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Investment Letter, Q3 2017
July 10, 2017

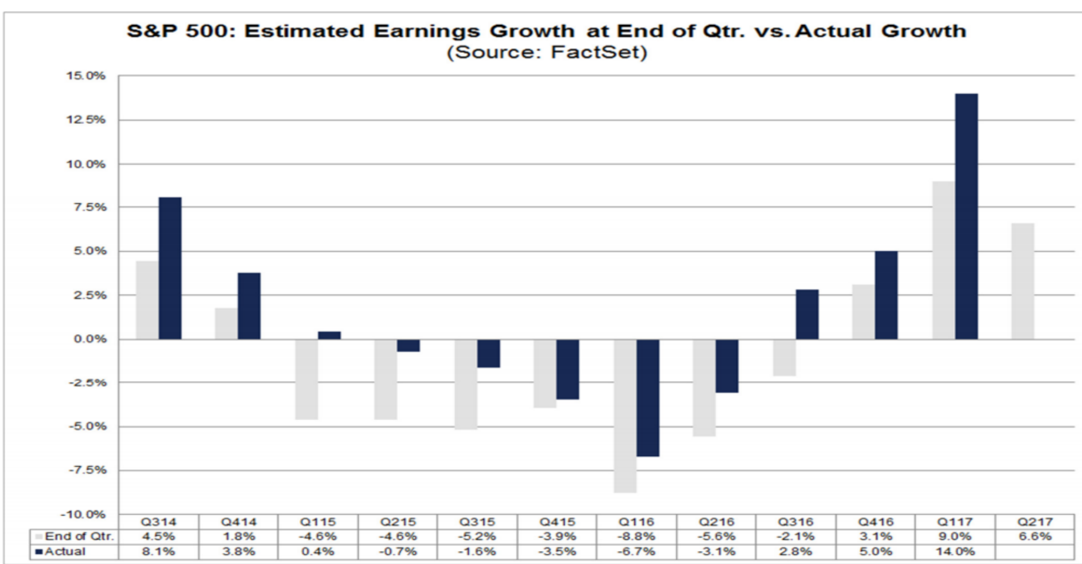
Global Monetary Policy and the Markets

During the second quarter, stocks continued to move higher, although on a slightly more subdued level than we saw during the first quarter. Wage inflation remains low; nevertheless, we have continued to see growth in the U.S. jobs market with the unemployment rate down to 4.4% and corporate earnings consistently coming in higher than analyst expectation. Please refer to the tables/charts below for a recap of the first half of the year:

	Q1 2017	**Q2 2017**	**Year-to-Date**
S&P 500 Total Return	6.07%	3.09%	9.34%
NYSE Composite Total Return	4.58%	3.06%	7.78%
Barclays U.S. Aggregate Bond Index	0.82%	1.45%	2.27%

	12/31/2016	**3/31/2017**	**6/30/2017**
U.S. 2017 GDP Estimates	2.3%	2.2%	2.2%
S&P 500 Earnings Growth Est. (Fwd 12-Month)	23%	19.9%	22.06%
S&P 500 P/E (Current)	21.18	21.69	21.44
S&P 500 P/E (Fwd 12-Month)	17.24	18.27	17.56

