RIVERVIEW QUARTERLY INSIGHTS

RIVERVIEW
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A CAUTIOUS LOOK AT THE YEAR AHEAD

Our reflections on the tumultuous economic climate and practical recommendations for staying the course.

Remember February of last year, when the price of oil fell like crazy and your portfolio followed? And then your portfolio bounced back, at least in part because it was clear that Britain would never leave the European Union and that Donald Trump could never be elected President? And then both those things happened, but stock prices went up dramatically anyway? Yeah, it's been like that.

2017 has been nearly as uncertain thus far. President Trump's economic behavior seems more reasonable than his campaign promises led people to believe it would be, but we still have no idea what might happen next. The rise of populism globally has put the ongoing existence of the European Union in question. The Fed has been sticking to its plan to raise interest rates. Emerging markets, notably India and China, have made questionable choices in monetary and fiscal policy as they stumble toward their own versions of market economies.

With all that uncertainty in mind, here are some thoughts about your portfolio as we head into the new year.

FACTORS TO WATCH OUT FOR

We could go on for pages about all the things that are uncertain in the world economy, but we've tried to narrow it to the following three as being most important.

1. The President And Stock Prices

Donald Trump the candidate promised to "drain the swamp." Donald Trump the President, based on his Cabinet choices, seems to be swimming in it, at least if you define "the swamp" as including business insiders. And that, from an economic perspective, initially was a good thing.

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As the Wall Street Journal reported on December 22, "Never before has a US president stocked his cabinet with as many businessmen as Mr. Trump is aiming to."

The stock market loved these choices, as they signaled a friendlier regulatory environment. After the election, the S&P 500 rose by about 10 percent.

But then reality set in. The Wall Street Journal tracked an interesting progression for the market in the week of March 22 through 29. On Wednesday the 22nd, it reported the biggest stock drop of the year, as it became clear that health care reform wouldn't pass, which cast doubt on the Trump administration's ability to pass tax reform or infrastructure programs. On Friday March 24, a Journal article pointed out that there was no clear reason for the drop, and that choppy markets might be the result until a clear narrative emerged. The next day, the Journal reported that the weekly fall in prices highlighted the "longstanding concern" that prices were too high, noting a survey of portfolio managers, 34% of whom thought stocks were "overvalued." Monday saw the Journal observing that a fall like this, though naturally to be expected, typically had an outsized effect on individual investors, because they tend to "pile in" after the market hits a landmark number (like Dow 20,000) but also tend to bail out at the first sign of trouble. In other words, they often buy too late and sell too early, which is why individual investors tend to underperform their own benchmarks.

On Tuesday the 28th, the Journal reported that government bond purchases increased as the "Trump trade" began to "unravel." But then, the next day, it reported that the Dow jumped by 150 points. Since that day, the Dow went from 20,701 to 20,705 on April 7. This pattern of reports shows what I think we all know intuitively. Since the election, no one knows what the heck is going on, and trying to bet on the market as though you do can hurt you.

Further, even if the benefits that investors seek from the administration come to pass, stock prices are historically high. The Shiller price-to-earnings ratio is a commonly used measure of how expensive stocks are relative to their underlying values. It shows the ratio of S&P 500 companies' stock prices to their earnings, after adjusting for macroeconomic factors. A month after the election, on December 9, the ratio hit 27.86. The only times it has been higher were right before the 1929 crash, the dot-com bubble of the late 1990s, and the run-up to the 2008 financial crisis.

So although President Trump is trying to make some market-friendly moves, it remains to be seen if his administration and Congress have the collective political skill to actually implement them. Further, it isn't clear, given the already inflated stock prices, how much more upward mobility the market has.

2. The Strength Of The Dollar

Immediately after the election, the dollar rose by 3 percent against a basket of developed world currencies. This increase has troubling consequences for America and the world. At the end of last year, according to The Economist, foreign governments and businesses had issued almost $10 trillion in dollar-denominated debt, $3.3 trillion of which was owed by corporate and government borrowers in emerging markets. When a debt is issued in a foreign country and the dollar rises relative to the local currency, the debt becomes much more expensive to pay off.

