REFLECTIONS

4th Quarter Newsletter 2017

WINDGATE
WEALTH MANAGEMENT

www.windgatewealth.com

VOLATILITY STRIKES BACK

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After nearly two years of unprecedented calm, the period of stable and rising global markets has been interrupted. By early February, the stock market had fallen more than 10% from its recent all-time highs, a reversal from several trends we have previously noted in your communications as likely unsustainable. On January 26, 2018:

- The S&P 500 had gone over 400 days without a 5% pullback, an all-time record.
- The stock market has not had a 10% correction since February 2016.
- 2017 year was the first year ever that stocks rose in each and every month.
- Last year was the ninth consecutive year of positive returns for the S&P 500 Index, tying the 1990's bull market and capping a remarkable run of over 300% since the depths of the financial crisis.

Corrections don't occur with great frequency, but they do occur with regularity. On average, a correction of 10% happens about once a year. A 5% pullback takes place about three times per year. This is based on data from 1900-2016.[1]

INSIDE THIS ISSUE

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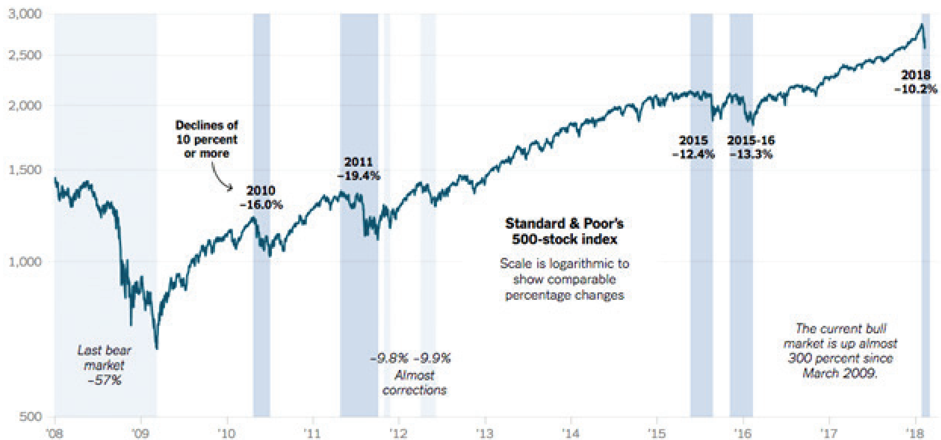
We believe the global economy is healthy, corporate profits are strong and the likelihood of a near term recession remains low. Without a recession, a bear market in stocks is unlikely. However, the next six or twelve months could very likely bring continued volatility. Taking a longer look in the chart below, the recent correction doesn't seem so unusual that it should cause a panic. In fact, there have now been five corrections throughout the market's rise of nearly 300% since the depths of the financial crisis in March 2009.

S&P 500 Return 2008-2018



Including the current one, there have been five corrections of the Standard & Poor's 500 during the bull market that began almost ninety years ago.

