18 U.S. Home Building Surveys
- 10/18 China GDP (3Q)

Week 4&5

- 10/23 Japan ESRI Leading Indicators
- 10/24 China Conf. Board Leading Indicators
- 10/25 U.K. GDP (3Q)
- 10/26 Eurozone ECB Rate Surveys
- 10/27 U.S. GDP (3Q)
- 10/27 U.S. Univ. of Mich. Sentiment Surveys
- 10/30 U.K. GfK Consumer Confidence
- 10/30 Eurozone ECB Confidence Surveys
- 10/30-10/31 Japan BOJ Policy Rates
- 10/31 U.S. Conf. Board Surveys

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Diversification and strategic asset allocation do not guarantee a profit nor protect against a loss in declining markets. All investments are subject to risk, including the loss of principal.

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Portfolios that invest in fixed income securities are subject to several general risks, including interest rate risk, credit risk, the risk of issuer default, liquidity risk and market risk. These risks can affect a security's price and yield to varying degrees, depending upon the nature of the instrument, and may occur from fluctuations in interest rates, a change to an issuer's individual situation or industry, or events in the financial markets. In general, a bond's yield is inversely related to its price. Bonds can lose their value as interest rates rise and an investor can lose principal. If sold prior to maturity, fixed income securities are subject to gains/losses based on the level of interest rates, market conditions and the credit quality of the issuer.

Foreign investments are subject to risks not ordinarily associated with domestic investments, such as currency, economic and political risks, and may follow different accounting standards than domestic investments. Investments in emerging or developing markets involve exposure to economic structures that are generally less diverse and mature, and to political systems that can be expected to have less stability than those of more developed countries. These securities may be less liquid and more volatile than investments in U.S. and longer-established non-U.S. markets.

An investment in small/mid-capitalization companies involves greater risk and price volatility than an investment in securities of larger capitalization, more established companies. Such securities may have limited marketability and the firms may have more limited product lines, markets and financial resources than larger, more established companies.

Portfolios that invest in real estate investment trusts (REITs) are subject to many of the risks associated with direct real estate ownership and, as such, may be adversely affected by declines in real estate values and general and local economic conditions.
Portfolios that invest a significant portion of assets in one sector, issuer, geographical area or industry, or in related industries, may involve greater risks, including greater potential for volatility, than more diversified portfolios.

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ETFs included in portfolios may charge additional fees and expenses in addition to the advisory fee charged for the Selected Portfolio. These additional fees and expenses are disclosed in the respective fund/note prospectus. For complete details, please refer to the prospectus.

For additional information regarding advisory fees, please refer to the Fee Summary and/or Fee Detail pages (if included with this report) and the program sponsor's/each co-sponsor's Form ADV Part 2, Wrap Fee Brochure or other disclosure documents, which may be obtained through your advisor.

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