TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

October 2017

Quarterly Insights

EXECUTIVE SUMMARY

Stocks Rise In All Major Regions In Q3; Bonds Also Rise

In the Third Quarter, the domestic S&P 500 Index was up 4.65% and is up 14.24% year-to-date. Noteworthy global regions were Europe (+8.10%) and Emerging Markets (+7.89%). Technology (+8.28%) led Q3 sector performance. Staples (-2.02%) and Consumer Discretionary (+0.48%) were laggards. The Barclay's bond index rose 0.75% in Q3 and is up 3.51% year-to-date. We remain bullish due to the prospect of tax reform and infrastructure spending in the midst of a healthy economy.

Keeping The Faith In An Up Market

The S&P 500 Index has almost quadrupled since bottoming in 2009 and is up strong in 2017. And yet, many investors are nervous about the rise - they say it is a "gut feeling" and want to take extreme actions such as going to cash. For many, it has become increasingly difficult to keep the faith in a rising market. Starting with an investment of $1 million, the average investor will lag the S&P 500 Index by close to $2 million over a 20-year time frame due to undisciplined investing. We have faith in the market because we believe in capitalism: over the last century, companies have consistently adapted to new market conditions to maximize profits. This should continue.

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Third Quarter 2017

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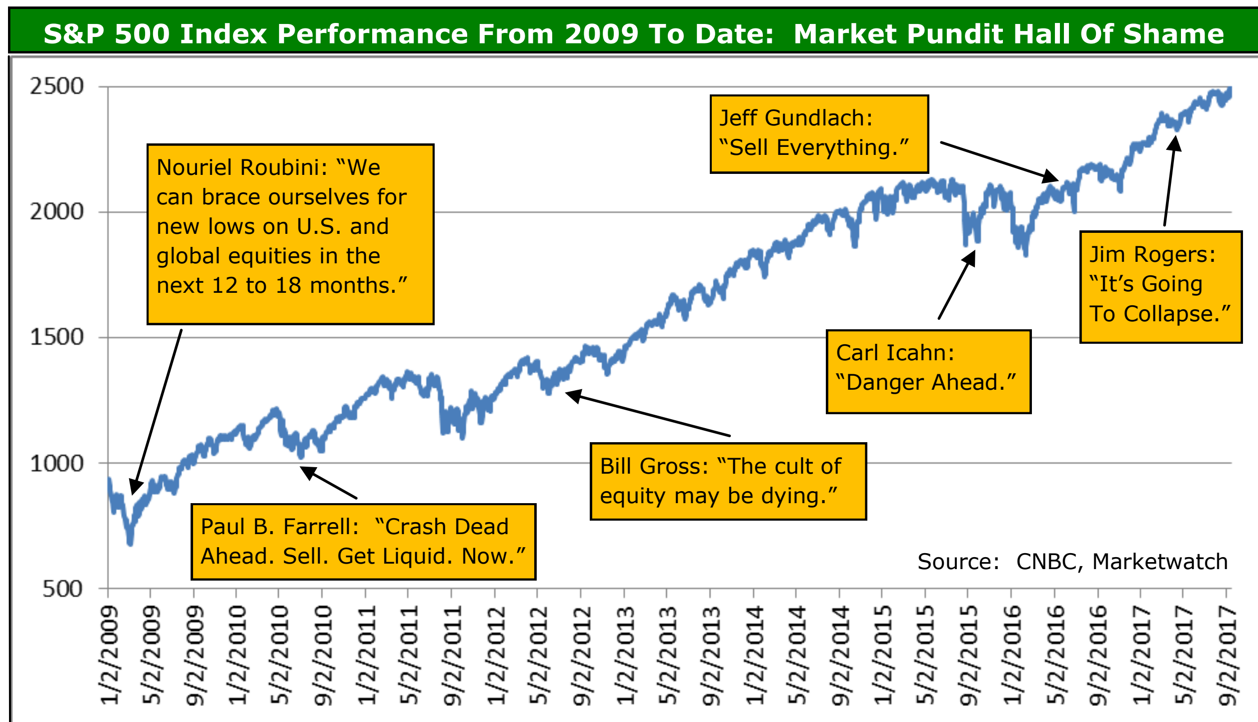
Many Investors Are Nervous Despite A Steady Market Ascent Since 2009

