FAIRPORT
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The Compass

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

September 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 September 1, 2017

John M. Silvis, CFA
Chief Investment Officer

It is an interesting fact that 2017 has started off the year with positive returns in each of the first seven months, a feat that has happened only 3 other times since 1926 according to Blackrock. August, which was down heading into the last day of the month, notched the eighth positive month in a row as markets rallied to end the month. By most measures, equity returns so far this year have been strong as we enter the seasonally weakest part of the year. With eight months in the books, the S&P 500 Index has registered a total return of 11.3% so far this year, while the MSCI All Country World Index (ACWI) has done even better with a return of 14.8% since the start of the year. Leading the way so far, Emerging Markets (as measured by the MSCI Emerging Market Index) booked the best returns of any asset class with a positive 28.5%. Two themes have emerged during the year that may persist over the next few quarters and into next year: International equities, both the developed and the emerging markets, are outpacing domestic markets and Large Cap equities are outperforming both Mid and Small Caps so far in 2017. While it's still early in the process, we believe the long term trends of the last few years are indeed changing. If the pattern of international equity outperformance holds into year-end, it will be the first time since 2012 and only the second time since 2007 that the S&P 500 Index lagged both components of the international equity markets. This year, more than most, has shown the benefits of diversification or being invested globally across different equity markets.

We believe, and the evidence is supportive, that we are in what many economists are calling a global synchronized expansion. Domestically, we have seen better economic growth in the last few months with the second quarter Gross Domestic Product (GDP) growth recently being revised up to 3.0% (ironically in line with President Trump's goal). We most likely are in the later stages of what will become the longest economic expansion on record dating back to 1900. To be fair, we are also experiencing the weakest expansion on record with growth averaging only slightly above 2% since this recovery started back in the summer of 2009. Nonetheless, we are on a "lower for longer" path that should see us eclipse the record of 120 months (…speaking of eclipse, I hope no one went blind. See our photo, not my best, on LinkedIn!).

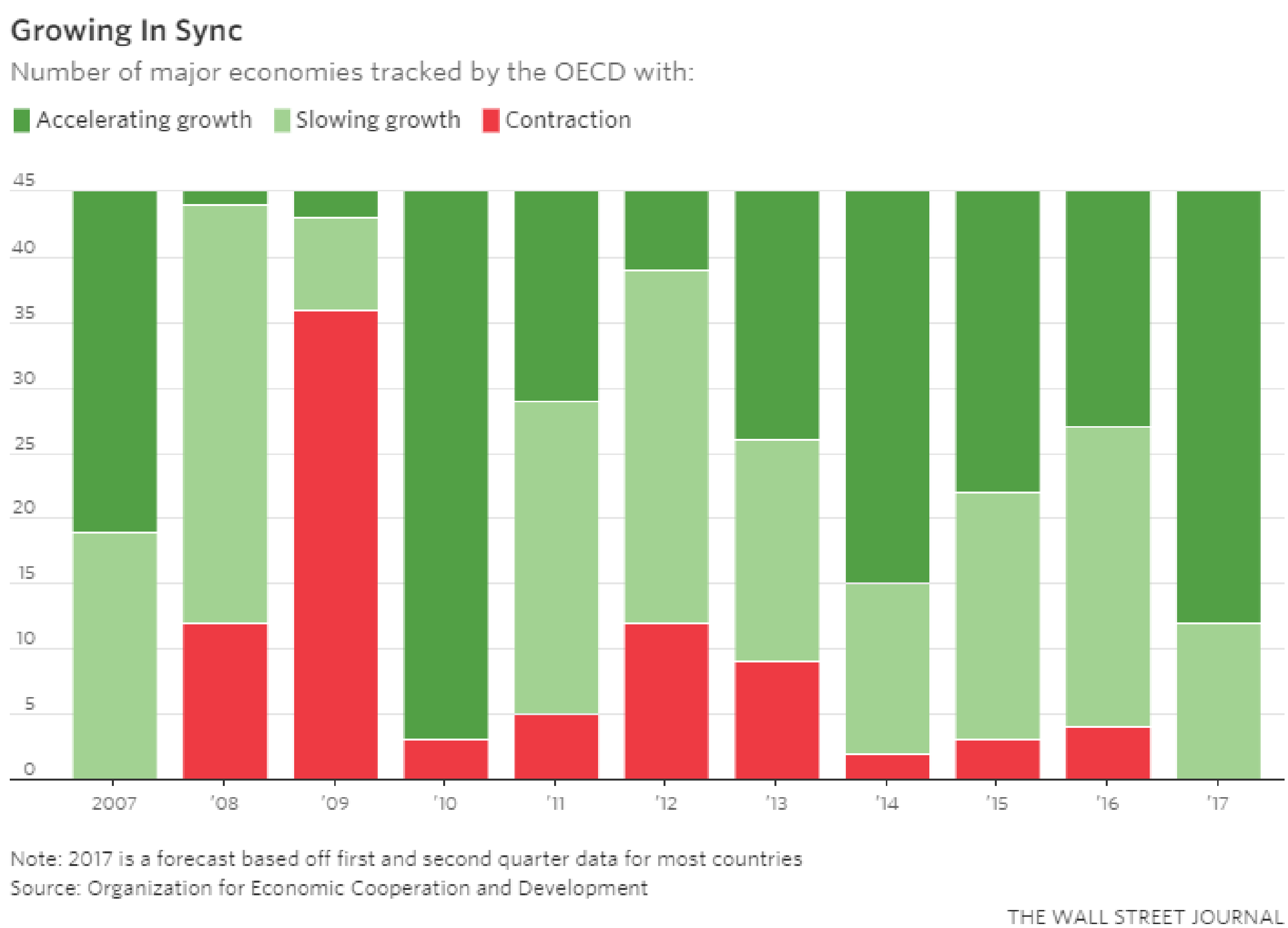
Recent economic data continues to support solid growth ahead. The unemployment rate continues to trend lower dropping to 4.4% in the most recent reading. Other leading indicators, like the aptly named Leading Economic Index (LEI), continue to rise indicating positive growth ahead. The Atlanta Fed's GDPNow econometric model is currently forecasting 3.4% GDP growth in the current third quarter, validating the economy is on solid ground. On the flip side, the Ned Davis Research's Recession Probability Model is only 3.7%, well below a reading of 50% or more that would flag an oncoming recession. Finally, the yield curve, which is the best indicator of an oncoming recession, has not inverted and is consistent with positive economic growth.

