THE H GROUP INC©

INDEPENDENT WEALTH MANAGEMENT SOLUTIONS℠

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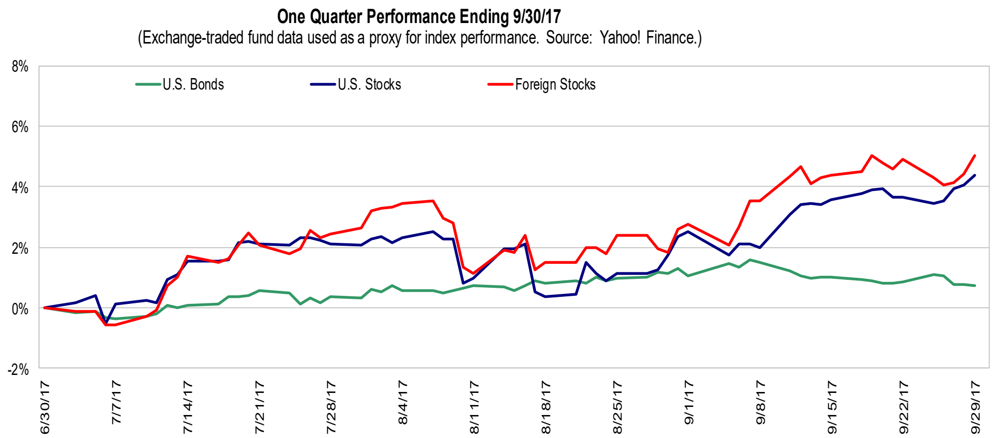
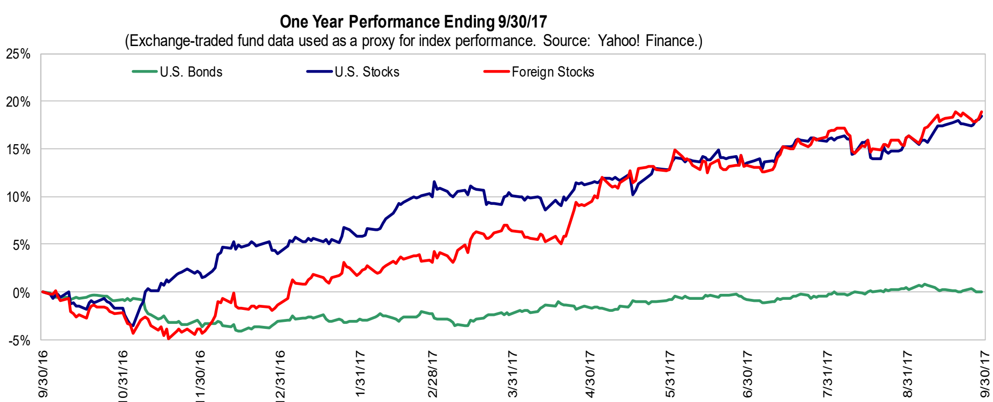
2017 Third Quarter Update

September 29, 2017

The long-awaited fall is finally upon us. We are pleased to present our review of the third quarter of 2017. Once again, it's been a good quarter for stocks, except for some rough patches during August.



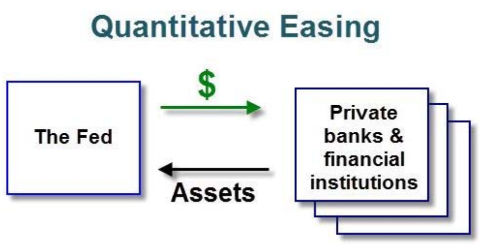
The past 12 months have been good too, especially for domestic and foreign equities. It's been a tough year for fixed income, except for the higher yield and foreign bonds.



Sell in May?