In a steady ascent, the S&P 500 Index has almost quadrupled since bottoming in 2009 and is up strong in 2017 through Q3 (+14.24%). And yet, many investors are nervous. When we ask them why, they say it is a "gut feeling". We hear vague comments such as "the market has to come down because it has gone up too much" or "I just don't feel good about things". For many, it has become increasingly difficult to keep the faith in a rising market. It is one thing to "feel" nervous but inevitably hazardous to act on those feelings. We believe many investors exit rising markets due to personal bias: they react only to what they want to hear.

Like Clockwork, Well-Known Pundits Make Bad Market Calls - And Investors Listen

There has been no shortage of well-publicized dire market predictions since 2009. While the bearish pundits themselves believe in their stance, they also attract many viewers/readers who want to believe in their stance. But the scoreboard does not lie. These pundits have been dead wrong. The sad thing is that prominent pundits can afford to be wrong - but most of the investors who listen to them cannot.

S&P 500 Index Performance From 2009 To Date: Market Pundit Hall Of Shame



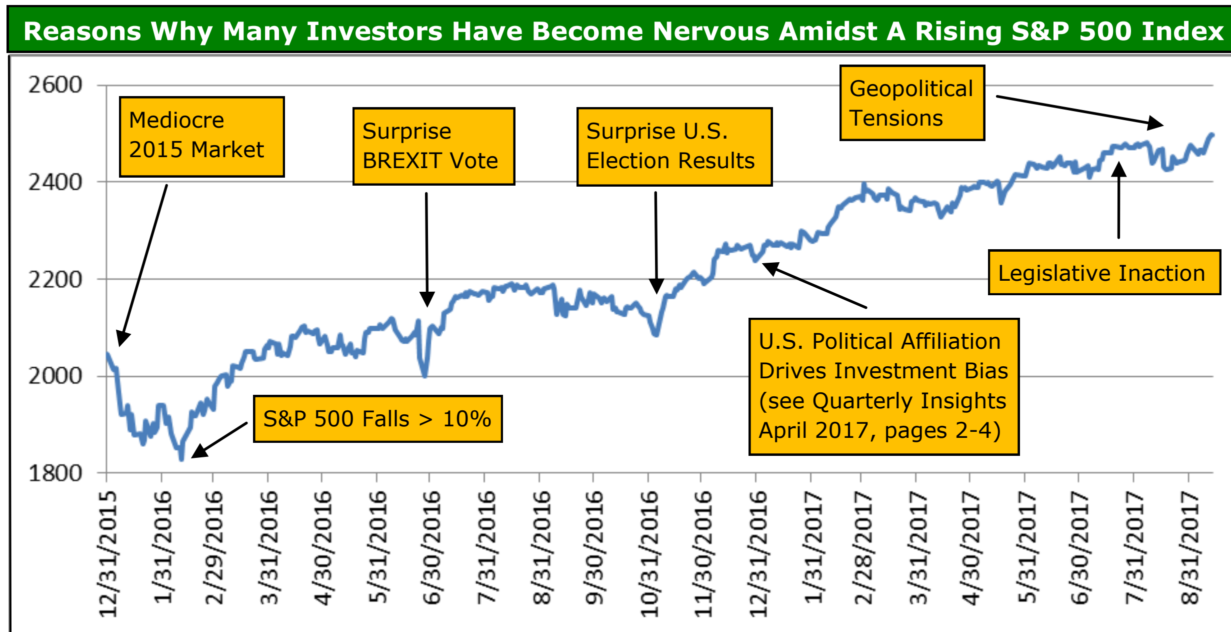
"Confirmation Bias": The Reason Why So Many Investors Act On Horrible Predictions