Source: Thomson Reuters, Yardeni Research, New York Times

[1] Source: Capital Research and Management Company 1900-2016

Time Heals All Wounds

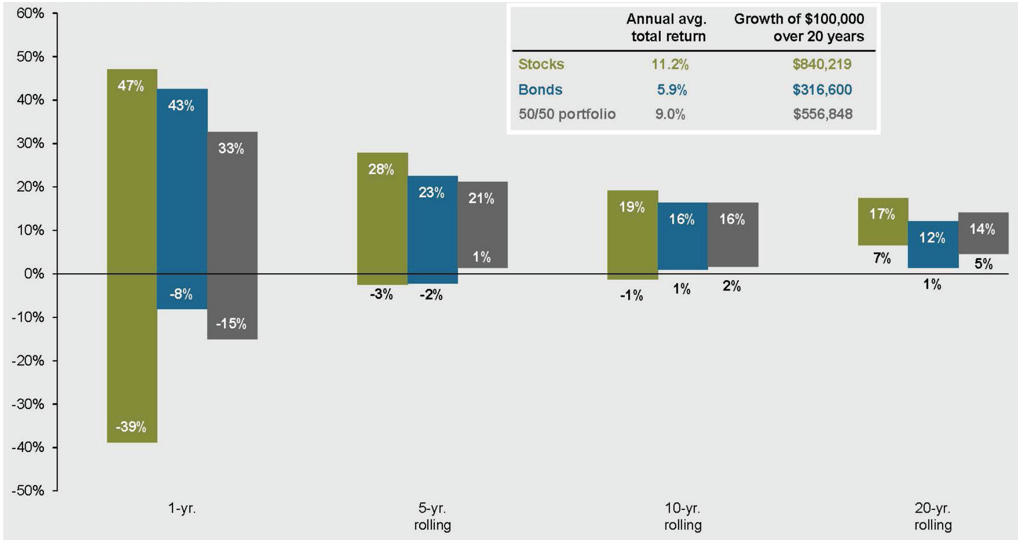
Because drawbacks are a such a normal part of investing, it can be helpful to see through the noise and focus on longer term results. The chart below shows how history suggests disciplined investors are unlikely to suffer large losses over longer periods. The bars represent the range of "rolling returns," that is the average annual return for the holding periods listed below (1-year, 5-year, 10-year and 20-year).

As you can see, the range of possible outcomes narrows significantly as your holding period increases. While 1-year stock returns have varied widely since 1950 (+47% to -39%), a blend of stocks and bonds has not suffered a negative return over any 5-year rolling period in the past 66 years.

Why do so many investors suffer from the "behavior gap," which is the tendency for actual investor accounts to far under-perform the market's long-term averages?

Range of Stock, Bond and Blended Total Returns

Annual total returns, 1950-2017



	Annual avg. total return	Growth of $100,000 over 20 years
Stocks	11.2%	$840,219
Bonds	5.9%	$316,600
50/50 portfolio	9.0%	$556,848

Source: Barclays, FactSet, Federal Reserve, Robert Shiller, Strategas/Ibbotson, J.P. Morgan Asset Management. Returns shown are based on calendar year returns from 1950 to 2017. Stocks represent the S&P 500 Shiller Composite and Bonds represent Strategas/Ibbotson for periods from 1950 to 2010 and Barclays Aggregate thereafter. Growth of $100,000 is based on annual average total returns from 1950 to 2017.

Buy and Hold: Easier Said than Done

If we are prepared with the knowledge that corrections occur regularly, and holding stocks over longer periods have historically made up for any losses (and then some), investing should be easy. Why then does it not always seem that way? Why do so many investors suffer from the "behavior gap," which is the tendency for actual investor accounts to far under-perform the market's long-term averages?

Part of the answer lies in the chart below, which shows how volatility is constantly tugging at investors' emotions to sell at the worst times. The red dots on this chart represent the maximum intra-year decline in every calendar year for the S&P 500, since 1980. The gray bars represent the calendar-year return.