Although the dollar has fallen in the first quarter against many currencies, if it rises again, that extra cost may get a lot worse. The Federal Reserve raised rates by .25% in December and March, and announced its intention to raise them two more times in 2017. As rates in the US go up, the dollar strengthens. Further, President Trump promises to cut taxes and put in place an infrastructure spending program, both of which will increase US inflation and further raise the relative value of the dollar.

This increase in the dollar's strength will hamper growth in emerging markets because firms in those markets will move to pay off their dollar-denominated debts sooner rather than investing. Additionally, a stronger dollar causes credit tightening in those markets generally and central banks in those markets could raise their own interest rates to avoid their own currency depreciation.

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More importantly, in the US the stronger dollar will be hard on exporters (because their goods will cost more and their overseas investments will be worth less), a challenge that will be made worse by any protectionist actions taken by the President.

3. Black Swans

In his 2007 book, *The Black Swan*, Nassim Nicholas Taleb defined the theory of "Black Swan" events as those which are a surprise, have a huge impact and are rationalized only after the fact as being in keeping with existing information. The Great Recession or the 9/11 attacks are frightening examples. This past year has had its share of Black Swans, the consequences of which are yet to be felt.

Brexit and the election of Donald Trump are both Black Swans: unpredicted by pundits and with future far-reaching impacts we can only guess at. Further, the markets' response to those events (so far) has itself been a Black Swan, because stock values have increased dramatically even though everyone expected them to go down.

What might 2017 Black Swans look like?

- Even though experts are worried about European Union disintegration, EU countries might stem the tide of populist defection (especially if Germany reelects Angela Merkel and France rejects Marine Le Pen), which could result in decent growth in Europe and the rest of the developed world (aided further by weaker currencies relative to the dollar);

- Even though investors are optimistic, President Trump and Congress could disagree on tax and spending policies (a possibility that seems more likely after the failure of health care reform), stronger dollar growth could hamper exports, and optimism for the country's economic future could already be built into stock prices. All three of these factors together could lead to sluggish growth, or even a down market, in US stocks for the year.

- Emerging markets (led by China and India) might show signs of life despite the stronger dollar from political and economic "engineering" of their currencies.

Of course, the fact that we've just identified those items as possible means, by definition, that they aren't really Black Swans. But they do point out the difficulty of betting on the directions of 2017 market movements. And 2016 definitely exposed the futility of expert predictions.

RECOMMENDATIONS FOR YOUR PORTFOLIO

Investment forecasting, always a fool's errand, looks even more difficult than usual for 2017. So think about the following for your portfolios.

1. Stick To Your Asset Allocation, Based On Your Time Horizon

Now is not a time to place bets. Don't go to cash, don't go heavy into stocks, don't follow commodities or hedge funds because "that's where the action will be." The world is not coming to an end, but its future is not clear either. The only thing you can make an educated guess about is how long your money needs to last, based on your age, your medical history and your current level of wealth.

Markets have certain truths in the very long run: stocks outperform bonds, small cap outperforms large cap, active management doesn't reliably outperform passive investing, value tends to outperform growth. But none of these truths will hold in every given year (or in the case of value, even in every given decade). Ignore the news, the weekly price fluctuations, the "hot tips." Stick to your plan.

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2. Stick To A "Home Bias," But Don't Ignore International Completely

The US bull market in stocks probably has a little more gas in the tank. The US economic indicators (including labor and consumer sentiment) still look good, and the strength in the dollar could cause problems for international markets, especially emerging markets.

Having said that, Europe could snap out of its EU funk and emerging markets could do well. Emerging markets tend to have the benefit of being exporters and growing consumers. So the balance in the equity portion of your portfolio should still have international developed and emerging market components.