While much of financial theory is based on the notion that investors act rationally and consider all available information in their decision making process, the reality is that they often don't. When investors "feel" that things are bad (despite a lack of concrete evidence or rationale), they seek validation to confirm their beliefs. This validation can come from a well-known pundit who says something that is in line with their "feelings". No consideration is given to the possibility that they or the pundit could be wrong. The only consideration given is that the pundit agrees with them by saying what they want to hear. This phenomenon is called "Confirmation Bias" (please see Behavioral Finance, Quarterly Insights October 2016, page 4). Investors only "tune in" data that confirms their belief that conditions are bad. Actions become emotional versus rational.

Recent Drivers That Have Caused Many Investors To Think Conditions Are Bad

There are several reasons why many investors have lost faith in a rising market over the last couple of years. Let's highlight some significant events:

Reasons Why Many Investors Have Become Nervous Amidst A Rising S&P 500 Index



Three Common Actions That Investors Take When They Feel Bad About The Market

There are three common actions that many investors take when they feel bad about the market. They go to:

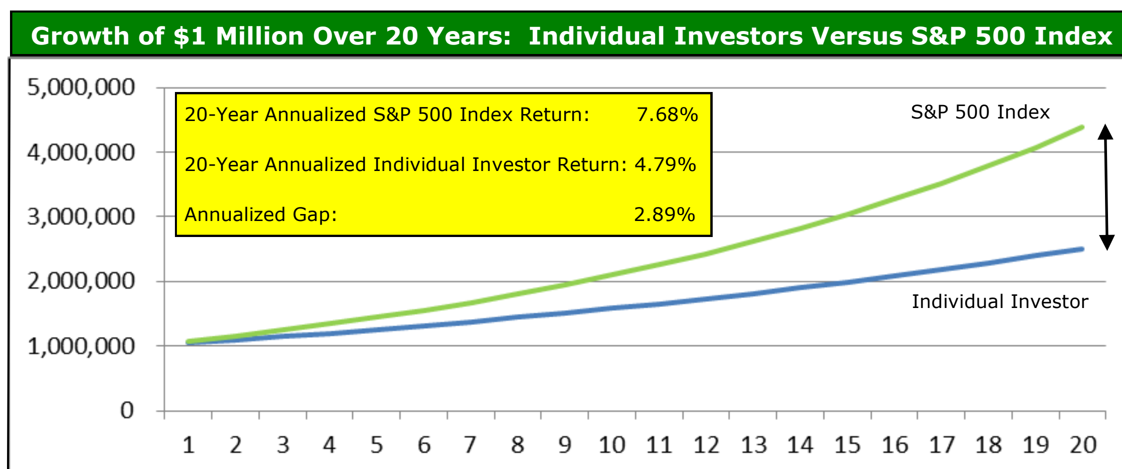
1. **Cash** (the S&P 500 Index has out-performed cash by roughly 14% year-to-date)
2. **Bonds** (the S&P 500 Index has out-performed the Barclays Bond Index by roughly 11% year-to-date)
3. **High Dividend-Paying Stocks** (the highest-decile dividend yielding stocks lost 1.62% through August)

There Are Dire Consequences When Investors Act On Their Emotions

> **"The most important aspect of (my work) was the recognition that economic agents are human."**
> **Richard Thaler, Behavioral Science Pioneer, 2017 Nobel Prize In Economic Sciences (announced October 9, 2017)**

Dalbar Inc. publishes an annual study called the Quantitative Analysis of Investor Behavior (QAIB). The research shows that the inability of individual investors to stay invested over time is a big detriment to their portfolio performance. Put another way, investors cannot time the market by jumping out every time they feel nervous and lose faith. They would be much better off being disciplined and sticking to their game plan.

Growth of $1 Million Over 20 Years: Individual Investors Versus S&P 500 Index



SAD BUT TRUE

Starting with an investment of $1 million, an individual investor will lag the S&P 500 Index by close to $2 million over a 20 year time frame due to undisciplined investing.

