FAIRPORT ASSET MANAGEMENT
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The Compass

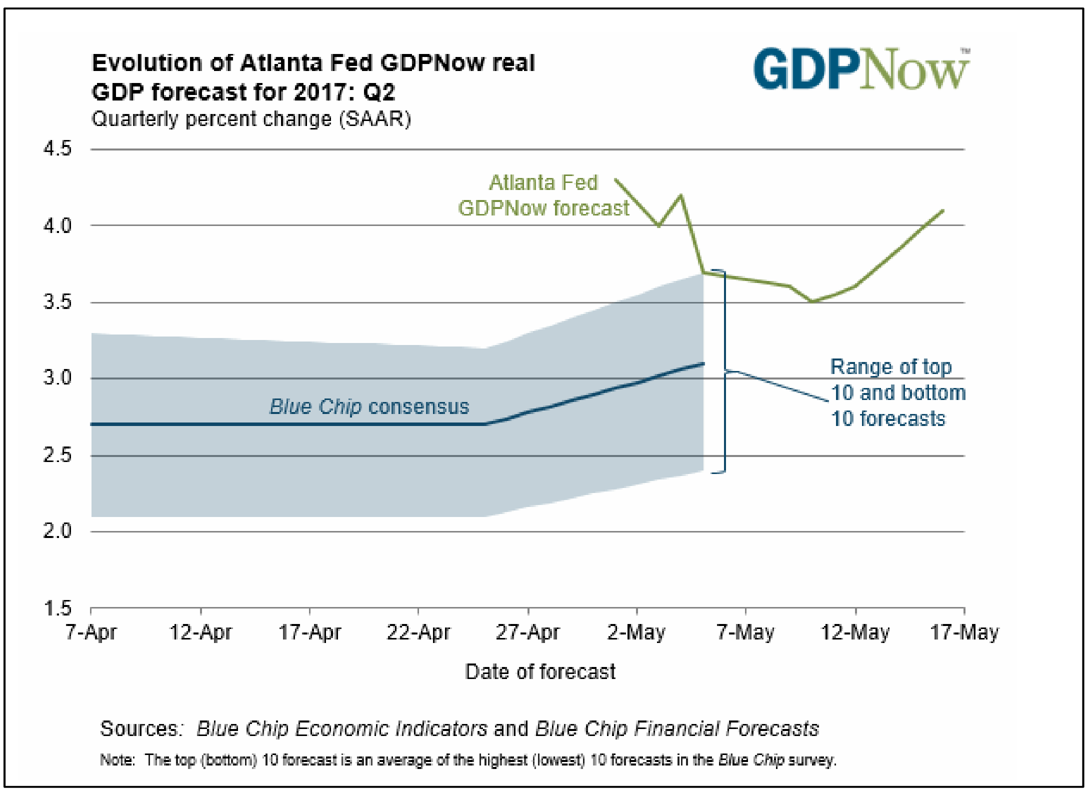
Wealth management tips, trends and articles that provide confident navigation for high net worth clients.

May 2017
Thank you for your continued trust, loyalty and generous referrals. As always, we encourage you to share this newsletter with friends, family members and colleagues.

Mid-Quarter Commentary as of May 24, 2017
John M. Silvis, CFA
Chief Investment Officer

The global equity markets remain resilient in the face of shifting geopolitical events. The S&P 500 Index has already notched a return of 8.27% so far this year while the MSCI All Country World Index (ACWI), which is a global measurement of equity performance, bested its domestic counterpart with a robust showing of 10.91% since the beginning of the year. While calls for a correction within the equity markets have increased in recent days, the overall health of the economy and improving global backdrop should prove to be a good foundation heading into the second half of 2017. We would not be surprised to see the markets build off the above-average gains already achieved this year.

It has been our view that the U.S. economy remains solid, and while the first quarter of 2017 saw GDP (Gross Domestic Product) growth slow to 0.7% on an annualized basis, the outlook for the rest of the year remains positive. It's been a pattern over the last several years for first quarter GDP growth numbers to come in on the weaker side, and the second quarter numbers to show a rebound. We believe that pattern will hold again in 2017. The Atlanta Federal Reserve Bank's GDPNow forecast (a real time econometric model) currently has second quarter GDP growth running at above 4%. While that is likely to come down in the coming weeks, the overall trend of the data points to better growth in the current quarter.



