Financial Advisory Service, Inc.

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FAS Monthly Economic & Market Update

August 2017

As of July 31, 2017

Contents

Economic Conditions

Gross Domestic Product (GDP) increased at an annual rate of 2.6% in Q2 2017, according to the advance estimate released by the Bureau of Economic Analysis. Although coming in slightly lower than expected (2.7%), this is a significant increase from Q1 GDP growth which increased at a rate of 1.2%. A large part of Q2 growth was driven by consumer spending which increased quarter-over-quarter by 2.8%. Net exports were also additive to GDP for the second quarter in a row as the trade deficit continued to narrow (meaning that exports are increasing faster than imports are).

Corporate earnings have continued to improve. As of Aug 4th 84% of S&P 500 companies had reported earnings. According to FactSet, 72% have beaten their average earnings-per-share (EPS) estimates and 70% have beaten their average sales estimates. The strong earnings growth in Q2 was predominantly driven by growth in the energy sector as energy companies are recovering from depressed earnings in 2016.

Market Conditions

Index Returns	Jul '17	YTD
S&P 500	1.93%	10.34%
DJIA	2.54%	10.77%
NASDAQ	3.38%	17.93%
MSCI EAFE	2.85%	15.02%
Barclays Aggregate	0.43%	2.71%

All three major indexes hit new milestones in the month of July. Both the Dow Jones and NASDAQ reached new all-time highs eight times last month. The S&P 500 reached new highs five times. The S&P 500, Dow and NASDAQ returned 1.93%, 2.54% and 3.38%, respectively. The three major indexes are up double digits for the year. With technology having an exceptional year (NASDAQ Tech Sector is up 22%), the NASDAQ has outperformed the other two major US indexes by over 7% year-to-date. The fixed income markets in July were once again fairly muted. The 10-year treasury rate ended the month essentially flat and the Barclays US Bond Aggregate returned 0.43% for the month and is up a modest 2.7% for 2017. Emerging markets continued its run as one of the best performing asset classes in July. The MSCI EM index returned 5.96% last month. After years of slowing GDP growth, growth rates in developing nations have begun increasing at faster rates, further increasing the spread in growth rates between emerging and developed countries, making equities in emerging economies more attractive after several years of underperformance.

Bitcoin and The Blockchain

We are sure that most of our clients are familiar with, or have at least heard of, the new craze that seems to be getting a lot of air time in the media lately – Bitcoin. Bitcoin itself is a cryptocurrency that was introduced to the world in 2008 by an anonymous person or series of programmers under the name Sitoshi Nakamoto. Its intent was to introduce the world to a secure, decentralized electronic cash network which was not regulated by a single central entity – essentially a "trustless" form of currency that did not require the public to trust a central bank or sovereign government to deem it as legitimate. The idea behind this was to allow the people, specifically programmers, to legitimize the currency by utilizing the technology behind Bitcoin, known as *blockchain*, to serve as what is best described as a public ledger to record every transaction ever initiated. The term *bitcoin* is often mistakenly used interchangeably with the blockchain technology. When hearing or reading about bitcoin, it is important to understand the difference between the digital currency, Bitcoin, and the actual technology behind it.

The easiest way to understand the blockchain technology as a public ledger is to consider the idea that instead of having individual ledgers, there is one main ledger for the entire currency system which is made public to everyone in the database and is being continuously verified by users within that database. Each transaction that is initiated is sent out to the network and is verified by individual users

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or groups of users. While the identities and transactions are encrypted in order to keep transactions private, the transaction itself is verified using complex math problems to assign each transaction what is known as a "hash," or its own mathematical identity, and a timestamp for the transaction. Once the transaction is verified, a block is created and added to the chain of transactions and recorded in the public ledger, which links every single block from the very first, known as the "genesis block," to the most current. This makes the issue of double-spending, which can be thought of as spending money that has already been spent (think counterfeit money), nearly impossible to achieve. While the blockchain technology itself has the potential to revolutionize not only the monetary system, but extend its reach far beyond that to include the insurance industry, fraud prevention, back office operations in the banking system, and even voting procedures, Bitcoin as a currency has significant flaws that would need to be worked out before it could ever be trusted as a true currency. And that day may never even come.

