SIA Perspectives

Stegner Investment Associates, Inc. **2nd Quarter 2017**

As investment consultants and fiduciaries, we are the most successful when our Clients are involved in the investment process and understand our portfolio strategies. Through our written communications and in-person meetings, SIA strives to provide Clients with insight into financial markets and the impact that economic policies and world events can have on a portfolio’s performance.

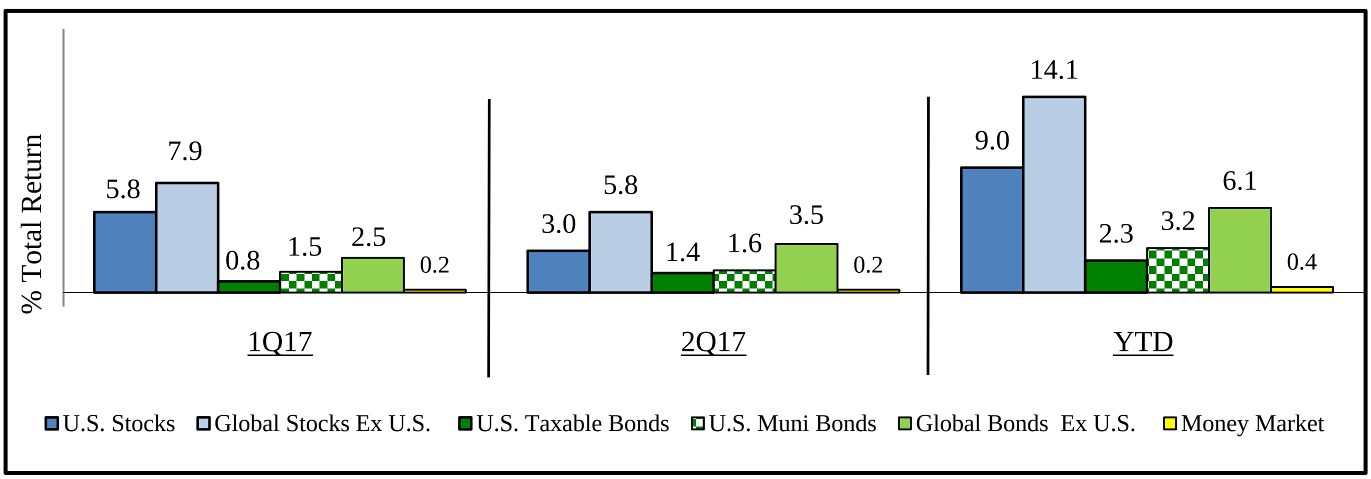
The production and delivery of our *SIA Perspectives* each quarter is an effort to engage Clients and to help them learn more about our time-tested, disciplined and successful investment strategies.

What Has Happened in 2017?

Our last *SIA Perspectives* detailed the “shockingly” good financial market returns for the 1st quarter. These returns proved many pundits wrong who early in the year warned of “hefty valuations” and “dangers lurking” as interest rates were destined to move higher. We have urged Clients to focus on the benefits of positive economic news, low interest rates and tame inflation and for them to disregard negative headlines like those listed below:

- “What Are the 7 Signs of a Bear Market?” *USA Today 3/7/17*
- “When Should Bulls Pivot into Bears?” *Wall Street Journal 3/10/17*
- “When Is the Next Big Dive?” *USA Today 6/12/17*

By ignoring such headlines, disciplined investors were rewarded again in the 2nd quarter as many stock markets reached new record levels and bonds provided additional sources of gains. In fact, most major stock market benchmarks, and several bond market benchmarks, posted 2nd quarter returns that pushed results for 2017 well-above what one might expect for an entire year!



To judge the positive impacts of SIA’s investment decisions and financial market performance on your portfolio for the 1st and 2nd quarters and to-date in 2017, please review the Portfolio Review mailed with this *Perspectives*. On the page titled Portfolio Overview we indicate how capital appreciation plus income equals the dollar amount of Investment Gain and your Portfolio Return in percentage terms.

Representative benchmarks for all charts are detailed on the last page of this SIA Perspectives.

Why Are Financial Markets Rallying?