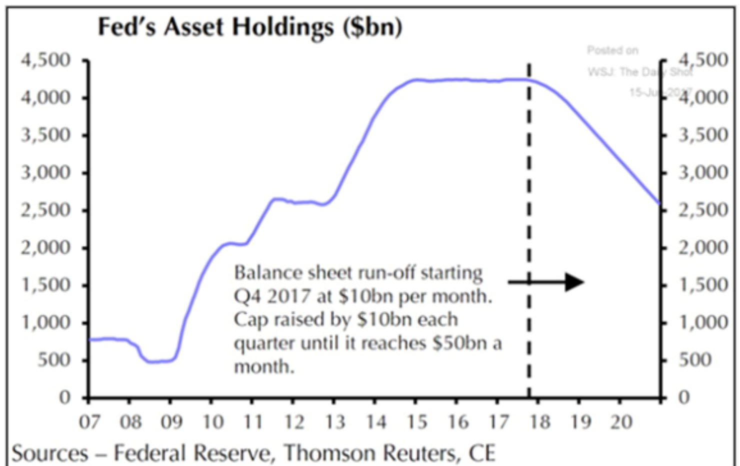
Remember the Wall Street adage, "Sell in May and go away (until November)?" That strategy doesn't work every year, as you can see by the charts above. Since May 1, the S&P 500 gained 5.1%. While there may be some validity to the saying, it doesn't apply to every class of equities or to bonds, and certainly not to every year, including this one—at least so far.

The Fed and Quantitative Easing



The Federal Open Market Committee met twice this quarter, choosing to leave interest rates unchanged at both meetings. At the close of their September meeting, they announced plans to begin reducing the size of their $4.5 trillion balance sheet, the first step toward unwinding the stimulus program.

By way of background, the Fed in late 2008 began large-scale purchases of assets such as U.S. treasuries and government-supported mortgage-backed securities (MBS) to stave off a complete collapse of the financial system. For six years, the Fed embarked on this asset purchase program — known as **quantitative easing** — which kept interest rates at record-low levels in the hope that increased bank lending would spur growth. The effectiveness of the program will never really be known, but the financial system in the U.S. did survive a scare of historic proportions. Some will argue QE went on for too long, leading to overinflated asset prices, but that's a whole other white paper.



Source: Capital Economics

The "balance sheet normalization program" will allow some of its bonds from these purchases to mature gradually and cap the amount that is automatically reinvested into new bonds. Bringing the balance sheet closer to historically normal levels (~$800 billion) will take time in order to avoid disrupting the markets. We don't expect this to have a major impact on the Fed's balance sheet in the short term as the proposed $10-$50 billion monthly roll-off's will take time to make an impact on the $4.4 trillion principal.

Why are these adjustments important? Normalizing the balance sheet now can give the Fed some wiggle room should it need to implement stimulus programs in the future when the economy slows.

The outlook for another 0.25% interest rate hike by yearend is at more likely than not. Hurricanes have historically had a short-term impact on GDP, hurting some industries like tourism, while helping others such as building materials and construction. Inflation, while up a bit this quarter, is still below the Fed's mandate. The country is at near-full employment. As always, the final decision is very dependent on the next three months.

Portfolio Update

During the third quarter, we made some changes to the fixed income portion of your portfolio. Our goal has been to reduce volatility where we can. In our U.S. bond holdings, this meant selling one of our high yield corporate funds in exchange for higher quality bonds with shorter duration. The last 9 years have seen a solid run in high yield fixed income, and we are following our own advice of selling high. In foreign bonds, we sold half of our global bond fund to further diversify your portfolio with a second fund that offers broader international exposure.

We have not made any changes to the over or underweighting that we apply to various asset classes within your portfolio this quarter.

Asset Class Weightings as of September 30, 2017

(Compared to our normal long-term allocations)

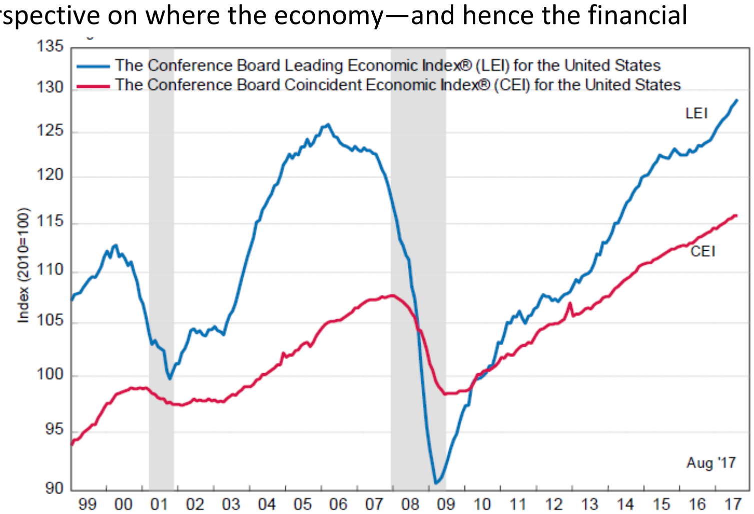
Asset Class	Underweight ⟵		Neutral		⟶ Overweight
FIXED INCOME					
Government		X			
Corporate				X	
Foreign			X		
EQUITIES					
US Large Cap				X	
US Mid Cap		X			
US Small Cap		X			
Foreign			X		
ALTERNATIVE					
Real Estate			X		
Commodities			X		

