THIRD QUARTER

2017 Market Review & Outlook

GO TO WWW.PERSONALCAPITAL.COM TO LEARN MORE ABOUT OUR FREE FINANCIAL TOOLS

Contents

03 EXECUTIVE SUMMARY

04 MARKET RECAP

07 CAPITAL MARKETS OUTLOOK

10 THE EQUIFAX BREACH

13 TAX REFORM

Executive Summary

> Personal Capital has surpassed $5 billion in assets managed. On the Dashboard, we released the Personal Strategy feature for clients on the website. It is an extension of the mobile version and helps you see more detail on Personal Capital managed assets, including performance, trade activity detail and overall strategy. We also released an Education Planner, embedded within the Retirement Planner, to track and prepare for college costs.

> Despite a laundry list of global concerns including North Korea, hurricanes, dysfunction in Washington and a massive data breach, the bull market marched forward unabated. It was a reminder that stock prices are based on supply and demand for companies, not countries, and of the importance of a strategic long-term asset allocation as opposed to market timing.

> S&P 500 earnings growth for Q3 is estimated at 5%, according to FactSet. This is respectable, but means the majority of gains in U.S. stocks over the last year came from PE multiple expansion rather than earnings growth.

> The first half of 2017 was dominated by large-cap technology, with the "FAANG" stocks capturing media focus and persuading many investors to double down. Q3 started in similar fashion, but there was a subtle shift about midway through the quarter. Tech began to modestly lag, and small-caps returned to favor.

> Valuations are elevated—but not extreme. Economic growth and corporate earnings are solid—but not exciting. Meanwhile, major central banks, including the Fed, have taken their foot off the gas and are contemplating periodic light taps on the brakes.

> A possible concern is a flattish yield curve. Historically, flat or inverted yield curves have often been precursors for recession and declining stock prices. An oft-cited reason is that banks are less incentivized to lend in such environments.

> In early September, Equifax announced a massive data breach. Based on conversations, it is apparent most people haven't taken any action to protect themselves.

> The basic thrust of the proposed tax reform is to lower taxes for corporations and very wealthy individuals. There is a lot more, but at this stage we don't think people should be spending much time in anticipation of tax reform which may or may not even occur.

Market Recap

In the past three months North Korea successfully tested a hydrogen bomb, threatened to explode another over the Pacific Ocean and fired multiple missiles over Japan. Devastating hurricanes battered Texas, Florida and the Caribbean. Political dysfunction in Washington featured more Russia controversy, significant White House staff turnover, and feuds with the NFL, civil rights groups and the mayor of Puerto Rico. Equifax reported a massive personal data breach. And the Fed indicated it remains on track to raise interest rates another 0.25% this year and begin the process of deleveraging its massive balance sheet.

Through it all, the bull market remained unfazed. U.S. stocks rose for an eighth consecutive quarter, and daily volatility stayed conspicuously absent. The U.S. Total Stock Market Index returned 4.5% for the quarter. Globally diversified investors fared better, as international stocks outperformed the U.S. for a third straight quarter by gaining 5.9%.

Q3 was a good reminder that stock prices are a function of supply and demand for ownership of companies—not a measure of geopolitical temperament or the state of the world. Optimism for corporate tax reform may have been one driver of demand. Small-cap stocks, viewed by many as primary beneficiaries of proposed tax legislation, surged late in the quarter after lagging for most of the year.

S&P 500 earnings growth for Q3 is estimated at 5%, according to FactSet. This is respectable, but means the majority of gains in U.S. stocks over the last year came from PE multiple expansion rather than earnings growth. Q2 U.S. GDP growth was revised up to a healthy 3.1%.

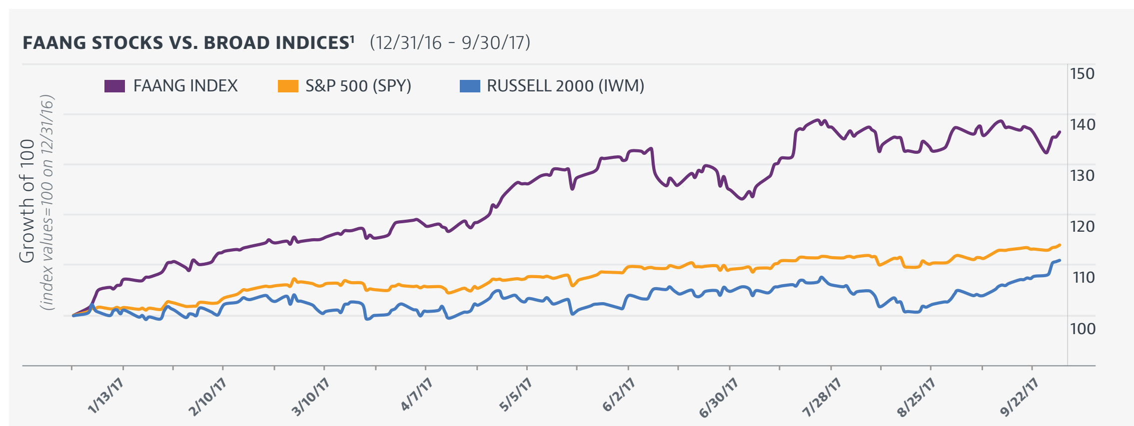
Counting dividends, the S&P 500 has been positive every month this year. If you are curious how many times the index has made it through a full year without a down month, the answer is zero. Identifying the top of a rising bull market is very hard to do, and we urge investors to fight the two primary enemies of success: fear and greed. Those who have stuck with a personalized, strategic asset allocation have benefited greatly from this bull market. They can feel confident knowing they are appropriately diversified for the full market cycle.