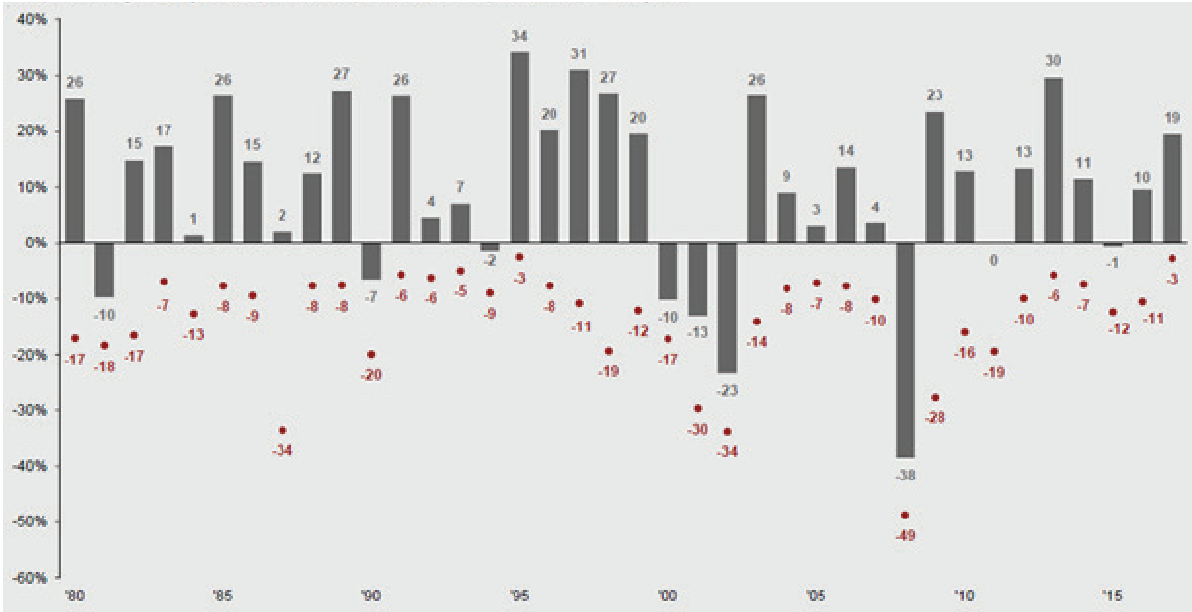
The average intra-year decline for the S&P 500 Index is 13.8%, and markets suffered double-digit declines in 21 of the last 37 years. Despite the many pullbacks, roughly 75% of those years ended with positive returns. While this volatility can and should be muted with a diversified portfolio, investors still need a plan for riding out volatile periods without reacting based solely on emotions.

"An investment in knowledge pays the best interest," as Benjamin Franklin wisely said, and we hope these figures can help you rest easier during more difficult times.

A blend of stocks and bonds has not suffered a negative return over any 5-year rolling period in the past 66 years.

S&P 500 Intra-Year Declines vs. Calendar Year Returns

Despite average intra-year drops of 13.8%, annual returns positive in 29 of 38 years



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management. Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2017, over which time period the average annual return was 8.8%.

YEAR IN REVIEW

This past year was yet another stellar year for U.S. stocks. Larger-cap U.S. stocks gained 6.6% for the quarter and ended the year with a 21.7% total return. This was the ninth consecutive year of positive returns for the S&P 500 Index—tying the historic 1990s bull market and capping a truly remarkable run from the depths of the 2008 financial crisis. Foreign stock returns were even stronger in 2017, with developed international markets gaining 26.4% and emerging markets up 31.5% for the year.

Our globally diversified portfolios generated strong returns for the year, consistent with the positive overall return environment for most financial markets and asset classes. Our meaningful exposure to European and emerging-market stocks was a significant contributor, as foreign stocks outpaced U.S. stocks in 2017.

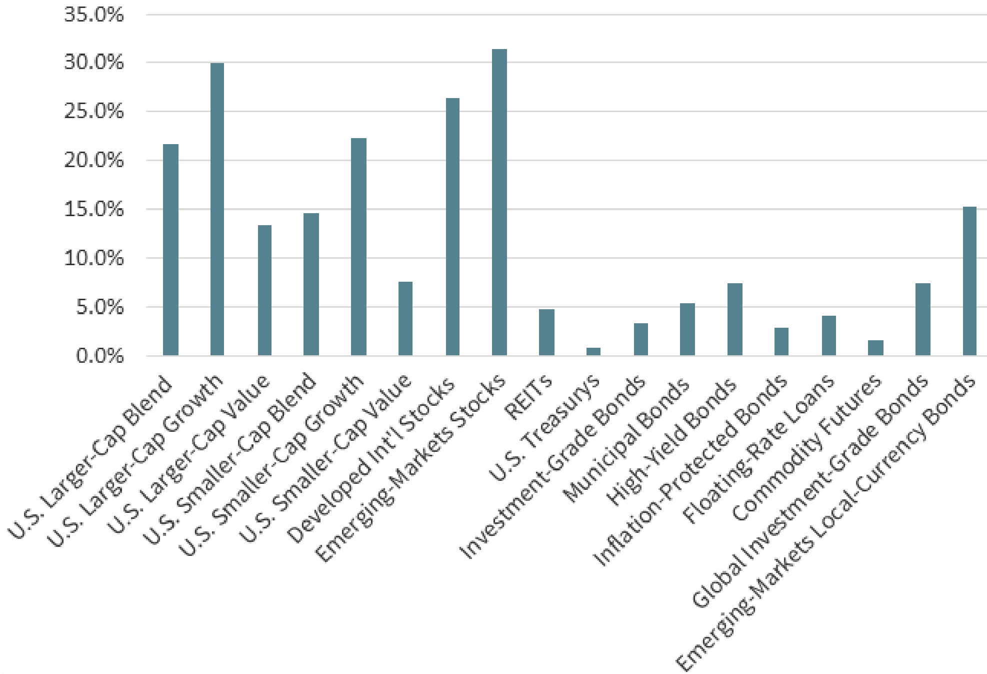
We believe the broad driver of the market's rise for the year was rebounding corporate earnings growth, which was supported by solid economic data, synchronized global growth, still-quiescent inflation, and accommodative monetary policy. U.S. stocks got an additional catalyst in the fourth quarter with the passage of the Republican tax plan, presumably reflecting investors' optimism about its potential to further boost corporate after-tax profits, at least over the shorter term.

