



FINANCIAL SENSE

	LAST MONTH	LAST 3 MONTHS	YTD
S & P 500 Index	2.06%	4.48%	14.24%
Russell Midcap Index	2.77%	3.47%	11.74%
Russell 2000 Index	6.24%	5.67%	10.94%
Dow Jones Industrial Average	2.16%	5.58%	15.45%
Morgan Stanley EAFE Index	2.49%	5.40%	19.96%
MSCI US REIT Index	-0.10%	0.93%	3.61%
DJ UBS Commodity Index	-0.15%	2.52%	-2.87%
Barclays Aggregate Bond Index	-0.48%	0.85%	3.14%

INDEX RETURNS

The third quarter produced gains across almost all asset classes. Economic growth continued with second quarter GDP growth of 3.1%. Hurricanes Harvey and Irma caused significant death and destruction in the third quarter. Texas and Florida took the biggest hit. It is still too early to tell how things will be affected long-term.

U.S. Large cap stocks ended the quarter up 4.48% and the S&P 500 is now up an impressive 14.24% on the year. Growth continues to outperform value with the S&P 500 growth index gaining 19.33% on the year while the S&P 500 value index is only up 8.49%.

Mid cap stocks produced a solid 3.47% gain in the third quarter while small cap stocks were up 5.67% according to the Russell 2000 index. Real Estate posted a positive gain of 0.93% in the quarter, while commodities squeaked out a gain of 2.52% in the three month period.

The bond market was positive in the third quarter with the Barclays Aggregate Bond index gaining 0.85%. Meanwhile, the JP Morgan Emerging Markets Bond Index rose another 2.68% in Q3 and is now up 9.18% YTD.

ECONOMIC REVIEW AND OUTLOOK

The U.S. economy grew at a 3.1% annualized rate in the second quarter thanks to an increase in business spending on structures. Early estimates for the third quarter are in the range of 1.5%-2.5% due to the negative initial impact of the two hurricanes. Activity should increase next quarter and the first half of 2018.

The Leading Economic Index increased in August by 0.4% to 128.8 following a 0.3% increase in July and a 0.6% increase in June. Solid growth should continue in the 4th quarter and probably through the first half of 2018.



Industrial Production declined 0.9 percent in August following six consecutive monthly gains. Hurricane Harvey was estimated to have reduced this number by roughly ¾ of one percent. The Capacity Utilization rate dropped to 76.1 percent. This is 3.8 percentage points below the historical average over the last forty years and suggests that there will not be much pricing pressure in manufacturing over the next few quarters.

Non-farm payrolls decreased by 33,000 in September and the unemployment rate dropped to 4.2%. Initial weekly unemployment claims were 243,000 for the week ending October 7. According to the JOLTS survey, there were 6.1 million job openings in August. Average hourly earnings increased to \$26.55 for private non-farm payrolls. American workers should continue to see decent wage growth with this very tight labor market.

Manufacturing increased in September to 60.8% from 58.8% in August on the ISM PMI index. This marks the 100th consecutive month of expansion. The ISM Non-Manufacturing index increased by 4.5 points to 59.8 percent in September which marks the 93rd consecutive month of expansion. The Business Activity Index was at 61.3% and the New Orders Index was also at 63.0%. All numbers point towards continued economic growth in 2018.

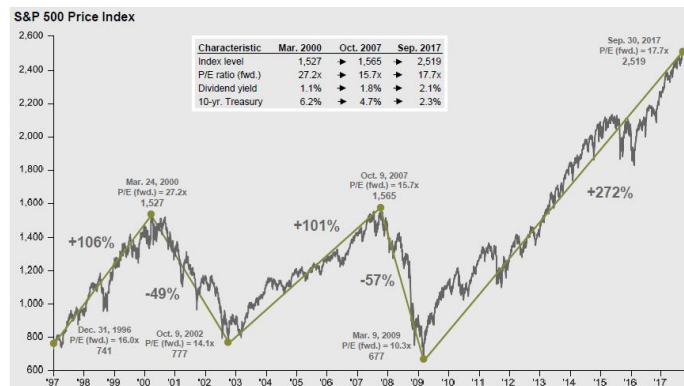
Global economies are growing nicely and not getting much attention. The JP Morgan Global PMI was at 53.2 in September up from 51.1 a year ago. The Euro area is at 58.1 lead by Germany and Italy who are at 60.6 and 56.3 respectively. Emerging markets continue to rally with an August reading of 51.7 lead by Taiwan at 54.2 and Mexico at 52.8. Growth outside of the U.S. will continue to be a big story for the final quarter of 2017 and as we head into 2018.



EQUITY AND BOND MARKETS

Hurricanes and wildfires have caused massive damage and destruction in the second half of this year. These events cause short-term disruptions in business activity and can hurt supply chains around the U.S. This will probably translate into a lower Q3 GDP number. However, the rebuild movement will begin soon and will translate into more production and higher earnings. If you analyze the last six hurricanes to hit the U.S., the S&P 500 was up on average 8.4% one year later. That number would be even higher but it includes a 16% decline in 2008 which is attributed to Hurricane Ike, but was really a result of the Financial Crisis and Recession.

The S&P 500 was at 2,519 at the end of the quarter. The index is up 272% since March 9, 2009. The forward P/E ratio is now at 17.7 times earnings. The 25 year average is 16.2 times earnings. When the market peaked in March of 2000, the P/E ratio was over 27 times earnings, the dividend yield was only 1.1% and the 10 year Treasury yield was 6.2%. In October of 2007, the P/E ratio was 15.7 times earnings, the dividend yield was 1.8% and the 10 year Treasury yield was 4.7%.