"*Running with the Bulls*"

The continued rally in most asset classes – especially a bull run for stocks – has been due to improving global economic trends and earnings data. In addition, central banks around the world have continued to be transparent in their actions to pursue low (and sometimes negative) interest rate policies.

However, according to *Bloomberg News*, during the last four weeks of the 2nd quarter, investors withdrew $15 billion from domestic stock funds and moved an additional $17 billion into taxable bond funds. Why are investors running?

What Happened to Stock Prices?

All stock market benchmarks listed in the table below marched steadily higher during the 2nd quarter with most of the gains earned in April and May. This steady move, combined with 1st quarter gains, generated solid returns for the 1st half of 2017.

U.S. large caps and mid caps have outperformed small caps this year, which is not surprising given that small caps were the clear winners in 2016. Developed international and emerging markets produced back-to-back excellent quarters due to good earnings growth and a weakening U.S. dollar relative to other currencies.

	%Total Return			
2016	**STOCKS**	**1st Qtr**	**2nd Qtr**	**1st Half 2017**
12.0%	Large Cap	6.1%	3.1%	9.3%
13.8	Mid Cap	5.1	2.7	8.0
21.3	Small Cap	2.5	2.5	5.0
1.0	International	7.2	6.1	13.8
11.2	Emerging Mkts	11.4	6.3	18.4

The style box grids of U.S. only benchmarks shown below illustrate the powerful switch in performance from 2016, when small cap reigned, to 2017's best performing large cap growth segment. A rebound in the growth style across the grid reflected expectations for continued slow and steady economic growth.

2016

	Value	Blend	Growth
Large	17.3%	12.0%	7.1%
Mid	20.0%	13.8%	7.3%
Small	31.7%	21.3%	11.3%

1st Half 2017

	Value	Blend	Growth
Large	4.7%	9.3%	14.0%
Mid	5.2%	8.0%	11.4%
Small	0.5%	5.0%	10.0%

Indicates worst performer

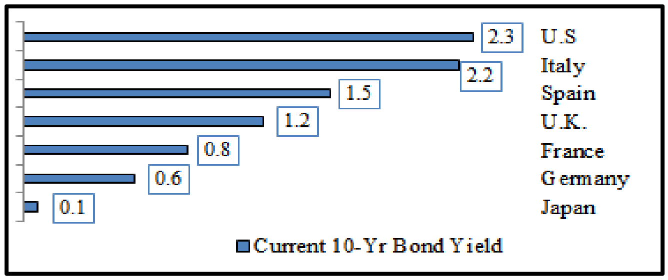
Indicates best performer

What Happened to Bond Prices?

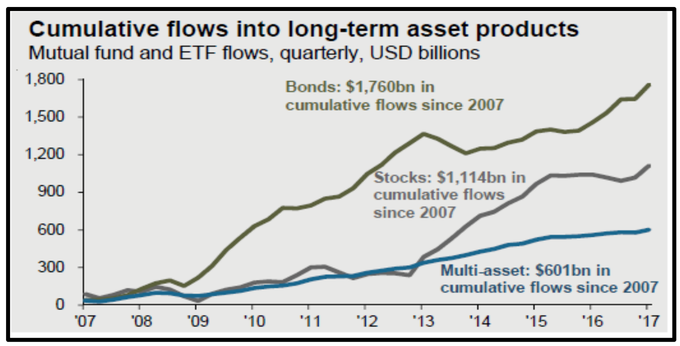
Data released during the 2nd quarter indicated that U.S. economic growth was better than initially reported for the 1st quarter. In addition, consumer spending is healthy and business confidence surveys suggest improvements in capital spending. Meanwhile, inflation has cooled off slightly in recent months and hovers near the Federal Reserve's (Fed) target of 2%.

These readings have allowed the Fed to stick to its plan for 2017, which included another 0.25% rate hike in June and indicated one more rate hike this year. They also published a plan for reducing their balance sheet to be executed by year-end. These decisions were well-communicated by the Fed and did not surprise investors.

The bar chart to the right shows the yields being offered by various countries for an investment in 10-year government bonds. Note that many offerings are well-below the 2% goals for inflation.



