



SilverOak

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Second Quarter 2017 Market Summary

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Second Quarter 2017 Market Summary

Most asset classes had positive returns during the second quarter of 2017, adding to gains seen in the first quarter. The positive momentum continued as there was not any major headline news that impacted the markets. Therefore, rather than "make a mountain out of a molehill" regarding any specific headline or theme during the quarter, let's take a trip back in time to gain a good perspective on the markets over the past 18-months. The following vignette highlights the past year's market turmoil and the subsequent recovery which illustrates the importance of investors keeping a long-term perspective.

Think back to February 2016. Equity markets were down 10% - 20% and credit bond spreads had reached levels typically associated with recessions as there were legitimate concerns about the world economy. The U.S. manufacturing sector was challenged. Internationally, China's economy was slowing, Europe and Japan were trying to kick start their economies by pumping trillions of dollars into the system, commodity prices were plummeting, developed and emerging market currencies depreciated considerably vs. the U.S. dollar, and India took roughly 90% of its currency out of circulation. International equities had underperformed U.S. equities since 2008. Additionally, news media had written in stone that active managers, specifically in the U.S. large cap segment, cannot and will not perform better than a passive index.

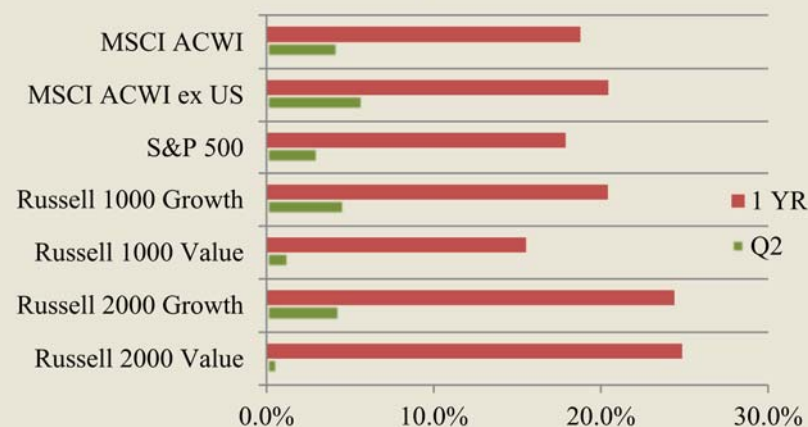
Fast forward to today. Equity markets have gained 35% - 50% since mid-February 2016. International equities have outperformed U.S. equities and the majority of SilverOak's U.S. large cap active managers have outperformed over the past year or more. This is in spite of several significant and surprising geopolitical events such as Brexit, the U.S. presidential election and a surge in terrorism. Those investors who focused on the "uncertain news of the day" may have missed the global corporate earnings recovery and corresponding rally in equities.

Ask yourself. At any time during the past two years, did you feel uncomfortable with the equity markets? Or maybe you felt the market swoon was a great buying opportunity? During this period of time, SilverOak encouraged investors to remain in well diversified portfolios, including exposure to international equities, with a level of risk commensurate with their tolerance for market volatility.

Unfortunately, many investors can be distracted from their long-term plan by worrying about weekly, monthly or even yearly returns. Long-term equity returns have averaged 9% - 10%, as measured by the S&P 500 from 1965 - 2016.

However, averages can be very deceptive as they hide volatility. It is important to remember that there are periods, such as the past year, in which equity returns will be up 20% - 30% and other times where they were down double digits. Investing is inherently uncomfortable. However, with a long-term view, investors can take solace that volatility decreases substantially as time-horizons extend and investors are rewarded for taking on risk. By not getting too emotionally high when markets rally and not getting too low when they fall, investors can reduce behavior biases that hinder the achievement of their goals.

Broad Market Index Returns Second Quarter 2017



Let's now turn our focus to the second quarter 2017 data. U.S. large company stocks, represented by the S&P 500 Index, were up 3.1%. U.S. small company stocks, represented by the Russell 2000 Index, had positive returns of 2.5%. Despite U.S. small company stocks trailing large company stocks year-to-date, on a one-year basis they have returned more than 24%. Broad U.S. equities, represented by the Russell 3000 Index, have had positive returns in 21 of the past 22 quarters. While overall markets were positive, performance in various industries was more volatile.