Source: DALBAR QAIB 2016

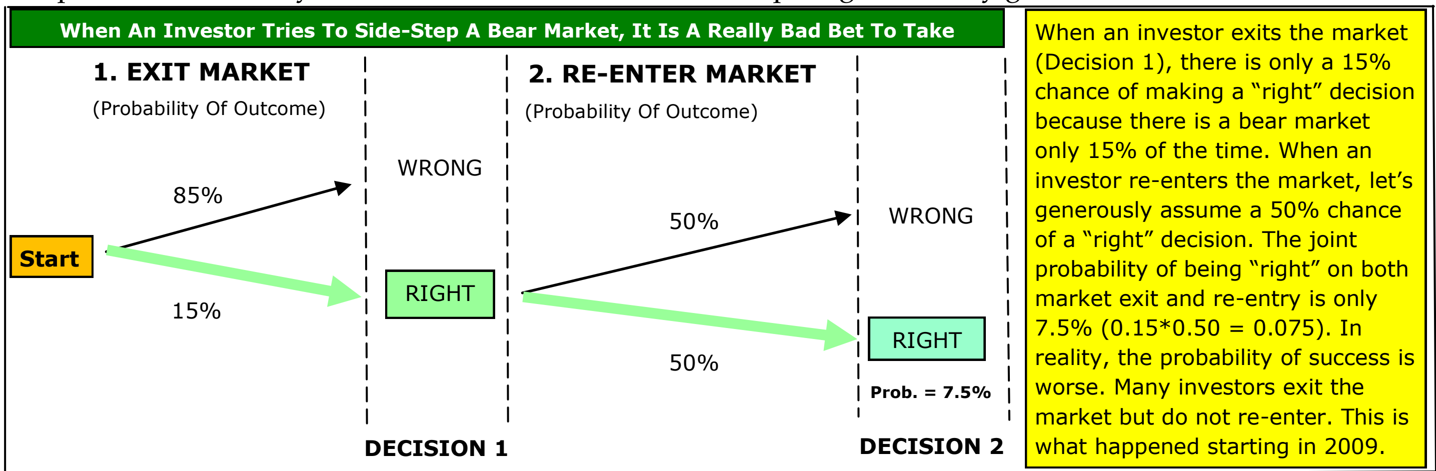
Over The Last 60 Years, We Have Been In A Bear Market 15% Of The Time

Investors attempt to time the market in order to avoid a bear market (a 20% or more market decline). It may surprise you that there have only been 11 bear markets in the last 60 years. The average duration is 308 days (roughly 10 months) with an average decline of 33%. Put another way, we have been in a bear market only 15% of the time. In spite of these bear markets, the market has averaged a 10% annualized rate of return. If you invested $1,000 in 1957 and did nothing, you would have $300,000 today (a return of 300 times principal).

There Have Been 11 Bear Markets In The Last 60 Years

Bear Market	# Days	Decline	Main Cause
1957	96	21%	Russia: successful Sputnik launch frightened Americans
1961-1962	195	28%	Russia: Cuban missile crisis
1968-1970	543	36%	High valuation
1973-1974	632	48%	Oil Embargo led to inflation; Nixon impeachment
1980-1982	630	27%	Fed fought inflation by raising rates to high double digits
1987	55	33%	Glitch in program trading led to market crash
1990	97	20%	Restrictive Fed monetary policy led to a small recession
1998	45	20%	Russia: bond default (caused implosion of LT Capital)
2000-2001	379	36%	High valuation - includes “Tech Wreck”
2002	213	34%	Fallout from terrorism concerns
2007-2009	501	56%	Sub-prime mortgage crisis
TOTAL	**3,386**	**Avg. = 33%**	

Trying to side-step a bear market is almost certainly going to cause an investor pain because the odds of executing a successful maneuver (both getting out of the market and getting back in) are so small. To add to the pain, investors may also encounter taxes for realized capital gains if they go to cash in a taxable account.