3. Don't Change Your Fixed Income Holdings Yet

The Federal Reserve has signaled its intention to raise rates three times in 2017, and has done so once already. Of course, that's what they said in 2016, and they wound up raising rates only once. In many ways, fixed income could become more volatile than equities. We will keep a close watch on rates and their impact on the bond markets, and reach out to you as we see developments that may warrant a change in your holdings.

FINALLY, DO THE BORING STUFF

And we can help. We'll help you make sure to rebalance your portfolio. We can help you with financial planning, to ensure that your portfolio reflects your needs and goals. We can talk with you about your existing estate plan, if you haven't looked at it in a while. The boring stuff matters!

SPOTLIGHT ON PLANNING

PROTECTING YOUR ASSETS USING RETIREMENT PLANS

Tapping into the asset protection power of retirement plans

Many of our clients worry about asset protection and risk management. They've worked hard to build their wealth and want to safeguard it. Many are current or former business owners, doctors, or real estate investors – professions with increased exposure to lawsuit. Of course, these days just owning a home or driving a car can increase risk. Effective use of retirement accounts can greatly reduce the risk of loss by putting those accounts out of the reach of creditors.

When people think of retirement plans and accounts, such as 401(k)s and IRAs, they generally think of them as tax-efficient savings devices – a way to fund a retirement nest egg, reduce current taxes, and enhance returns with tax-free growth. But they can also provide valuable asset protection in the event of bankruptcy or lawsuit.

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Employer sponsored qualified plans, such as 401(k)s, offer the maximum amount of protection because they are covered under the federal Employee Retirement Income Security Act (ERISA) which was enacted to protect the interests of employee benefit plan participants and their beneficiaries. ERISA qualified plans include anti-alienation protection, meaning that the assets cannot be transferred, sold, or given away to someone else. This feature protects your retirement assets from civil court judgments and bankruptcy (other than judgments for federal taxes, or awards in favor of an ex-spouse under a Qualified Domestic Relations Order or for child support).

Non-ERISA retirement plans or accounts, such as IRAs, do not receive the anti-alienation protection afforded under ERISA. However, federal bankruptcy law does exempt at least $1 million of IRA assets from bankruptcy attachment, and many states have enacted statues protecting all or portions of retirement assets from bankruptcy and or lawsuit judgments. Oregon and Washington, for example, treat IRAs and similar retirement accounts as exempt property, protecting the full value of the account. California, on the other hand, has a more subjective rule using a needs-based approach, where excess amounts may be at risk.

An effective asset protection plan should have multiple layers, including insurance, titling, and legal structures. A simple first step, applicable to most, is to contribute as much as possible to the retirement accounts available to you. How much you contribute depends on numerous factors (type of account or plan, cash flows, time horizon, level of risk of lawsuit or bankruptcy, state of residency). However, if you are not already maximizing your annual contributions, it’s worth considering.

Give us a call if you have any questions.

ECONOMIC SNAPSHOT

MARKET SUMMARY - First quarter 2017 index returns

As a whole, we've seen a strong first quarter, with most segments recording positive performance. Emerging markets was the strongest performer increasing by 11.44%. This is a change from 2016 which saw the US stock market produce the strongest return for the year.

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
1Q 2017	**STOCKS**				**BONDS**	
	5.74%	**6.81%**	**11.44%**	**1.44%**	**0.82%**	**-0.35%**
Since Jan. 2001						
Avg. Quarterly Return	1.9%	1.4%	3.0%	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**