Source: Bloomberg



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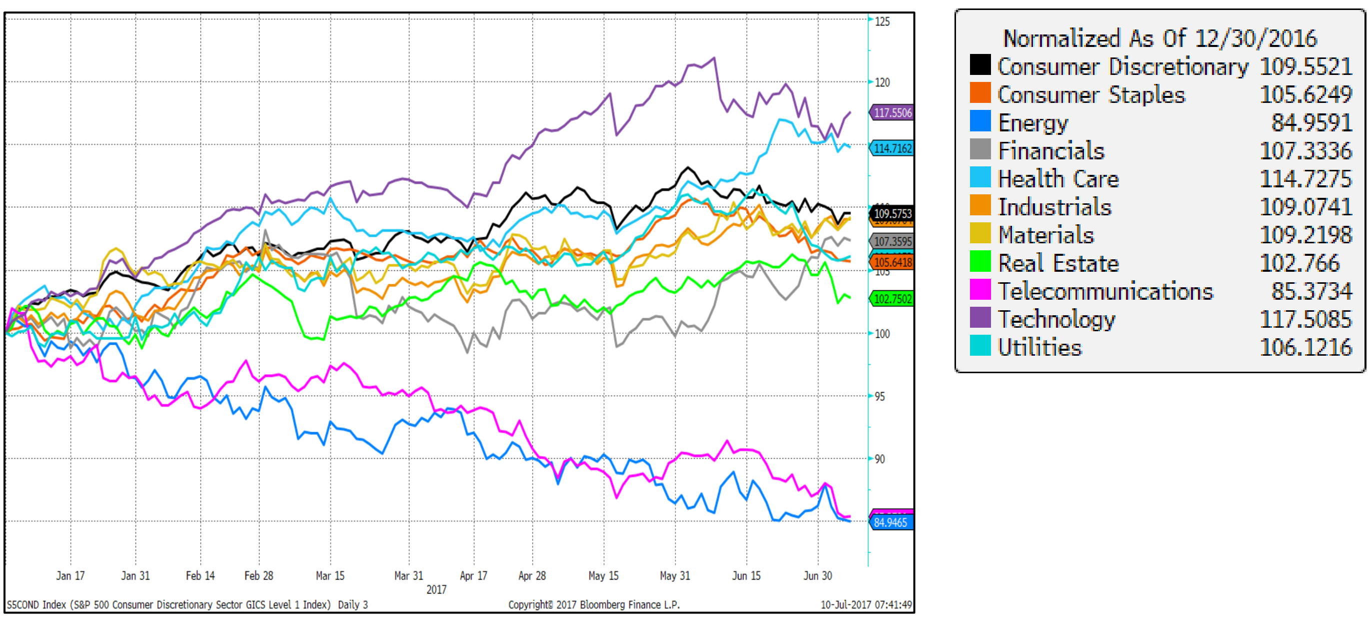
The current P/E on the S&P 500 remains high at 21.44x relative to the historical average of around 17x, but the forward P/E has dropped from the previous quarter as estimates for corporate earnings growth have increased. This is a positive sign that the market could grow into these elevated valuations.



As can be seen from the chart above, the rally year-to-date has been led predominantly by the Technology sector, followed closely by Health Care, while Energy and Telecommunications have noticeably lagged. Going forward, we expect Technology to continue to be a driver of growth in the markets with Financials establishing a trend and making more of an impact. As we see international monetary policies converge, meaning that we see economies strengthening and monetary policy tightening to raise interest rates around the globe, the domestic interest rate environment should become more favorable for banks and other financials as demand for U.S. debt declines and both yields and net interest margins improve. We have already seen some initial rotation from technology into financials over the last month or so. This may be a short-term phenomenon or the beginning of an intermediate-term trend reflecting the potential change in global monetary policy.

On the subject of domestic monetary policy, the Federal Reserve hiked rates in the June meeting by another 0.25 percentage points from a range of 0.75-1.00 to the current range of 1.00-1.25. Since the announcement, the yield on the 10-year Treasury note has rallied from 2.138% to 2.393% as of July 7th; however, this rally is likely less to do with the actual hike and more to do with the Fed's announced plans to begin unwinding its $4.5 trillion balance sheet that it has accumulated as well as international factors. The Fed intends to set caps on the amount of its balance sheet that it will let run off each month, reinvesting any excess, and they will raise this cap over time.

Shortly after the announced Fed hike, the European Central Bank hinted at potential plans to begin winding down the Eurozone's large monetary stimulus. This caused the Euro to spike versus the U.S. dollar as money flowed into international markets. The combined effect of the Fed's balance sheet wind down and the ECB halting its stimulus will likely be lower U.S. bond prices and higher yields over time.

As we mentioned in our previous letter, we continue to believe it is prudent to hold some cash positions in the current market environment. Geopolitical tensions are high, rates may be rising, market valuations are not low, and the various policy initiatives of the Trump administration have yet to materialize. We intend to use any potential market volatility to add to the portfolios.

Sincerely,

Todd Walsh & the ACI Portfolio Management Team

Data presented herein was sourced 7/9/2017 from Bloomberg.