Our Outlook

When we talk about the outlook for the financial markets, we must do so in the context of the overall economy. Basically, when the economy is doing well, equities do well. Bonds, on the other hand, perform better in periods of declining economic conditions.

Right now, while political and global news are sucking most of the oxygen out of the air, the financial markets are rather boring. Why do we say this? Because the economic indicators and the profitability of companies continue to be good. The National Association for Business Economics (NABE) just released its latest survey results of 47 corporate economists. They project that, based on all the data, the GDP will chug along at about 2.2% this year and 2.4% in 2018. These are not the numbers of a roaring economy that proceeded our last two major recessions. Rather, they are simply slow and steady.

In our April update letter, we discussed the Conference Board's Leading and Coincident Indicators. The chart they publish every month gives us a good perspective on where the economy—and hence the financial markets—are going. The indicators are even higher now than they were last April.



Latest LEI Trough March 2009, Latest CEI Trough June 2009

Shaded areas represent recessions as determined by the NBER Business Cycle Dating Committee.

Source: The Conference Board

A coincident indicator is a metric which shows the current state of economic activity within an area. These areas include employment, real earnings, average weekly hours worked in manufacturing and the unemployment rate. **Leading indicators** are a more forward-looking list of 10 indicators that are helpful but not always accurate. Some of the items are the consumer confidence index, building permits, weekly jobless claims, purchasing managers index and stock prices.

Generally, when both lines are trending upward, we aren't on the verge of a recession or a major bear market. Right now, the trends are still upward. While we pay attention to these indicators, we don't use them to time the market. They are helpful, however, as we adjust our asset allocations in our portfolios.

Fundamentals Matter

With debates about health care, tax reform and infrastructure projects, we are clearly in a period of uncertain economic policy. We are also in a period of major geopolitical risk, such as North Korea and the Kurdistan referendum on independence. However, these two types of risks historically have had little effect on financial markets. Rather, business and economic fundamentals, such as the ones tracked by the Conference Board, are what tend to drive the market.

We've had a smooth ride. Our current rally has gone over 10 months without out a sell-off of 3% or more, the third longest stretch since WWII. With that in mind, we are probably overdue for a correction or a sell-off, perhaps as a result of political or geopolitical events. ***We expect some volatility ahead—it is part of the natural cycle and not the end of the world. Fundamentals matter, and right now, they look solid.***

Misc.

- Some of you may have recently received a letter from Fidelity informing you of your required distribution for 2017. As always, we track your required distribution and withdrawals for the year. If we don't hear from you by November, we begin to make some calls to assure we have a plan in place to get your distribution processed before year-end.

- You'll soon receive an email introducing you to the first monthly summary of our blog posts. In it, we will share with you links to the blogs from the month prior. September was all about security. If you haven't already done so, we encourage you to check out our recent posts about the Equifax data breach. You can find them by going to thehgroup-salem.com, then click on the "Our Blog" tab.

- Don't forget to mark your calendars to come celebrate Ron and Kathy Kelemen's retirement. The party will be on **November 2, 2017 at The Grand Hotel, 4:00-7:00 pm**. If you haven't made a reservation yet, please call us at **503.371.3333** to RSVP. Or, simply reply to this email. We want to make sure we have plenty of food and beverages.

Thank You

As always, we welcome your feedback and questions. We appreciate your continued confidence and business. Whether you're sending the kids or grandkids back to school, planting your winter crops or enjoying that pumpkin spice latte on a crisp morning, we wish you all the best this autumn.