



1551 Atlantic Boulevard, Suite 103 Jacksonville, FL 32207
Telephone: (904) 396-6944 Fax: (904) 396-7275

Goldilocks

MARKET SUMMARY

Equities

S&P 500	2,519
Price / Earnings	21.6x
Dividend Yield	2.0%

US Treasury

2 Year Yield	1.5%
10 Year Yield	2.3%
30 Year Yield	2.9%

US Corporate Spreads

Investment Grade	1.0%
High Yield	4.2%

Volatility

CBOE Market Volatility	9.5
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US Economic Figures

Real GDP Growth (2Q17)	3.1%
Unemployment	4.2%
Inflation (Core CPI Y/Y)	1.7%
Fed Funds Rate	1.25%
3 Month LIBOR	1.33%

Commodities

Oil (Brent Crude)	\$55.62
Natural Gas	\$3.01
Copper (\$/lb.)	\$3.03
Gold (\$/oz.)	\$1,283

Foreign Exchange

Euro	\$/€	1.18
Japanese Yen	¥/\$	113
Chinese Yuan	元/\$	6.58

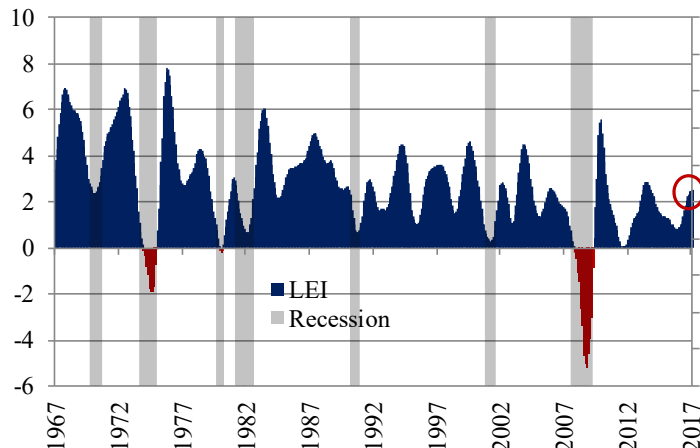
Market summary data as of:
September 30, 2017



Strong returns from financial markets continued in recent months, adding to gains from the first half. Inclusive of the third quarter, year-to-date market returns are 17.3% for global equities (MSCI All Country World), 14.2% for US equities (S&P 500), and 3.1% for US fixed income (Bloomberg Barclays US Aggregate).

The modest improvement in the global economy we described in last quarter's letter continued with further strengthening in forward-looking activity measures in most major economies. The OECD leading indicator that covers the top seven major economies illustrates the outlook for economic growth, and the consensus forecast for earnings indicates mid-to-high single digit percentage growth from year ago levels.

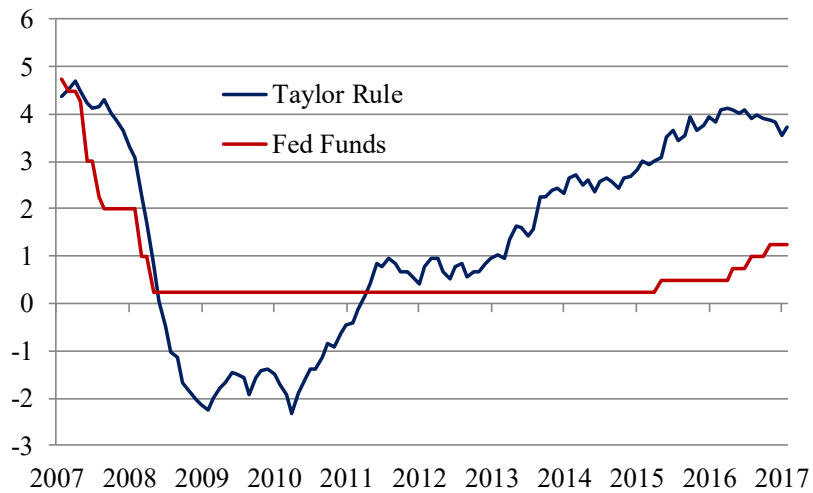
Exhibit 1: OECD G7 Leading Economic Indicator



This positive backdrop for the economy and earnings has provided fundamental support for higher stock prices and tighter credit spreads, while expectations for continued stimulus from central banks have led investors to believe high valuations can be maintained.

The current stage of economic expansion is normally described as mature. Typical “late cycle” conditions present today include elevated asset valuations, full employment, expanded indebtedness, and speculative market behavior. Also typical yet absent (for now) in this cycle are tightening financial conditions, led by rising policy interest rates. A measure developed by economist John Taylor that estimates the appropriate Fed Funds rate based on inflation and output in the economy illustrates how abnormally low rates are (and have been for some time) versus the strength of the economy.

