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Second-Quarter 2017 Market Review

The Fiduciary Rule

July 2017 - With tax reform and infrastructure spending stalled in Congress, prospects for corporate profits led stocks higher in the second quarter. International diversification continued to pay off in 2017, as developed and emerging markets produced the best returns for the second quarter, rising 6.4% to 8.3%. Domestic stocks added 2.5% to 3.1%.

For the first half of 2017, international markets had a mid- to high-teen climb. Domestic stocks posted mid- to high-single-digit returns. The Dow Jones Industrial Average rose 8.0%, the Standard & Poor's 500-Stock index (total return) jumped 9.3%, while the tech-heavy NASDAQ Composite index surged 14.1%, its best first half since 2009.

With the exception of U.S. Treasury TIPs, which were off 0.4%, major bond sectors lodged across-the-board advances in the second quarter. All of the bond sectors were ahead for the first half of the year. The top performers at mid-year were Emerging Markets, picking up 5.1%, and U.S. Corporate High Yield, gaining 4.9%.

Citing continued job market strength and moderately rising economic activity, in June, the Federal Reserve raised its target interest rate by a quarter percent to a range of 1.0% to 1.25% from a range of 0.75% to 1.0%, the third increase within the last six months. The central bank forecasts one more hike in 2017 and three in both 2018 and 2019.

The Fed reduced its 2017 inflation forecast to 1.6% from 1.9%, while increasing its economic growth forecast to 2.1% from 2.0%. Projections of 2.0% inflation and 2.1% economic growth for 2018 remain unchanged.

After the June meeting, the Fed said that later in 2017 it would begin to shrink its more than $4 trillion balance sheet by decreasing its reinvestment of the principal payments it receives from the Treasury and agency securities acquired after the 2008-09 financial crises. The reinvestment reduction will begin with $10 billion per month and ramp up to $50 billion monthly over 12 months.

At mid-year, the yields on five and 10-year Treasury notes were 1.89% and 2.30%, respectively. This was little changed for the second quarter and the start of the year, lower by three and nine basis points for the quarter, respectively, and down four and 14 basis points for the first half, respectively.

Below are rates of return for selected market indices for the second quarter and first half of 2017, and the three, five, and 10-year compound annual returns as of December 31, 2016.

	2Q:2017	YTD-2017	3-Year	5-Year	10-Year
Equity (Stock) Indices					
Domestic					
Russell 1000 - Large Cap	3.06%	9.27%	8.59%	14.69%	7.08%
Russell Midcap	2.70%	7.99%	7.92%	14.72%	7.86%
Russell 2000 - Small Cap	2.46%	4.99%	6.74%	14.46%	7.07%
Real Estate (FTSE NAREIT Equity REITs)	1.52%	2.70%	13.38%	12.01%	5.08%
Commodity (S&P Global LargeMidCap)	-3.02%	-0.78%	-4.64%	-1.87%	2.44%
International					
MSCI EAFE Developed Large Cap	6.37%	14.23%	-1.15%	7.02%	1.22%
MSCI EAFE Developed Small Cap	8.30%	17.04%	2.45%	10.92%	3.30%
MSCI Emerging Markets	6.38%	18.60%	-2.19%	1.64%	2.17%
Global - MSCI All Country IMI	4.42%	11.65%	3.79%	10.20%	4.38%
Fixed-Income (Bond) Indices					
Bloomberg Barclays					
Global Aggregate - Unhedged	2.60%	4.41%	-1.01%	1.34%	4.00%
Global Aggregate - Hedged	0.99%	1.43%	3.97%	NA	NA
U.S. Aggregate	1.44%	2.27%	1.45%	3.25%	4.52%
U.S. Treasury TIPs	-0.40%	0.85%	0.03%	3.99%	4.66%
U.S. Corporate High Yield	2.17%	4.93%	0.45%	4.27%	6.56%
Municipal	1.96%	3.57%	4.16%	5.96%	5.02%
International Emerging Markets	1.77%	5.11%	2.40%	6.26%	7.30%

Source: ftserussell.com, reit.com, us.spindices.com, msci.com, bloombergindices.com

The Fiduciary Rule

The Department of Labor's new fiduciary rule to reduce conflicts of interest between financial advisers and workers/retirees went into effect on June 9. The new rule requires that financial advisers put their clients' interests first when giving advice about investments in a retirement plan (401k, IRA, etc). The new rule elicits at least two main questions:

1. Shouldn't this always have been the case?
2. Why doesn't this apply to all of my accounts, not just retirement?

The good news is that, if your financial advisor is a Registered Investment Adviser (RIA), as is Kalorama Wealth Strategies, you always have been provided guidance under a fiduciary standard. RIAs have a "fiduciary duty" to act in the best interest of clients.

If an adviser (i.e., salesperson) is employed by a broker or insurance company, then they are held to a different (i.e., lower) standard that their advice be "suitable" for customers, not necessarily the best. They were allowed to recommend investments that cost the customer more, but made the adviser more money, as long as those investments were generally “suitable” for the customer.

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Am I a Client or a Customer? Is it a Service or a Product?

Much confusion exists among financial consumers as to who they work with and under what circumstances. The litmus test continues to be who is paying whom for the service or product. Fee-only RIAs provide investment advisory and financial planning "services" so that their interests are aligned with the "client." Compensation is solely from the "client"; commissions or compensation of any kind are not accepted from any other source.

When you purchase a "product" (investment/insurance) from a broker or agent, you are a "customer." The representative earns a commission from the third-party product sponsor. Thus, their duty is to the sponsor, not the customer, creating an inherent conflict of interest. Further, there is usually a complete lack of transparency with regard to the amount of compensation.

Under the new rule, brokerage firms and insurance companies may continue to offer both fee and commission accounts for retirement plans, but requires that advisers recommend the type of account that is best for the investor.

Hmmm… and the old "suitability" rules still apply to non-retirement accounts. Conclusion: to avoid any confusion and conflicts of interest, work with an independent, fee-only Registered Investment Advisor.

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Please feel free to forward this newsletter to friends and colleagues who can benefit from information about investing and financial planning. As always, if I can be of any assistance to you or anyone you know, please do not hesitate to contact me. It would be my privilege to assist with your investment and financial planning needs. For more information, please see our web site at www.kaloramawealth.com.

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