Second Quarter 2017 Market Summary (continued)

Overall, international stock markets had strong performance for the quarter with the MSCI ACWI ex US Index up 5.8%. Emerging markets performed even better with a return of 6.3% during the quarter. The quarter continued the trend of international equities outperforming domestic equities that we have seen over the past year. The U.S. dollar has been depreciating since the beginning of the year as the rate of positive economic change is greater in international economies. The U.S. economy and equity markets have been strong since the depths of the financial crisis in 2009 and many analysts feel incremental growth in the U.S. will be more challenged. However, there have been areas around the world such as the Eurozone and Japan that have had a tougher time over the past 8-years. This weakness has turned around and we are seeing improving economic data, employment and corporate earnings in many regions overseas. Actually, June was the first month since 2011 that global manufacturing was healthier than manufacturing in the U.S. (measured by Global PMI).

For the quarter, bonds were slightly positive. The Barclays U.S. Aggregate Index, which represents a broad basket of bonds, was up 1.5%. Municipal bonds have outperformed taxable bonds year-to-date as they have recovered following the selloff post-presidential election. The Federal Reserve raised the Fed Funds rate by 25bps in June. Despite this action by the Fed, intermediate-to-long dated U.S. Treasury interest rates fell during the quarter as domestic economic growth was soft. The Fed's commentary had little impact on the volatility of the bond markets as their actions were expected. In the June announcement, the Federal Reserve stated they expect to raise rates again and begin to reduce their balance sheet later this year. The Fed is walking a fine line of normalizing rates and their balance sheet while not restricting economic growth. If economic growth and inflation reaccelerate in the second half, bonds may have slight negative returns similar to last year.

Based on probabilities, it is not likely that equity markets will be up 30% - 50% over the next year. So, it is important to set proper expectations. Market corrections of 10% on average occur about once a year (We know another average!). However, volatility tends to cluster and it is not unusual to have long periods of stability. As investors look for the catalyst of the next large pullback in the equity markets, it is important to keep in mind that bull markets do not typically end of old age nor do they end because of high valuations. Generally, an external shock or central bank over-tightening will be the catalyst. As a result, for the foreseeable future (which is very limited), there does not appear to be significant concerns in economic data, credit markets or market sentiment globally.

HIGHLIGHTS

MACROECONOMICS

- The Bureau of Economic Analysis released the advanced estimate of second quarter 2017 real GDP, an annual rate increase of 2.6% from the preceding quarter. The estimate was slightly lower than the 2.7% growth rate analysts were expecting.
- The University of Michigan Consumer Sentiment Index final reading for June was 95.1, which was a decrease from the first quarter. Consumer sentiment remains very strong and has risen to levels last seen over a decade ago.
- The ISM Manufacturing Index increased during the quarter from 57.2 in March to 57.8 in June. The ISM Index has risen steadily since the beginning of 2016. Typically, when the ISM Index is above 55 it is bullish and when it is below 45 it is bearish.
- In June, the Conference Board Leading Economic Index increased 0.6% month-over-month to 127.8. The Index has increased gradually over the past year showing steady growth in the economy.
- The price of WTI Crude Oil was \$46.02 at the end of June, which is 9% lower than \$50.54 at the end of March. The price of Brent Crude Oil decreased 10% in the quarter to \$47.08. The price of oil is starting to find an equilibrium around \$50.
- In June, headline CPI increased 1.6% year-over-year, down from an increase of 2.4% in March. Core CPI, which does not include food and energy, had a 1.7% increase. Inflation levels increased in 2015 & 2016 with energy and housing prices rising; however, inflation has subsided since the beginning of 2017.

HOUSING

- The housing sector has been very strong the past few years with increasing sales and home prices.
- Preliminary existing home sales decreased slightly in the quarter with a monthly average annualized rate of 5.57 million units from 5.62 million units in the first quarter. The June annualized rate is 0.7% higher than the 5.48 million units in June 2016. Unsold home supply remains at very low levels.
- Median existing home sale prices increased during the quarter. The preliminary prices for June were 6.5% higher than the levels of one year ago and have been trending up since the beginning of 2012. Prices are now higher than the previous peak in 2007.

- New home sales have been strong the first half of the year and have been increasing since 2011. However, new home sales remain slightly below average due to the below average housing starts since 2009.
- S&P Case-Shiller 20-City Home Price Index (seasonally adjusted) showed home prices rose 5.7% year-over-year in May.

