Veratis ADVISORS

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Quarterly Commentary

At Veratis, we are passionate educators and we believe the contents of this newsletter are helpful in providing a high level summary of the stock and bond markets on a quarterly basis. However, it is important that investors refrain from market timing as this can have a potentially negative impact on one's long-term wealth accumulation. With this said, investors should continue to make allocation decisions based on their unique time horizon and risk tolerances. All references to the charts herein are reflected on page 3 of the newsletter.

U.S. Economy

- The U.S. economy continued to expand at a moderate pace. 1st and 2nd quarter GDP were revised upward to an annual 1.2% and 3.1% rate, respectively. Both quarters in 2017 have been stronger than last year and the expectation for 3rd quarter GDP, according to the Federal Reserve Bank of Atlanta, is 2.5% (see Chart 1).
- Key metrics in the underlying economy have continued to show signs of strength since midyear. In particular, manufacturing readings were tied for the highest level since 2011 and the unemployment rate has fallen to 4.2% as of the end of the 3rd quarter.
- The Federal Reserve's target for inflation has not been met thus far in 2017. However, while inflation data has been more muted, it appears as though this is on an upward trajectory.
- The U.S. dollar has continued to weaken throughout the course of the year, although we have seen a slight rebound in recent weeks (see Chart 2).
- Oil prices declined significantly in the first six months of 2017, but they have since rebounded due to 1) a weaker U.S. dollar, 2) a pickup in economic growth, and 3) lower inventories (see Chart 3).

U.S. Stocks

- The U.S. equity market continues to advance, which led to even tighter valuations. However, while stocks as a whole are more fully valued, higher prices may be justified if earnings growth continues.
- The gap between growth and value has widened since midyear. The Russell 3000 Growth Index is now beating its value counterpart by 12.7%, which is up from 9.4% at midyear.
- Small cap stocks have started to make a comeback. The gap between large and small caps was 4.3% at midyear, but the difference has converged to 3.2%. In addition, micro caps are now outperforming small caps by a narrow margin.
- There is still a wide deviation among sectors. The difference between the best (Technology) and worst (Energy) sector is 33.8%. Technology, Basic Materials, Financials, and Energy stocks have been the strongest performers since midyear, while Consumer Defensive, Real Estate, and Consumer Cyclical stocks have been the weakest performers.

(Continued on page 2)

Benchmark Performance	Sector	Quarter	YTD	1-Year Average	3-Year Average	5-Year Average	10-Year Average
Index : Russell 3000 TR USD	Total US Stock	4.57	13.91	18.71	10.74	14.23	7.57
Index: S&P 500 TR USD	Large Blend	4.48	14.24	18.61	10.81	14.22	7.44
Index: Russell 2000 TR USD	Small Cap Stock	5.67	10.94	20.74	12.18	13.79	7.85
Index: MSCI ACWI Ex-US IMI NR USD	Total Foreign Stock	6.27	21.47	19.55	5.16	7.32	1.59
Index: Barclays Aggregate Bond TR USD	Bond	0.85	3.14	0.07	2.71	2.06	4.27
Index: US Treasury Bill 3-Month	Stable Value	0.27	0.66	0.77	0.35	0.23	0.40

Data Source: Morningstar September 30, 2017;

U.S. Bonds

- The Federal Reserve indicated that they will begin to unwind their $4.5 trillion balance sheet in October of this year. Moving forward, they are planning to reduce their holdings by $10 billion/ month this quarter and increase the increment by an additional $10 billion per quarter up to $50 billion.
- In their latest meeting, the Fed voted to leave their target for interest rates at 1.00% to 1.25%, but expected that one more rate hike will occur in 2017 and three will occur in 2018.
- Amid a persistent low interest rate environment, the demand for riskier sectors in fixed income remains high, which has contributed to strong performance within Corporate bonds (specifically High-Yield). On the other hand, high-quality Treasury Inflation Protected Securities (TIPS) and U.S. Treasuries have been negatively impacted as inflation has been muted and investors have sought higher-yielding fare. This has generally been the case since the Financial Crisis (see Chart 4).