Despite these low yields, a cumulative flow into bond mutual funds and exchange traded funds (ETFs) picked up significantly in the past year and is highlighted in the line chart to the right.



The flow of monies into bonds has happened as U.S. stock prices climbed to high levels that are seen as unsustainable by many as healthcare reform, tax reform, infrastructure spending and other pro-business policies have failed to materialize in the U.S.

In turn, the demand from investors for bonds pushed prices higher, leading to solid gains in the first half of the year for benchmarks listed in the table below:

2016	BONDS & MONEY MARKET	%Total Return 1st Qtr	%Total Return 2nd Qtr	1st Half 2017
2.6%	Taxable U.S.	0.8%	1.4%	2.3%
1.5	Taxable Global-ex U.S.	2.5	3.5	6.1
0.0	Municipal Intermediate	1.5	1.6	3.2
17.1	High Yield	2.7	2.2	4.9
0.3	Money Market	0.2	0.2	0.4

How Does Recent Performance Impact Investment Strategies?

In the 1st quarter *SIA Perspectives* we mentioned that our bond model strategy was under review due to stellar outperformance from several of our managers. Throughout the 2nd quarter, SIA's Investment Committee researched and debated potential adjustments to this model, especially since our global bond fund's one-year 12% return beat our U.S. bond benchmark's slight loss of 0.3%. As a result of our review, we decided to eliminate this position during the 3rd quarter and rebalance proceeds into the other bond funds in our model. This move will decrease our exposure in areas with heightened geopolitical risk, increase exposures to higher U.S. based yields and lessen the duration bet we had in place.

What is Our Role as Investment Consultants?

Last quarter's *SIA Perspectives* introduced to Clients our seven value-added practices and announced that throughout the next two years we will highlight one specific practice each quarter. As a reminder, these are our seven value-added practices:

1. Asset Allocation
2. Asset Location
3. Rebalancing
4. <u>Behavioral Coaching</u>
5. Total Return Versus Income Investing
6. Cost Effective Implementation
7. Withdrawal and Savings Rates

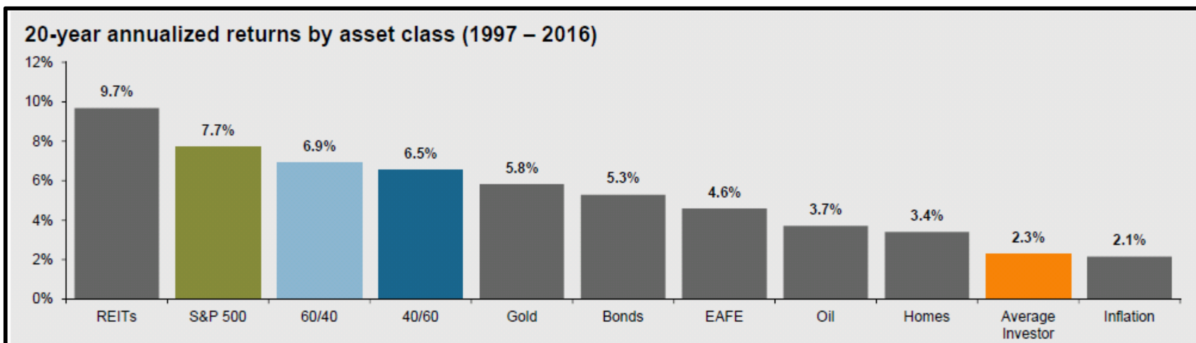
This *SIA Perspectives* begins the process of sharing the details of SIA's framework. "Behavioral Coaching" was selected as the first practice to explain due to the increased level of investor anxiety regarding record highs for stock market benchmarks and potential stresses on bond markets dealing with higher interest rates.

What is Behavioral Coaching?

Because investing evokes emotions, SIA assists Clients in maintaining a long-term perspective and disciplined approach. Investors are aware of these time-tested principles, but the hardest part of investing is sticking with the plan during the best and worst times. A common question being asked by Clients currently regarding the rally in stocks is not "aren't we fortunate to have maintained our disciplined investment strategy?" but instead the anxious question of "when will it end?"

