Third Quarter Report 2017

LUCIEN, STIRLING & GRAY ADVISORY GROUP[SM]

"Smart Decisions About Serious Money"

MEET OUR TEAM

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Exec. VP, Operations

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VP and Chairman, IPC

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Director of Financial Planning

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A MESSAGE FROM THE PRESIDENT

Thomas G. Twombly

You've heard this from me before, but it's always worth repeating: investing, in *anything*, is first and foremost an act of faith. Yes, there are many other factors that go into a great investment decision. But, whether you're building a company, investing your hard-earned money in one, committing yourself to a marriage, starting a family, or writing massive checks for your child's college tuition bills, you must first have a deeply held conviction that it will pay off. Otherwise, you may not have the courage and determination necessary to see it through. You must be convinced that the future will be better because of your efforts and sacrifice. You must believe that you, or someone you care about, will be there to greet that future, and that the actions you take today will have a profound impact on the outcome.

Successful long-term investors, in my experience, almost always display that sense of gritty, determined optimism as a matter of course. They expect setbacks, to be sure, because they know success is rarely easy, but they firmly believe that with patience, discipline and careful navigation they will eventually prevail in the end. They cultivate a strength of *will*, and in many respects, *they thrive on resilience.*

Lately, I've spoken to plenty of people who feel like their faith in the future is being tested. Whether it's exhausting political and social vitriol; breath-taking natural disasters like the hurricanes devastating Houston and Puerto Rico, or the wildfires doing the same in California; belligerent strongmen with nuclear weapons blithely threatening annihilation of entire populations; or mass murder and mayhem perpetrated by an evil calculating maniac in Las Vegas, folks feel like external events beyond their control are playing havoc with their confidence and sapping their strength.

I get it. Sometimes I feel the same way. In fact, looking back over all we've endured in the 21st century so far, one might agree that it has taken extra resilience and regular inoculations of hard-nosed, long-term economic, social and political perspective *not* to feel that way. (To see some of my efforts to bolster your perspective and resolve – as well as my own - read through some of my past President's Messages from all those years. You can find them on our website at http://lsggroup.com/resources/reports/.)

Simply looking backwards for reassurance doesn't do it, though. Investing requires constantly looking forwards, and sometimes in finding strength, resolve and determination in your obligations. In fact, George Bernard Shaw, the famous Irish playwright, once said: ***"we are made wise not by the recollection of our past, but by the responsibility for our future."*** I thought, therefore, it might be helpful to share some of the obligations and responsibilities that motivate us, as a team, so you understand why we too keep doing the difficult work of building towards the long-term future.

The median age of our clients right now is 61. In four years those clients will be 65, and applying for Medicare. Five years after that they'll be 70, and soon obliged to take Required Minimum Distributions

from retirement accounts. With those milestones alone, plus plenty of other personal changes, they face many vexing financial, tax and investment planning challenges going forward. And here's something to ponder: the average 65-year-old couple alive in the United States today has about even odds (49%) that one of them will live to see their 90th birthday. That's 25 *additional* years of unknown, uncharted financial, investment and life-planning territory they need to traverse – hopefully with the help of **one** stable, trustworthy team of advisors, behavioral coaches and investment specialists to help guide the way.

I'm not sure how many of our clients think about this challenge on a regular basis, but we do. I don't know how many in our profession worry they aren't doing enough to prepare themselves or their clients for this inevitable progression, but we do. We're determined to keep investing – in ourselves, in each other, and in the long-term health and sustainability of this team – so our clients can have the confidence and trust that we will be here for them for the long run.

The senior advisors on this team - Glenda, Cass, Mark, Bleckley, Megan and me – have worked together for an average of almost 20 years now. Our senior staff – Ray, Donna and Diane – average more than 11 years on this team. We're fortunate. We share a deep sense of trust, we work well together, and we each contribute in unique and important ways. Nevertheless, to sustain it in the long run, we have an obligation to keep adding new breadth and depth to this firm - and we are, in every department.

