FORZA

Forza Investment Advisory, LLC

Strengthening Our Clients' Financial Lives

FROM THE DESK OF BOB CENTRELLA, CFA:

I hope you all had a great 4th of July celebration to cap of a booming 1st half in the financial markets. With summer finally in full swing it's time for hitting the beach and taking vacations. Now the question is whether stocks will take a vacation for a few months as seasonality suggests. We've now had 8 straight months of gains for the S&P 500 returning 11.93%, the longest stretch since 6/06 thru 1/07 when the return was 14.6%. Odds are we will see a negative return month in the near-term. Read on for more info and our recommendation (that is called a teaser!).

The first half of 2017 is complete and it has been a very good year so far for global stock markets. The S&P 500 gained 8.2% while the Dow Jones Industrial Average rose 8.0% and the Nasdaq Composite climbed 14.1%, all to record highs. It has been a remarkable move considering the first half of the year has been dominated by political uncertainty, sluggish economic growth, and a hawkish Federal Reserve that has raised the Fed Funds rate twice. To be fair, it has also been accented by strong earnings growth. So, at this half-way point, the question is, what next? Below is the 1st half 2017 scorecard. Anybody own any bitcoin?! No that is not a misprint.

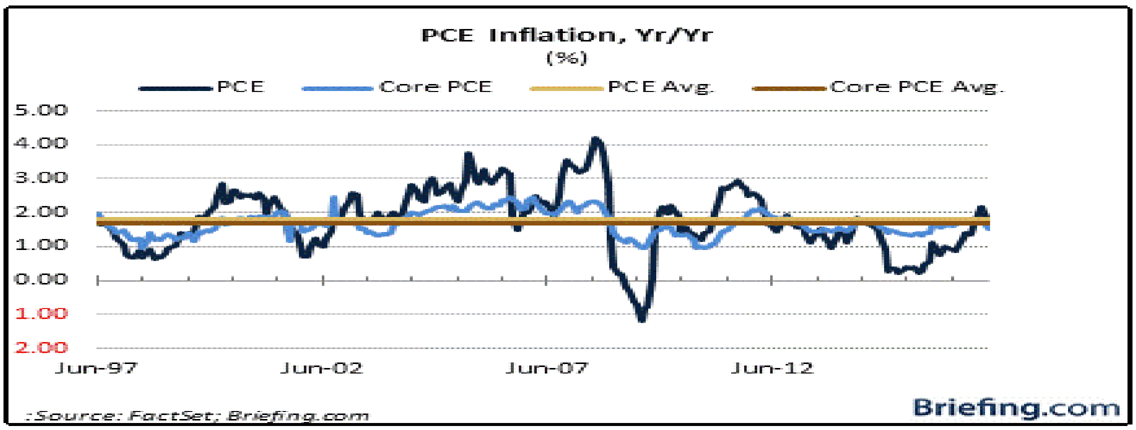
Asset Class	1st Half %	Asset Class	1st Half %
Bitcoin	158.2	British Pound	5.5
Hang Seng Hong Kong	17.1	S&P Midcap 400	5.2
S&P Technology	16.4	Euro Stoxx 600	5.0
Mexican Peso	14.4	US High Yield	4.9
NASDAQ Comp	14.1	Nikkei Japan	4.8
MSCI World ex US	13.2	Russell 2000 (small)	4.3
Ibex 35 Spain	11.7	Japan Yen	4.1
Euro	8.6	Silver	4.0
S&P 500	8.2	Barclays Bond Agg	2.4
Dow Jones Avg	8.1	FTSE UK	2.4
Gold	7.9	US 7-10 Yr Bond	2.4
DAX Germany	7.4	Coffee	-8.3
FTSE Italy	7.0	Crude Oil	-14.3
Dow Transports	5.7	Natural Gas	-17.6

ECONOMY

First quarter real GDP increased 1.4%. The Fed's model forecast for real GDP growth in the second quarter currently stands at 3.2%. That averages to 2.2% for the first half of the year which is pretty consistent with the average

annualized real GDP growth of 2.27% for the last 20 years. The US economy is now entering its 9th straight year of growth but hasn't seen 3% annual growth since before the recession.

The PCE Price Index (inflation measure) is up 1.7% year-over-year and the core PCE Price Index, which excludes food and energy, is up 1.5% year-over-year. Both readings are just about average for the last 20 years. This low inflation environment has led some to believe that the Federal Reserve can't afford to hike rates much higher. Still there is a shift that has taken place by the Fed over the last six months or so. It's not a tectonic shift -- not yet anyway--