EMPLOYMENT

- The labor market data has generally been positive. The job growth rate has slowed slightly as the labor market is closer to full employment. Wages have been slowly rising over the past few years; however, year-to-date wage growth has weakened.
- During the quarter, nonfarm payrolls averaged 194,000 jobs added per month, which is higher than the second quarter in 2016.
- The unemployment rate declined to 4.4% from 4.5% during the quarter.
- Initial Jobless Claims have been decreasing since 2009 and dipped to lows last seen in 1973, reflecting a tight labor market.

DOMESTIC CORPORATIONS

- Corporate operating earnings in the first quarter 2017 were higher than the previous year as the energy sector rebounded and a weaker U.S. dollar aided exporters and multi-nationals. Estimates for the remainder of 2017 show an acceleration of earnings growth and should surpass peak levels set in 2014. However, current forecasts may end up being too optimistic as earnings estimates have historically been revised down throughout the year.
- Operating margins are currently at all-time highs and well above historical averages. Margins could continue to be pressured if interest rates rise and wages increase.
- Forward and trailing P/E multiples are slightly above historical averages.
- The U.S. dollar has depreciated vs. major currencies since the beginning of the year.

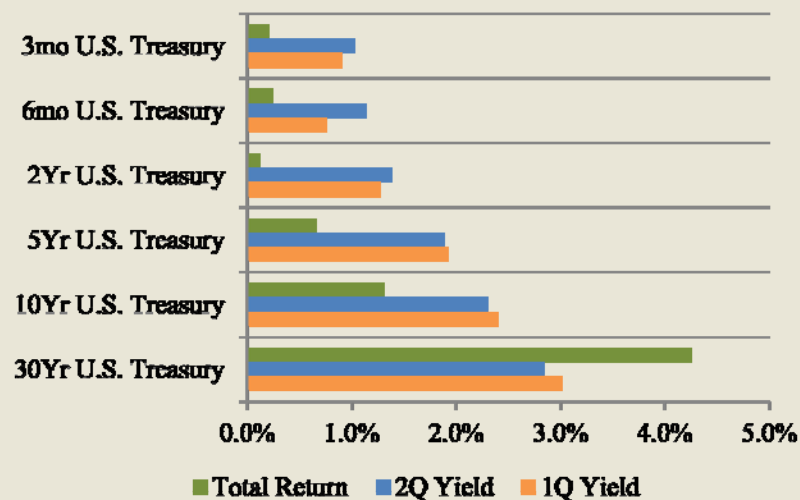
FED POLICY

- In June, the Federal Open Market Committee (FOMC) decided to raise the federal funds rate by a quarter percent to 1.00% - 1.25%. The announcement to raise rates was expected by the market as the Fed had been forecasting the rate hike for a while. The Fed's assessment of economic conditions were positive noting the economy is expanding moderately and the labor market continues to strengthen.
- The Fed is still forecasting that they expect to raise rates again in 2017 and three times in 2018; however, they will remain data dependent. Market expectations currently believe the Fed will only raise once or twice by the end of 2018. In the June meeting, the Fed announced a few details on its plan to reduce their balance sheet over the next three years by letting bonds mature rather than reinvesting. The market will continue to monitor the Fed's forecasting and policy changes as they may be a source of volatility and impact economic expansion.