As part of our coaching strategy, we often offer historic analyses proving that running away from a planned investment strategy can be costly. The biggest derailers to long-term success are behavioral – the allure of guessing the direction of the markets and the temptation of chasing performance. The chart below is one we often share with Clients to maintain our investment discipline. It indicates that over the past 20 years:

- the average investor has earned a return that just meets the rate of inflation, indicating very poor timing of buying and selling decisions.
- stocks are the best investment long-term as measured by the returns of REITs and the S&P 500.
- a 60% allocation to stocks and a 40% allocation to bonds has generated an annualized return of almost 7% which would be supportive of a 4-5% withdrawal rate + 2-3% inflation rate.
- international stocks have lagged U.S. based investments. However, as noted earlier, investor sentiment can shift quickly and powerful returns can be earned overseas too.
- home prices have generally kept ahead of inflation but below the return of bonds.

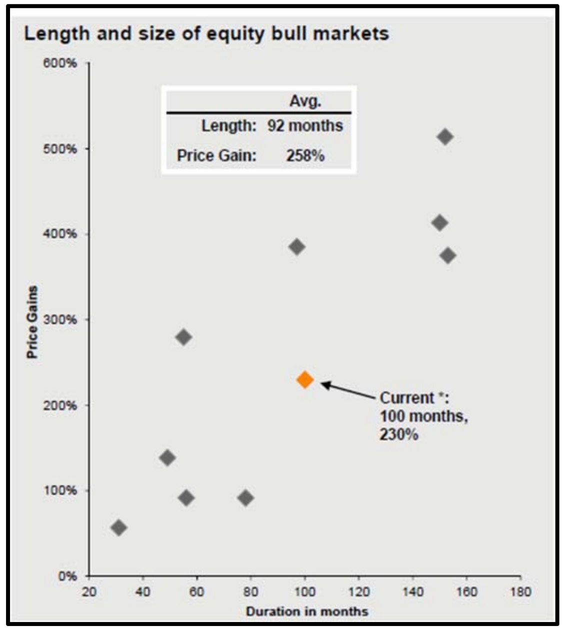


Source: J.P. Morgan Asset Management; (Top) Barclays, FactSet, Standard & Poor's; (Bottom) Dalbar Inc.
Indexes used are as follows: REITS: NAREIT Equity REIT Index, EAFE: MSCI EAFE, Oil: WTI Index, Bonds: Barclays U.S. Aggregate Index, Homes: median sale price of existing single-family homes, Gold: USD/troy oz, Inflation: CPI. 60/40: A balanced portfolio with 60% invested in S&P 500 Index and 40% invested in high quality U.S. fixed income, represented by the Barclays U.S. Aggregate Index. The portfolio is rebalanced annually. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and represent the 20-year period ending 12/31/16 to match Dalbar's most recent analysis.
Guide to the Markets – U.S. Data are as of June 30, 2017.

J.P.Morgan Asset Management

Another form of our coaching is to address issues in advance of Client concerns. For example, the current length in months and the price gain of the U.S. stock market is cited as a reason why stocks must decline. This scatterplot chart measures the price level of the S&P 500 compared to past bull markets. Our analysis indicates that even though this rally may be longer than the average 92 months, the price gain is actually less than historic averages.

> "A lot of people with high IQs are terrible investors because they've got terrible temperaments. You need to keep raw irrational emotion under control."
>
> Charles Munger
> Vice-Chairman, Berkshire Hathaway

