INVESTMENTNEWSLETTER

“I have found that the importance of having an investment philosophy—one that is robust and that you can stick with— cannot be overstated.”
—David Booth

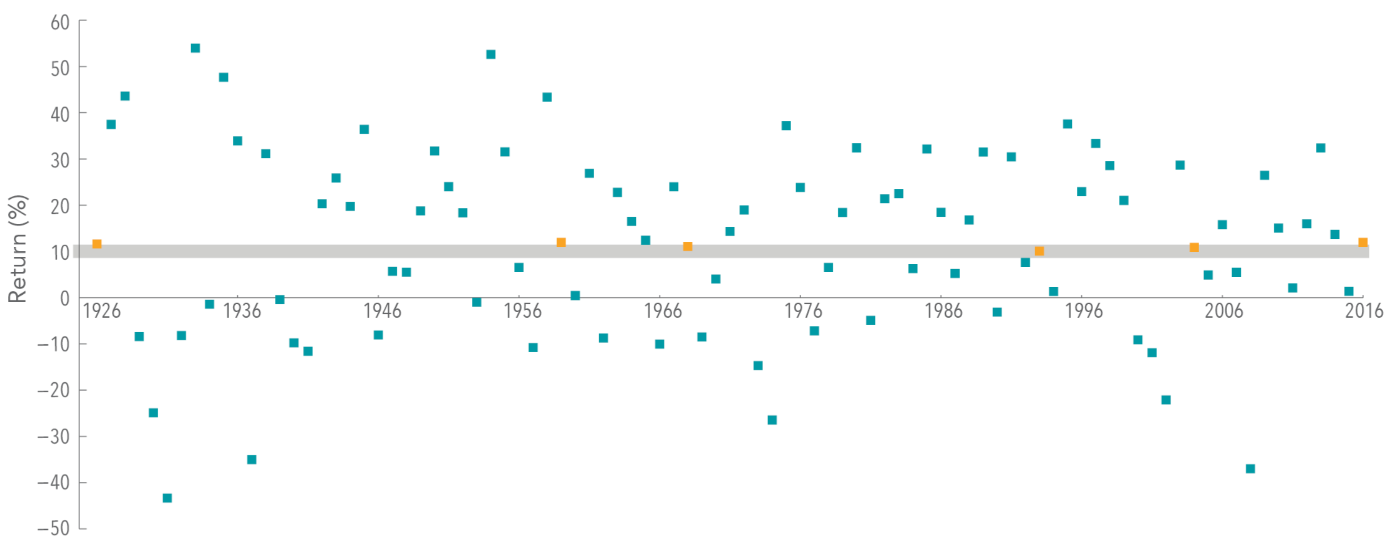
THE UNCOMMON AVERAGE

OCTOBER 2017
Dimensional Fund Advisors

The US stock market has delivered an average annual return of around 10% since 1926.[1] But short-term results may vary, and in any given period stock returns can be positive, negative, or flat. When setting expectations, it’s helpful to see the range of outcomes experienced by investors historically. For example, how often have the stock market’s annual returns actually aligned with its long-term average?

Exhibit 1 shows calendar year returns for the S&P 500 Index since 1926. The shaded band marks the historical average of 10%, plus or minus 2 percentage points. The S&P 500 had a return within this range in only six of the past 91 calendar years. In most years the index’s return was outside of the range, often above or below by a wide margin, with no obvious pattern. For investors, this data highlights the importance of looking beyond average returns and being aware of the range of potential outcomes.

Exhibit 1. S&P 500 Index Annual Returns 1926–2016



In US dollars. The S&P data are provided by Standard & Poor’s Index Services Group. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Index returns do not reflect the cost associated with an actual investment.

