KFS

KUMMER FINANCIAL STRATEGIES, INC.

Helping You Create Financial Independence

August 18th, 2017

Weekly Market Update

Despite a positive start to the week on easing geopolitical tensions, U.S. stocks fell for the second straight week as politics dominated the news cycle. The S&P 500 Index declined 0.7%, the Dow Jones Industrial Average lost 0.8%, the Nasdaq Composite fell 0.6% and the Russell 2000 Index of small-cap stocks finished 1.1% lower. Outside of the U.S., a proxy for developed international markets, the iShares MSCI EAFE exchange-traded fund rebounded 0.5% while a proxy for emerging markets, the iShares MSCI Emerging Markets exchange-traded fund, added 1.9% on the week.

The yield on the 10-year U.S. Treasury finished an up and down week unchanged at 2.19% while the 2-year U.S. Treasury yield added 2 basis points to 1.31%. Oil prices recovered from earlier losses in the week to finish flat. Meanwhile, gold was off 0.3% and the S&P GSCI, which measures the returns on a basket of commodities, fell 0.6%.

On Monday, stocks continued to rebound from the previous week's sell off as tensions between the U.S. and North Korea continued to ease. Tuesday saw mixed performance amid stronger-than-expected economic data that raised the possibility of another rate hike in the coming months. Earnings news was dominated by retailers this week as the second quarter's earnings season wound down. While there were a few retailers that posted positive surprises, most provided disappointing results one way or another. President Trump's response to recent protests that turned violent sparked an exodus of CEO support this week, raising the uncertainty of Trump's ability to get his agenda through amid what appears to be waning support from the business community. On Thursday, U.S. stocks posted their worst one-day decline of the year amid the dysfunction in Washington and uncertainty over the timing of the Fed's next rate hike. A somewhat weak end to the earnings season added to investor angst. Friday saw U.S. markets recover from early losses to finish flat following news that Trump's chief strategist, Steve Bannon, was leaving the administration.

We saw some rather upbeat economic data this past week. Retail sales grew at a relatively healthy clip in July, suggesting that the U.S. consumer remains in good shape. It also suggests economic growth remains solid early on in the third quarter. A couple key regional manufacturing gauges came in above expectations and pointed to steady and healthy business activity as well. On somewhat of a negative note, housing starts and building permits disappointed, both slowing down a bit and suggesting housing activity may be moderating. Some reports we've reviewed recently have pointed to labor and land shortages as possible reasons for the unevenness in new home construction. Demand remains strong and builder optimism remains high even though they have had a tough time keeping up with demand during this cycle. Industrial production was a little light of forecasts but improved in July while capacity utilization remained relatively low for where we are in the current economic cycle. Excess capacity is one of the reasons why inflation and capex spending has remained relatively tame.

Lastly, the Federal Reserve released the minutes from July's monetary policy meeting which showed a division over the need to raise interest rates sooner rather than later. Some members expressed concern over softening inflation data while noting an "increased uncertainty about the outlook for inflation." These same members felt patience is warranted to see if the soft inflation readings of late are a new trend or a

Patricia Kummer, CFP ◆ Certified Financial Planner ◆ 8871 Ridgeline Boulevard, Suite 100 ◆ Highlands Ranch, Colorado 80129

TEL 303-470-1209 ◆ FAX 303-470-0621 ◆ 1-877-767-0763 ◆ www.kummerfinancial.com

temporary development. On the other hand, there was concern that the tight labor market and elevated asset prices warranted a more aggressive policy stance. The market-implied probability of another rate hike by year end was approaching its lows of the year as the week came to a close, suggesting growing skepticism over another rate occurring. We are leaning towards the idea that the Fed raises rates one more time this year, unless inflation data continues to soften. Moving sooner rather than waiting lowers the chance the Fed falls behind and possibly has to quicken the pace of increases to get ahead of accelerating inflation later on. The Fed has often suggested that it prefers a more gradual pace of increases so as not to derail the current economic expansion prematurely.

Next week's economic calendar is light on releases but includes some key data on the housing market in the form of new and existing home sales. Durable goods orders are also due. Market participants will turn attention to Jackson Hole, Wyoming, for the Fed's annual symposium that is scheduled to include speeches from a few key central bankers. Most will be looking for clarification on the timing of potential policy changes.