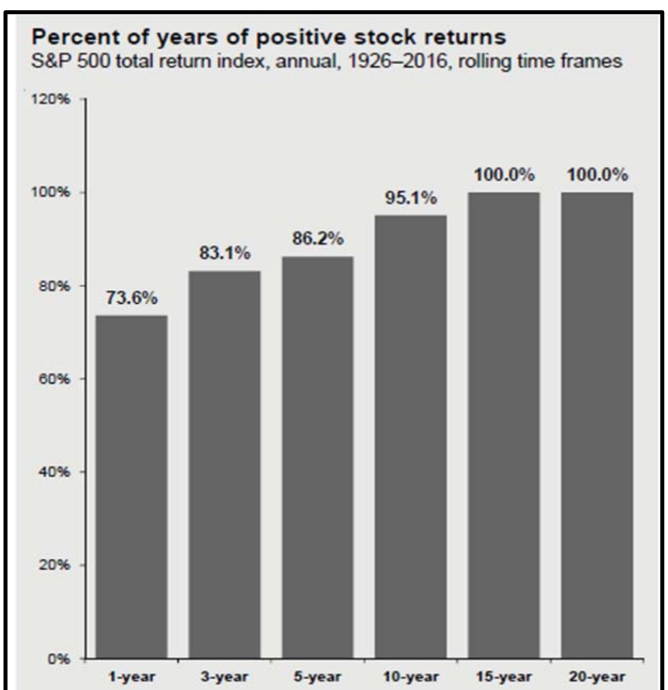


In summary, our behavioral coaching practice includes providing Clients with historical and current perspectives which can be most helpful to maintain discipline in both the best and worst times of financial market performance.

What Are Potential Warning Signs for Financial Market Volatility?

"Investors, Stop Worrying About Why 'Nobody' Is Worrying" *7/21/17 Wall Street Journal*

The healthcare reform bill is stalled, tax reform is questionable, global alliances are fraying, but stock markets continue to set record highs. By some measures market volatility is less than at any time since 1993. While no market rally can last forever, the current calm in financial markets is reasonable due to a lack of traditional worry signals such as extreme investor optimism, an overly aggressive Fed, recession risk due to weakening economic data, top performing stocks declining, a narrowing of the range of stock market winners and/or falling consumer confidence.



Source: Ibbotson, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management. *Guide to the Markets – U.S.* Data are as of June 30, 2017.

Until many of these signals surface, stock markets will provide a much greater opportunity for long-term investors than the current low yields offered from most bonds.

This bar graph to the left is an excellent reminder that stocks generally provide positive returns over long-term periods despite inevitable pullbacks.

Meanwhile, allocations to bonds as part of an investment strategy are designed to outpace the rate of inflation and to cushion portfolios during periods of stock market downturns.

Behind the Scenes at SIA

SIA is guided by a key principle to enhance and improve our investment consulting services. In 2017 we have implemented several key initiatives towards this goal by:

- Creating an environment where our nine Associates can learn, mentor and grow professionally and personally.
- Expanding our investment and industry knowledge through in-person and off-site meetings with representatives from JPMorgan, T. Rowe Price, PIMCO, American Beacon, Longleaf Partners, Baird, Harding Loevner, Lord Abbett, Templeton, Westwood, Goldman Sachs, Vanguard and Artisan.
- Enhancing our breadth of client services by meeting with other registered investment advisors at conferences conducted by Morningstar, JPMorgan and Vanguard.
- Accepting an invitation from the Vanguard Group for Beth Peabody to serve as a member of a newly formed Registered Investment Advisory Council. Beth was one of eleven people selected nationally to provide guidance to Vanguard in their commitment to serve the RIA community.
- Communicating with Clients about potential cybersecurity threats and insuring that our systems are capable of warding off any such intrusions.

Reviewing Enclosed Reports

Please take time to review performance as mentioned earlier and also to review your portfolio's allocation to stocks, bonds, money markets and other asset classes as of June 30, 2017 as indicated by the Portfolio Overview's pie chart. The pages after this are the Portfolio Holdings which lists each of your investments, the current market value and percentage weight in the portfolio.

We take pride in the trust you have placed with us and strive to continue to build your confidence in our investment strategies and our talented Associates.

Thank you for sharing our story with family and friends who also might benefit from our investment consulting services.

Best wishes for a safe and happy summer.

*****Benchmark Indexes used in this SIA Perspective include****: Dow Jones Total US Stock Market Index, MSCI ACWI- ex US, Bloomberg Barclays US Aggregate Bond, Global Ex-US and Municipal Bond Index and US Corporate High Yield, US Treasury Bill Index, S&P 500 Index, Russell Mid Cap and Small Cap Index, MSCI EAFE and EM Index.*