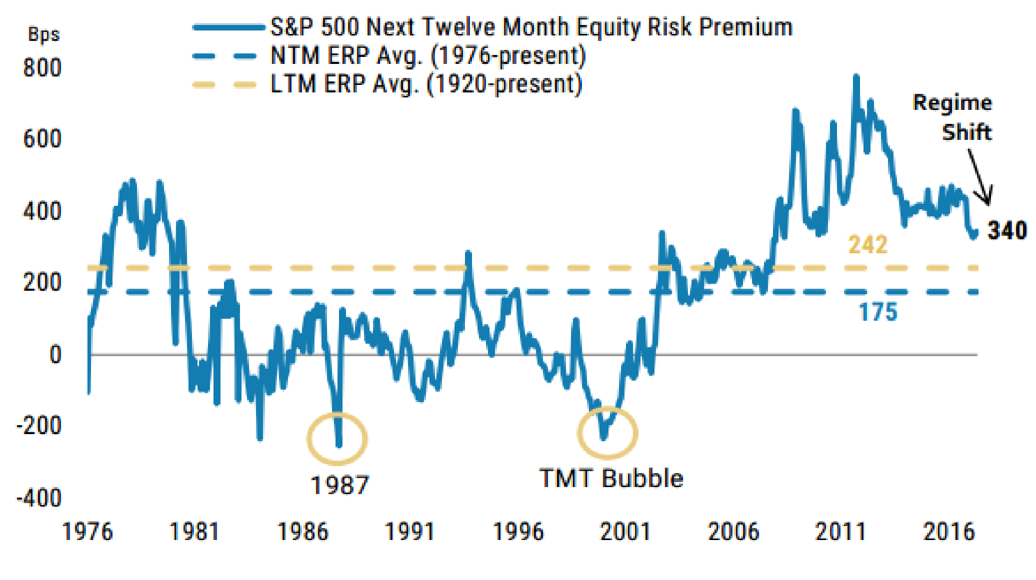
The overall employment picture continues to show signs of strength with the unemployment rate falling to a low of 4.4%, approaching what many consider full employment. Weekly initial unemployment claims released by the Department of Labor remain at historic lows and should point to further improvements in the labor force. Evercore ISI, using their proprietary econometric model, predicts the unemployment rate could fall as low as 3.5% in the current economic cycle. All this should put further pressure on wages, driving them higher in the months ahead.

Housing, another driver of the economy, continues to show signs of improvement. Home prices continued to expand in February, hitting their fourth consecutive all-time high according to the S&P CoreLogic Case-Shiller Index. This all points to a low risk of a recession occurring in the next 12 months.

Historically, bear markets (equity declines of 20% or more) proceed recessions, so it is important to watch for signs on the horizon. One such sign that would signal a slowdown and eventual recession is an inversion of the yield curve (the 10-year yield being lower that the federal funds rate). Yield curves have traditionally inverted prior to recessions by 1-2 years, and we are currently well off that mark. The Federal Reserve did raise interest rates in March of this year and has forecasted two more hikes in 2017. This should flatten the slope of the curve, but is not likely to lead to an inversion.

We maintain our overweight position in equities (we moved to a 5% overweight relative to our strategic targets), which we initiated in the spring of 2013. There has been an increasing chorus of pundits and strategists preaching that the markets, mainly the S&P 500 Index of Large Cap domestic equities, are overvalued. While multiples such as the price to earnings ratio are elevated relative to their longer term averages, we do not believe we have yet entered a euphoric stage in the equity markets. Earnings during the first quarter of 2017 have been much better than expected, with over 71% of the companies surprising on the upside. Growth overall versus last year has been reported at over 13%, and revenues have climbed over 7% versus the same period last year. Expectations are for further improvements in the second half of the year, and for earnings overall to grow north of 10% in 2017. One last note on valuations – Morgan Stanley recently published a study showing that the current equity risk premium (ERP) is nowhere near the levels of previous “bubble” periods in the past. With a spread of over 3%, the markets have further room to go before we would have concerns of entering “bubble” territory.

Exhibit 1: In a normalized environment, equity risk premiums have room to fall to long term averages



Source: Factset and Bloomberg as of May 12, 2017; note S&P 500 fundamental data used post March 1993; Top 500 by market cap data used before 1993

We still could see a comprehensive tax plan passed this year (the consensus view is not until the first half of 2018) in Congress that would lower both the corporate and personal rates. Even if the plan is delayed until 2018, any reduction in rates should help earnings in 2018.

Within Large Caps, cyclical sectors have come under pressure after rallying post-election and into the beginning of the year with Industrial, Energy and Financials all underperforming the S&P 500 Index year-to-date. The only exception within the group is the Technology sector, which has lead the market since the start of 2017. Alphabet (parent company of Google) and Apple, the two biggest companies in the index, have been strong performers and have both contributed to the sector performance. A pullback in rates from their peaks earlier in the year have pressured the Financials, led by the banks. We believe, with the Fed likely to raise rates in June and potentially again later in the year, Financials may finally be ready to keep pace with the market and jockey for leadership in the second half of the year. Overall, we remain overweight in cyclical sectors and believe they have the most to benefit from a rebound in global growth.