Foreign Economies

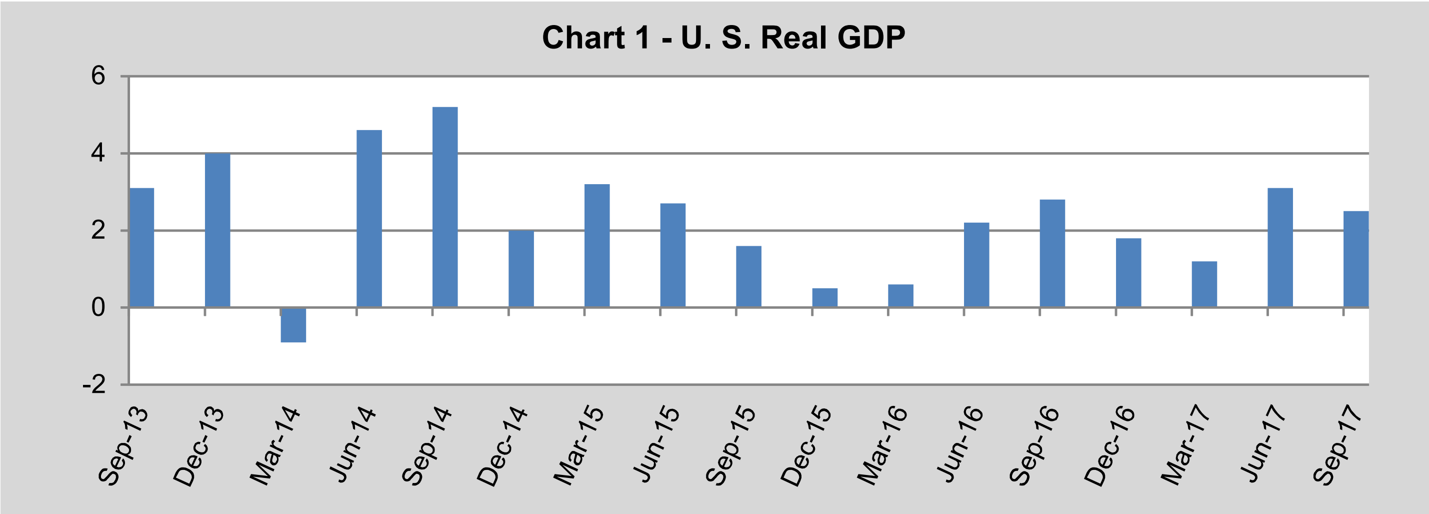
- Foreign economies continue to show signs of improvement in several key metrics. Alongside strong data in the U.S., it appears as though we may be in the midst of the most synchronized global recovery in years.
- According to the Global Purchasing Managers' Index (PMI), manufacturing around the globe is healthy. No individual country received a score below 50 in September (a reading above 50 indicates expansion, while a reading below 50 indicates a contraction).
- With regards to the European workforce, the unemployment rate has fallen from its peak of 12.1% midyear 2013 to 9.1% most recently. Japan has also been a bright spot as their unemployment has been steadily declining since 2010 and has now fallen to 2.8%. A rebound in economic growth has been a key driver behind these results as European economies are expanding slowly and Japanese GDP is above its 20-year average.
- As China has continued to transition from an economy driven by government investment to one driven by the consumer, it seems as though this is occurring without any major disruptions to growth.

Foreign Stocks

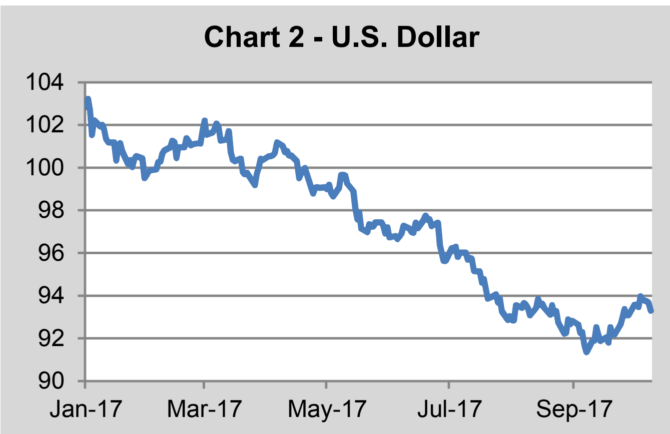
- While U.S. and Japanese corporate earnings are at all-time highs, European and Emerging Markets earnings are still well below their peak, which could bode well for these regions since stock valuations are more attractive on a relative basis.
- Foreign stock outperformance has widened versus domestic stocks since the 1st half. The MSCI ACWI ex-U.S. Index is up 21.5%, which is 7.6% ahead of the Russell 3000 Index - up from a 5.4% difference at 6/30. This has helped to narrow the gap between domestic and foreign stock performance since 2010 (see Chart 5).
- Little has changed since midyear within the foreign equity markets. Smaller cap stocks are outperforming large cap stocks by 2.7% and growth is outperforming value by 6.5%, compared to 1.8% and 5.8% at midyear, respectively.
- Emerging Markets (EM) have also continued to advance strongly with a 27.1% gain through the end of the 3rd quarter. The performance gap between EM and Developed Market stocks has widened to 6.4%.

