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## Third Quarter 2017

Enclosed are your Portfolio Statement, showing your portfolio's holdings and asset allocation, Performance Analysis, displaying investment returns for your portfolio, and Statement of Management Fees for the fourth quarter of 2017.

We would like to welcome Linda Gilles, Bernard Wealth Management's new Client Service Manager. Linda has extensive experience in the financial services industry, working in a variety of roles including financial planning, operations, trading and compliance. She is responsible for providing excellent client service, and for improving our firm's technology and systems.

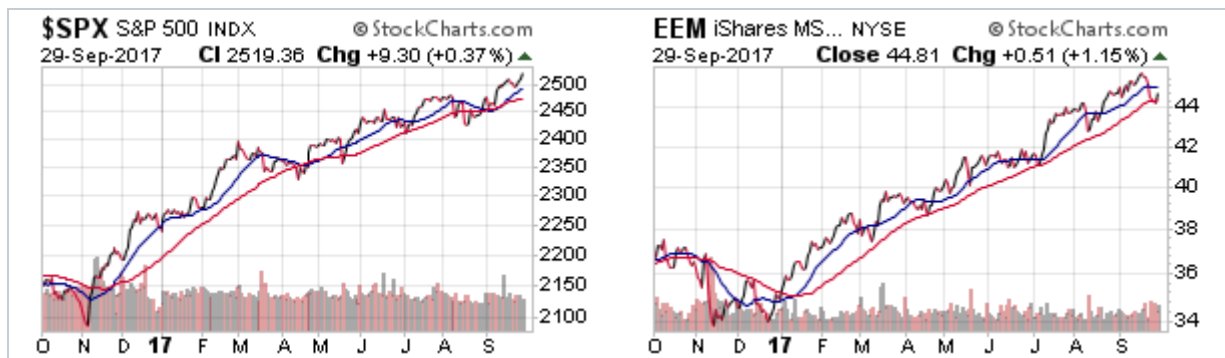


Fig. 1 – S&P 500

Fig. 2 – iShares Emerging Markets Index

Stocks moved higher again in the third quarter. The large cap S&P 500 index (**Figure 1**) posted a total return of +4.5%, and is now up +14.2% for the year. Smaller companies outperformed for the first time this year, with the Russell 2000 Small Cap index gaining 5.7%. International stocks continued their leadership. MSCI's emerging market index rose +7.0%, while developed economies outside the U.S. (Europe, Japan, Australia ...) were up +5.4%.

Earnings growth for S&P 500 companies in the second quarter slowed to +11.1% after a very strong jump of +13.1% in the first quarter. According to Factset, 73% of reporting companies topped analyst earnings estimates. Revenue results were relatively stronger, as 70% of companies beat revenue projections, versus 65% in the prior quarter. The improving revenue picture may be a sign of increasing demand in the economy, which has been tepid for much of this recovery.

S&P 500 earnings are forecast to rise only 3.1% in the coming quarter. Some of this may be lowered expectations following the hurricanes of August and September. Large company earnings are expected to increase 11% in 2018, boosted by strength in cyclical sectors, including transports, industrials and energy. In addition, small cap earnings, after a rough start this year, are expected to accelerate in the fourth quarter and in 2018. This earnings growth is an important factor in helping stocks move higher.

U.S. gross domestic product grew 3.1% in the second quarter, topping expectations of 2.6%, and improving on the first quarter's 1.4% increase. Consumer spending, still about 70% of the U.S. economy, was particularly strong. Economic activity seemed to soften slightly in mid-quarter, but as of this writing, purchasing manager surveys in manufacturing industries signaled acceleration of new orders. Unemployment has remained very low, adding to consumer confidence.

*Index returns taken from Morningstar.com*

Inflation has stayed below the Federal Reserve's target of 2%, supported in part by plentiful crude oil. Consequently, interest rates are likely to increase very slowly, supporting future economic growth.

Outside the U.S., economies continued to improve. Growth forecasts for both developed and emerging countries were increased during the quarter. In addition, the World Trade Organization increased its estimate for trade volume growth in 2017 to +3.6%, from +2.4% in its previous forecast, a substantial jump from the +1.3% logged in 2016. On the negative side, China suffered a credit downgrade, due to concerns over a rapid increase in debt levels. But growth there has increased, and is supported by additional activity throughout East Asia. At the same time, European employment has stabilized, and industrial production increased more than expected. These and other similar developments suggest that stronger global growth will continue into 2018. After lagging the U.S. for most of the past 6 years, foreign markets may continue to post stronger returns (**Figure 2**).

Most sectors posted solid gains in the third quarter. However, financials and industrials (**Figure 3**) displayed relative strength in September. These economically sensitive stocks responded to the late quarter uptick in economic activity, and may have also benefited from more positive talk of corporate tax reform. If economic growth continues to accelerate, even slightly, these sectors may continue to outpace traditional growth sectors like technology, which have been among the strongest performers year-to-date.

As noted above, small cap stocks lagged for much of this year, but outperformed in the third quarter (**Figure 4**). Larger companies, which tend to do more business overseas, were helped earlier by a significant drop in the U.S. dollar, but this decline seems to be abating. A strengthening dollar would be a positive for small caps. Corporate tax reform might also benefit small caps more than large companies, which already tend to pay lower overall tax rates.



**Fig. 3 – Dow Jones Industrial Sector**



**Fig. 4 – Russell 2000 Small Cap Index**

There are many heuristics in the world of investing and trading. One is “Sell in May and go away”, which refers to a perceived softness in stocks during the summer months. Indeed, it is often the case that those months are weaker than the rest of the year. This year, the S&P 500 rose in May, June, July, August and September. This speaks to the difficulty in timing the stock market. Part of our goal is to help clients stay invested in a long-term asset allocation appropriate for their circumstances, and to alter their investment mix as their lives change, rather than in response to noisy headlines. Patient, disciplined U.S. stock investors have clearly benefited from this approach.

We hope to speak with you in the coming quarter, and encourage you to contact us at any time.

Sincerely,

Kenneth M. Bernard, CFA