We Have Faith In The Market Because We Believe In Capitalism - And So Should You!

At this time, we do not see signs of what caused the last 11 bear markets (factors such as recessions, valuation concerns, oil shortages, high interest rates and inflation, toxic assets, or problems in Russia). What we see is moderate economic growth, a market that is fairly valued, low oil prices, stable interest rates and little inflation. In the near-term, we also see tax reform and more infrastructure spending. There is no cause for abrupt actions. We have faith in the market because we believe in capitalism: over the last century, companies have consistently adapted to new market conditions in a manner that has maximized profits. And we expect this trend to continue over the next century. Have faith in this up market - we do.

Stocks Positive In All Major Regions In Q3

In the Third Quarter, the domestic S&P 500 Index was up 4.65% and is up 14.24% year-to-date. Noteworthy global regions continue to be Europe and Emerging Markets. European stocks (+8.10% in Q3 and +26.78% year-to-date) have been driven by both a strong economic recovery and currency (the Euro has appreciated 6.35% versus the US Dollar over the last year). Emerging Markets (+7.89% in Q3 and +27.78% year-to-date) has been led by China (+14.66% in Q3 and +43.16% year-to-date). Investors continue to move funds outside the US. Merrill Lynch cited a 10-week Q3 outflow, the longest outflow streak since 2004.

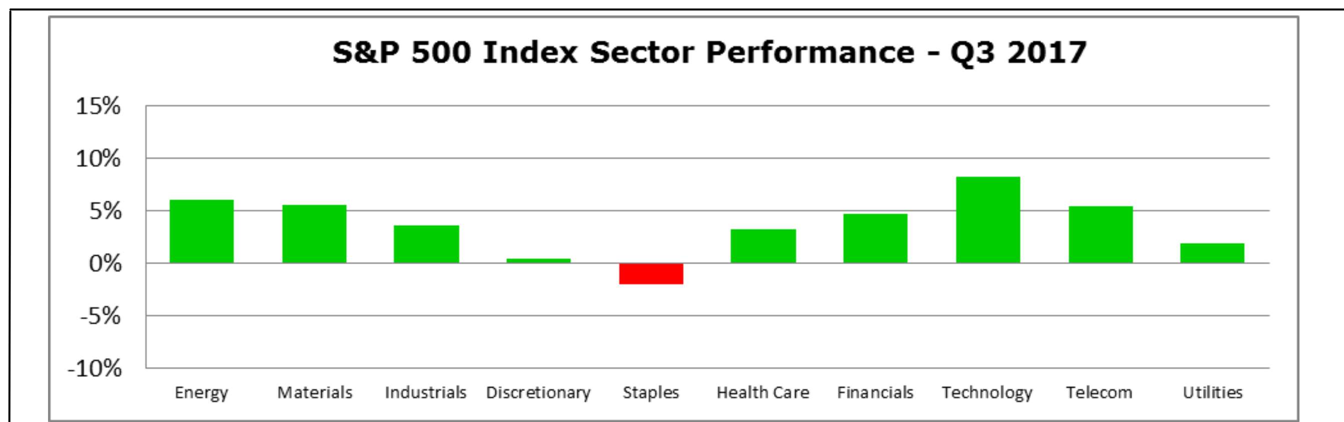
Equity Index Performance

Index	Q3 2017
S&P 500 (Domestic)	**4.65%**
MSCI EAFE (Foreign) *	**5.40%**
MSCI Emerging Markets	**7.89%**
MSCI EMU (European Monetary Union)	**8.10%**
MSCI Japan	**3.97%**

* Europe, Australia and the Far East

Technology Leads Sector Performance In Q3

Technology (+8.28%) led Q3 sector performance. Staples (-2.02%) and Discretionary (+0.48%) were the laggards. Year-to-date, Technology (+26.02%) and Health Care (+18.75%) lead, while Energy (-8.62%) lags.



Holding Companies With A High Level Of Foreign Revenues Has Been Key In 2017

Over the last year, the US Dollar has depreciated versus the currencies of most of its largest trading partners.

