FERGUSON JOHNSON
WEALTH MANAGEMENT

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Year End Report & Commentary, 2017

"Let us not seek to satisfy our thirst for freedom by drinking from the cup of bitterness and hatred."

-Martin Luther King, Jr.

For many, 2017 was a year of pessimism, anguish, fear, and anger. For 65,853,516 voters it was a defeat that was hard to swallow and, still to this day, hard to live with. The loser received 48.2% of the popular vote and the winner 46.1%. While there's obviously something to make of the loser receiving nearly 3,000,000 more votes than the winner, I don't think that's the story here. We all know about the Electoral College and how it decides our Presidential Election. This isn't new. We can remember 2000 when the loser of the national popular vote won the Presidential election, as well.

In my opinion, the real story was - and is - the complacency of our adult, eligible voting population. The truth is, this election, like most of our local, state and national elections, was decided by about a quarter of Americans that are eligible to vote. Donald Trump received votes from roughly 25% of eligible voters, and that allowed him to be the President of the United States. Many of those out there complaining day-in and day-out over the management of our country are the same that couldn't be bothered to let their voice be heard when it counted.

**All voter data from the Federal Election Commission as of January 30, 2017.*

We have a President who tweets. The President's comments are disseminated worldwide in a matter of seconds. Those few words are then analyzed ad infinitum by the news pundits. We are subjected to political minutia on a scale never before seen. There is more chaos in the news each day than I can ever remember there being by a large margin. Yet, 2017 just closed as one of the most stable (and positive years) in stock market history. The S&P 500 moved 1.0% or more in just eight trading days this past year. Compare that to an average of 50 days of movement in excess of 1.0% in prior years dating back to 1945. The lack of volatility observed in 2017 was astounding.

A number of well-respected market commentators have gone on the record this past year having said something to the effect of: the markets no longer care about what's going on in the White House. That may be true, but also, I'm not sure markets have ever cared.

In nearly all of our previous commentaries, we've refrained from offering analysis on the future direction of the economy, the stock markets, or political outcomes. Instead, we attempt to lay out the fact that diversification of assets, with a long-term perspective, remains the most reliable and prudent means of improving and preserving one's wealth.

2017 Market Report Card

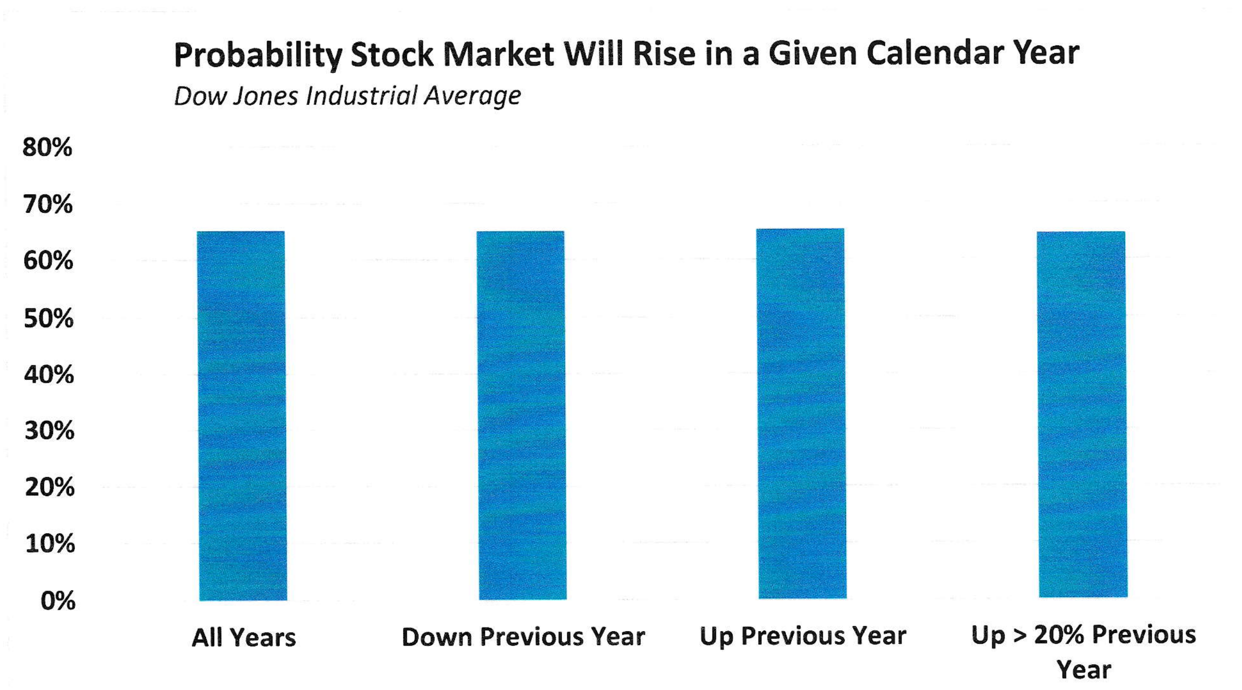
It wouldn't be a new year's commentary without some reflection on the year that was. Let's check in with how the various broad asset classes fared in 2017:

Index	2017 Return
S&P 500 (U.S. Large Companies)	21.83
Russell 2000 (U.S. Small Companies)	14.65
MSCI EAFE (Developed International)	25.03
MSCI Emerging Markets	37.28
S&P U.S. REIT (U.S. Real Estate)	4.33
Bloomberg Barclays U.S Aggregate Bond	3.54
S&P U.S. Treasury Bond, 10-year	2.26

**Source: Morningstar, as of December 31, 2017. Total Return.*

2017 was what we might describe as "a good year" in the markets - one of those years where it's fun to be a financial advisor. Global equities soared with international markets generally outperforming the U.S.

We've observed that top of mind for many investors has been, will this continue? I tend to discount arguments based on regression-to-the-mean, or momentum, or relative valuations, or a multitude of other situational takes on markets as a whole. At the end of the day, we don't believe the previous year has much bearing on what we might expect to see in the future. Historically, it turns out, the previous year's return tells us almost nothing about the probability of future returns.



**Source: Yahoo Finance, Dow Jones Industrial Average calendar year performance since 1897, as of December 31, 2017.*

Strong gains in 2017 do not mean we're due for a correction or that stocks are poised to continue providing investors with positive returns. The odds are simply tilted in the favor of further growth.

Unfortunately, depending on an individual investor's risk appetite, 2017 may not have yielded quite the same windfall for all participants. Overly cautious investors, who kept all their funds in "safe" bond assets, struggled to keep pace with inflation, producing negligible real returns. Low interest rates have been a boon to home buyers and borrowers, but not beneficial for the retired and/or risk-averse investor.

This is partly why we often advocate for retirees to maintain healthy allocations to equities. The days of being able to purchase treasury bonds at retirement and ride off into the sunset are over. For current retirees, equity exposure is necessary to achieve retirement goals.

A Quick Anecdote on Hedge Funds

Hedge funds are something we have investigated over the years. We have an obligation to our clients as fiduciary advisors to perform the due diligence of ensuring our clients' assets are invested in the securities that best serve their goals.

We do not feel Hedge Funds are a prudent investment for the overwhelming majority of investors. The fees are exorbitant. Many hedge funds operate on a "2-and-20" expense schedule. Which means, investors pay the hedge fund 2% of the assets they manage per year, and then an *additional* 20% of all profits the fund earns for them... and those profits have left a lot to be desired.

You may remember seeing headlines, early in the recession, that Warren Buffet made a friendly wager with a money management company called Protégé Partners. Buffet bet that simply placing the entirely of his gamble in the S&P 500, he could outperform a basket of hedge funds Protégé Partners constructed over the 10-year time period of the wager. December 29th, 2017 marked the end of the bet which saw Buffett's investment grow by 7.1% annually vs. 2.2% from the hedge fund basket[1]. Quite a startling show of underperformance from the hedge funds.

Needless to say, we will continue to refrain from recommending hedge funds to our clients.

After a wonderful 2017, both personally and professionally for our team, we look forward to an exciting 2018.

All the best,

John, Derek, Jon, Stacie, and Kadeem.

[1] "Buffett wins his hedge-fund bet — and this nonprofit wins bigger", Nicole Friedman, MarketWatch, December 30, 2017.

The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 actively traded "blue-chip" stocks, primarily industrials, but includes financials and other service-oriented companies. The components, which change from time to time, represent between 15% and 20% of the market value of NYSE stocks.

Derek Johnson is an Investment Advisory Representative of Ferguson-Johnson Wealth Management, a values-based investment management firm located in Maryland. Derek Johnson can be reached at (301)670-0994 or djohnson@mymoneymanager.com.