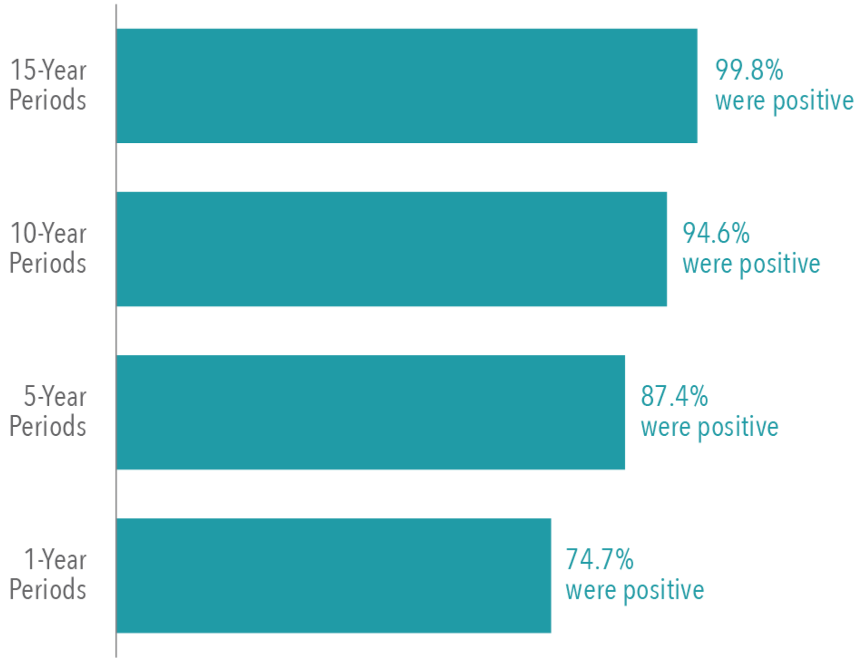
1 As measured by the S&P 500 Index from 1926–2016.

Canandaigua National Bank & Trust

TUNING IN TO DIFFERENT FREQUENCIES

Despite the year-to-year uncertainty, investors can potentially increase their chances of having a positive outcome by maintaining a long-term focus. Exhibit 2 documents the historical frequency of positive returns over rolling periods of one, five, 10, and 15 years in the US market. The data shows that, while positive performance is never assured, investors' odds improve over longer time horizons.

Exhibit 1. Frequency of Positive Returns in the S&P 500 Index
Overlapping Periods: 1926–2016



From January 1926–December 2016 there are 913 overlapping 15-year periods, 973 overlapping 10-year periods, 1,033 overlapping 5-year periods, and 1,081 overlapping 1-year periods. The first period starts in January 1926, the second period starts in February 1926, the third in March 1926, and so on. In US dollars. The S&P data are provided by Standard & Poor's Index Services Group. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not an indication of future results.

CONCLUSION

While some investors might find it easy to stay the course in years with above average returns, periods of disappointing results may test an investor's faith in equity markets. Being aware of the range of potential outcomes can help investors remain disciplined, which in the long term can increase the odds of a successful investment experience. What can help investors endure the ups and downs? While there is no silver bullet, having an understanding of how markets work and trusting market prices are good starting points. An asset allocation that aligns with personal risk tolerances and investment goals is also valuable. Financial advisors can play a critical role in helping investors sort through these and other issues as well as keeping them focused on their long-term goals.

Source: Dimensional Fund Advisors LP.

FOUR TIPS FOR THE RMD SEASON

CHRISTINE BENZ
Morningstar

Complaining about required minimum distribution from retirement accounts might seem a little like grousing that the pool is too crowded in Florida. It may be a nuisance, but it's a high-class problem to have. That's because for the majority of people, RMDs are a non-issue. For affluent retirees, however, RMDs can be unwelcome, shrinking the amount of assets that can enjoy tax-deferred compounding. With the deadline to take required minimum distributions fast approaching—Dec. 31—here are some tips to bear in mind.

1) TAKE THE RIGHT AMOUNT AT THE RIGHT TIME.

If you've just turned 70 1/2 this year then your deadline to take the first withdrawal is April 1st of the following year. Calculating RMDs, meanwhile, is a matter of dividing each of your RMD-subject account balances on Dec. 31 of the previous year by your life-expectancy factor. In most instances you'd use the IRS' Uniform Lifetime table to calculate your RMD. But if your spouse is at least 10 years younger and also the sole beneficiary of your RMD-subject account, you'll use the IRS' Joint Life and Last Survivor Expectancy table (Table II in IRS Publication 590), finding the intersection between your age and your younger spouse's age. That results in a smaller payout than would be the case if you based your RMD on your life expectancy alone. It's also worth noting that you don't need to take RMDs from each and every IRA account. As long as you take the right total from at least one of the accounts, you've met your distribution requirement.