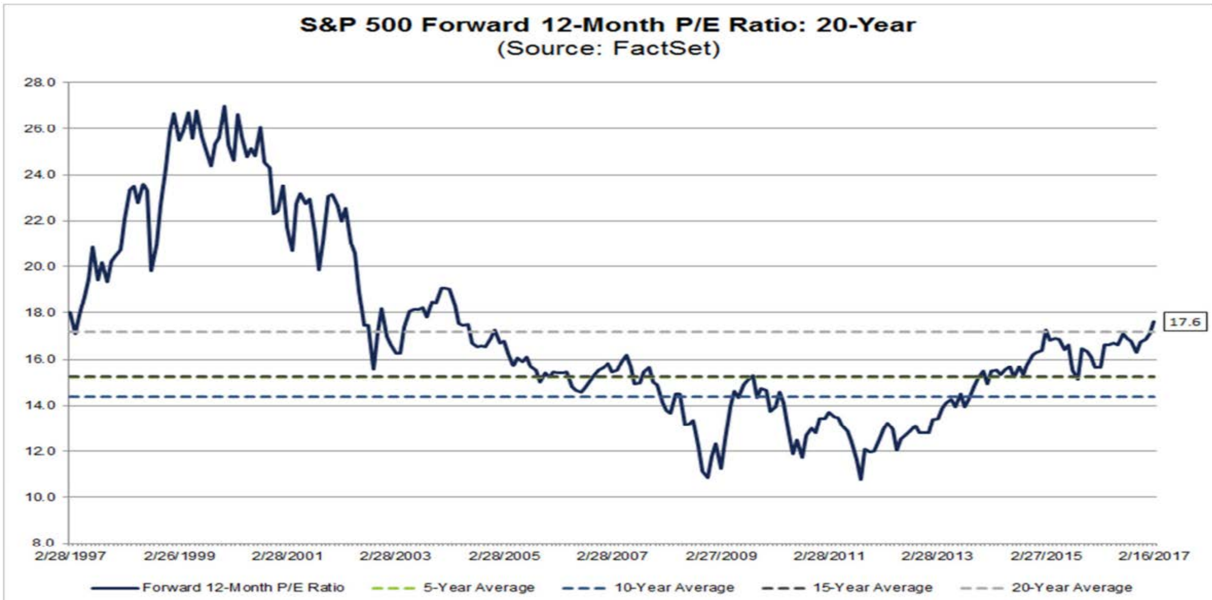


but it's a shift that has created some tremors. The world's most influential central bank (1) has raised the target range for the fed funds rate three times in the last six months, (2) it thinks another rate hike will be likely before the end of the year; (3) it is projecting three more rate hikes in 2018, and (4) it has revealed a plan to begin normalizing its balance sheet "relatively soon" if the economy evolves as it anticipates. In brief, the stock market-friendly Fed is getting a little less friendly by taking steps to remove its policy accommodation. This is happening here as China and the US are also tightening and the ECB recently hinted that it may also become less accommodative and slow down bond purchases.

The stock market has taken the monetary policy shift in stride thus far, taking the position that the Fed's tightening actions are reflective of an economy that has gotten stronger and is expected to get stronger. The Fed's hopeful outlook has been predicated on the tightening labor market; however, it has yet to be corroborated with stronger wage growth, robust spending activity, and accelerating inflation. In short, we have a an economy that is growing, but slowly - for 8 years running now...

STOCKS

Stocks were the place to be among traditional investors with gains registered across the world. The MSCI world index (ex-US) gained 13.2% in the first half. Here in the US, large outperformed small and mid, while growth stocks bettered value stocks. Some of the big winners driving the market included the FAAMG stocks of Facebook (+31.2%), Amazon (+29.1%), Apple(+24.4%), Microsoft (10.9%) and Google (17.3%). On a valuation basis, the P/E multiple for the S&P 500 on a trailing twelve-month period is 19.3.x. On a forward twelve-month basis, it is 17.7.x. That is well above the historical averages of 15.4x and 14.1x, respectively, for the last 10 years, but still well below the previous highs seen around 2000 during the dot.com bubble of 26x.



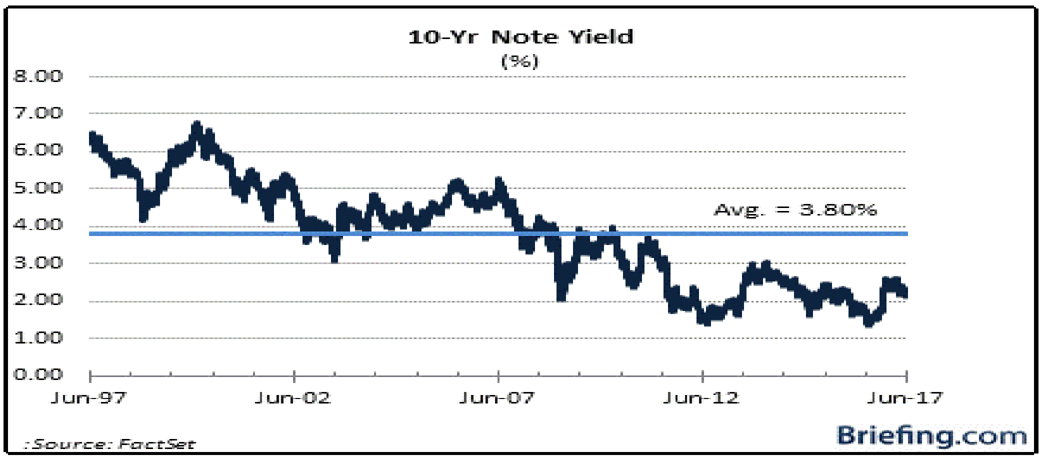
So, GDP growth is average and Price inflation is about average, yet the S&P 500 P/E multiple is well above average. How can that be? The stabilizing forces have been the strong earnings growth and the persistence of low interest rates. It stands to reason, then, that the destabilizing force would be disappointing earnings growth and/or rising interest rates that lessen the relative appeal of owning equities. Looking ahead, the expectation is for S&P 500 earnings to grow 6.5% in Q2 but it is likely that it will be above that in reality and FACTSET estimates closer to 10% growth. Revenue growth is forecasted at 4.8%. The earnings growth rate for the rest of 2017 is 7.3% in Q3 and 12.4% in Q4 for an overall rate of about 10% for all of 2017 on 5% revenue growth. As long as companies continue to report at or above expectation, earnings should keep its end of providing support for stock prices.

