



# OUR VIEW



## Second Quarter Review

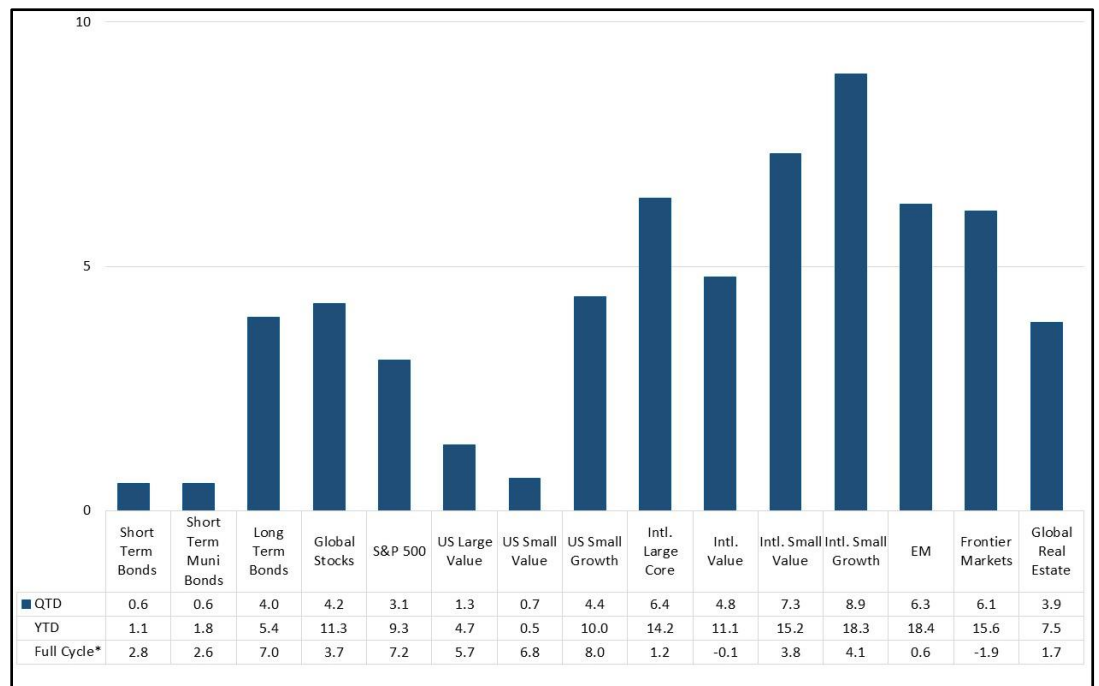
Equity markets continued to rise in the second quarter, boosted by positive global economic momentum and strong corporate earnings growth. The combination of synchronized global growth and low inflation overcame investor disappointment about the lack of progress on tax reform and other reflationary policies.

Global equities gained more than 4% for the quarter and more than 11% for the first half of the year. International and emerging markets equities continued to lead the way, with emerging markets providing notably strong year-to-date returns.

Value stocks trailed growth stocks, continuing the rotation from value to growth that started in the first quarter. Technology was the best performing sector during the first half of the year, gaining nearly 20% despite a reversal near the end of the quarter. Oil prices declined during the second quarter, consequently the energy sector was the worst performer for the quarter and first half of the year.

The Federal Reserve raised rates near the end of the quarter and provided more details about plans to reduce the Fed's considerable holdings of Treasury and mortgage-backed securities. 10-year Treasury yields finished the quarter at 2.35%. Beyond the Treasury market, U.S. high yield bonds had another strong quarter.

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TFC Chart- Historical Asset Class Returns as of June 30, 2017

Source: FactSet Data

\* Full Cycle is the annualized return from October 2007 peak to present.



## TFC Portfolio Performance

TFC portfolios rose in the second quarter, driven by strong equity markets and solid performance from non-U.S. investments. TFC's international small company holdings were particular standouts. Frontier markets and non-U.S. real estate also contributed positively to performance. Value stocks were out of favor during the second quarter and most of our value-oriented holdings struggled. U.S. real estate holdings also detracted from performance. TFC's holdings in mostly high-quality, shorter-duration fixed income investments provided positive, albeit unexciting, returns during the quarter.

For the first half of the year, the rising equity tide has lifted TFC portfolios. International equities led the way, with emerging markets and international small company equities the strongest performers. Value stocks were the first-half laggards. Fixed income provided a moderate amount of return during the first half of the year, with mortgage-backed and municipal bond holdings the best performers. Bonds may not offer a compelling value today, but may become more attractive in the latter part of 2017 as rates continue to move higher.

## Economic and Market Outlook

Hopes that President Trump would implement market-friendly policies early in his administration faded with the failed attempt to repeal and reform the Affordable Care Act, continuing scrutiny over Russian connections to Trump advisors, and lack of apparent progress on tax reform. It's natural to look at the negative political environment and be skeptical about the strength of the stock market. In our view, investors are responding positively to an environment of moderate economic growth, a bullish corporate profits outlook and healthy consumer sentiment. Manufacturing is recovering, and recent reports provide indications that the manufacturing rebound will continue. The Institute of Supply Management (ISM) manufacturing index hit a three-year high in June, while the Euro Area manufacturing Purchasing Managers Index (PMI) reached its strongest level since 2011.