I think it's fair to say that most of the excitement in the equity markets in the beginning of the year was driven by the surprise election outcome and the hope of the administration following through on the pro-growth agenda President Trump outlined during the transition after the election. After seeing the President and Congress stumble on health care reform while continuing to struggle with tax reform and the budget, we believe most of the "Trump Trade" has been discounted. However, the driver starting back near the end of the first quarter has instead been the rebound in earnings and confidence of corporations to guide expectations higher. Both the first and second quarter earnings reports for the

S&P 500 saw better than 10% earnings growth versus the same time frame last year. The top line, or revenues, also saw better than expected growth. Evercore ISI predicts earnings growing to $130 per share for the S&P 500 in the third quarter, well above last year's level with risk to the upside. With inflation well in check, we are in an environment for the rest of the year where we see rising earnings and possible multiple expansion which has fostered positive returns in equities. On a valuations call, we still think stocks look attractive relative to bonds, as measured by the current equity risk premium. We would have to see rates on the 10-year Treasury to rise above 3.3% to bring that reading back to its historical average.

Within domestic equity markets, Large Caps have outpaced both the Small and Mid Caps so far this year – a trend we think will continue heading into 2018. Larger companies that have exposure to overseas markets have benefited from the global expansion that is taking place along with a weaker dollar. The Dollar Index was down almost -10% year-to-date before bouncing back a few days ago. While the currency may be oversold and due for a short term reversal, the intermediate trend is likely lower as growth overseas is at a higher pace than here at home. Technology and Healthcare remain the top two sectors in 2017 with Utilities rebounding as interest rates move lower. We think cyclical sectors will reassert themselves as we work through the summer months and rates find their footing. We believe we'll see further gains as we enter the fourth quarter, typically the best quarter for market returns.

Central banks overseas, led by the European Central Bank (ECB) and the Bank of Japan (BOJ), remain accommodative and continue to provide a positive backdrop for international equities. Emerging Markets have registered strong returns leading all asset classes, helped by rising demand in the U.S. (the largest trading partner for several emerging market economies) and attractive valuations. According to the Organization for Economic Cooperation and Development, all 45 countries they track are seeing positive economic growth with no country in economic contraction (the first time since 2007 – see chart below).



As we look out to 2018, central policy overseas is likely to shift, as the ECB looks to end their version of quantitative easing sometime in the first half on the year. We remain overweight Emerging Markets and continue to believe they will lead the global equity markets in the coming quarters on the back of solid earnings growth.

While we won't argue the fact the equity markets especially the S&P 500 is well overdue for a pullback or correction, trying to time it has historically been futile. We like to remind clients that more money has been lost waiting for a correction than is normally lost in a correction. Geopolitical concerns remain high on investors' minds but so far have not rattled markets. Volatility, which has been at or near historic lows for most of 2017, could spike as global events unfold. For now we would view these as opportunities in a continuing bull market in equities.