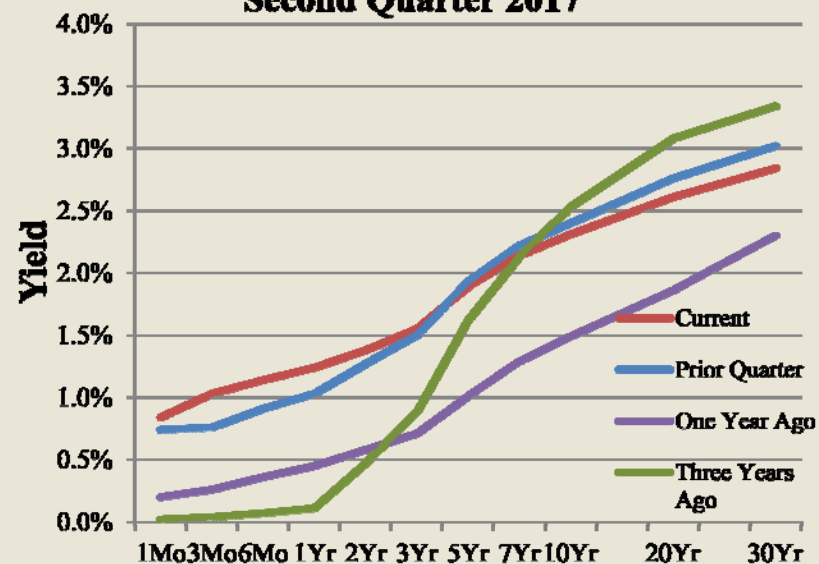
FIXED INCOME

- Intermediate to long term yields fell quarter-over-quarter; however, the short end of the curve rose causing the yield curve to flatten. The long-end of the curve declined as inflation waned and economic growth did not accelerate. Short-term rates rose roughly in line with the Fed Funds rate increase. Short term interest rates are controlled or heavily influenced by central banks where as long term interest rates are controlled by market forces and economic growth. Historically, the yield curve has flattened as the Fed raises interest rates and the business cycle matures.
- Despite the low rates of Treasuries and other developed country sovereign debt, investors have continued to buy fixed income. In search of income, investor demand has moved out on the yield curve and down in quality. However, investors should question whether they are receiving adequate return for the risk being taken. The credit cycle has matured over the past year as there has been an increase in aggressive underwriting, higher leverage, and significant credit spread tightening