2) LET YOUR YEAR-END CHECK-UP DRIVE WHAT YOU SELL.

Before you actually pull the trigger on your RMDs, conduct a thorough year-end portfolio review, taking stock of your asset allocation. Holdings that look unattractive or are simply consuming too large a share of your portfolio might be at the top of your list to sell to meet RMDs. That can serve the dual goal of potentially improving your portfolio and satisfying the IRS' requirements.

3) ASSESS HOW THEY'LL AFFECT YOUR TAXES.

Even if you don't intend to take your RMD until later in the year, it's still valuable to calculate your RMD as soon as possible. That way, you can take steps to offset the tax impact—with tax-loss selling or accelerating deductions by prepaying property taxes, for example. A tax advisor should be able to help you gauge the impact of your RMDs on your tax bill and may be able to suggest steps you can take to reduce it.

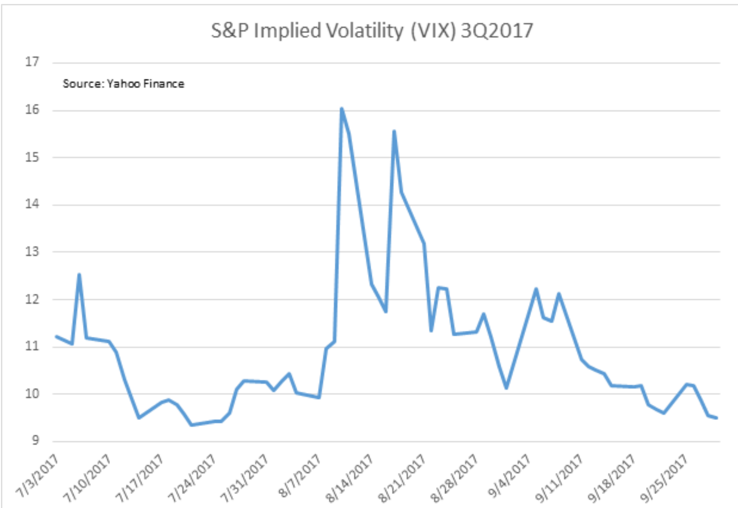
4) CONSIDER A QUALIFIED CHARITABLE DISTRIBUTION.

For the charitably inclined, taking a qualified charitable distribution (QCD) can help kill three birds with one stone. By steering the IRA distribution directly to charity (rather than pulling the money out and then making a charitable contribution which is then deducted), the QCD enables the investor to fulfill the RMD, contribute to charity, and reduce adjusted gross income at the same time. From a tax standpoint, reducing AGI is preferable to taking a 'below-the-line' charitable deduction, because a lower AGI may qualify the taxpayer for credits and deductions. Trouble is, Congress typically hasn't approved the QCD maneuver until the end of the year. But there's no downside in steering distributions directly to charity anyway. If Congress gives the go-ahead for QCDs, the retiree can use the distribution to reduce AGI. In the worst-case scenario, that the QCD provision remains dormant, the retiree could simply deduct the donation, as with a typical charitable contribution.

THIRD QUARTER
PERFORMANCE REVIEW

JAKE HERTZFELD
OBS FINANCIAL

After finishing the first half of the year with gains, markets continued their climb — showing strong advances heading into the final quarter of 2017. At the closing bell for the month of September, major US indices (NASDAQ, S&P 500, and Russell 2000) were at all-time highs. In fact, all-time highs seemed to be a normal occurrence as the DJIA hit this milestone 20 times, while the S&P 500 accomplished this feat 15 times, and the Nasdaq saw 12 highs throughout the quarter. In terms of implied volatility, the VIX started the quarter at levels well below its historical average hitting a low of 9.36 in July before spiking to 16.04 in mid-August amid tensions with North Korea and post-Harvey disaster recovery. By quarter end, it had settled down to levels in the 9-10 range.