Fixed Income Commentary as of September 1, 2017
Rick D'Amico, CFA
Manager of Investments

At 2.15%, 10-year U.S. Treasury yields remain stuck near the lower end of their post-election trading range. The longer-term downtrend, which dates back to 1988, remains intact, with important resistance between 2.65% and 2.70%. In our view, in order to see a breakout to the upside in yields, we will likely need to experience (1) a synchronized improvement in global growth, signaled by an increase in developed manufacturing PMIs or (2) an inflation surprise to the upside. As long as major developed country manufacturing PMIs (i.e., Japan, Eurozone, United States) remain mixed, and inflation remains missing in action, yields are most likely to muddle around in their current trading channel between 2.00% to 2.65%.

The current backdrop draws similarities to the 1990s, which was also a period of rapid technological change; and if the 1990s are any indication, inflation could still be a few years off in the distance. In the 1990s it was the widespread adoption of the internet putting downward pressure on inflation; today it is big data, robotics and artificial intelligence. To illustrate the influence technology has had on pricing power, consider the example below from a recent Bloomberg article titled *Tech Improvements so Dramatic, They're Depressing*:

> "Fifteen years ago, Japan's Earth Simulator was the most powerful supercomputer on Earth. It had more than 5,000 processors. It consumed 6,400 kilowatts of electricity. It cost nearly $400 million to build. Two weeks ago, a computer engineer built a "deep learning box" using off-the-shelf processors and components that handily exceeds the Earth Simulator's capabilities. It uses a maximum of 1 kilowatt of power. It cost $3,122."

Finally, the inability of Congress to raise the debt ceiling by mid-October could also act as a catalyst for higher yields; however, we currently view the odds of not extending the debt ceiling in time as low, given the political damage it could cause the party perceived to be most at fault.

Fairport remains defensively positioned in fixed income portfolios and is short duration relative to the Barclays U.S. Aggregate Bond Index. The duration of the Barclays U.S. Aggregate benchmark continues to drift higher, potentially exposing investors to more interest rate risk. At 6.0 years, the duration of the Index is significantly higher than its 30-year historical average of 4.8 years. With interest rates still near historically low levels, longer duration portfolios are even more sensitive to rates, as illustrated by the following example from Ryan ALM:

> "The "duration" of the current 2.75% coupon, 30-year Treasury bond was 20.296 "years" as of 8/18/17, i.e., if interest rates go up 14 basis points on the 30-year bond, the resulting 2.75% price decline would completely offset the bond's 2.75% coupon over a 1-year time horizon."

In addition, valuations remain rich across most sectors of the fixed income market. Historically low volatility in the bond markets, as represented by the Merrill Lynch Bond Option Volatility Estimate Index (MOVE), has contributed to the downward pressure on credit spreads.

Given the absolute low levels in yields and rich valuations, we continue to have muted return expectations for this asset class going forward.

Promotions

Fairport continues to grow and develop talent internally which has led to several exciting promotions within the firm.

Kristen Lucas has been promoted to Director of Marketing and will join the Leadership Team as functional head of Marketing.

Kristen's contributions to the firm are numerous including the construction and growth of Fairport events such as our annual client appreciation and educational programs, our movement into social media and most recently her integral role in the development and successful launch of Luma Wealth Advisors. Since joining the firm in 2003, she has always been a client advocate and exemplifies what it means to live to the firm’s core values.

Fairport clients and staff will benefit from the energy, creativity and client perspective that she will bring to the Leadership Team. Well-deserved congratulations, Kristen!

As we announced in June, **David Bosak** was promoted to the role of Analyst and **Tia D’Aveta** to the role of Client Service Manager.

Since joining the firm in 2014, David and Tia have demonstrated a commitment to continuous improvement by earning additional professional designations (CFP® and RP®, respectively). They have helped Fairport deliver of an exceptional client experience with their attention to detail, knowledge level and client-centric attitudes.

Well done, David and Tia!

Welcome New Team Members

Sarah Morgan joined the Fairport team in July. As Operations Coordinator, her responsibilities include receptionist obligations and departmental support for Finance, Operations and Compliance.

Her positive attitude leaves a terrific impression with our clients and guests and she has already taken ownership of several internal projects with great enthusiasm.

Sarah has a passion for helping people and carries that into teaching a class for inner city girls on the weekends and participating in various church ministries. She lives in Westlake with her husband and her two "fur babies."

Valerie Murray joined the Fairport team in May. She brings considerable customer service, administrative and training experience to Fairport. As Client Service Representative, she is responsible for providing organizational support to client teams and ensuring an excellent in-office experience for clients and guests.