Treasury Yields & Returns Second Quarter 2017

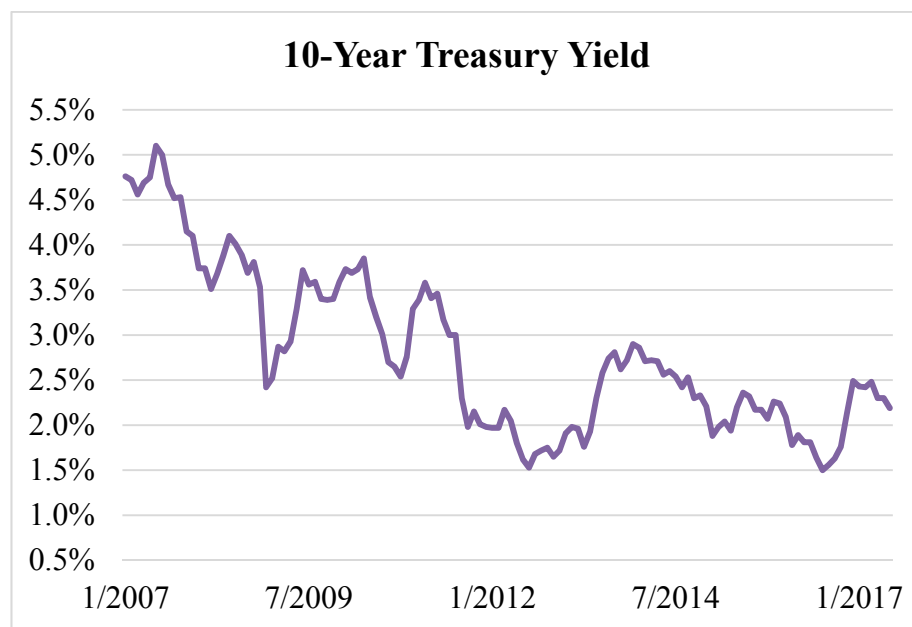


U.S. Treasuries Yield Curve Second Quarter 2017

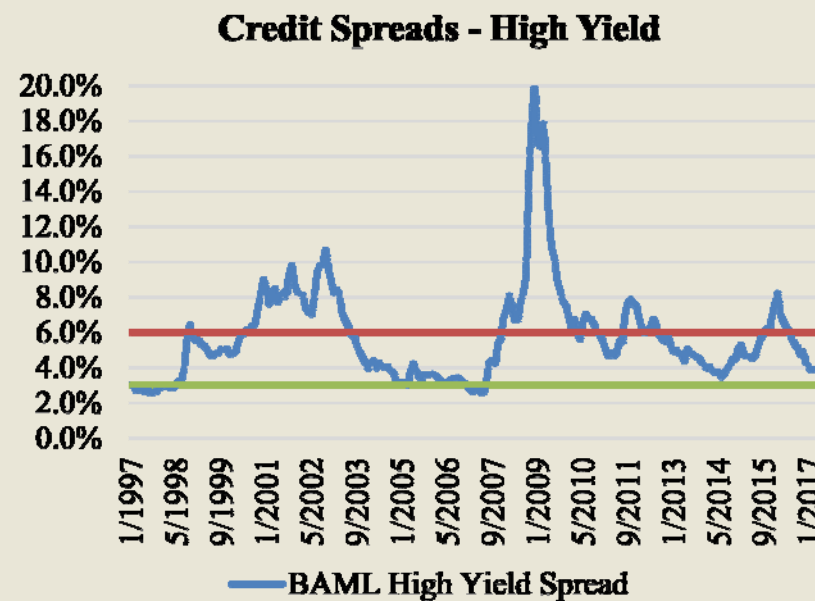
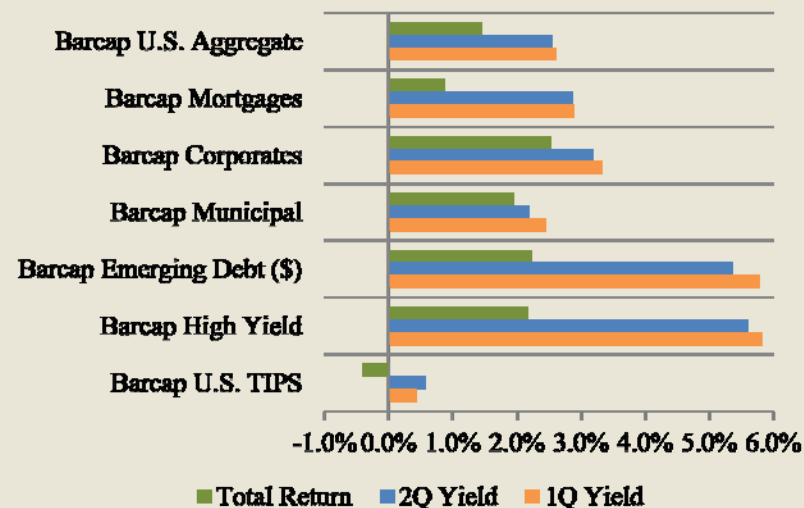


FIXED INCOME (continued)

- Returns across fixed income sectors were positive except inflation protected bonds as inflation decreased. The Barclays U.S. Aggregate was up over one percent during the quarter. Municipal returns outperformed taxable bonds due to strong demand for tax-exempt bonds as many of the new administration's policy proposals have not come to pass. High yield and corporates performed well as credit spreads tightened due to strong corporate earnings and investors' appetite for income. Emerging market debt also performed well with rising global growth prospects.
- Fixed income returns, going forward, are expected to be lower than historical averages as interest rates are still at a very low level. Historically, future ten year fixed income annualized returns have been about equal to the 10 year Treasury yield at the start of the period. Credit sectors could benefit if the economy continues to grow; however, credit spreads are near historical averages.

