Cherry Bekaert Wealth Management

Market Update: The Quarter in Review

Summary

Second Quarter 2017

Looking at broad market indices, non-US developed markets and emerging markets recorded similar returns, outperforming the US during the quarter.

The value effect was negative in the US, non-US, and emerging markets. Small caps outperformed large caps in non-US developed markets but underperformed in the US and emerging markets.

The broad US equity market posted positive returns for the quarter but underperformed both non-US developed and emerging markets. Value underperformed growth indices in the US across all size ranges. Small caps in the US underperformed large caps.

In US dollar terms, developed markets outperformed the US equity market and had similar performance to emerging markets indices during the quarter. Looking at broad market indices, the value effect was negative across all size ranges in non-US developed markets.

Small caps outperformed large caps in non-US developed markets. In US dollar terms, emerging markets indices outperformed the US and recorded similar performance to developed markets outside of the US.

Looking at broad market indices, the value effect was negative across all size ranges in emerging markets.

Small caps underperformed large caps in emerging markets.

Interest rates were mixed across the US fixed income market during the second quarter. The yield on the 5-year Treasury note decreased 4 basis points (bps) to 1.89%. The yield on the 10-year Treasury note decreased 9 bps to 2.31%. The 30-year Treasury bond yield decreased 18 bps to finish at 2.84%.

The yield on the 1-year Treasury bill rose 21 bps to 1.24%, and the 2-year Treasury note yield rose 11 bps to 1.38%. The yield on the 3-month Treasury bill climbed 27 bps to 1.03%, while the 6-month Treasury bill yield increased 23 bps to 1.14%.

In terms of total returns, short-term corporate bonds gained 0.59% and intermediate corporates gained 1.49%.

Short-term municipal bonds gained 0.56%, while intermediate-term muni bonds returned 1.97%. Revenue bonds gained 2.19%, outperforming general obligation bonds by 39 bps.

Past performance is no guarantee of future results. This information is provided for educational purposes only and should not be considered investment advice or a solicitation to buy or sell securities. Please see page 4 for additional footnotes and disclosures.

When Rates Go Up, Do Stocks Go Down

Second Quarter 2017

Should stock investors worry about changes in interest rates?

Research shows that, like stock prices, changes in interest rates and bond prices are largely unpredictable.[1] It follows that an investment strategy based upon attempting to exploit these sorts of changes isn't likely to be a fruitful endeavor. Despite the unpredictable nature of interest rate changes, investors may still be curious about what might happen to stocks if interest rates go up.

Unlike bond prices, which tend to go down when yields go up, stock prices might rise or fall with changes in interest rates. For stocks, it can go either way because a stock's price depends on both future cash flows to investors and the discount rate they apply to those expected cash flows. When interest rates rise, the discount rate may increase, which in turn could cause the price of the stock to fall.

However, it is also possible that when interest rates change, expectations about future cash flows expected from holding a stock also change. So, if theory doesn't tell us what the overall effect should be, the next question is what does the data say? Recent research performed by Dimensional Fund Advisors helps provide insight into this question.[2] The research examines the correlation between monthly US stock returns and changes in interest rates.[3]

For example, in months when the federal funds rate rose, stock returns were as low as –15.56% and as high as 14.27%. In months when rates fell, returns ranged from –22.41% to 16.52%. Given that there are many other interest rates besides just the federal funds rate, Dai also examined longer-term interest rates and found similar results.

So to address our initial question: when rates go up, do stock prices go down? The answer is yes, but only about 40% of the time. In the remaining 60% of months, stock returns were positive. This split between positive and negative returns was about the same when examining all months, not just those in which rates went up. In other words, there is not a clear link between stock returns and interest rate changes.

There's no evidence that investors can reliably predict changes in interest rates. Even with perfect knowledge of what will happen with future interest rate changes, this information provides little guidance about subsequent stock returns. Instead, staying invested and avoiding the temptation to make changes based on short-term predictions may increase the likelihood of consistently capturing what the stock market has to offer.

1. *See, for example, Fama 1976, Fama 1984, Fama and Bliss 1987, Campbell and Shiller 1991, and Duffee 2002.*
2. *Wei Dai, "Interest Rates and Equity Returns" (Dimensional Fund Advisors, April 2017).*
3. *US stock market defined as Fama/French Total US Market Index.*

Discount Rate: *Also known as the "required rate of return," this is the expected return investors demand for holding a stock.*

Correlation: *A statistical measure that indicates the extent to which two variables are related or move together. Correlation is positive when two variables tend to move in the same direction and negative when they tend to move in opposite directions.*

Source: Dimensional Fund Advisors LP.