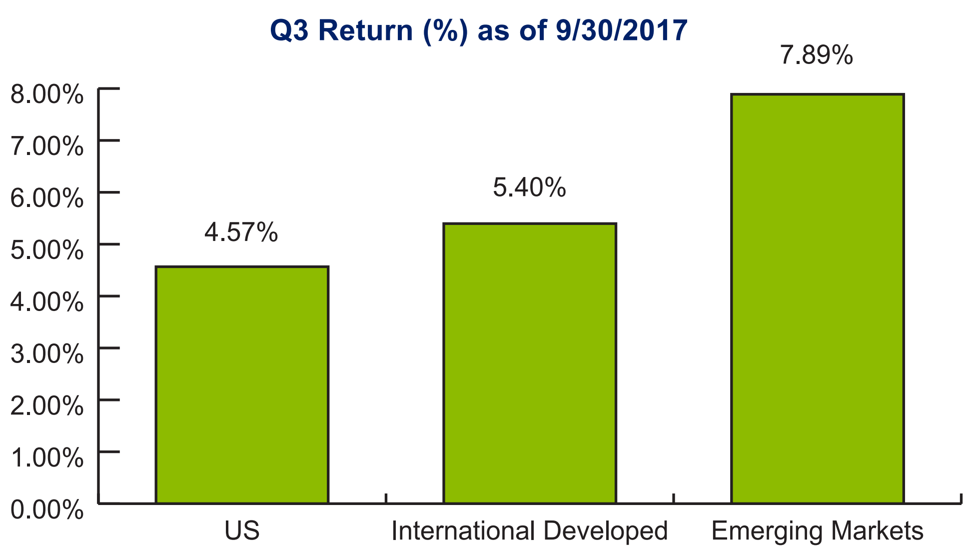


In terms of economic expansion, the US saw stable growth during the second quarter at 3.1%, higher than initial advanced estimates. Early forecasts for the third quarter (GDPNow™) are 2.5% as of 10/26/2017. Post-hurricane impacts likely had a negative impact in certain labor markets as nonfarm payrolls were added in July and August but decreased by 33,000 in September. Overall, despite the aftermath of these extreme weather events, the labor market remains strong as unemployment rates dropped to 4.2% in September.

Earnings remained strong in the second quarter as S&P 500 companies were up 10.3% which is the first time the Index reported 2 consecutive quarters of double-digit earnings growth since Q3 and Q4 of 2011, according to FactSet. Early FactSet reports for earnings in the third quarter look promising as out of the 17% reported, more companies (76%) are reporting actual EPS above estimates compared to the 5-year average. Companies are undoubtedly keeping a watchful eye on corporate tax reform as any news on the progress front will surely be a positive sign for profits. From a valuation perspective, the forward 12-month P/E ratio for the S&P 500 is 17.9, above both the 5-year average (15.6) and the 10-year average (14.1). Interest continues in the Federal Reserve as a new chair will likely be elected and expectations to continue raising rates and reducing its balance sheet may have lasting impacts on this relatively light economic expansion.

Commodities overall experienced a positive quarter as the Blomberg Commodity Index Total Return returned 2.52%, led by energy. Oil prices rose to over $50 per barrel to end the quarter, suggesting that OPECs attempts at production cuts and demand increases may be helping prices rebound.

Capital markets in the US lagged global markets for the third consecutive quarter helped by improving growth prospects, reduced political tension, and a weakening US dollar. Developed markets overseas experienced a gain of 5.42%, measured by the MSCI EAFE Index USD, while Emerging Markets continued their impressive run with a 7.89% gain, measured by the MSCI EM Index USD. US stocks were still positive overall with a 4.57% gain, represented by the Russell 3000.



See Index Representation disclosure at end of document.

Across more stylized asset classes, small-capitalization stocks rallied to outperform their large-capitalization counterparts in both the US and non-US developed markets, but were behind in emerging markets. High book-to-market (value) securities made up some ground relative to low book-to-market (growth) securities at the end of the quarter, but still lagged for the quarter in both the US and emerging countries.