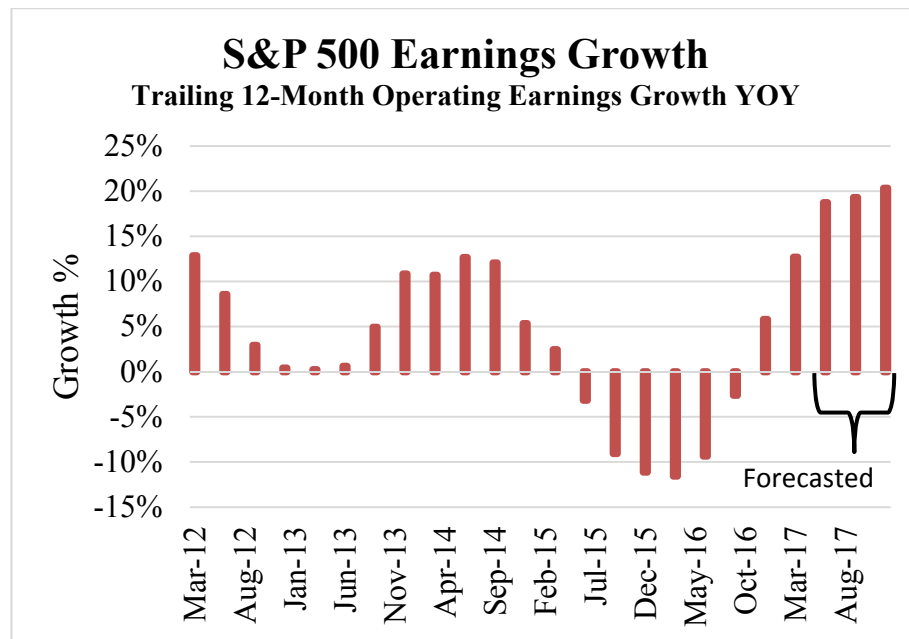


Fixed Income Yields & Returns Second Quarter 2017

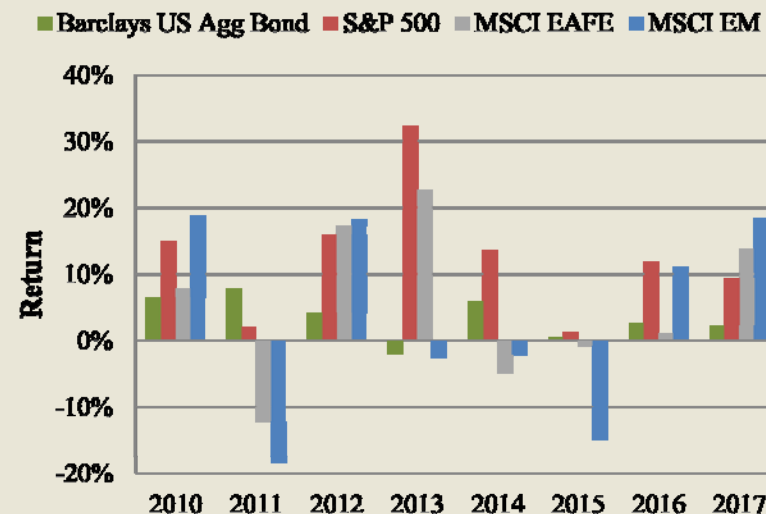


EQUITIES

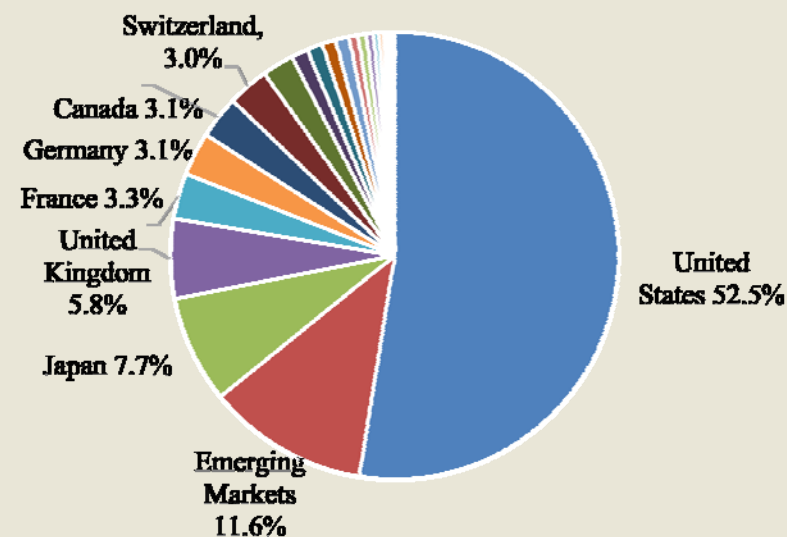
- The synchronized global economic expansion continued which led global equities to have strong performance during the quarter with unusually low volatility. The election of Macron in France, the bailout of some European banks by the European Central Bank and China's stabilization have reduced uncertainty for investors which has helped drive outperformance in those regions.
- Recent economic data has pointed to stronger growth; however, the equity markets have some headwinds. Valuations remain higher than average which should give caution to investors if earnings and the administration's pro-growth policies do not meet expectations. However, valuations have little correlation with equity returns over the short-term. Equity returns will likely be driven by revenue and earnings growth rather than valuation expansion. Correlations among equities has moderated which may provide benefits for a diversified equity portfolio.