The U.S. is at what the Fed considers to be full employment, and unemployment in Europe has dropped considerably from crisis levels. Wages are rising at a moderate pace, with wage growth to date likely restrained by the degree to which hiring has been centered in low wage jobs. Signs that jobs are becoming harder to fill may create additional upward pressure on wages. Despite rising interest rates in the U.S. and talks about a reduction in stimulus from the European Central Bank, monetary policy and financial conditions are reasonably easy in much of the world.

The Fed is projected to raise rates one more time this year, with the current consensus for a December rate hike. The Fed also plans to gradually shrink the size of its balance sheet, potentially starting in September. The Fed is motivated in part by a desire to "normalize" rates from abnormally low levels and in part to reduce the risk of asset "bubbles" developing in an environment of easy financial conditions.

European stocks are benefiting from improving economic growth, lower unemployment and fading political risks. Europe's economic recovery is behind that of the U.S., leaving room for further improvement in profits, margins, and unemployment. Europe is farther from full employment than the U.S., in part because of extensive use of part-time employees. The employment picture may

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only improve slowly, as labor market rigidities still create challenges in most of Europe. A favorable outlook for earnings growth in Europe is coupled with undemanding valuations, as stock market valuations in Europe are lower than that of the U.S.

The European Central Bank (ECB) is signaling the intention to shift away from extraordinarily easy monetary policy, though a cautious exit is likely, given low inflation expectations and considerable remaining economic slack. Debt burdens in Europe, particularly Italy, may limit the degree to which rates will rise. Although near-term European political risks have eased, Italy remains a concern given high debt, low competitiveness and the uncertainty about who will win their upcoming election. The Brexit situation remains unresolved, with uncertainty about whether Theresa May will retain power long enough to lead the UK through Brexit talks.

China, which represents more than 40% of global GDP growth, is seeing softer manufacturing activity and weaker commodity prices. However, the service sector is still strong, and capital outflows have eased dramatically. It appears that China is taking steps to rein in shadow banking activity, a major concern for TFC, while still providing ample credit to the “real” economy. We continue to expect a soft landing in China, rather than an abrupt decline that would disrupt global growth.

## Closing Thoughts

U.S. equities continue to reach new records, against a backdrop in which volatility measures are at historically low levels. Given the “age” of the current economic expansion, many worry that an economic slowdown and stock market correction may be imminent. It’s commonly said that “bull markets don’t die of old age.” Although bull markets don’t necessarily “die” of old age, there are numerous risks that could interrupt the economic recovery and stock market rally. We think that the seeming disconnect between mounting risks and the market’s assessment is attributable to consensus thinking that none of the risks seem imminent enough to price into the market today. The danger, as we see it, is that one or more longer-term risks could be brought forward and cause a market correction.

We continue to monitor policy signals from the Fed, given differences between market projections for rates in 2018 and the Fed’s more aggressive “dot plot” of estimates. The likely change in leadership at the Fed is another potential risk factor with Janet Yellen’s term expiring early next year. President Trump will have several seats on the Fed to fill, and early speculation centers on candidates who favor a rules-based approach to monetary policy. A rules-based approach could lead to a more dramatic move upward in rates, which in our view would increase the likelihood of a market correction.

Geopolitical risks remain elevated, with missile launches by North Korea a continuing worry for which there are limiting, if any, appealing options for resolution. Foreign policy challenges could interrupt the equity rally and renew the appeal of bonds as a safe haven in an uncertain world. Trade also remains a high profile concern for the markets, and any major anti-trade steps by the Trump administration is likely to interrupt the market rally.



There are few signs of recession or economic bubble, though speculation is building that the second half of 2018 may be an economic inflection point. U.S. stock market valuations are high, but elevated valuations in the U.S. imply lower forward returns rather than a collapse in equity prices. European and Japanese stocks are inexpensive and have more room for profit margins to rise than the U.S., but the valuation discount is far from extreme levels, and margins may be stickier than expected.

To date, our current strategic portfolio allocation among global economic regions, the market capitalization spectrum (small, mid and large cap), investment styles, and sectors continues to be aligned with our views and outlook, and has benefited, in particular, from recent outperformance of international equities.

Policy mistakes or geopolitical conflict are potential risks for the markets. We monitor the risks outlined above and will incrementally adjust the portfolio based on new information.

### In Other News

Also, we are pleased to share that TFC Financial Management has been named to the 2017 edition of the Financial Times 300 Top Registered Investment Advisers (FT 300). The list recognizes top independent RIA firms from across the U.S.

This is the fourth annual FT 300 list, produced independently by the *Financial Times* in collaboration with Ignites Research, a subsidiary of the FT that provides business intelligence on the investment management industry.

RIA firms apply for consideration, having met a minimum set of criteria. Applicants are then graded on six factors: assets under management (AUM); AUM growth rate; years in existence; advanced industry credentials of the firm's advisers; online accessibility; and compliance records. There are no fees or other considerations required of RIAs that apply for the FT 300.

The FT 300 represents firms with an "average" practice existing for 24 years and managing \$2.7 billion in assets. The FT 300 Top RIAs hail from 37 states and Washington, D.C.

As always, we welcome your comments and questions.

Sincerely,

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