# 3RD QUARTER 2017 UPDATE

October 13, 2017

*"We've never have had QE like this before, we've never had unwinding like this before. Obviously that should say something to you about the risk that might mean, because we've never lived with it before."*

Jamie Dimon, CEO JP Morgan Chase
Comments on the announcement the Federal Reserve will begin unwinding its quantitative easing programs.

All of the major US stock market indexes finished the 3rd quarter of 2017 at or near all-time highs. After a pause from February 2015 into the 2016 election, the bull market in stocks has forged higher. From my perspective, the renewed uptrend in stocks has resulted from a synchronized global economic expansion and a continuation of historically low global interest rates. While the US economy remains in the late stages of its business cycle, the growth in the rest of the world has helped extend our growth path and support our stock market.

As we entered this year, I viewed global economic growth as a positive tail wind. I viewed most other relevant factors as likely triggers for stock market volatility. In my mind, high stock market valuations, rising U.S. interest rates (even from a very low level) and geopolitics were all going to contribute to big swings in stock prices. At least to date, I have been exactly wrong. In fact, the volatility in the stock market this year has been among the lowest in history. As measured from new stock market highs, there has only been one drop in the S&P 500 this year that reached 3%. That is not normal! As pleasant as this gentle climb in stocks has been this year, we know from history that it will not last.

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As longtime readers of this letter know, I regularly chronicle the actions of the Federal Reserve (the Fed) because of the outsized impact that shifts in its monetary policy can have on the economy and the financial markets. The Fed's dual mandate is maximizing employment and stabilizing prices. As our economy revolves through its business cycle, the Fed tries to balance those mandates and keep the economy from getting too hot or too cold through appropriate implementation of its various policy tools. Functionally, while the tools directly affect short-term interest rates and money supply, the indirect impacts include the psychology and behavior of lenders, consumers, investors and businesses. Depending on the timing and magnitude of policy shifts, the Fed can and will affect your wealth. From that perspective, it is important for all participants in the financial markets to keep tabs on where the Fed is heading. Right now I feel like investors are, at least on some level, looking the other way.

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There has been a material change in the economic landscape. The Fed has officially begun to unwind its $4.5 trillion balance sheet this month, October 2017. Its balance sheet was built up primarily through the purchase of U.S. Treasury securities and mortgage-backed bonds under its quantitative easing programs, known as QE. In response to the Great Recession of 2008, the Fed, under the leadership of Ben Bernanke, implemented QE as the most aggressive U.S. monetary policy tool of our lifetime. In the name of avoiding a deflationary depression, the Fed electronically "printed" almost $4 trillion over six years and injected it into our economy. Bernanke let the world know that the Fed would do whatever was needed to reflate the U.S. economy. QE provided liquidity and confidence to bond market participants, helped lower longer-term interest rates and helped push investors into stocks and other riskier asset classes to seek out higher potential returns. To begin the unwinding of its QE policy, the Fed plans to shrink its balance sheet by $10 billion a month through the end of this year and then slowly accelerate the unwinding over time until it reaches a $50 billion per month runoff rate.  That means the money that the Fed previously printed and injected into our economy through bond purchases is now being withdrawn.

The reaction in the financial markets to the directional reversal of the most aggressive monetary policy in our lifetime has been almost non-existent.  While the Fed is both raising interest rates and reducing the size of its balance sheet, the stock and bond markets are at or near all times highs and volatility is near an all-time low.  From one perspective, that reflects investors' confidence in our Federal Reserve and the positive global economic statistics.  From another, it reflects investors' complacency in the face of fundamental changes.  As portfolio managers, we at Peak are working hard to balance the investment environment with our clients' individual needs and goals.  We are aligned with Jamie Dimon's quote at the beginning of this letter and are well aware that "we've never had an unwinding like this before."

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We appreciate your business and we continue to work hard to earn the trust you have placed in us.  Please let us know if you have a friend or family member that could use our assistance.

John McCorvie, CFA