



**BlackDiamond
Financial**

INVESTMENT INSIGHTS

THIRD QUARTER 2017





International Stocks Continue Outperformance

Stocks remained calm and continued to climb in the third quarter despite North Korean tensions and the worst hurricane season in history. The S&P 500 has now risen in 17 of the last 18 quarters and is in its second-longest bull market since 1945 spanning 101 months. Positive corporate earnings growth (10.2% in the second quarter), strong consumer spending, global economic progress, and a growth-oriented U.S. government agenda focused on lowering corporate tax rates continue to give investors confidence to invest in the stock market.

International stocks amplified their recent outperformance over U.S. stocks by returning 6.2% this quarter compared to 4.5% for the S&P 500. Year-to-date, international stocks are up 21.1%, besting the S&P 500 by 6.9%. A primary driver of this outperformance is the attractive relative valuations that international stocks provide. While the S&P 500 is trading at 20 times 2018 earnings estimates, the FTSE Developed Markets Index of international stocks can be purchased at a 25% discount of only 15 times earnings. Emerging market stocks trade at a further discount of just 13 times earnings. As economic conditions improve globally, investors are increasingly perceiving these discounts as bargain-buying opportunities. In addition, the U.S. dollar depreciated further this quarter by 2.9% (now down 9.1% for the year) against a basket of international currencies, making foreign denominated earnings more attractive for U.S. investors.

Bond prices remained stable this quarter as the Barclays Aggregate Bond Index rose 0.9%. The bond market closely monitors comments from the Federal Reserve and estimates an 82% probability (based on futures trading on the CME) that a .25% increase in the Federal Funds rate will be announced at the Fed's December 13th meeting. This anticipated increase would put the Fed on schedule for its stated goal of three .25% increases for the year.

Public real estate investments continued to lag this quarter and rose just 0.9%. While residential real estate values have done well this year, other segments of the real estate market, including office and retail oriented properties, have declined in value. According to the National Association of Real Estate Trusts, residential real estate focused companies are up 9.6% year-to-date, but retail focused real estate investments are down 11.4% after posting just a 1.0% gain in 2016. Consumer preferences toward online shopping are clearly impacting retail real estate values and causing some companies to struggle.

How Long Can the Bull Market Persist?

For years, a myriad of market pundits have warned that stocks have risen too far, too fast, requiring investors to brace for dramatic declines. Clearly these market timers have all been wrong so far, but after an eight year bull run, should investors listen to them now?

Bear markets can start at any time, and they virtually never provide advanced notice. The next one will likely be caused by a recession, which does not appear imminent. While valuation metrics for some stock market segments are at the high end of their historical range, there are many reasons to be invested in stocks. Unemployment is at a ten year low, inflation is tame, oil prices and interest rates are low, and new technological efficiencies are abundant. In addition, the simple fact that stocks have gone up for a long time has no impact on whether they will drop in the near future.

Stocks are inherently volatile (10% market corrections occur about every two years), making a long-term view important for successful investors. One of the most famous investors, Warren Buffett, recently stated, “Whenever I hear people talk pessimistically about this country, I think they’re out of their mind.” Buffett also predicted that the Dow Jones Industrial Average will eclipse 1,000,000 in 100 years. This may be a longer time horizon than most people have, but it exemplifies his confidence in the ability of companies to make money for their shareholders.

When stocks experience a substantial decline, which should be expected from time to time, long-term investors should view the decline as an opportunity. Through portfolio rebalancing, tax-loss harvesting, and dollar-cost averaging, investors can capitalize on falling stock prices and position their portfolios to take advantage of the inevitable market upswing that follows.

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Comparative Returns

	Annualized Performance					
	Q3 2017	YTD	1 Year	3 Years	5 Years	10 Years
Large Cap U.S. Stocks ⁽¹⁾	4.5%	14.2%	18.6%	10.8%	14.2%	7.4%
Small Cap U.S. Stocks ⁽²⁾	5.6%	11.0%	22.1%	11.7%	13.8%	7.9%
International Stocks ⁽³⁾	6.2%	21.1%	19.6%	4.7%	7.0%	1.3%
Real Estate ⁽⁴⁾	0.9%	3.5%	0.4%	9.5%	9.5%	6.0%
U.S. Bonds ⁽⁵⁾	0.9%	3.1%	0.1%	2.7%	2.1%	4.3%

1. Measured by the S&P 500 index, which includes 500 of the largest U.S. companies in all sectors of the economy

2. Measured by the Russell 2000

3. Measured by the MSCI ACWI ex-U.S. index, which includes large and mid-capitalization stocks from developed and emerging international markets

4. Measured by the MSCI U.S. REIT index, which includes domestic publicly traded real estate stocks

5. Measured by the Barclays Aggregate Bond index, which includes a representation of the performance of the entire U.S. investment grade bond market

ABOUT US

Black Diamond Financial, LLC is a fee-only registered investment advisor with a unique focus on preserving and enhancing wealth through index investing strategies. Our mission is to create an individualized index-based investment portfolio for each client that is risk-appropriate, returns-optimized, and tax-efficient. As an employee-owned firm, we make our clients' interests our highest priority. We believe cost is a critical factor in any successful investment strategy. As such, we offer fully transparent pricing that is well-below industry standard.

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