Equity & Fixed Income Market Annual Returns

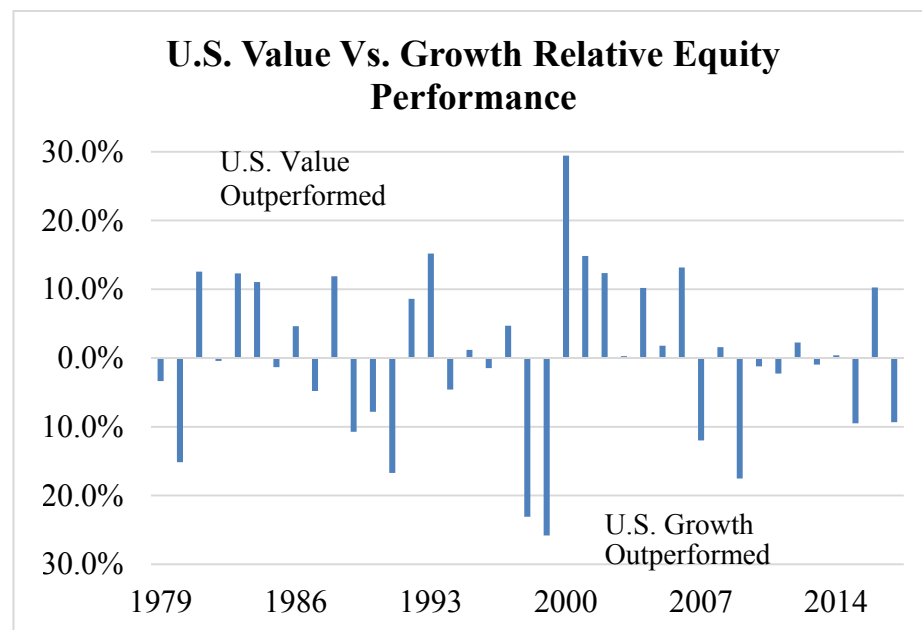


Country Weighting in MSCI ACWI (as of 7/26/2017)



DOMESTIC EQUITIES (continued)

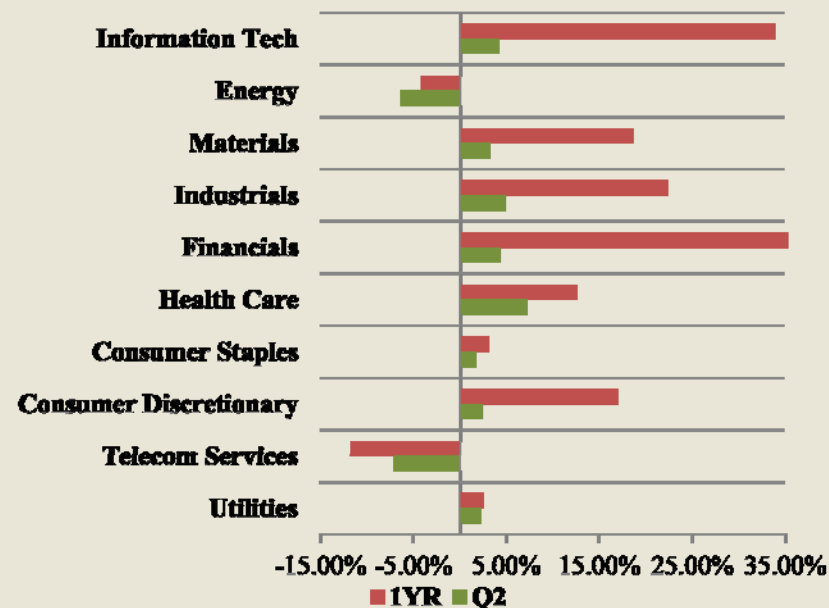
- The Russell 1000 Index of large capitalization stocks posted a total return of 3.1% during the quarter. On a year-over-year basis, the Russell 1000 Index has increased 18.0%.
- Small capitalization stocks, as represented by the Russell 2000 Index, posted a total return of 2.5% during the quarter. On a year-over-year basis, the index has increased 24.6%.
- Market leadership in the first quarter continued throughout the second quarter. Growth outperformed value across market capitalization and geography. Technology, Health Care and Industrials were the best performing sectors. Energy stocks lagged with the price of oil declining during the quarter.



Second Quarter 2017 Returns

	Value	Core	Growth
Mega Cap		2.6%	
Large Cap	1.3%	3.1%	4.7%
Mid Cap	1.4%	2.7%	4.2%
Small Cap	0.7%	2.5%	4.4%
Micro Cap	2.9%	3.8%	5.3%