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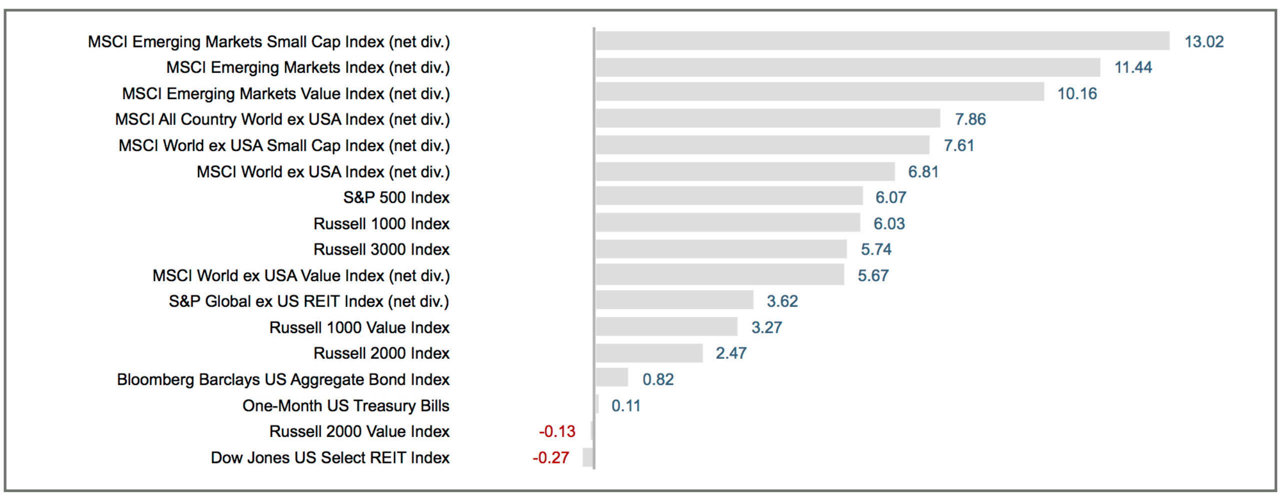
WORLD ASSET CLASSES - First quarter 2017 index returns (%)

Looking at broad market indices, emerging markets outperformed both US and non-US developed markets during the first quarter. Real estate investment trusts (REITs) lagged their equity market counterparts. Small caps outperformed large caps in emerging markets and non-US developed markets but underperformed in the US.



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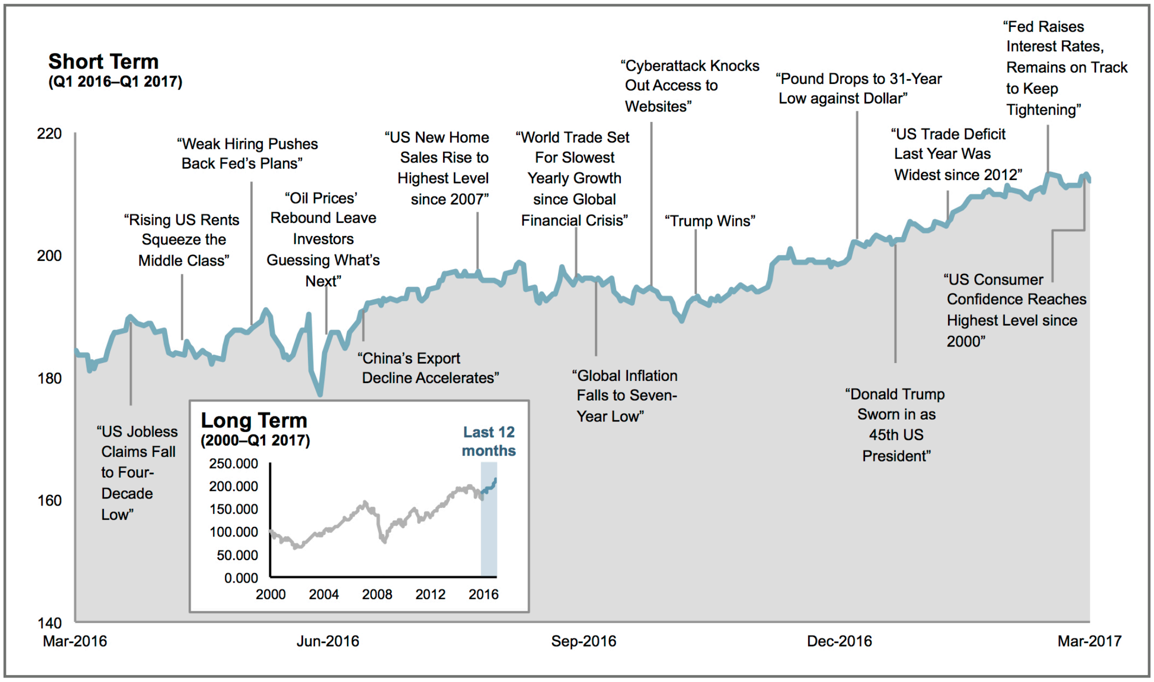
WORLD STOCK MARKET PERFORMANCE & HEADLINES

MSCI All Country World Index with selected headlines from the past 12 months

These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.