Exhibit 2: Taylor Rule Implied Appropriate vs. Actual Fed Funds Rate %



In fact, financial conditions – driven in large part by interest rates that are set for recessionary conditions rather than a mature expansion – are so conducive to risk taking that expected and realized stock market volatility has reached all-time lows, the yield premium for riskier corporate bonds has

Exhibit 3: CBOE Stock Volatility Index

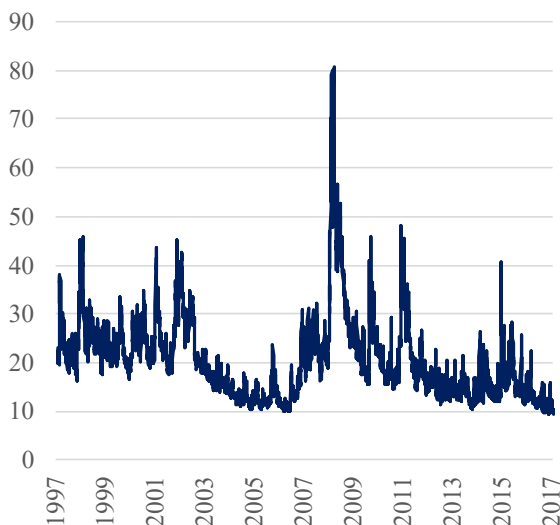
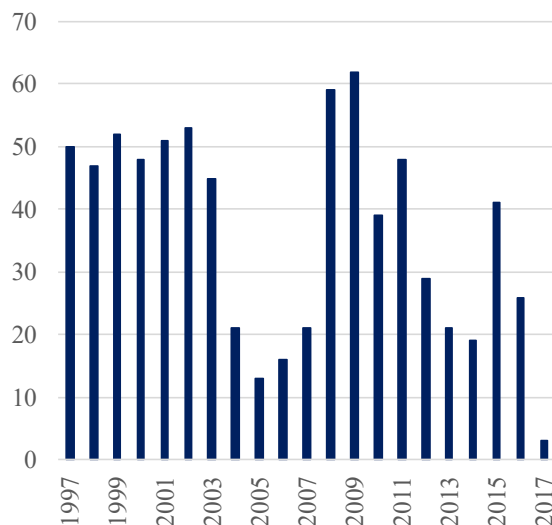
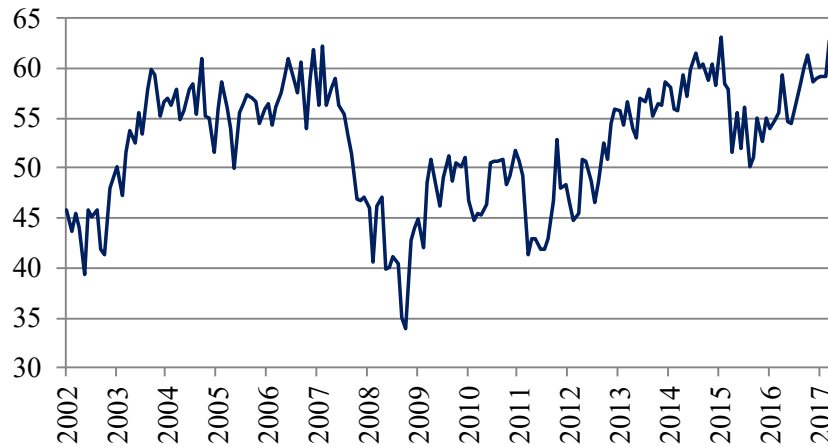


Exhibit 4: Days Per Year of Declines > 1%



reached three-year lows, and investor sentiment has become among the most optimistic ever recorded.

Exhibit 5: University of Michigan Survey: % Expecting Stocks to Rise over 1 Year



While certainly pleased that client portfolios are benefiting from ebullient markets, we remain watchful for any change in market dynamic that would begin the inevitable return to more normal valuations. With market conditions nearly perfect in the mind of many investors, what would change the outlook from the ideal balance of economic growth that is fast enough to provide rising earnings yet not fast enough to cause inflationary pressures and a more restrictive monetary response? What could upset the goldilocks scenario of non-inflationary growth and still ultra-loose central banking that has tilted market psychology toward the high end of the fear-greed spectrum?

Any softening of consumer spending, which represents the majority of the global and domestic economies, would shift the market's taste test from "just right" to "too cold". Likewise, an increase in inflation at least above the Federal Reserve's 2% target is "too hot" and may cause investors to question the permanence of very accommodative policy currently priced into the market.

Client portfolios are invested to take advantage of the current environment with a tilt toward value and quality that is warranted when valuations and sentiment are as high as they are today. In recent months, we've added to positions in the healthcare sector and in emerging markets in equity portfolios. In both cases, we see compelling valuations compared with the overall market. In fixed income portfolios, we continued the shift highlighted in last quarter's letter from high yield into investment grade credit based on the low spreads offered by the higher risk category.

We would welcome further discussion of our outlook and strategy and your portfolio. Please contact us with any questions.