Overseas, equity returns have outpaced their domestic counterparts as both Developed Markets led by Europe and Emerging Markets led by India booked returns of over 15% so far this year. Leadership from international markets is well overdue and could be the beginning of a longer term theme in the coming years. They have not led over a calendar year since 2012, marking a drought of over four years. One of the catalysts for Europe's resurgence has been the pro-EU outcome of the French election avoiding another exit vote. The economy is also showing signs of improving as the Markit Manufacturing PMI hit a 73 month high in May. Earnings growth is also picking up and the European Central Bank (ECB) is signaling they are preparing to wind down their monetary stimulus by year's end. Valuations for the region remain attractive and we have added to our positions over the last few months. Emerging Markets are responding from better growth globally as well as in the U.S., their biggest trading partner. China continues to show signs of stabilizing and any issues with the new administration in Washington seems to be dissipating. A possible threat could be the political instability in Brazil and the talks of impeachment and corruption are on the rise. The MSCI Emerging Market Index has returned 10.91% so far year-to-date.

Fixed Income Commentary as of May 25, 2017
Rick D'Amico, CFA
Manager of Investments

10-year U.S. Treasury yields, at 2.25%, remain near the low end of their technical trading range between 2.20% and 2.70%, while valuations appear rich across most sectors of the fixed income market. High yield credit spreads, at 381 basis points, are now well below their historical median of 562 basis points and are significantly tighter than the 577 basis point spread the sector was trading at 12 months ago. The same holds true for investment grade corporates, emerging markets debt, floating-rate loans, and mortgage-backed securities, all of which are trading below their median historical spreads. (Note: a credit spread is the difference in yield between a US Treasury security and a debt security with the same maturity but lower credit quality. The additional yield compensates investors for the risk associated with holding lower quality bonds. Credit spreads are often used as a valuation metric to assess the relative attractiveness of sectors within the fixed income market.) While valuations remain stretched, fundamentals are still sound, as high yield bonds and bank loans have a trailing 12 month default rate of 1.39% and 1.43%, respectively, comfortably below the historical default rates for these sectors. In summary, given that 1) rates are currently trading near the low end of their technical trading range and 2) valuations remain rich, we have modest return expectations for the fixed income asset class for the second half of 2017.

Going forward, central bank policy will continue to have a significant impact on yield trends both domestically and overseas. Fed funds futures markets currently imply a 97.5% probability that the Federal Reserve increases the Fed funds rate by 25 basis points at its June 14th meeting. In addition to the June rate increase, our base case calls for one additional rate hike in 2017, and 2 to 3 rate increases in 2018. Fed policy decisions will also impact the shape of the yield curve, which has flattened by 7 basis points on average during each Fed tightening cycle since 1976, as the short end of the yield curve (2-years) typically responds more strongly to Fed funds rate increases than the long end (10-years). In addition to the expected increases in the federal funds rate, it will be important to monitor the Fed's plans for its $4.5 trillion balance sheet, which the Fed will most likely begin to shrink towards end of this year. Our expectation is that the Fed's balance sheet strategy will be well communicated in advance, and minimally disruptive to the fixed income markets as the Fed allows its Treasury and MBS (mortgage-backed securities) holdings to gradually roll-off or mature over a 5-year period.

We are pleased to announce that **David Bosak** has been authorized by the Certified Financial Planner Board of Standards (CFP Board) to use the CERTIFIED FINANCIAL PLANNER™ and CFP® certification marks.

David joins five other Fairport team members who have met the rigorous experience and ethical requirements of the CFP Board, have successfully completed financial planning coursework and have passed the examination covering the financial planning process, risk management, investments, tax planning and management, retirement and employee benefits, and estate planning.

Congratulations, David! This most recent accomplishment demonstrates your commitment to *continuous improvement* – one of Fairport's core values.

Strong Passwords

We all have countless electronic passwords; making them strong and keeping track of them often feels like a daunting task. Here are a few tips for electronic password security:

- A strong password should look like a series of random characters.
- Use passwords of at least eight (8) characters or more (longer is better).
- Use a combination of upper case letters, lower case letters, numbers, and special characters (for example: !, @, &, %, +) in all passwords.
- Avoid using people's or pet's names, or words found in the dictionary; it's also best to avoid using key dates (birthdays, anniversaries, etc.).
- It's tempting but…do not write down your passwords! Consider using a password manager software product. Some are free; none are very expensive. Using one of these products, you can create truly random, very long, and unique passwords for each site, and because the software will remember them for you, you never have to worry about what your password is.

Click here to download a two-page guide on password security and instructions on how to create strong, complex passwords.

Source: KnowBe4, Inc.