It is clear that while U.S. equities are more expensive than they were a year ago, they are not as expensive as they have been at prior peaks when looking at other variables. What is also clear is that international equities have had a good run this year and are still relatively cheap. The MSCI All Country World ex-US index has a P/E ratio of only 14.2 times earnings and a dividend yield of 3%.

Earnings in the U.S. are at all-time highs, while Europe and most Emerging Market markets still have a long way to go before they return to their 2011 peaks. With relatively low valuations and improving fundamentals, we believe that international stocks will continue to outperform U.S. equities over the next few quarters.

The bond market continues to be challenging for investors. The Federal Reserve chose to not change its overnight rate in September keeping it in the 1.0% to 1.25% range. The market is expecting a rate hike at the December 13 meeting and then possibly three more hikes in 2018. This would put the overnight rate around 2.0-2.25% in 2018.

In addition to the rate hikes, the Federal Reserve has indicated that it will be reducing its balance sheet over the next few years. The current balance sheet contains \$4.46 Trillion of Treasuries and Mortgage Backed Securities. They would like to reduce this to around \$2.6 Trillion by 2022. This extra inventory could put pressure on prices and drive up yields over this time frame. Existing bonds may face a stiff headwind during this next phase.



PORTFOLIO MANAGEMENT

The Investment Committee recently added a new position to the international equity side of the portfolio. We purchased a 3 year structured note from Citi Group which will mature in August of 2020. This note is tied to the Euro Stoxx 50 Index (Roughly the Dow Jones Industrial Average for Europe). We have a 10% downside buffer which means that Citi picks up the first 10% of any loss upon maturity. If the index is down 9% upon maturity we would get the entire principal back. It also pays 180% of any upside. So, if the index is up 10% at maturity, the note will return 18%. We felt like this would be a great addition to the portfolio.

So far this new purchase has worked out well. The index is up 4.7% since the purchase date and the note is up around 3.5%. If the note matured today, we would get a return of 8.48%! We will see how this plays out over the next few years. Meanwhile, the rest of the portfolio is doing great. Our international funds are having a great year and have carried returns. Through the end of the quarter our international funds were up about 23% which pushed our overall equity returns up to around 16%!

The bond side of the portfolio is also doing quite well. The combination of our global bonds, convertible bonds and market neutral fund has our fixed income up around 3.8% through the end of September while the Barclays Aggregate Bond index is only up 3.14% on the year.



FINANCIAL PLANNING

Required Minimum Distributions must be completed by December 31, 2017. For individuals over age 70 ½, please make sure that you satisfy the RMD for the year. The penalty for not taking the full amount is 50% on the shortfall. Congress has made permanent the Qualified Charitable Deduction for those individuals over age 70 ½. This allows direct contributions to charities from your IRA to qualify as your RMD. This is a great way to give to charity and reduce your Adjusted Gross Income, thereby lowering your tax liability.

The deadline to make your 2017 529 plan contribution is approaching. Contributions must be received by the plan provider by December 31, 2017. A \$5,000 contribution to the Indiana 529 Plan will enable you to receive a \$1,000 state tax credit. That is a 20% rate of return! Other states also have very good deductions and credits available. Please talk to us about your current situation so that we can help you maximize this technique.

There is still time for tax planning in 2017. Should you convert some of your retirement assets into a Roth IRA? If you are under age 70 ½, this could be an effective strategy. You will pay taxes on the amount that you convert, but this will reduce your future distributions at potentially higher tax brackets. Contact Andy Young, CPA at Andy@galecki.com to see how much you should convert this year.

Here are some smart phone apps that we think you might enjoy. Please let us know if you have any new apps that you would like to share with everyone.



- **Spot Hero:** This application allows you to find and reserve parking in major cities. They have access to thousands of garages and lots and most are offered at steep discounts, sometimes up to 50%. The application is free on most platforms.



- **IFTTT:** IFTTT stands for %This Then That+. Simplify and automate everyday tasks between apps by creating custom actions. Stay informed about news, weather, stock prices and more. Trigger certain events based on your location. The possibilities are endless. This is a free app.



- **Turo – Rent Better Cars:** This application is comparable to %Air B&B+ but for cars. Users can list their own cars for rent or rent from others. Rent any type of car at any time from anyone in the community. Renting is often 30% less than traditional rental companies. It is a free application.



Company News



Joy Sanders

Joy Sanders joined Galecki Financial Management in August of 2017. She is an Asset Management Specialist within the Client Service Department. She is responsible for the daily download, report creation, special projects and general service on all client accounts.

After earning her Bachelor's degree from Indiana University at Fort Wayne in 2007, Joy began her career with PNC bank. During her time with PNC, she went on to earn her Masters Degree of Business Administration from Indiana Wesleyan University in 2009. She worked for a few other companies over the last eight years including Lincoln Financial Group.

In her free time, Joy is the consummate outdoorswoman. You can find her exploring the woods of Indiana or surrounding states in search of beautiful landscapes, new adventures, and wildlife. GFM is happy to add Joy to our team and believes she will be a tremendous asset. Please help us welcome Joy to the GFM family. Her email address is Joy@galecki.com.

- Galecki Financial Management Investment Committee

Special Note: If you would like to schedule an appointment with a Certified Financial Planner™ Professional, please visit www.galecki.com.