	US	International Developed	Emerging Markets
Small Cap	5.67%	7.45%	5.63%
Large Cap	4.48%	5.21%	8.19%
Difference	1.19%	2.24%	-2.56%
Small Cap Value	5.11%	7.11%	6.48%
Small Cap Growth	6.22%	7.79%	4.79%
Difference	-1.11%	-0.68%	1.69%
Large Cap Value	3.11%	5.93%	5.68%
Large Cap Growth	5.90%	4.41%	10.64%
Difference	-2.78%	1.52%	-4.96%

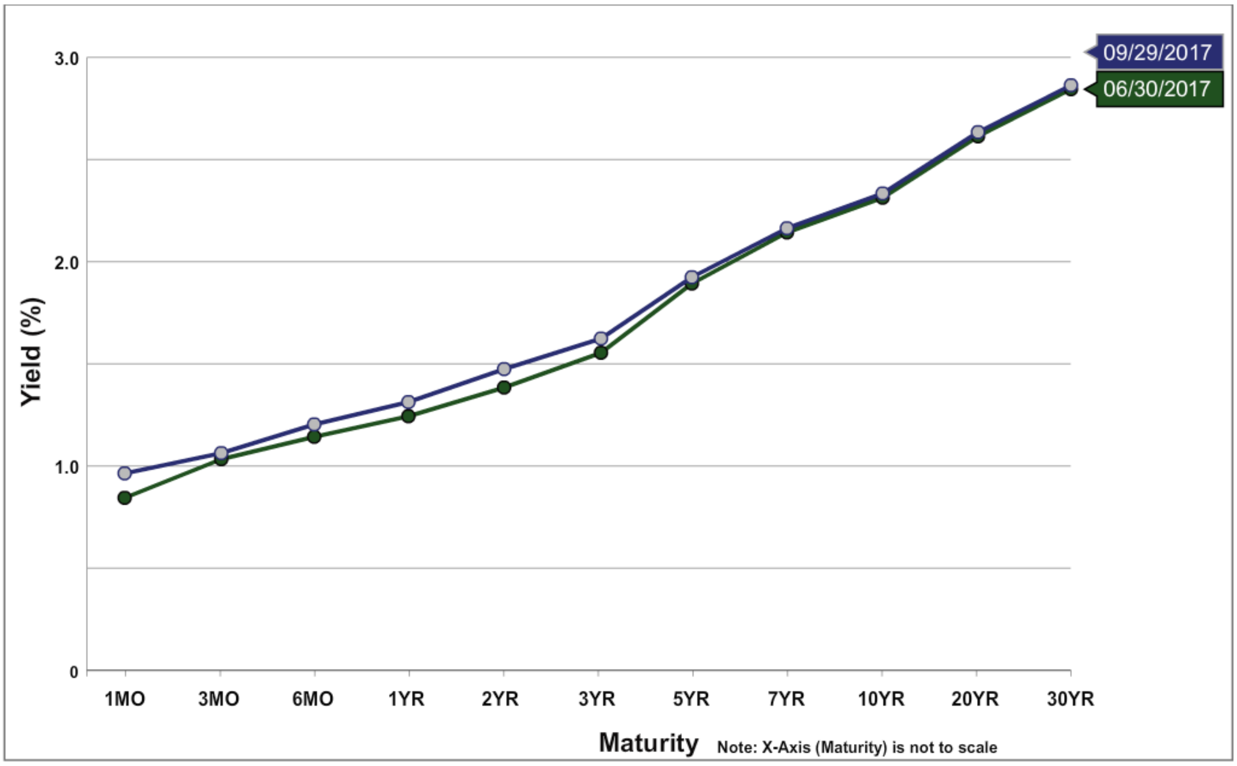
Major World Equity Indices Ranked
Q3 Return (%) as of 9/30/2017

