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Nauset Market Commentary
Third Quarter 2017

Market Performance Recap: **Steady Stock Gains Continue**

Stocks tacked on another solid quarter of gains in both US and international indices. Continued economic growth won out over political discord and natural disasters. As in Q2, international stocks led the way with a gain of +5.4% in EAFE and +7.9% in Emerging Markets indices. The Russell 1000 US stock index rose +4.5% in Q3 after another positive earnings period. The tech stock sector was a leader, up +7.6%, along with industrials, energy and materials, while telecom and consumer staples lagged. In a quiet quarter for bonds, Barclays Intermediate Gov't/Credit bond index returned +0.6%.

Economic & Market Discussion: **Market Headwinds & Tailwinds**

Many, maybe most, investors are surprised that equity markets continue to set record highs. Can the rally continue? To answer that question, we focus on key factors that feed into the three major stock price determinants: earnings, valuation and interest rates. Here is what we are watching:

- US Leading Indicators Climb – For the past year, US economic indicators have been improving (see the chart below of the US Coincident Index which includes: nonfarm payroll employment, the unemployment rate, average hours worked in manufacturing and wages and salaries), creating a slow, but steady drumbeat of positive economic news. This is the key underpinning to earnings growth and thus stocks. We expect these indicators to track upward at least into early 2018.

- Policy Reform Cuts Both Ways – Lack of policy reform has not hurt the market yet. However, the promise of new tax reform has created positive momentum in the markets that could be undone if it fails to deliver on expectations. We'll keep close tabs on tax reform developments.
- Spotlight on the Fed – Fed rate hikes and balance sheet reduction will likely to be a headwind to stocks. And naming a new Fed chief this fall may create some waves in the market. While we expect the Fed to continue its cautious ways, any push up in rates can draw investors away from stocks.
- Good Global Growth – Synchronized global growth for most of 2017 has been supportive of US markets as it helps US exports and foreign capital investment into the US. In the near term, accommodative central bank action in major non-US markets will likely keep this tailwind in place.

Portfolio Strategy: **Staying the Course with Caution**

Our current market strategy remains in place to slightly overweight stocks versus bonds, but gains are likely to be limited by high historical valuations and slowly increasing interest rates.

- Lower Stock Expectations – We continue to favor equity over fixed income despite current valuations. We see relative value in health care and financial sectors as well as non-US stock opportunities.

- Managing Rising Rate Risk – Rising rates generally hurt income-producing classes and subclasses. As a defensive measure, our yield investments favor hedged fixed income, business development corporation investments, and infrastructure.
- Eventual Correction = Opportunity – While we are not trying to time a possible market correction, we are prepared to seek new opportunities when one occurs. Based on conditions, we may use non-equity holdings to rebalance into new positions if stocks suffer a significant decline.

Market Performance **% Change for Periods Ended 9/30/2017**

Market Index	Third Quarter	2017 YTD	1-Year	3-Year Annual.	5-Year Annual.
Russell 1000	4.48	14.17	18.54	10.63	14.27
MSCI EAFE – Non-US	5.40	19.96	19.10	5.04	8.38
Russell 2000	5.67	10.94	20.74	12.18	13.79
MSCI Emerging Markets Equity	7.89	27.78	22.46	4.90	3.97
DJ US Real Estate	1.13	7.09	3.76	9.72	9.21
NASDAQ 100	6.17	23.98	24.08	15.26	17.91
Barclays Gov't/Credit Interm. Bond	0.60	2.34	0.23	2.13	1.61
IQ Hedge Multi-Strategy	1.95	5.22	3.31	2.22	3.26
3-Month T-Bill	0.25	0.56	0.64	0.29	0.19