Fairport Wellness Week

Advisor Rachel Margulis (pictured in middle) coordinated an internal "Wellness Week" from May 15-19th. Fairport team members were invited to take a fitness class at any of the neighborhood studios, all within a block radius of our office. Fifteen team members (more than half the firm!) took Fairport up on the offer and attended a complimentary class during wellness week. Classes included Pilates, yoga, TRX, meditation and high intensity interval training.

The week began with a presentation on postural health for the desk worker from Jen and David of Relevation Physical Therapy & Wellness and ended with a mindfulness session and guided mediation from Daneen at Inner Bliss Yoga. Thanks, Rachel, for demonstrating tremendous initiative and providing us with some healthy tools and resources to be well at work!

Fairport News
Read about our most recent community involvement, awards and accolades, conferences and continuing education.

Ken Coleman and **Heather Ettinger** attended the Entrepreneurial Operating System (EOS) Conference in Atlanta in April. The national conference was for leaders using EOS to strengthen and bring growth and focus to their business.

Andrew Connors is participating in the elite Schwab Executive Leadership program that focuses on developing leadership, innovation, talent management, strategic marketing, and entrepreneurship skills to help leaders manage and grow their firms. **Andrew** shared his research and experience with family business owners at a presentation for The Estate Planning Council of Cleveland in April. **Andrew** and **Emily Shacklett** attended the Crain's Family Business Forum on May 3. Fairport has acted as a proud sponsor since the forum's inception three years ago.

Pamela Dagostino began regularly volunteering at the American Cancer Society Discovery Shop in Lyndhurst. The shop helps support the fight against cancer through the sale of high quality, gently used, donated merchandise. Come visit Pam on a Saturday!

Emily Drake (below) was recognized as a 2017 YWCA Woman of Achievement by the YWCA at a luncheon on May 8th. Watch the honoree video **https://lnkd.in/e9Cd9Z3** and check out our Facebook album for pics from the awards ceremony **https://lnkd.in/e5Fd7hM**.

Heather Ettinger attended *InvestmentNews'* 2016 Women to Watch award luncheon in New York City in March and participated in a think tank of top women in the financial advisory industry working to affect the advancement of women in leadership roles, develop positive solutions and generate resources to bring about change. Heather, notably, was a 2015 Woman to Watch. In April, she and **Kristen Lucas** attended *InvestmentNews'* Women Advisor Summit in Chicago. At that event, Heather was part of a panel moderated by *IN* Publisher Suzanne Siracuse on "Engaging, Serving and Retaining Female Clients."

Janet Havener is being honored by the University Hospitals Diamond Advisory Group with the 2017 Distinguished Advisor Award for her role in helping individuals and families create meaningful legacies at UH. The Distinguished Advisor Award was created to annually recognize a member of the Diamond Advisory Group for his or her commitment of generosity, foresight and civic vision to the UH mission. Jan will be recognized at an award luncheon on June 2nd.

Chris Isabella attended the Cavitch Familo & Durkin 2017 Select Strategies for Insurance and Estate Planning Seminar in mid-May. The panel of speakers presented on relevant issues spanning from the economy to the impact of divorce on beneficiaries.

Mike Kalinoski and **John Silvis** attended Goldman Sachs Economic & Political Perspectives Discussion and Lunch on May 9th. The discussion focused on the current economic and political environment and the potential implications on the equity and fixed income markets

Rachel Margulis attended "Legislative Update from Washington" hosted jointly by the Estate Planning Council and the Tax Cub of Cleveland in March. In May, she attended "IRS Dispute Resolution" by Tax Club of Cleveland, "OSCPA Advance" by the Ohio Society of CPAs and "2017 Social Security Basics" by the Estate Planning Council. **Rachel**

received 14 continuing education credits for volunteering with the Cuyahoga Earned Income Tax Credit Coalition during tax season and joined the Tax Club of Cleveland as a member.

Dave Rubis attended IMCA's 2017 Annual Conference Experience in San Diego. The conference for investment and wealth professionals included insights from some of the world's foremost thought leaders. Also, **Dave** become a member of the Estate Planning Council of Cleveland.

Joyce Zak attended the 12th annual Retirement Income Summit in April in Chicago sponsored by *InvestmentNews*. It is the industry's premier retirement planning conference.

Paul Zappala attended the Schwab Compliance Technologies annual conference in Key Biscayne, Florida in May.

Newsletter Disclosures

This newsletter represents an assessment of the economic and market environment at a specific moment in time and is not intended to be a forecast of future events or any guarantee of future results. It is for informational purposes only and should not be relied upon as research or investment/financial planning/tax advice. It should not be considered as a solicitation or recommendation by Fairport to buy, sell or continue to hold securities or other investments. Past performance is not a guarantee of future results, and is not indicative of any specific investment. It should not be assumed that the investment process and strategy discussed herein has been or will prove to be profitable. Diversification and strategic asset allocation do not assure profit or protect against loss in declining markets.