MSCI EM Large Growth NR USD	10.641%	MSCI EAFE NR USD	5.400%
MSCI EM Large NR USD	8.191%	MSCI EAFE Large NR USD	5.211%
MSCI EM NR USD	7.890%	MSCI ACWI NR USD	5.172%
MSCI EAFE Small Growth NR USD	7.791%	Russell 2000 Value Index	5.109%
MSCI EAFE Small Cap NR USD	7.447%	MSCI EM Small Growth NR USD	4.792%
MSCI EAFE Small Value NR USD	7.112%	Russell 3000 Index	4.571%
MSCI EM Small Value NR USD	6.485%	S&P 500 TR USD	4.480%
Russell 2000 Growth Index	6.218%	Russell 1000 Index	4.478%
Russell 3000 Growth Index	5.927%	MSCI EAFE Large Growth NR USD	4.406%
MSCI EAFE Large Value NR USD	5.926%	Russell 3000 Value Index	3.265%
Russell 1000 Growth Index	5.899%	Russell 1000 Value Index	3.115%
MSCI EM Large Value NR USD	5.679%	S&P Global ex US REIT Index (net div.)	2.192%
Russell 2000 Index	5.669%	Dow Jones U.S. Select REIT Index	0.382%
MSCI EM Small NR USD	5.632%		

See Index Representation & Index disclosure at end of document.

Fixed income posted mostly positive results across the globe as rates increased slightly for the quarter and the curve once again flattened. The Federal Reserve decided not to increase rates in September but kept their forecast for another rate hike this year and unveiled their plan to unwind their hefty balance sheet. On the short end of the yield curve, the three-month nominal yield increased by 3 basis points to 1.06%, while the five-year nominal yield increased slightly to 1.92% and 30-year treasuries increased 2 basis points to 2.86%. Intermediate credit bonds outperformed governments in the US by 65 basis points while short term fixed-income indices remain marginally above zero. TIPS were positive on the quarter logging a 0.86% gain.

Treasury Yield Curve[1]



1 Source: https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield

Major World Fixed Income Indices Ranked
Q3 Return (%) as of 9/30/2017

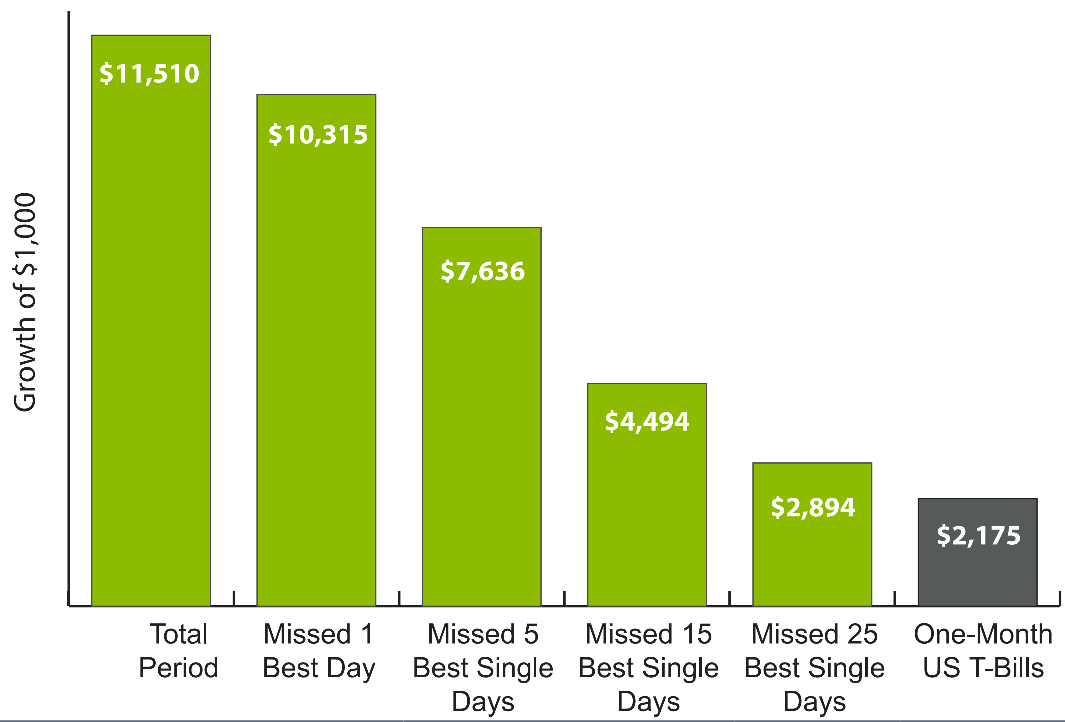
Bloomberg Barclays Credit Bond Index Intermediate	0.99%	Bloomberg Barclays U.S. Government Bond Index Intermediate	0.34%
Bloomberg Barclays U.S. TIPS Index	0.86%	BofA Merrill Lynch Three-Month US Treasury Bill Index	0.26%
Citi World Government Bond Index 1-5 Years (hedged to USD)	0.42%	BofA Merrill Lynch 1-3 Year US Treasury and Agency Index	0.24%
Citi World Government Bond Index 1-3 Years (hedged to USD)	0.35%	Bloomberg Barclays U.S. TIPS Index	-0.40%