The best way to think of Bitcoin is to view it as a commodity. There is a finite amount of Bitcoin in circulation, which leads people to refer to it as "digital gold." And similar to the price of gold, the price of Bitcoin is highly volatile and fluctuates based on not only supply and demand, but additionally with coverage that it receives from the media. If you have $5 to spend each day on a cup of

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coffee you know that by having five US dollars in cash or in your bank account, that amount will provide you with your cup of coffee each day. Since the price of Bitcoin fluctuates relative to the dollar, the price you pay for your coffee each day would fluctuate as well. And even if the coffee shop you went to each day allowed you to pay in Bitcoin, that cup of coffee is still priced in US dollars. The price of Bitcoin is merely a reflection of the price relative to the local currency (i.e. US dollars). Just as the value of gold (and all other commodities) is priced in dollars, Bitcoin is priced the same. But unlike gold, which can be thought of as a store of value due to its protection against a weakening dollar (i.e. inflation), Bitcoin is not necessarily a store of value due to its high volatility. This makes it no different than a traditional commodity.

Additionally, Bitcoin is only one of several digital currencies being circulated right now. The popularity of Bitcoin has spawned a number of different "initial coin offerings" that use the same blockchain technology, making all digital currencies essentially the same, which leads to the notion that there really is no true finite amount of Bitcoin or any other of the "alt coins" issued. The blockchain technology essentially allows anyone to create a cryptocurrency, all of which are still being priced relative to US dollars or other fiat currencies. If I were to dip a gold bar in black paint, it doesn't change the fact

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Bitcoin and The Blockchain

that it is still a gold bar. A new and different cryptocurrency is still a cryptocurrency built using the blockchain technology. And a currency is only worth what others are willing to accept for it.

The rise in popularity of Bitcoin has caused the price to rally, reaching a value of around $4,000. The price of Bitcoin has quadrupled in 2017 and is up nearly 40% in the month of August. It shouldn't be surprising that a decentralized currency has skyrocketed on the news of geopolitical tensions between the US and North Korea. But make no mistake, this is further proof that the "currency" is nothing more than an asset. And just as an asset can rise, it can fall just as fast, if not faster, as history has shown.

The blockchain technology truly has the potential to shift the landscape of the world as we currently know it. This is why venture capitalist firms are investing hundreds of millions of dollars in the technology. But perhaps we should be finding ways to improve it before finding more ways to implement it in applications. Quoted in the book *The Age of Cryptocurrency* by Paul Vigna and Michael Casey, blockchain.info's CEO Nicolas Cary stated, "It's like we're Henry Ford and we're working with this incredible new invention – the automobile – but we haven't even gotten around to the production of the Model T and now we're saying 'Hey, let's go out and build a rocketship.'"

Disclosures & Index Definitions

Under style performance boxes, indexes referenced in the equities section for large, mid and small reference the Russell 1000, Russell MidCap and Russell 2000 stock indices, respectively. The Barclays US Government, Barclays Credit and Barclays High Yield fixed income indices refer to Gov't, Corp, and HY, respectively. Short, Intermediate and Long refer to the time frame of the investments and their positions on the yield curve.

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All dates are as of July 31, 2017 unless stated otherwise.

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Index Definitions

The **S&P 500 Index** is based on the market capitalizations of 500 large companies whose stocks are listed on the NYSE and NASDAQ. This is widely regarded as the single best gauge of large cap US Equities.

The **Dow Jones Industrial Average** is a price-weighted average of 30 actively traded blue-chip stocks, primarily industrials. It is used as a barometer of how shares if the largest US companies are performing.

The **NASDAQ** is a market capitalization weighted index of the more than 3000 common equities listed on the NASDAQ Stock Exchange. These securities include American Depository Receipts, common stocks, real estate investment trusts, and tracking stocks.

The **MSCI EAFE (Europe, Australasia, Far East) Net Index** is recognized as the pre-eminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America, Europe, Australia, and the Far East.

The **MSCI Emerging Markets Index** captures large and mid cap representation across 23 Emerging Markets (EM) countries. With 822 countries, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The **Barclays US Aggregate Index** is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS, ABS, and CMBS.

All index information has been gathered from public sources who are assumed to be reliable, although we cannot guarantee the accuracy or completeness of those public sources.