Results shown during periods prior to each Index's index inception date do not represent actual returns of the respective index. Other periods selected may have different results, including losses. Backtested index performance is hypothetical and is provided for informational purposes only to indicate historical performance had the index been calculated over the relevant time periods. Backtested performance results assume the reinvestment of dividends and capital gains.

Eugene Fama and Ken French are members of the Board of Directors for and provide consulting services to Dimensional Fund Advisors LP.

There is no guarantee investment strategies will be successful. Investing involves risks including possible loss of principal.

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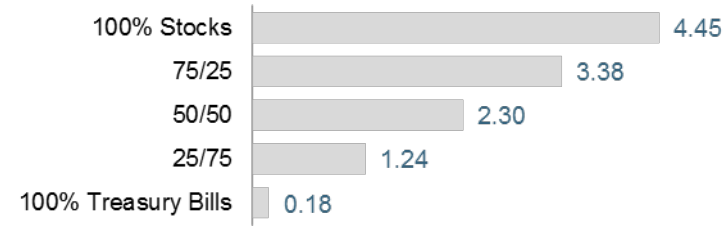
Impact of Diversification

Second Quarter 2017 Index Returns

These portfolios illustrate the performance of different global stock/bond mixes and highlight the benefits of diversification. Mixes with larger allocations to stocks are considered riskier but have higher expected returns over time.

Ranked Returns (%)

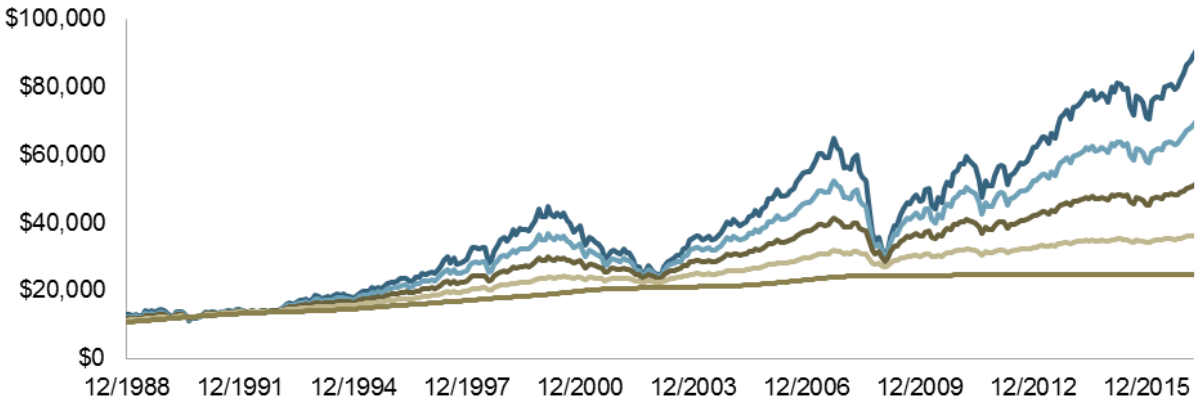


Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*	10-Year STDEV[1]
100% Stocks	11.82	19.42	5.39	11.14	4.27	16.96
75/25	8.84	14.41	4.17	8.38	3.60	12.71
50/50	5.93	9.57	2.89	5.62	2.73	8.46
25/75	3.08	4.90	1.56	2.87	1.68	4.22
100% Treasury Bills	0.29	0.40	0.17	0.12	0.45	0.29

Growth of Wealth: The Relationship between Risk and Return



1. *STDEV (standard deviation) is a measure of the variation or dispersion of a set of data points. Standard deviations are often used to quantify the historical return volatility of a security or portfolio.*

Diversification does not eliminate the risk of market loss. Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio. Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals.

Market Summary

Index Return

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Q2 2017	**STOCKS**				**BONDS**	
	3.02%	5.63%	6.27%	1.67%	1.45%	0.60%
Since Jan. 2001						
Avg. Quarterly Return	1.9%	1.5%	3.1%	2.7%	1.2%	1.1%
Best Quarter	16.8% Q2 2009	25.9% Q2 2009	34.7% Q2 2009	32.3% Q3 2009	4.6% Q3 2001	5.5% Q4 2008
Worst Quarter	-22.8% Q4 2008	-21.2% Q4 2008	-27.6% Q4 2008	-36.1% Q4 2008	-3.0% Q4 2016	-3.2% Q2 2015

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond ex US Market (Citi WGBI ex USA 1–30 Years [Hedged to USD]). The S&P data are provided by Standard & Poor's Index Services Group. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2017, all rights reserved. Bloomberg Barclays data provided by Bloomberg. Citi fixed income indices copyright 2017 by Citigroup.