Redhawk Quarterly Commentary

September 30, 2017

Each quarter, Redhawk's Investment Committee provides a Quarterly Commentary. We look at what's going on in the investment landscape and provide our perspective on a variety of topics. These aren't predictions and it represents our perspective on important market and economic topics designed to help make decisions affecting your long-term financial strategy.

Market Commentary

US Market

Despite some early volatility, September ended up being a positive month for most financial markets. This capped off a solid quarter where markets also saw gains across the board. In the U.S., the Dow Jones Industrial Average led the pack with a 2.16% gain for September. The S&P 500 Index was up 2.06% for the month, and the Nasdaq Composite gained 1.11%. On a quarterly basis, the NASDAQ had the best return, climbing 6.06% percent. The Dow was right behind with a 5.58% return for the quarter, while the S&P 500 finished up 4.48% percent.

These positive results were backed up by solid fundamentals. The estimated third-quarter earnings growth rate for the S&P 500 was 4.2% percent. This growth is expected to be broad based, occurring in 8 of the 11 sectors, with the energy sector leading the pack.

Despite the recent hurricanes, more companies have issued positive guidance than negative which is another good sign. Even so, it will be important to watch actual earnings for the third quarter as the effects of the hurricanes remain uncertain. Technical factors were also supportive for all three U.S. indices during the quarter.

The chart below shows the year-to-date returns.

International Markets

Internationally, results were similar. The MSCI EAFE Index gained 2.49% for September and 5.40% for the quarter on better economic and political news, especially in Europe. Emerging markets experienced a small pullback in September which led to a 0.38% decline in the MSCI Emerging Markets Index, but the index outperformed all other equity indices for the quarter, surging 8.04%. Much of this outperformance in emerging markets can be attributed to the declining value of the dollar during the quarter. The technicals for developed and emerging indices were positive, as both remained well above their trend lines for the quarter.

Fixed Income Markets

In the fixed income space, results were mixed. The Bloomberg Barclays U.S. Aggregate Bond Index lost 0.48% in September. A sell-off in global fixed income toward month-end caused domestic interest rates to rise to their highest levels in more than two months. In addition, the yield on the 10-year Treasury bond increased from 2.16% at the start of the month to 2.33% by month-end due to expectations that the Federal Reserve would start raising rates. For the quarter, however, the index was up 0.85%. High-yield corporate bonds had a strong month and quarter, with spreads remaining near post-recession lows. The Bloomberg Barclays U.S. Corporate High Yield Index notched gains of 0.90% percent and 1.98% percent for the month and quarter, respectively.

Economic Outlook

We think the outlook for U.S. economic growth remains at 2% to 2.5%, slightly faster than average in this long-running expansion. Although the hurricanes are likely to reduce the economy's growth rate short-term, rebuilding as well as signs of strong manufacturing and services activity suggest stronger growth ahead. Consumer confidence remains high, supported by solid job growth, rising wealth, and still-low interest rates. We expect more optimistic consumers to continue spending as wages increase and the pickup in global growth is also positive for the U.S. The possibility of corporate and individual tax cuts has improved the prospects for growth in 2018 and beyond, aided by ongoing regulatory relief and still-low interest rates.

Equity Markets

U.S. large-cap stocks have risen steadily in 2017, primarily because of rising earnings, strong fundamentals, and solid economic growth. We think they'll continue to increase over time but at a slower rate. Equity investments have outperformed bonds, T-bills, and inflation over time, as well as in 2017. That's one reason we think owning a well-diversified portfolio with a variety of equity asset classes is important over the long-term.

Although they've lagged year-to-date, smaller companies (small- and mid-cap stocks) have grown faster and outperformed large-cap U.S. stocks over time. They've also been more volatile. We expect them to continue to report faster earnings growth over time, averaging about 1% to 2% above large-cap stocks.

In addition to attractive long-term returns, stocks don't rise smoothly. In fact, they've dropped by 10% or more almost every year. But those pullbacks were opportunities for long-term investors to buy at lower prices. Although we expect a return to normal volatility rather than the calm markets of the past two years, we don't recommend waiting to invest. Historically, economic and earnings growth has been a key driver of rising stock prices, and we think both will continue to rise through 2018.