With best wishes and warm regards,

Jeffrey E. Bernardo, CFA

Neil J. Sullivan, CFA

Gregory M. Estes, CFA

Frederick M. Blum

Austen P. Cornell, CFA

Milena D. Spasova, CFA CIPM

Franco Cirelli, CPA CFP®

Chart 1: S&P 500 Index

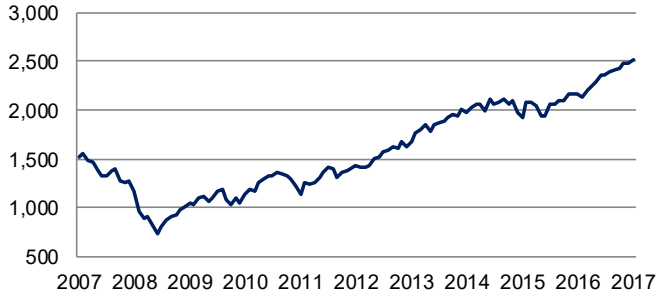


Chart 6: US Unemployment Rate %

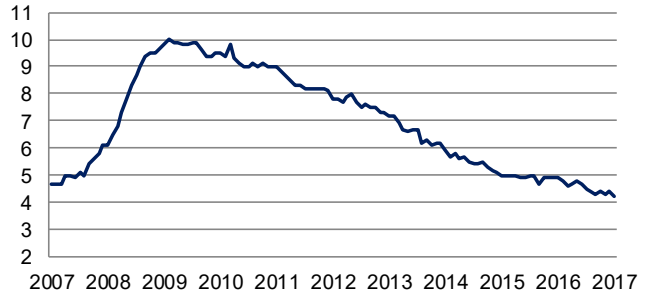


Chart 2: US Treasury 10 Year Yield %



Chart 7: US Consumer Confidence Index

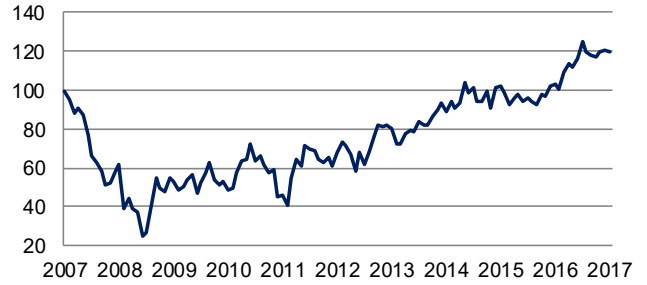


Chart 3: US Annualized GDP Growth %

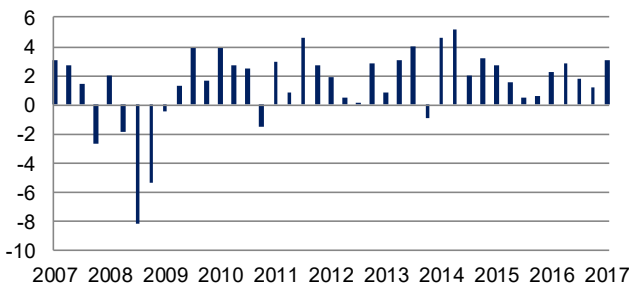


Chart 8: US Retail Sales Growth %

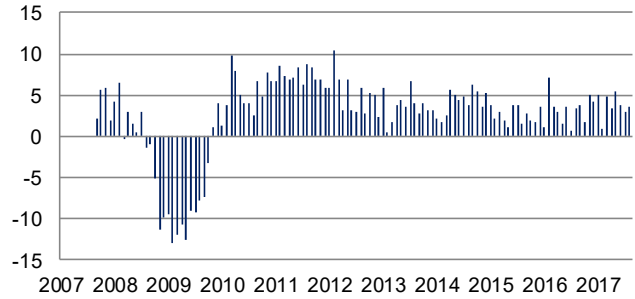


Chart 4: US Core Consumer Price Index %

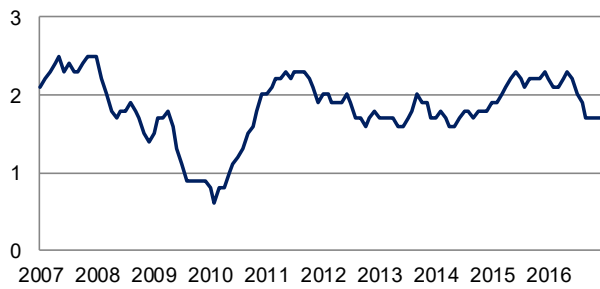


Chart 9: US ISM Manufacturing Index

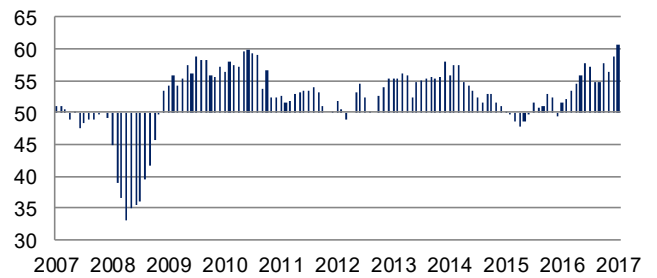


Chart 5: Trade-Weighted US Dollar Index



Chart 10: Conference Board Leading Index