Chris Vasquez, who joined us just 3 ½ years ago, has now successfully completed all his Certified Financial Planning Certificate coursework. He'll soon sit for the comprehensive exam, and if all goes well he'll become a Certified Financial Planner before next summer. Preston Neumann, who joined us 2 ½ years ago, recently sat for the CFA Level II exam, and has now begun attending due diligence conferences with money management firms on our behalf. Chaney Barton-Nichols, who also joined us 2 ½ years ago, has been promoted to Marketing Director, and recently attended her second conference sponsored by Junxure, the maker of our client relationship management software system. In the process, she has helped to distinguish this firm as an advanced adopter (imagine that!) of this cloud-based technology, and has proven herself invaluable in teaching us old dogs some new tricks. And six months ago, we welcomed our newest member, Daisy Lopez, to the team. Daisy is mastering our complex portfolio accounting software system, and will soon be taking on additional accounting responsibilities. She also brings valuable bilingual capabilities to our team for the very first time. So, no matter what anyone else says about their generation – our Millennials rock! It's exciting to witness, and it gives me great confidence for the future of this talented team of people.

Thank you, again, for *your* confidence and trust.

Thomas G. Twombly

President

INVESTMENT COMMENTARY

Overall, the first nine months of 2017 have been an auspicious time for financial markets throughout the world. U.S. equities hit record highs as we closed out the third quarter, with small, medium and large-cap indices all displaying a powerful upward trajectory. International developed market equites and emerging market equities posted even stronger showings, rising by +18% and +28% respectively for the year so far. Bonds, too, have held up well. Despite an almost constant drumbeat of divisive politics, social upheaval, and sobering natural disasters, the global economy continues to show marked signs of steady, synchronized improvement, and investors with broadly diversified portfolios have been well-rewarded for their patience and discipline. We are pleased with the results.

In the U.S., small-cap growth stocks led the way during the quarter with results of +6.2%. Large-cap growth stocks also rose impressively, turning in +5.9% returns for the period and +20.7% for the year thus far. Technology (+27.4%) Healthcare (+20.3%) and Materials (+15.8%) stocks have contributed the most overall, while energy (-6.6%) and Telecom (-4.7%) have been the laggards so far for the year.

For investors in non-U.S. equities, which includes the vast majority of our clients, a falling dollar has contributed substantially to very attractive results for 2017 so far. Developed Euro-zone economies like France (+28% in dollar terms) Germany (+25%) and the U.K. (+15.7%) have proved the wisdom of maintaining long-term investment holdings in those areas, while year-to-date returns from China (+43.4%) India (+24.1%) and Brazil (+26.9%) have provided strong underpinnings to emerging market equity results.

Looking down the road, a lot of eyes in the financial world will be focused on a couple of key issues. One will be the U.S. Federal Reserve Board, and their commitment to start

shrinking their balance sheet beginning this month. The other will be on the U.S. Congress, and whether or not they will be able to pass some sort of meaningful "tax reform" (really tax cuts) by years end. In both cases, the way forward is not clear, and the economic, fiscal and political territory we're treading is completely unexplored. As always, there are any number of potential challenges and reasons for caution. At the same time, there are also potential opportunities and ample reasons not to be blinded by trepidation.

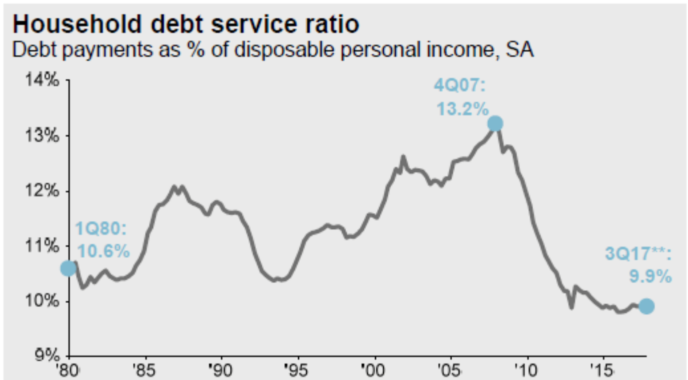
Additional fiscal stimulusis possible in the United States, but to get it we'd need to see our lawmakers accept a compromise budget agreement in the next month or two. If that were to happen, combined with what is likely to be the economically stimulative effects of rebuilding from recent natural disasters, it's possible the U.S. economy could experience an acceleration in measured growth rates in the first half of next year – perhaps up to as much as 3.5%. Hope and anticipation for this outcome may be one of the primary reasons we experienced such strong results for small and mid-cap U.S. equity indices in the final weeks of September. We shall see.