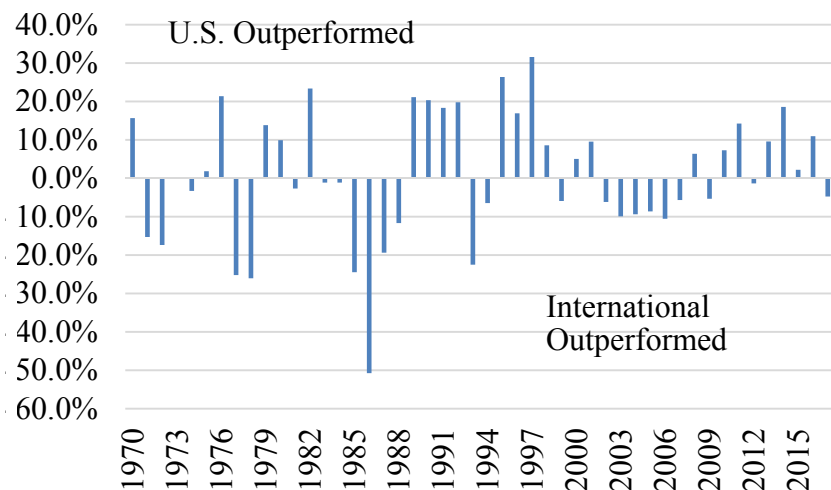
U.S. Equity Market Returns by Major Sector (Securities in S&P 500, Second Quarter 2017)



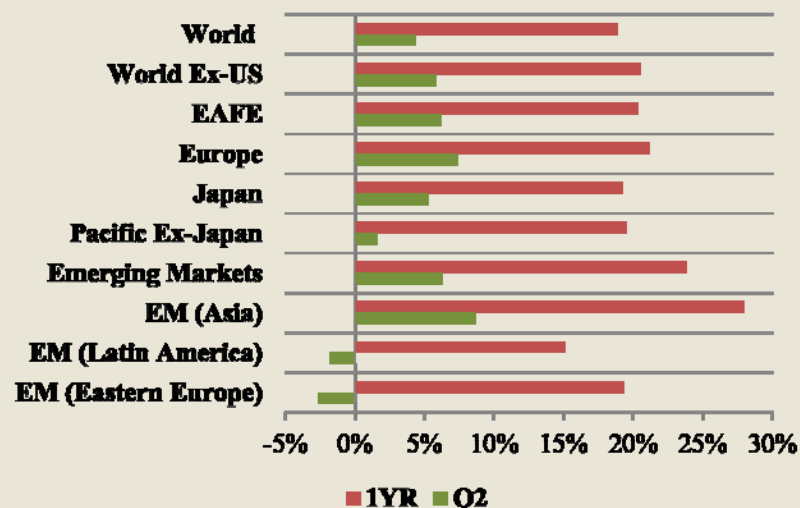
INTERNATIONAL EQUITIES (continued)

- Developed international stocks, as represented by the MSCI EAFE, were up 6.1% during the quarter and performed better than U.S. domestic equities. On a year-over-year basis, the EAFE is up 20.3%.
- Emerging market stocks had a strong quarter, outperforming developed markets. The MSCI Emerging Markets Index increased 6.3% in the quarter and has increased 23.8% over the past year.
- Global economic and manufacturing data is growing faster than any time in the past six years. In particular, Europe has seen rising consumer and business confidence, increased consumer demand, labor market recovery and benefits from a lower exchange rate. Developed international and emerging market corporate earnings and margins have grown the past year; however, they are still below pre-crisis levels. Despite the many risks globally, growth is currently the strongest it has been in years.

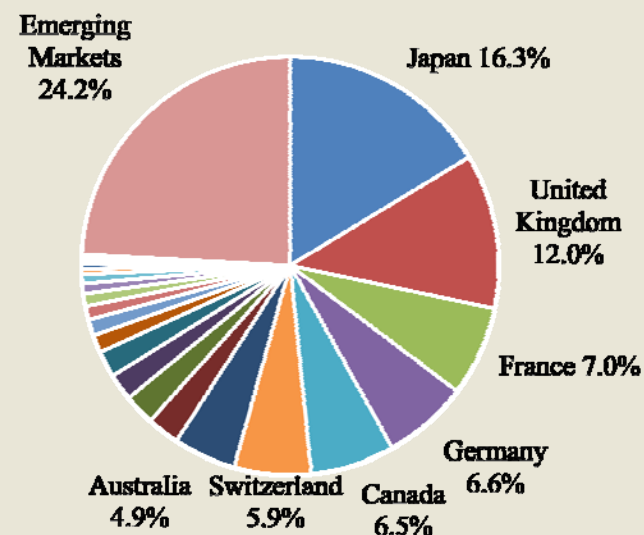
U.S. vs. International Equity Performance



Non-U.S. Equity Market Returns Second Quarter 2017



Country Weighting in MSCI ACWI ex US (as of 7/26/2017)



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