So going back to valuation, as I've talked about for a while now, I believe stocks at 17.7x forward earnings are near full valuation on the whole but there are individual stocks that are undervalued. So an active investing approach is attractive for finding those undervalued situations. I continue to favor a diversified approach to investing and like stocks in the financial, technology and industrial sectors balanced with consumer and healthcare stocks. Energy stocks have gotten beaten down dramatically this year and are a good area to look for bargains if oil can stabilize. Speaking of oil, WTI crude is back below $45 a barrel, down 14% YTD including a recent drop of over 20% into bear market territory as supply outweighs demand. Energy stocks will not perform well unless oil gets solidly back to $50-$55. I'd be looking for good companies and be ready to buy a few when oil rises or in anticipation if you have the stomach for it.

International stocks had a nice move in the first half and withstood British and French election jitters. Economic growth is accelerating in Europe as are company earnings. Emerging markets have become a popular place to invest as they were undervalued as were many international markets. But international markets too have moved up and now like in the US we need to see earnings growth from companies. I continue to recommend some exposure to international stocks through broad-based ETFs as the easiest way to own companies rather than individual equities unless you have the time to do the research.

BONDS

I know I sound like a broken record but I've been neutral on bonds for several years now and yes I will continue hold that view through 2017. During Q2 bond yields actually dropped after the Fed raised rates. But in the past 2 weeks the 10-yr yield has risen from 2.14% to about 2.39% as prices have declined, thus steepening the yield curve. The recent flight to safety given some geopolitical events seems to be unwinding as investors also ponder how the Fed will taper its balance sheet and factor in that central banks are starting to move away from accommodative monetary policies. So my recommendation for fixed income is still short to be in medium term, including corporates, high yield and some floating rate debt. Bonds deserve a place in a balanced portfolio but I would not be on the long-end of maturities as you risk price erosion and capital depletion unless you use a barbell approach. As the chart below shows the benchmark 10-yr rate is well below average, which enhances the relative appeal of owning stocks over bonds.



Of course, with the benchmark rate sitting well below its 20-year average, it's pretty clear that bonds, despite their low rates, have held plenty of appeal themselves for a lot of holders. It goes to show, however, that interest rate risk factors prominently for both markets, each of which has basked in the low growth-low inflation environment that has kept policy rate hikes and market volatility to a minimum. But with another rate hike likely this year and the Fed looking to take action on reducing its balance sheet, bond yields may move towards the higher end of a 2.10% to 2.75% trading range on the 10-yr UST.

SUMMARY

So in summary, not much has changed in Forza's recommendation. As always the wildcard is some sort of political or geopolitical uncertainty. On a fundamental basis, I still like equities compared to bonds and I would mix in some exposure to international stocks. With equities having moved up 8-9% already, I'm looking for stocks to rise at least in line with earnings growth or low double digits for the year. I continue to recommend a diversified portfolio with exposure to various asset classes led by US equities. As pointed out earlier, we are now exiting a seasonally strong period (8 straight months of gains) before a summer slowdown may hit. Although I expect a slight pullback could happen, I would let stocks settle and use weakness as a buying opportunity. Looking ahead to the latter half of the year, earnings should be strong and fiscal policy actions by the Trump administration could aid stocks and provide support. We still await an infrastructure package, less regulation and tax reform along with health care reform. Hopefully we get some combination of the above and sooner rather than later as these efforts could help the economy and stocks to move higher as we move into 2018. The problem is that it takes three -- the House, the Senate, and the President -- to tango on legislative matters. And all three parties seem to have two left feet at the moment, which is raising reasonable doubts as to whether any reform can get done before the end of the year -- if at all by the midterm elections. So I can't argue with taking some profits and holding a little extra cash through the summer to provide some piece of mind and give you some powder to buy if we get a pullback. It also guards against the uncertainty that could crop up during the quiet summer months.

Enjoy the rest of your summer and feel free to email or call at 908-344-9790 if you want to discuss anything.

-Bob