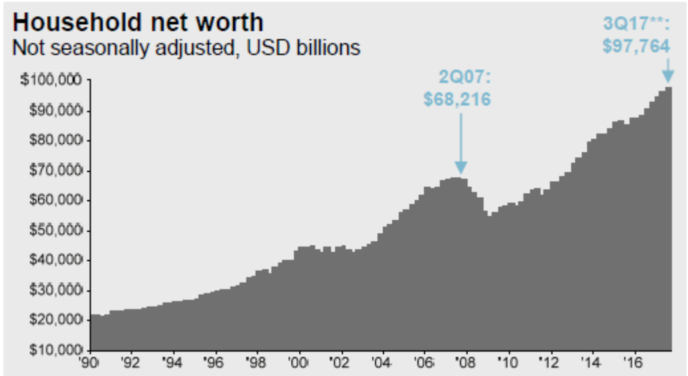
Nevertheless, the recent legislative record isn't exactly robust, and there are any number of counter-balancing forces that will likely impact financial markets in other ways. The Fed's decision to stop purchasing bonds from the U.S. Treasury, and to begin simply letting their existing $4.5 trillion worth of bond holdings mature without replacing them – first at an average rate of $10 billion per month, but rising to a rate of $50 billion per month next year – will likely have an impact on long-term interest rates. The Fed has been a substantial buyer of U.S. Government debt for the last 9 years, and their presence in the marketplace has been specifically designed to help keep rates very low. Even without actively selling off their bond holdings, their absence as an on-going buyer will mark a notable change to the dynamics of global debt markets.

Additionally, any acceleration in economic growth is likely to drive unemployment rates even lower still – perhaps to levels as low as 3.5% - and it's likely that eventually average hourly wages will begin to rise as well. While this will be welcome news to workers, it's important to remember it will represent a rising cost to employers and manufacturers – one that is likely to be passed on to consumers in the form of higher prices. These effects, combined with oil prices that are now starting to show signs of increase, and a weakening U.S. dollar that is likely to continue the -9% decline it has experienced in 2017 so far, may start to drive inflationary forces upwards. These influences have been absent from our economy for a long while, and their failure to emerge during the last nine years despite many repeated warnings has led many to believe they're not to be worried about any more. Perhaps… but unchecked complacency can eventually lead to some very painful outcomes, as many of us learned from cautionary tales as children. For our part, we think we might be starting to hear the first faint strains of Sergei Prokofiev's "Peter and the Wolf" playing in the background.

For these reasons, we remain broadly diversified in our portfolio allocations, with an slight preference towards developed international and emerging markets equites over U.S. equity holdings. We're maintaining lower bond allocations, shorter duration in the bond holdings we do have, and some smaller hedge positions in areas we would expect to do well in the event of surprising inflation numbers, such as Treasury Inflation Protected Securities (TIPS) and oil and gas Master Limited Partnerships (MLPs).

If you would like to discuss our perspective, or your own individual financial situation, please give us a call. We would be happy to schedule time for a conversation.





Source: FactSet, FRB, J.P. Morgan Asset Management; (Top and bottom right) BEA.
Data include households and nonprofit organizations. SA – seasonally adjusted.
*Revolving includes credit cards. Values may not sum to 100% due to rounding. **3Q17 figures are J.P. Morgan Asset Management estimates.
Guide to the Markets – U.S. Data are as of September 30, 2017.

Save the Date for Lucien, Stirling & Gray's Annual Holiday Party!

Thursday, December 14th 3:30 – 7:00 PM

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RSVP at info@lsggroup.com or 512-458-2517

General Market Results

	3rd Quarter	YTD	One Year	Three Year	Five Year	Ten Year
CPI	0.23%	1.69%	1.69%	1.04%	1.19%	1.65%
Barclays Agg Bond	0.85%	3.14%	0.07%	2.71%	2.06%	4.27%
S&P 500	4.48%	14.24%	18.61%	10.81%	14.22%	7.44%
DJI	5.58%	15.45%	25.45%	12.35%	13.57%	7.72%
S&P 400	3.22%	9.40%	17.52%	11.18%	14.43%	9.00%
Russell 2000	5.67%	10.94%	20.74%	12.18%	13.79%	7.85%
NASDAQ	5.79%	20.67%	22.29%	13.07%	15.83%	9.17%
MSCI EAFE	5.47%	20.47%	19.65%	5.53%	8.87%	1.82%
MSCI EM	8.04%	28.14%	22.91%	5.28%	4.36%	1.65%

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