Moving on to bonds, the core bond index fund gained 3.5% in 2017. This return was close to the index's yield at the start of the year, as intermediate-term interest rates changed little during the year. Although the Federal Reserve raised short-term rates three times, yields at the long end of the Treasury curve declined and the yield curve flattened.

The year 2017 was a very good one for most financial markets. While the macro outlook remains positive, unprecedented central bank policy shifts could trigger increased volatility, a stock market correction (as we've now experienced), or even a recession sometime in this business cycle.

During this uncertain time, it is important to stay disciplined and patient. This environment should keep any sensible investor from being overly confident about how things will play out. We focus on the more realistic goal of sticking to our investment discipline and only taking on risk when we believe it raises our portfolios' return potential without materially increasing the potential downside. We remain confident in our diversified portfolio positioning, looking ahead over our long-term investment horizon.

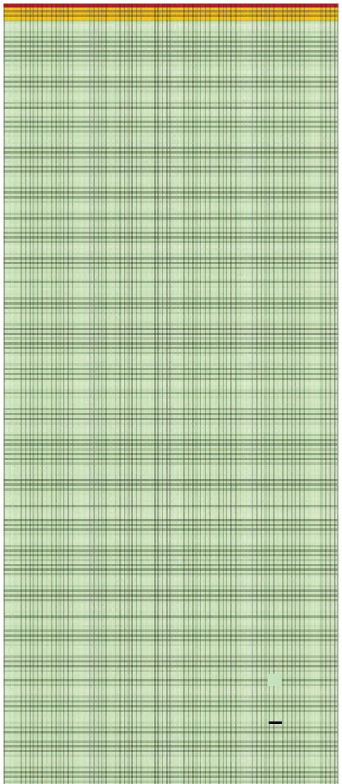
2017 Asset Class Returns



The year 2017 was a very good one for most financial markets.

THIS IS YOUR LIFE: MARKET CORRECTIONS

10% correction | 5% pullback | days the market is open | days the market is not open



Market Corrections don't happen very often, but they are very memorable when they do. This is because we are wired to feel a greater impact when we face losses than when we experience gains. This idea is explored more in detail in the best-selling (and recommended) book *Thinking Fast and Slow* by Nobel Prize-winning psychologist Daniel Kahneman. In fact, Mr. Kahneman's research has shown that the negative psychological impact of losses on humans *are twice as powerful* as the positive feeling associated with gains.

Because of this "loss aversion," it is perfectly normal to feel like market corrections happen more often than they actually do. The table to the left is designed to give you a perspective on how often you can expect to experience large losses over your lifetime.

Each of the boxes in the table represent a single day in the average American lifespan. The 78 columns (one per every year of an average lifespan of 78.5 years) each consist of 365 days.

- Red boxes represent one 10% correction per year.
- Yellow represents three 5% pullbacks per year.
- Green boxes represent the remaining number of days markets are open over a 78-year lifetime.
- Blue boxes represent days over a 78-year life where the market is closed.