Graph Source: MSCI ACWI Index [net div.]. MSCI data® MSCI 2017, all rights reserved.

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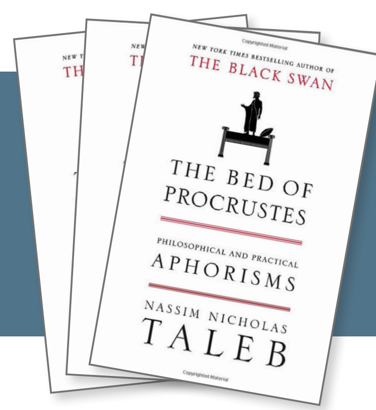
BOOK REVIEW



The Bed of Procrustes

Like many Greek myths, the story of Procrustes is pretty creepy. The owner of a small estate on the road to Athens, Procrustes would abduct travelers, feed them well and then put them up for the night. But his guests always had to fit perfectly in the bed he provided for them: if they were too short, he'd have them stretched; if too tall, he'd cut their feet off.

In his 2010 book, *The Bed of Procrustes*, Nassim Nicholas Taleb (also the author of *The Black Swan*, discussed earlier) uses this myth as a theme for his observations about the way that humans tend to squeeze or stretch life and the world into “crisp commoditized ideas” and “prepackaged narratives,” with occasionally “explosive” consequences. He does so through a collection of aphorisms, concise statements of principles that are more deeply discussed in his other works.

When an investor squeezes or stretches his or her view of investments into one of these “prepackaged narratives,” the explosive consequences can take the form of a significant hit to the portfolio value. If, for example, your narrative of domestic economic policy is that a business man as President HAS to be good for the economy, and you invest your entire portfolio in US large cap stocks based on that narrative, but that business man enacts protectionist policies that hamper multinational trade, your portfolio could be what explodes. And not in a good way.

This short book (only 112 pages) could be read in one sitting. However, doing so would defeat its purpose. This is the kind of book that should live on the nightstand and be thought about. The reader can open it at random, choosing one or two aphorisms to mull over for the day. And these aphorisms do require mulling over; unlike the pop-psych slogans that appear on athletic t-shirts and Facebook memes, each statement in this book is nuanced and sometimes elusive.

Although each aphorism follows the same general theme, they are divided into chapters, like “The Sacred and the Profane,” “Charming and Less Charming Sucker Problems” and “Ethics.” Some are profound (“an idea starts to get interesting when you get scared of taking it to its logical conclusion”), while others are witty (“an erudite is someone who displays less than he knows; a journalist or consultant, the opposite”). Some are accurate and hilarious (“trust people who make a living lying down or standing up more than those who do so sitting down”), and some are just a little arrogant, but still accurate (Taleb “can predict when an author is about to plagiarize me, and poorly so when he writes that I ‘popularized’ the theory of Black Swan events”). All, however, are worth thinking about, especially when you think at first that you disagree with them.

The more I read from this book, the more I feel like I’m having a really interesting conversation with an old friend who is a lot smarter than me. And that, in the end is the mark of a really great book.

- Christopher P. Cline, CEO

IMPORTANT DISCLOSURE INFORMATION

INVESTMENT AND INSURANCE PRODUCTS ARE: NOT FDIC Insured | NOT Bank Guaranteed | MAY Lose Value.

Past performance is not a guarantee of future results. Asset allocation does not guarantee better performance and cannot eliminate the risk of investment losses. 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]).

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