KEYES & ASSOCIATES, INC.

Chris Keyes, CFP®
Financial Planner

121 Spruce Ave
Fairbanks, AK 99709-4150
Phone: 907-452-6393
AK Only Toll Free: 800-478-6393
Fax: 907-452-1600
chris.keyes@LFG.com

www.lfa-fairbanks.com

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Dear Valued Client,

As 2017 began, investors sized up the year ahead. As usual, the picture was unclear. While financial markets had performed well over the past few years, the recovery had been uneven and often beset by macro-economic and geopolitical events. Given the amount of economic stimulus in the economy, many feared a return of inflation. A polarized electorate, political intrigue, and a pending White House regime change added to the uncertainty.

Given this level of apprehension, many analysts had expectations of large price swings and a flat or sideways market. *The Wall Street Journal* quoted analysts at two of the largest investment banks. While they differed a bit as to the movements throughout the year, both agreed that the S&P 500 would end 2017 at 2,300. Before dividends, that would represent a scant 2.7 % return for 2017. However, it wouldn't turn out as the analysts expected.

% Return as of 12/31/2017

Equity Indexes	**4th Q**	**1 Yr**	**3 Yr**
S&P 500	6.6	21.8	11.4
Russell 2500	5.2	16.8	10.1
MSCI EAFE	4.2	25.0	7.8
Emerging Market	7.4	37.3	9.1
Wilshire REIT	1.7	4.2	5.2
Bond Indexes			
TIPS	1.3	3.0	2.1
Aggregate	0.4	3.5	2.2
Governments	0.0	2.3	1.4
Mortgages	0.2	2.5	1.9
Investment Corporate	1.2	6.4	3.9
Long Corporate	3.3	12.1	5.9
Corporate High-Yield	0.5	7.5	6.4
Municipals	0.7	5.4	3.0
Cash Equivalents			
3-Month T-Bill	0.3	0.8	0.4
Consumer Price Index	1.0	2.2	1.5

As we have noted before, distrust of the political system is not an investment strategy. What drives the market is often corporate earnings growth. While the political posturing continued, corporate earnings increased the most since 2011. Rather than a sideways market, the S&P 500 would rise dramatically; turning in a total return of 21.8%, which is the largest increase since 2013. Notably, these gains were achieved with significantly lower volatility than average. In 2015, the Dow Jones Industrial Average experienced 89 days during which the index moved more than 1% in either direction. In 2017, moves of 1% or more occurred on only 10 days.

All of this reminds us of a well-known quote from a college commencement address. *"Accept certain inalienable truths: Prices will rise. Politicians will philander. You, too, will get old. And when you do, you'll fantasize that when you were young, prices were reasonable, politicians were noble, and children respected their elders."* We will continue to use the truths we know to construct portfolios that account for the unique circumstances and risk tolerances of our clients. We prefer that to short-term forecasting.

Domestic Equities: As noted above, it was a banner year for U.S. equities with the S&P 500 jumping to a 21.8% return. The advance was broad: Of the 11 sectors in the S&P 500, nine were positive for the year. Only telecom services and energy showed losses, although those were a modest decrease of less than 2%. While large stocks were the clear winners, smaller caps also turned in impressive gains. The Russell 2500, an index representing smaller stocks, rose 16.8% for the year.

Fixed-Income: Many believed that when the Fed finally began to raise interest rates, bond prices would fall precipitously. 2017 was the year that belief would be put to the test. The Fed raised rates in March and would increase rates twice more throughout the year. The Barclays Aggregate Bond Index, which reflects the total U.S. bond market, defied the predictions by actually rising 3.5% for the year. Despite the possibility of lower federal tax rates, the Municipal Index did even better, rising 5.4%.

International Equities: After several years of underperforming U.S. equities, many investors were ready to abandon international equities. Economies in Europe and Asia had been slower to recover from the challenges of the previous recession. Europe was also dogged by uncertainties associated with the U.K.'s withdrawal from the European Union. As with all investments, valuations matter. As an asset class gets cheaper and cheaper in relation to other securities, the spring often gets more and more compressed. When prices revert to the mean, the movements can be dramatic. This was the case with international stocks in 2017. The Developed Markets stocks increased 25.0% for the year, while the Emerging Markets Index soared to a 37.3% gain.

It is gratifying to see investors' discipline rewarded. The returns we have seen over the past few years are more than just money. They can mean security and confidence in your family's future. Unfortunately, not everyone participated. EPFR Global, a firm that tracks investment flow and allocation data, estimated that retail investors withdrew a net $600 billion from equity investments since 2012 despite more than a 100% increase in the S&P 500 since that time. It is likely that a memory of the financial crisis, combined with the Ebola scare, Brexit, and other headlines, contributed to this behavior.

The disparity between market returns and investor returns shows the power of advice. It is human nature to try to predict the short term and avoid loss. It takes discipline, mathematics, and knowledge of goals to act appropriately.

2018 will likely have its share of unique problems and opportunities. We will be here to help.

Sincerely,

Chris Keyes, CFP®