CLEAR CREEK ADVISORS

ECLIPSED REALITY?

Market Review **SEPTEMBER 2017**

The world's most influential policymakers recently held their annual conference under a perfect solar eclipse in Jackson Hole, Wyoming. Synonymous to the perfect blockage of sunlight by the eclipse, the final speeches that came after the monetary symposium kept financial market participants and economists in the dark.

The Federal Reserve's Chairwoman provided no clues for the next interest rate increase and no clarity for how the Fed is going to unwind a 4.5 trillion-dollar balance sheet. Likewise, the President of the European Central Bank provided no timetable as to when the investing community can expect Europe's own quantitative easing to stall.

Without any new information to update prior beliefs, it was back to business as usual for the investing public. The Euro currency made a quick rebound on the US dollar reversing some small losses prior to the Jackson Hole conference. The Euro has gained 15% against the US dollar since the beginning of the year.

Interest rate differentials help to explain a small part of the Euro's strength. For example, the year began with a twelve-month yield-spread between the US dollar and Euro of 1.78% (measured by the USD LIBOR and EURO LIBOR). The bank rates on US dollars are higher than rates on Euros. The concept of a 'Carry Trade' is when investors attempt to earn the yield-spread by borrowing lower-yielding currencies (Euros) and lending higher-yielding currencies (US dollars). In theory, the Euro must appreciate by an equal amount of the yield-spread. Otherwise, traders are practically able to earn a riskless profit without contributing any of their own capital should the Euro not appreciate.

Reality has so far surpassed theory. Undoubtedly, US investors who took on European stock bets at the beginning of the year are quite comfortable with reality. Take a broad basket of European stocks that has made capital gains of about 4.6% this year. That may seem like only a fraction of the 8.4% capital gains made by a broad basket of US stocks, but when combined with the currency gains, total capital gains on European stocks are nearly 20%.

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Today, the differential between the USD LIBOR and EURO LIBOR is even wider. Perhaps those sophisticated traders who can take advantage of the yield-spread are providing further strength to the Euro. Even ordinary investors have already observed this trend and are jumping on board with the European carry trade.

Sentiment for Eurozone stocks has certainly improved in 2017. During the first 4 months of this year, Exchange Trade Funds (ETFs) tracking European stock performance recorded inflows of EUR3.7 billion (USD4.1 billion) opposed to the outflows of EUR11.5 billion (USD12.8 billions) in the first 11 months of last year (sourced by etfexpress.com). Although ETFs only account for a tiny portion of the total wealth invested in European stock markets, investors accessing European equities by ETFs and other methods have pushed up the price-to-earnings multiple (trailing 12-month earnings) to 18.2 times from a one-year ago multiple of 16.6 times.

The behavior of fiat currency like the Euro is noticeably different after the global recession of 2008. For instance, private credit and the money supply in the Eurozone practically grew at near equal rates of 7% in the 8 years leading up to the 2008 recession. After Europe's 2012 recession, however, private credit expansion has averaged 1.2%-to-2.0% per year while the money supply has grown at an average annual rate of 4.4%.

There are more challenges facing the Eurozone's full recovery besides orchestrated monetary policies. Ailing economies and weak financial centers are two examples of this. Now that the European Central Bank's balance sheet is roughly the size of Japan's total annual output (USD5 trillion), investors have to wonder where the visible effects of unconventional monetary policy will show up next apart from financial markets.

Market Movers

The price of gold broke some critical price resistance points and set a new high for the year. It is interesting and somewhat ironic that the new annual high set for gold coincided with meeting of central bankers in Jackson Hole. It is possible that investors are reevaluating physical assets as a mechanism to store their wealth. Our diversified Core Allocation portfolios strive to perform and protect when the tides of financial markets begin to change. Year-to-date, the Core Allocation strategies continue to outperform their respective benchmarks: the Morningstar's World Allocation and Tactical Allocation category averages. The investment team has and will continue to follow the monetary policy story closely. Overall, we expect current interest rate policies set forth by global central banks to remain accommodative to stocks and bonds. Nevertheless, our use of hard assets and other diversifying, specialty investments continues to add value to our investors.

Asset Categories	*Monthly*	*YTD*
US STOCKS	-0.95%	6.25%
FOREIGN STOCKS	1.08%	22.09%
US BONDS	0.38%	3.33%
FOREIGN BONDS	1.08%	7.72%
HARD ASSETS	1.57%	3.51%
HYBRIDS	-0.03%	8.54%

*DATA USED IS SOURCED FROM MORNINGSTAR®

US STOCKS were weighed down by Small Caps (IJR) and Mid-Caps (IJH). Both Small and Mid-Caps peeled back over a percent of their prior month's returns. Large Caps (IVV) barley etched out a gain, but were up nonetheless. Our Large Cap Growth (VUG) bias allowed the Core Allocation portfolios to produce a small gain in the US stock space despite a loss shown for the category average.

FOREIGN STOCKS had another month of spectacular performance. Most of the category's gains came from Emerging stocks (VWO). Emerging stocks are up over 25% this year. The Core Allocation portfolios have been positioned all year to capture this incredible performance. We expect the trend to continue for Emerging stocks for a variety of reasons and will retain our increased allocation to this region.

US BONDS sold off risk and bought into safety last month. High Yield Bonds (JNK) and Bank Loans (BKLN) posted small losses while Government Bonds (VGIT) and Corporate Bonds (VCIT) put up small gains. Recent trading gains and losses inside the US Bond category have been rather insignificant. Perhaps US bonds have reached a point of equilibrium until macro conditions are set to change.

FOREIGN BONDS had another good month of positive gains. Again, the story is all about Emerging Markets. Emerging Bonds (PCY) offer an excellent yield pick-up trade and diversification benefits. Our decision to bias our Foreign Bond holdings towards Emerging Bonds has paid off handsomely for the Core Allocation portfolios.

HARD ASSETS had a strong month. Precious Metals (IAU) made healthy advances resulting in year-to-date gains of 12%. Energy posted a positive return reversing some of its recent losses. Our positions in the Core Allocation portfolios have participated in the gains of Precious Metals and limited the recent losses in Energy by our use of Master Limited Partnerships (AMJ).

HYBRIDS closed last month relatively unchanged. For the full year, our allocations to Convertible Debt (CWB) and Variable Preferred Stock (VRP) has added tremendous value to the Core Allocation portfolios. Both asset classes have earned attractive year-to-date returns with minimal price volatility. We expect our allocations to Hybrids to remain a significant yield enhancer and diversifier in the Core Allocation portfolios.