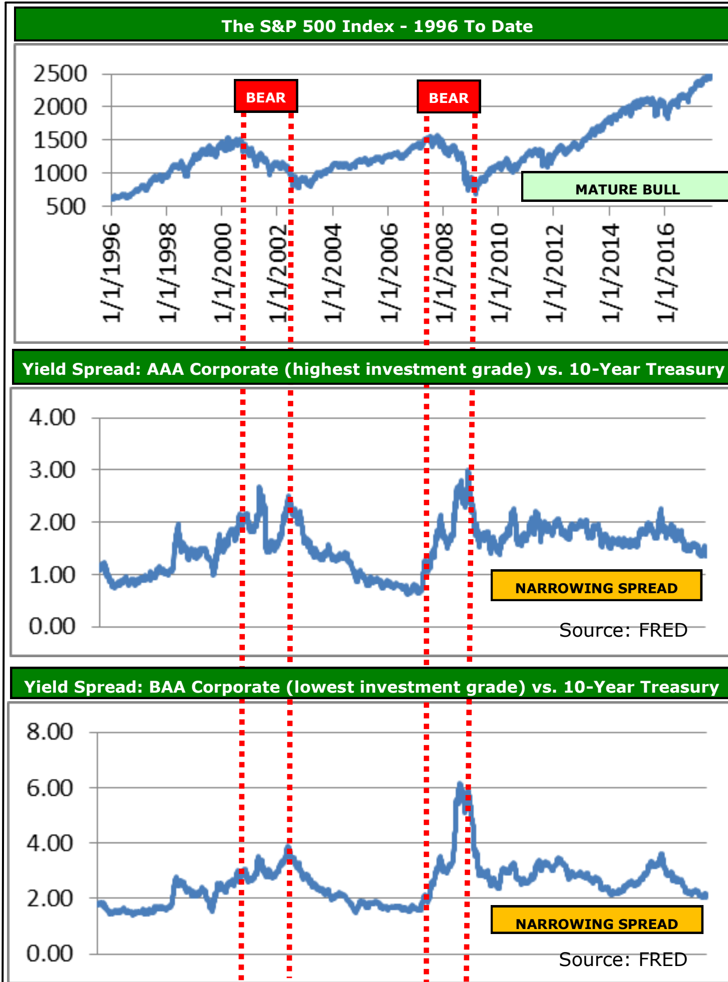
Falling US Dollar (USD)	Net 360 Days	Rising Foreign Currencies	Net 360 Days
USD to Euro	-6.02%	Euro to USD	+6.35%
USD to British Pound	-5.56%	British Pound to USD	+5.94%
USD to Mexican Peso	-5.21%	Mexican Peso to USD	+5.49%
USD to Canadian Dollar	-5.42%	Canadian Dollar to USD	+5.58%

Source: Telemet

The top decile S&P 500 Index stocks that generate the highest percentage of their revenues outside the US are +19.87% through August 25, while the three bottom deciles (stocks that are mostly domestic) are flat (source: BESPOKE). A key success factor in 2017 is to have a high level of global revenues - as we do in your portfolio.

Narrowing Spread Between Corporates and Treasurys Signals A Mature Bull Market

The "yield spread" between a corporate bond (which has default risk) and a risk-free Treasury bond is the extra return an investor receives for taking added risk. Spreads narrow in bull markets (lower default risk in "good times") and widen in bear markets (higher risk in "bad times").



We are in a mature bull market. Regarding style rotation, we want to rotate to high quality bonds (safer bonds such as lower-yielding Treasurys) at the end of a bull market. While we do not know the timing of how much longer this bull market will run, we do know the spreads between corporates and Treasurys have considerably narrowed. Put another way, riskier corporate bonds have become less attractive to hold, and will become even less attractive when the bull market ends. To illustrate, during the 2007-2009 bear market the AAA corporate spread versus the 10-Year Treasury widened from 0.65% to 3.00% and the BAA spread widened from 1.60% to 5.88%. Through the bear market, 10-Year Treasurys considerably out-performed corporate bonds.