Foreign Bonds

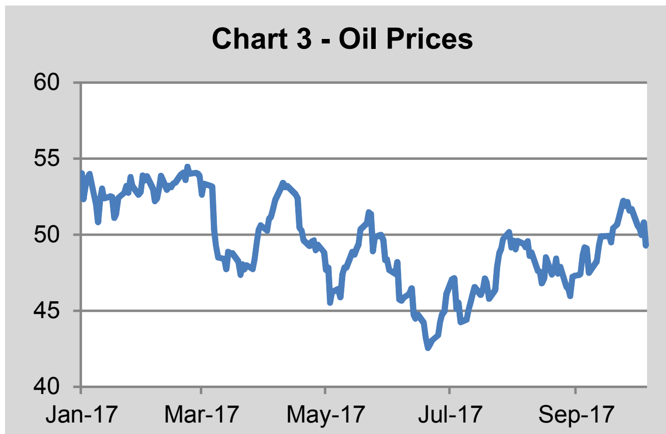
- As economic data continue to gradually improve, there is increasing discussion that foreign central banks will start to normalize monetary policy and taper their stimulative efforts. However, given the fragile state of many foreign economies, there is a high likelihood that these measures will be gradual (if any).
- Foreign bonds continue to outpace domestic bonds by a wide margin, and the degree to which they are outperforming has widened since midyear. The Bloomberg Barclays Global Aggregate ex-U.S. Index is 5.6% ahead of the domestic Bloomberg Barclays U.S. Aggregate Bond Index as of the end of the 3rd quarter.
- Within fixed income abroad, Emerging Markets bonds continue to be the top-performing sector as the demand for risk assets continues to remain strong. This has generally been the case since the Financial Crisis. The gap in performance between varying bond sectors can be found in Chart 4.



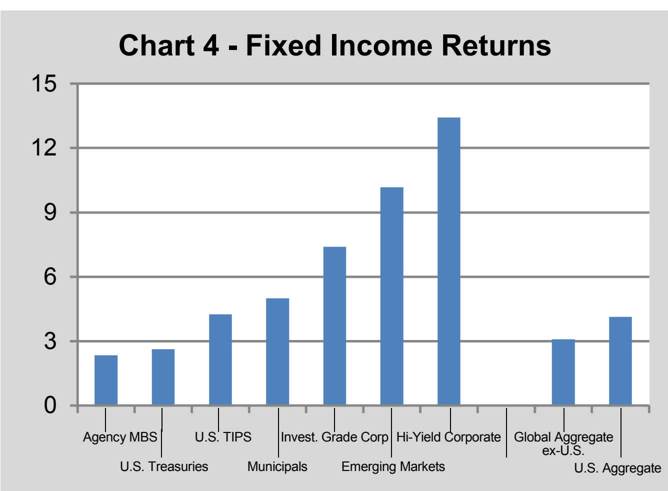
Source: U.S. Bureau of Economic Analysis. Represents seasonally adjusted annual rates.



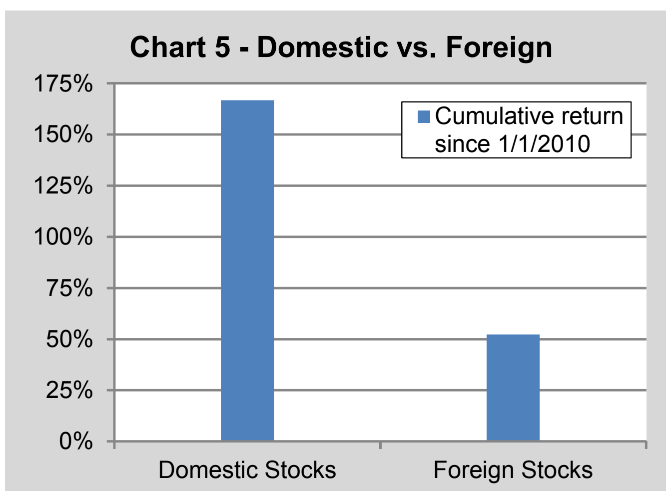
Source: CNBC. Represents the data from the DXY U.S. Dollar Currency Index.



Source: CNBC. Represents West Texas Intermediate (WTI) oil price data.



Source: Morningstar Direct. Represents annualized fixed income returns by sector, as well as the broad domestic and foreign bond markets, since the market bottom on March 9, 2009.



Source: Morningstar Direct. Represents the cumulative returns for the broad domestic and foreign stock markets since January 1, 2010.

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