Market Comment

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GATIEN STRATEGIC WEALTH MANAGEMENT

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Market and Economic Update

The first half of 2017 has provided significant returns across multiple asset classes. US stocks are near all-time highs and most major market indices are positive with developed international and emerging markets leading the way. This is a reversal from the last several years where US stocks have outperformed international stocks by a wide margin.

We are heading into the 9th year of the current economic expansion – one of the longest expansions we've experienced since 1900, leading some to worry about how much longer it can last. However, age is only one measure of economic growth. Current productivity gains, as measured by GDP growth, remain far below the average gains in previous expansions, leading us to believe that economic growth can continue for the foreseeable future.

The Fed met in June and voted to raise rates for the second time this year by .25%, bringing the target range to 1.00%-1.25%. Economic activity has been rising, business spending has been expanding and the unemployment rate has declined. The FOMC will meet again this month, but we believe they will hold off on another rate hike until later this year, likely September.

Global economic expansion continues with especially strong growth in the Eurozone. We remain committed to international exposure in our diversified portfolios, for both the diversification benefit as well as the opportunity we see in global stocks. Since the lows of 2009, US stocks have gained cumulatively 258%, while international stocks have gained a more moderate 106%. US stocks remain on the more expensive side of average valuation levels, but international market valuations are lower than their 20-year averages, leading us to believe that our selective international exposure should help boost returns.

With the rising rates, several of our bond funds are down a bit for the trailing 12 months, but are positive so far year to date. In a rising rate environment, which can put pressure on bond prices, we are often asked why we own bonds at all. Bonds have two very important roles in a diversified portfolio. First, they provide income. Second, they provide a buffer in periods of market volatility. A bad year for bonds is negative 2-3% - we all know how much worse a bad year in the stock market can be. Bonds are not about maximizing returns – they are there to help minimize losses in times of stock market declines and to provide diversification and income.

The Importance of Preparing for the Unexpected

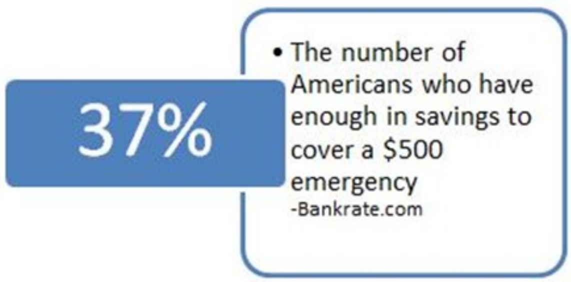
One of the best predictors of investment success is time in the market. And one of the biggest risks investors face is needing money from their investments during a market decline. So, how do we protect our clients from those market drops when a financial emergency arises?

Emergency Fund

Most of us are very familiar with the concept of an emergency fund. In its most basic form, an emergency fund is an account that holds funds to be used in the event of financial hardship – the loss of a job, a major household expense, a severe illness, etc.

For most households, an emergency fund should contain enough money to cover three to six months of living expenses. The "right" number will vary from household to household and from person to person. **Couples take note: you might need to compromise!** The funds should be highly liquid, in a checking or savings account, allowing quick access to cash in the event of an emergency.

With money market and savings account rates so low given the current interest rate environment, some investors have balked at the idea of having much money in cash earning essentially nothing. However, let's take a look at why an emergency fund is so important. We know that markets move up over the long-term and on average the market is positive more years than it is negative. Since 1980, annual returns in the S&P 500 have been positive in 28 out of 37 years; so the odds are in your favor that the market could be up in a year that a financial hardship occurs.



But what if that hardship occurs in a down year? If you have $100,000 invested in all stocks, and the market goes down by 20%, your $100,000 is now worth $80,000. Even without a withdrawal, you now need to make 25% to get back to $100,000 (yes, you read that right – a 20% drop requires a subsequent gain of 25% just to get back to even). But what if you had to take out $10,000 after the drop and your account value is now $70,000? You would have to make almost 43% to get back to your original $100,000.

Having emergency funds set aside means that you don't have to sell into a declining market to cover an unexpected financial need and helps protect your investments for your future goals.

Cash flow reserve account

A cash flow reserve account takes that emergency fund to a different level for those who depend on their investments for income. With the cash flow reserve account, we keep at least one year of withdrawals in cash and very short-term bonds and a second year of withdrawals in slightly longer term bonds. If you need $2,000 sent to the bank each month, your cash flow reserve account is going to equal $48,000.

Once you are drawing income from your portfolio, a market drop can have both a financial and emotional impact. The financial impact is clear – market drops mean fewer dollars to create the income you need. By having cash available to cover expenses, you don't need to sell into that declining market, which would further exacerbate losses. Instead, you can leave the stock portion of your portfolio alone and wait for the market recovery.

The emotional impact of a market decline in retirement sometimes takes new retirees by surprise. Even those investors who shrugged off market drops while they were saving often find themselves affected more deeply than they expect during the first market decline they experience after they start drawing income from their portfolio. Having a cash flow reserve account can help ease the fears a market drop can instill. Knowing that you have enough in cash and short-term bonds to cover two years of living expenses no matter what the market does, can help lessen the impulse to sell into a market decline, potentially causing far more long-lasting damage to your financial health than you would realize by waiting out the drop.

If you or someone you know has questions about how much you should have in your emergency fund or want more information about implementing the cash flow reserve account, please don't hesitate to reach out. I'm always happy to help.

Christy

Please visit our website:

http://www.gatienstrategicwealthmanagement.com