See Index disclosure at end of document.

While equity markets across the globe continue to experience impressive gains, any type of policy reform has yet to make significant headway.   Recovery from natural disasters and rising tensions of conflict may also cause investors to be on high alert. Concerns regarding rich equity valuations are also viewed as a potential for a market correction and many question if the Feds decision to continue raising rates along with reducing the balance sheet may cause an economic halt, especially in the absence of significant inflation. The potential for the tightening of monetary policy by major central banks overseas could also have similar impacts in foreign markets.

On the other side of the coin, economic indicators such as earnings growth and employment indicate a relatively optimistic outlook for the economy and markets continue to post impressive gains while consumer confidence remains high. Similar to predicting asset prices, predicting economic activity is extremely difficult and even more difficult to accomplish consistently. It is for these reasons we feel most clients will be best served by following a disciplined investment strategy while maintaining consistent exposure to capital markets. Missing out on periods of outperformance can prove to be detrimental to the end investor, even over a span of several days or weeks. The below chart illustrates how missing out on only a few of the best days in the S&P 500 alone can create great opportunity costs to an investor. Accordingly, we encourage all clients to remain steadfast in their investment plan, designed specifically for them to attain their goals.

Performance of the S&P 500 Index, October 1989 – December 2016



Annualized Compound Return	9.38%	8.94%	7.75%	5.67%	3.98%	2.89%

In US dollars. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. S&P data provided by Standard & Poor's Index Services Group. "One-Month US T- Bills" is the IA SBBI US 30 Day TBill TR USD, provided by Ibbotson Associates via Morningstar Direct. Data is calculated off rounded daily index values.

Index Representation Disclosure
US Market segment (index representation) as follows: Marketwide (Russell 3000 Index), Large Cap (Russell 1000 Index), Large Cap Value (Russell 1000 Value Index), Large Cap Growth (Russell 1000 Growth Index), Small Cap (Russell 2000 Index), Small Cap Value (Russell 2000 Value Index), and Small Cap Growth (Russell 2000 Growth Index). Russell data © Russell Investment Group 1995–2017, all rights reserved. US REITs (Dow Jones US Select REIT Index) Dow Jones data (formerly Dow Jones Wilshire) provided by Dow Jones Indices. Non-US Developed Market segment (index representation) as follows: Marketwide (MSCI EAFE Index), Large Cap (MSCI EAFE Large Cap Index), Large Cap Value (MSCI EAFE Large Cap Value Index), Large Cap Growth (MSCI EAFE Large Cap Growth Index), Small Cap (MSCI EAFE Small Cap Index), Small Cap Value (MSCI EAFE Small Cap Value Index), Small Cap Growth (MSCI EAFE Small Cap Growth Index). All index returns are net of withholding tax on dividends. MSCI data © MSCI 2017, all rights reserved. Emerging Market segment (index representation) as follows: Marketwide (MSCI Emerging Markets Index), Large Cap (MSCI Emerging Markets Large Cap Index), Large Cap Value (MSCI Emerging Markets Large Cap Value Index), Large Cap Growth (MSCI Emerging Markets Large Cap Growth Index), Small Cap (MSCI Emerging Markets Small Cap Index), Small Cap Value (MSCI Emerging Markets Small Cap Value Index), Small Cap Growth (MSCI Emerging Markets Small Cap Growth Index). All index returns are net of withholding tax on dividends. MSCI data © MSCI 2017, all rights reserved.

Index disclosure
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