(These numbers are approximate)	10-Year Treasury	AAA Corporate	BAA Corporate
A. Yield as at 06/07/2007 Spread vs. 10 Yr. Treasury	5.11% **N/A**	5.76% **0.65%**	6.71% **1.60%**
B. Yield as at 03/18/2009 Spread vs. 10 Yr. Treasury	2.51% **N/A**	5.51% **3.00%**	8.39% **5.88%**
Delta = Yield Change Over Time Frame	-2.60% (yield falls, price rises)	-0.25% (yield falls, price rises)	+1.68% (yield rises, price falls)
Total Return Over Time Frame	**+21.91%**	+11.74%	3.64%

Proposed US Corporate Tax Rate Cut Will Further Narrow The Yield Spread

In the recently proposed Trump tax plan (September 28), the top corporate tax rate would be slashed from 35% to 20%. A lower tax rate is potentially a huge plus for the equity markets since it can quickly boost company earnings by as much as 23% (see table). The tax cut (if passed) would also further narrow the yield spread between corporate bonds and Treasurys. Why? More cash available for debt repayment further reduces bond default risk. The narrower the yield spread between corporates and (safer) Treasurys, the less attractive the risk/return tradeoff. Tax reform could push us to rotate from corporates to Treasurys.

Cutting US Corporate Tax Rate From 35% to 20% Can Add As Much As 23% To A Company's Bottom Line

	35% Corporate Tax Rate	20% Corporate Tax Rate
Pre-Tax Earnings	$100	$100
Tax	($35)	($20)
After-Tax Earnings	$65	$80
Bottom Line Benefit Of Tax Cut		**+23.08%***

* Bottom Line Benefit Of Corporate Tax Rate Cut From 35% to 20% = (80 - 65) / 65 = 23.08%

We made a few portfolio adjustments in Q3. The rationale for these moves included a desire to simply switch one gold mining company for another, and to begin the process of "tax-loss selling" as we approach year-end.

We bought Newmont Mining Corp (symbol: NEM), a mid-cap ($21 billion market cap) gold and copper mining company with operations in North America, South America, Asia Pacific, and Africa. One of the world's largest gold and copper producers, NEM produced nearly 5 million ounces of gold and 120 million pounds of copper in 2016. NEM has significant proven and probable gold reserves - roughly 69 million ounces as of year-end 2016.

We sold Goldcorp Inc (symbol: GG), a Canadian based mid-cap ($12 billion market cap) gold mining company with operations in Canada, the United States, Mexico, and Latin America. GG produced nearly 2.8 million ounces of gold in 2016, but we became concerned about the accuracy of GG's stated proven and probable gold reserves (42 million ounces as of year-end 2016). It was best to simply switch from GG to NEM.

We started to "tax-loss sell" for 2017 in select taxable accounts. Tax-loss selling is when we try to mitigate/ reduce realized capital gains by realizing losses with stocks whose price is (currently) below acquisition cost. We will continue to tax-loss sell when feasible as we approach year-end in an effort to be as tax-efficient as possible. As we are not tax professionals, we are happy to work with you and/or your tax advisor as needed.

We will continue to closely monitor the market and adjust your portfolio as needed. Please feel free to contact us anytime to discuss questions or comments you may have. We will keep you informed of portfolio progress.

Respectfully submitted,

TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

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Disclaimer

The information presented herein is intended for informational purposes only. All views are subject to change based on updated indicators. The recommendations made in this publication are made without regard to individual suitability. Investors should consider their own needs and objectives before making any investment decision.

Commentary in this review reflects our portfolio strategy. Many of our clients have different objectives and circumstances which are reflected in unique portfolio considerations. Please note that accounts may not contain all elements of the strategy discussed here. Additionally, individual client customizations and start dates may preclude certain elements of this strategy from being implemented.

Past performance is no guarantee of future results. A risk of loss is involved with investments in stock markets.