This is a simple table but we hope its message is meaningful. Of course, market corrections take more than one day to play out, and often include both up and down days. The red and yellow boxes just represent how often corrections typically occur, not how long they last.

Market corrections are a normal part of investing. The red and yellow boxes are far less frequent than the green and blue, but they are consistently there. Thankfully, investors benefit from the relative frequency of green boxes and the compounding growth over time that can build wealth over generations.

Notably, there are many days that don't have anything to do with the market at all. Rather than worry about the ups and downs, spend time focusing on the things that motivate you to save and grow your assets in the first place – be it your family, your experiences, or whatever else it is that moves you.

[1] As noted earlier in this letter, a correction of 10% happens about once a year on average, and a 5% pullback takes place about three times per year. This is based on research by the Capital Research and Management Company looking at data from 1900-2016.

WINDGATE

In The Community

Windgate Wealth Management is committed to giving back to the communities in which we live and work. We aim to make an impact by investing our resources – financial contributions, employee volunteering and mentoring to support outstanding charities, such as Erika's Lighthouse.

Erika's Lighthouse History

Erika's Lighthouse: A Beacon of Hope for Adolescent Depression was founded in 2004 by Virginia (Ginny) and Thomas (Tom) Neuckranz after their daughter Erika lost her life to the illness of depression.

Tom and Ginny founded Erika's Lighthouse to be a beacon of hope for the many other young people who struggle with depression, empowering them with the knowledge and skills to understand and cope with this illness.

Tom and Ginny have provided a consistent vision and have given countless hours to ensuring that our vision is carried out in our daily activities.

As President of the Board of Directors, Ginny has seen the growth of the organization from having a pilot program in one school to having a presence in schools throughout Chicagoland and beyond.

Erika's Lighthouse Programs

Thomas and Virgina Neuckranz, Founders

Erika's Lighthouse: A Beacon of Hope for Adolescent Depression is a not-for-profit organization dedicated to educating and raising awareness about adolescent depression, encouraging good mental health, and breaking down the stigma surrounding mental health issues.

Teen Depression: Stories of Hope & Health for Middle School Students

The Erika's Lighthouse Curriculum: Depression and Suicide Awareness for High School Students

High School Teen Clubs

Teacher Trainings

Depression Awareness Campaign for Teens

IRA CONTRIBUTIONS DEADLINE

Don't forget, **2017 contributions for IRAs and Roth IRAs must be made by April 15, 2018.** Maximum contributions are $5,500 per individual ($6,500 if you are age 50 or over). Income limits for contributing to Roth IRAs or making deductible contributions to Traditional IRAs are below. You can also still benefit from tax-deferred growth in a traditional IRA by making non-deductible contributions should your income exceed the limits. Remember, contributions can be made from both cash on hand or from your taxable investment accounts. Give us a call to determine if this is the right option for you.

IRA 2017 INCOME LIMITS

Filing Status	Roth IRA Can contribute if your Modified AGI is	TRADITIONAL IRA Can deduct contributions* if your Modified AGI is
Single or Head of Household	<$133,000	<$72,000
Married Filing Jointly	<$196,000	<$119,000
Spousal IRA (Those with spouse who earns no income)	N/A	<$196,000

*If you are not covered by an employer plan, you can deduct 100% of IRA contributions regardless of income.

Source: IRS.com.

QUOTES ON MONEY, WORK AND HUMOR

Money can buy happiness, but words are free. Here are a few of our favorite quotes regarding money, work and humor.

- "Time is your friend; impulse is your enemy." - Jack Bogle
- "The secret of staying young is to live honestly, eat slowly, and lie about your age." - Lucille Ball
- "Money isn't the most important thing in life, but it's reasonably close to oxygen on the "gotta have it" scale." - Zig Ziglar
- "I find a duck's opinion of me is largely influenced by whether or not I have bread." - Mitch Hedberg
- "Do you want to make money from Facebook? It's easy. Just go to your Account Setting, Deactivate your account, and Go to Work!" - Anonymous
- "Before you marry a person, you should first make them use a computer with slow Internet to see who they really are." - Will Ferrell

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