GFG CAPITAL
A FAMILY OFFICE

WHAT LIES AHEAD

4Q 2017 OUTLOOK

QUARTER IN REVIEW

Stocks and bonds moved largely in unison during the third quarter of the year as global equity and bond markets managed positive periods across the board. Global equities continued their march higher, led by international markets, developed and emerging alike. Emerging market equities continued to flex as they were the leading equity measuring stick for 3Q adding about 15% in the period, totaling a 27% return for the year.

On the fixed income side, EM debt both local and hard currency were the leaders in the period once again. This fixed income exposure has proven to be the bond of choice for investors in 2017 as a way to protect against inflation and add the yield they have been craving. But investors showed their hand in September, as flows into long-term U.S. government debt (as measured by the iShares 20+ Year Treasury Bond ETF) saw its strongest monthly, quarterly and year-to-date inflows of assets in its 15-year history. The fund saw over $4.4B in inflows in September alone.

LOOKING AHEAD

EQUITIES

U.S. equity valuations are high by conventional metrics. When taking the current investment environment into consideration, valuations take on a less frothy profile. Historically, valuation alone has been enough to be the catalyst for equity markets to move higher or lower. Today, investors must take valuations into consideration with context. When looking at the equity landscape on a global level, we think internationally exposed companies stand to continue to benefit from the pickup in global growth.

SOURCE: [1] Data provided by Bloomberg database. Past performance is not indicative of further returns.

FIXED INCOME

With yields still low on a historical level, we've seen a small pickup in what government paper is paying across the globe. Signs of rising yields, as well as borrowing costs, across the globe has reset many expectations set at the beginning of the year. The yield action we've experience on the US-10 year over the past 11 months seemed to depict an optimistic and then unsure profile of market participants. The sideways action we've seen in yields since the ~2.4% mark shows us investors continue to wait for hard evidence to drive their investment decisions.

MARKET DRIVERS

One of the most popular words used during the third quarter was "bubble." From everything from stocks to bonds to cryptocurrencies; media pundits were blowing pretty bubbles in the air. This isn't a word we take lightly, and use seldom. A bubble is generally used to refer to a period of assets being valued way beyond their comprehendible intrinsic value. To us, there isn't evidence of this today.

Sector rotation has persisted all year giving life to the equity rally throughout months that we typically do not see positive equity performance (September). We will continue to see this trend play out so long as no shock to the system is presented, triggering an all-out flight to quality.

The synchronization of global growth has been the single largest contributor to investor sentiment so far this year. With promising growth characteristics coming from segments that were once points of concern, global growth appears to be on pace for an acceleration in 2017 and 2018. This above pace growth is also looking to be carried by non-U.S. markets which continues to support globally exposed companies.

With the easy money spigot appearing to be turned off, we now enter a period of unwinding of the most extreme quantitative easing we've ever experienced. But what has become a focal point in recent months is the intentions to roll off the balance sheet that has been built up through years of unprecedented quantitative easing. Recent FOMC meetings have revealed exactly what we'd expect and want to hear from the board. The intentions to make this a non-event. In our previous quarterly insights we outlined the expected timeline of this process to begin. Since the effect of balance sheet reduction on broader financial conditions is uncertain, it is prudent not to begin that process until short-term interest rates are comfortably away from their effective lower bound, leaving the Committee room to offset any unanticipated effects. This is partially the reason behind why we believe we will continue to see the Fed nudge interest rates closer to the anticipated normal rate of about 2%.

An investment year that has seen decade-low volatility hasn't exactly been a quiet one. Coming into the year there was no shortage of theories of policy making its way to the Senate floor in the U.S., ramping up growth. But what we've seen thus far has been a lot of noise that provides no value to investors' portfolios. What we have received is no shortage of twitter threads on everything from DACA to ACA to the NFL. What we've continued to repeat to ourselves and our clients is focus on the facts. Evidence-based investment decisions are the only thing we let impact our portfolios. We've yet to see policy make it through the ringer in D.C. which by effect, has left investors two options: listen to the noise, or invest based off evidence. What we've seen, and outlined above, is evidence of the global expansion continuing on with or without fiscal policy being enacted here in the States.

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