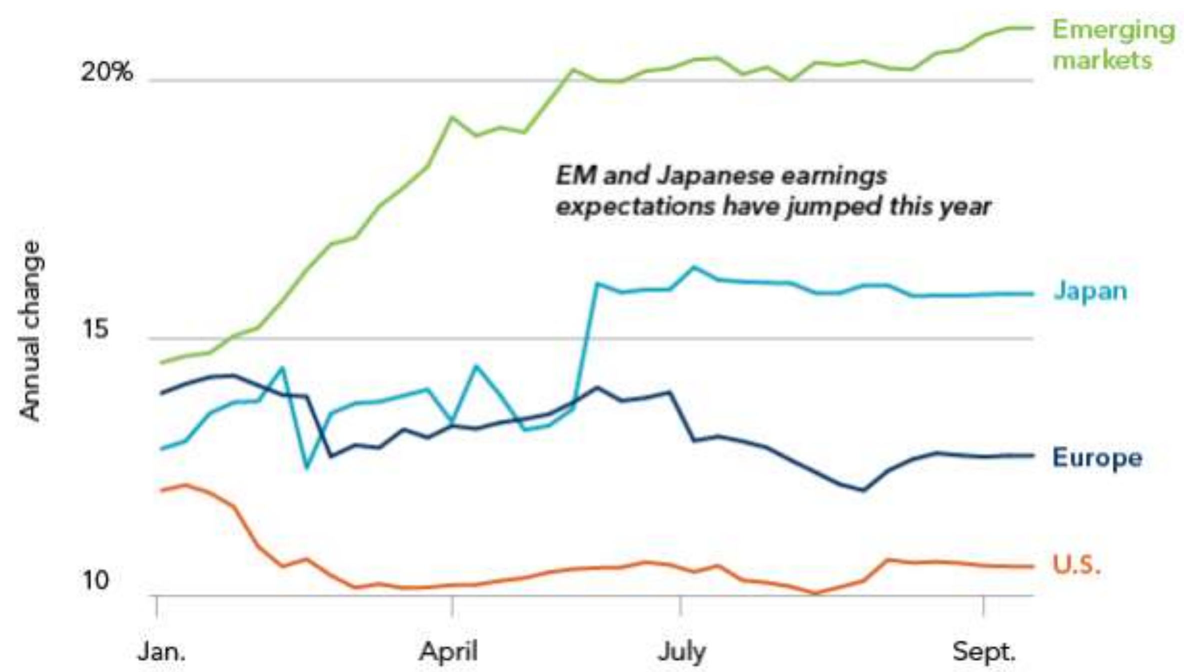
International Markets

Global economic growth started to improve in the middle of 2016 and has strengthened even more as favorable conditions appeared in more countries. The outlook for developed country growth continues to improve, supporting our view that international equity investments are likely to continue to rise over time.

A weaker dollar has played a part in the strong performance of international investments and U.S. corporate earnings in 2017. We think the dollar is likely to keep declining compared to foreign currencies, but at a slower rate as central banks start reducing the stimulus they've been providing.

We remain cautious on commodity investments due to our concerns about longer-term returns, although their short-term performance could still benefit from better global growth. Rising commodity and technology prices also contributed to another strong quarter from emerging-market stocks, where the opportunities and risks still appear balanced. We feel that a small allocation to emerging- market stocks is appropriate in a portfolio.

The chart below shows the analyst forecasts of 2017 corporate earnings growth.



Sources: BlackRock Investment Institute, with data from Thomson Reuters, September 2017.
Note: The lines show the path of aggregate analyst expectations of 2017 earnings growth for companies in various regions.

Fixed-income Markets

Interest rates remain low globally, but they have started to gradually increase as the Fed and other central banks begin to shift away from stimulus policies. If inflation remains low and economic growth continues at a modest pace, we expect slowly rising interest rates as the Fed raises short-term rates at a measured, but cautious pace. Uncertainty is higher than in the past, though, as the Fed starts to shrink its balance sheet and there is a change in leadership.

Consumer prices have started to rise more quickly, returning to annual increases of about 2%. That's in line with average gains in the "core" Consumer Price Index (CPI) which excludes volatile food and energy prices. In addition to continuing its slow pace of short-term interest rate increases, the Fed has started to shrink its $4.5 trillion balance sheet by not replacing some bonds as they mature. We think this strategy will continue unless economic conditions shift significantly.

Setting Realistic Expectations

Stocks have been setting new highs and interest rates remain low, pushing investment returns well-above their long-term averages. Over the past five years, U.S. stocks returned almost 15% per year, about twice as much as we expect long-term. Since high stock market valuations in the past were followed by low long-term returns, we expect returns over the next ten years will be in the 6%-8% range annually.

But high valuations don't mean more frequent corrections as they've happened almost every year, regardless of whether valuations were high or low. The S&P 500's price-to-earnings ratio has been above-average since June 2014. The total return since then was an above-average 38%. We expect a return to normal market volatility but also believe that modest economic growth and rising earnings will support slowly rising stock prices over time.

Summary

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has been above-average since June 2014. The total return since then was an above-average 38%. Additionally, the national US unemployment rate of 4.4% is at a 16-year low. Second quarter GDP was recently revised to 3.1% growth, a very healthy rate. We expect a return to normal market volatility but also believe that modest economic growth and rising earnings will support slowly rising stock prices over time.

It's not enough to own a portfolio personalized for your situation, based on your comfort with risk and long-term financial goals. You have to be patient and disciplined, too. With our risk management process, our investment committee is reviewing the market conditions and underlying investments on a weekly basis. Please contact your Redhawk advisor to learn more.