Valerie has achieved both a B.S. in Gerontology/Nutrition from California State University Sacramento and a B.S in Hospitality Management from The Ohio State University. She furthered her education at Rice University in Financial Planning.

Valerie resides in Hudson with her husband Tom. She is an avid golfer, Cleveland sports enthusiast and amateur foodie.

Click [here] to learn more about Valerie and Sarah and the rest of the team

Follow the Leader in Wealth Planning for Women. Connect with Luma Wealth.

LUMA WEALTH

Did you hear the good news? Fairport Asset Management launched a new division, Luma Wealth Advisors, a think-out-of-the-box wealth planner that understands women are unique. We take the time to listen and understand our clients' financial situation and goals, because we know one size does not fit all.

Luma Wealth offers women the highly personalized service for which Fairport is known, and we pride ourselves on the community we offer.

If you are a Fairport client, we invite you to join in on Luma Wealth's range of informational and social events for women. Share your story while learning the basics of planning and investing, make new friends and connections, and help us celebrate women.

Want to find out more? Here are 3 ways to connect with the Luma Wealth community today:

1) Sign up to receive our informative emails here
2) Check out our website at lumawealth.com
3) Like us on Facebook, follow us on Twitter and LinkedIn

It's back to school time!

Make fiscal responsibility part of the curriculum

Many parents understand the value of a good education and encourage their children to do well in school, but often do not put the same emphasis on money management. This can be a big mistake. According to a study conducted by the Federal Reserve Board, (not surprisingly) indebtedness increases the likeliness that a young adult will find it necessary to move back home with their parents. Between 2005 and 2014, this "boomerang" generation increased by 15%*.

Your children look to you for guidance on many things, and finances are no different. Take advantage of opportunities to talk to them about money. Studies have shown that children are looking for information, and prefer learning from parents over friends or books. First and foremost, be a role model for your children, demonstrating the difference between "wants" versus "needs." A good way to do this is to show them how you are saving up for a big purchase.

A conversation about money can start when your children are young, and continue through college with age appropriate messages. For example, you can teach pre-school children through play, while older children can be taught about budgeting, saving, and philanthropy through an allowance. Teens and college-aged children can start to learn about credit card responsibility and debt, as well as the importance of investing for the future.

If you want to learn more, reach out to your Fairport team for additional information on raising financially responsible kids. We hold periodic events to help guide parents on talking to their children about money, and meet with adult children to provide coaching on financial literacy. We can also suggest resources, games and tools to help your children stay on a financially responsible path.

**Source: Dettling, Lisa J., and Hsu, Joanne W., "Returning to the Nest: Debt and Parental Co-residence Among Young Adults," Finance and Economics Discussion Series Divisions of Research & Statistics and Monetary Affairs, Federal Reserve Board, Washington, D.C., 2014*

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

Luma Wealth Advisors received outstanding press following the June launch (including the cover of a national industry publication!). Click below to read the articles:

InvestmentNews
Retirement gets a new look
Advice firm carves out unit for women investors

Crain's Cleveland Business
Fairport Asset Management debuts women-focused division

Rick D'Amico attended AQR University in May at the University of Chicago Gleacher Center and the First Trust Insight Forum in May at The Waldorf Astoria Chicago.

Heather Ettinger participated on a panel at *InvestmentNews'* Women Advisor Summit in Boston. She attended Barron's Top Independent Women Advisors Summit in Washington, D.C., Pax World Funds conference on impact investing in New York City and met up with her Family Wealth Advisors Council study group in Montreal.

Chris Isabella attended Wolters Kluwer Top Federal Tax Issues for 2017 for continuing education credit.

Mike Kalinoski and **John Silvis** attended the First Trust Financial Forum in August.

Rachel Margulis participated in an Ohio Virtual Tax Academy webinar in August.

Valerie Murray and **Paul Zappala** attended Schwab Solutions 2017 in Columbus in August.

Emily Shacklett has been named President of the Estate Planning Council of Cleveland. EPC Cleveland boasts nearly 430 members, making it the sixth largest estate planning council affiliated with National Association of Estate Planners & Councils (NAEPC) in the country. The membership includes attorneys, accountants, bankers and trust officers, financial planners, insurance agents, appraisers and representatives from various charitable organizations. Notably, EPC Cleveland has recently been honored with the 2017 Council of Excellence Award by the NAEPC. This award recognizes councils that are successful in their efforts to provide a strong multi-disciplinary environment and is intended to honor those councils that truly work to grow their programs and services.

John Silvis attended the Westfield Investment conference and JP Morgan Investment Summit. John also wrapped up his term as President of the CFA Society Cleveland.

Newsletter Disclosures