As tensions between the U.S. and North Korea eased this past week uncertainty over the Trump/Republican agenda resurfaced amid continued turmoil within President Trump's administration. The latest events are once again bringing into question Trump's ability to get enough support in Congress to move his agenda forward. And the market's latest reaction to the news is evidence that market participants may be beginning to lose patience. At a minimum, there appears to be less optimism that corporate tax reform and infrastructure initiatives will materialize as advertised. As a result, market participants may be growing a little wary that the positive economic and earnings momentum we've seen over the last six months will continue for much longer.

Real corporate tax reform in the U.S. would likely go a long way in helping to extend the current economic expansion and in improving the earnings picture for U.S. companies. Any perceived progress towards that end could help push risk assets higher. But the risks of a near-term pullback have risen in our view. After all, we have not seen a 5% decline in U.S. equity prices in over a year. This is an unusually long stretch. Since 2012, the average intra-year decline in the S&P 500 Index has been just above 9% with the worst one being 12% in 2015. So far this year, we have only seen a decline of roughly 3% from the most recent high. Should a pullback unfold over the next few months, we believe it would likely be mild and follow the pattern we've seen over the last few years. Regardless, we do not think it would represent the end of the current bull market given what appears to us to be a favorable economic backdrop worldwide.

We've seen market sentiment decline over the last couple weeks, something we think is a healthy development. Valuations remain somewhat of a concern for us, but the low inflation low interest rate environment and the fact that several of our economic indicators continue to suggest a low risk of a recession unfolding over the next several months leaves us favoring risk assets at this time. Our key momentum indicators have not yet rolled over but we are alert to the potential for a breakdown that may warrant a more defensive near-term positioning in our dynamic sleeve.

We continue to believe that higher volatility is likely over the short term. The key near-term risks to the economy and the stock market in our view surround an unforeseen geopolitical shock, disappointing earnings growth over the second half of the year, gridlock in Washington over the debt ceiling and other policy initiatives, and a faster pace of policy normalization from the Fed and other central banks.

Patricia Kummer, CFP ◆ Certified Financial Planner ◆ 8871 Ridgeline Boulevard, Suite 100 ◆ Highlands Ranch, Colorado 80129
TEL 303-470-1209 ◆ FAX 303-470-0621 ◆ 1-877-767-0763 ◆ www.kummerfinancial.com

For the second week in a row, political/geopolitical events played a key role in driving market sentiment. We prefer to follow fundamental and technical indicators when making investment decisions in our dynamic sleeve and they have not yet suggested to us that we are at a turning point in the risk environment. We think there may be a near-term opportunity to take some profits and take advantage of the higher volatility that may unfold in the coming months. Longer term, non-U.S. equities remain more attractive from a valuation perspective and we think they are likely to outperform over the next few years. As a result, we continue to maintain our international tilt in our dynamic positioning. We also have maintained our overweight to corporate credit and small-cap stocks. We believe this is consistent with our intermediate-term macroeconomic outlook and assessment of the overall environment over the next several months.

Regardless of the market's near-term direction, it is important to remember that setting the appropriate strategic asset allocation for your circumstances and risk preferences are important steps to executing your financial plan. If you would like to discuss your asset allocation, time horizon, or risk tolerance please contact us at 303-470-1209 and we would be happy to address your concerns. We are here to assist you, your friends, family or in any way we can.

Disclosures:

- Kummer Financial Strategies, Inc. is an independently registered investment advisor.
- Investors should be aware of risk when investing, including potential loss of principal.
- Past performance is not a guarantee of future results. Rebalancing, asset allocation or alternative strategies may or may not produce positive results. Thank you.

Performance, economic, and market statistics were provided by Yahoo Finance and Ned Davis Research.

Patricia Kummer, CFP ◆ Certified Financial Planner ◆ 8871 Ridgeline Boulevard, Suite 100 ◆ Highlands Ranch, Colorado 80129
TEL 303-470-1209 ◆ FAX 303-470-0621 ◆ 1-877-767-0763 ◆ www.kummerfinancial.com