INSIDE THE NUMBERS

The first half of 2017 was dominated by large-cap technology, with the "FAANG" stocks capturing media focus and persuading many investors to double down. Q3 started in similar fashion, but there was a subtle shift about midway through the quarter. Tech began to modestly lag, and small-caps returned to favor. There was no obvious catalyst, but the trend seemed to accelerate in September following an uninspiring new phone lineup from Apple.

It would be far too premature to declare the tech rally over — despite the slowdown in September, it was still the leading sector for the full quarter. But with high expectations built into stock prices, today's tech darlings must continue to execute at a high level to produce future gains. Major sector rallies always come to an end, often in ugly fashion. However, timing these reversals is extremely dangerous. This is a major reason we prefer a more equal weighted approach to both company size and economic sector. Periodic rebalancing is a key to long-term success.

FAANG STOCKS VS. BROAD INDICES[1] (12/31/16 - 9/30/17)



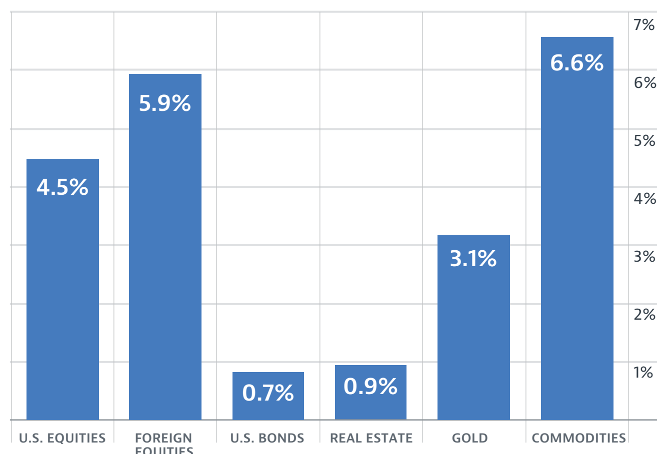
After dropping nearly 10% in Q2, the price of oil rebounded and finished September hovering around the $50 mark, which has become the new standard baseline since mid-2016. We view this as positive for the economy and equity markets. A more stable market will reduce energy-related bankruptcies and prevent larger dislocation. Moreover, oil prices are at about half of what they were just a few years ago, which helps drive profit margins for virtually every sector outside of energy. But the road ahead remains unclear. Oil is struggling to hold on to $50 a barrel in a relatively strong economy. If we hit a recession, OPEC abandons supply ceilings, or the transition to electric cars moves faster than expected, prices could fall rapidly. While it is hard to envision a sharp rebound in prices, investment in new production has been cut and anything is possible. Like stocks, energy prices have a long history of doing the unexpected.

BONDS

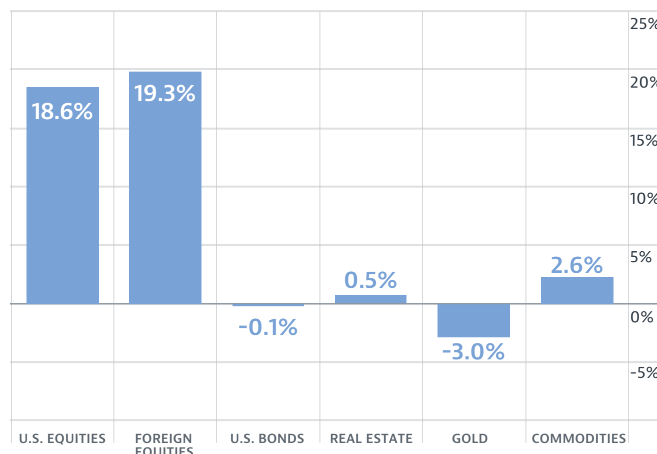
Once again, almost everyone agrees bond rates will rise. And once again, they were mostly wrong in Q3. The 10-year Treasury yield finished the quarter at 2.33%, essentially flat from where it began. The 2-year yield did rise modestly from 1.38% to 1.47%, further flattening the yield curve.

With yields near all-time lows on much of the curve, the upside from owning bonds is moderated. Moreover, short rates are now closer to long rates, meaning longer-duration bonds don't offer much in the way of extra yield to justify their inherent higher interest rate risk. Even so, bonds remain one of the best tools to provide absolute return and diversification from stocks over full market cycles. They should continue to play an important part of most portfolios—investors just need to pay close attention to how their bond portfolio is constructed. Ideally, bond holdings should contain a mix of different kinds of bonds including Treasuries, TIPS and corporate issues of multiple credit qualities. Maturity and duration should be managed to control risk in the event yields do rise rapidly.

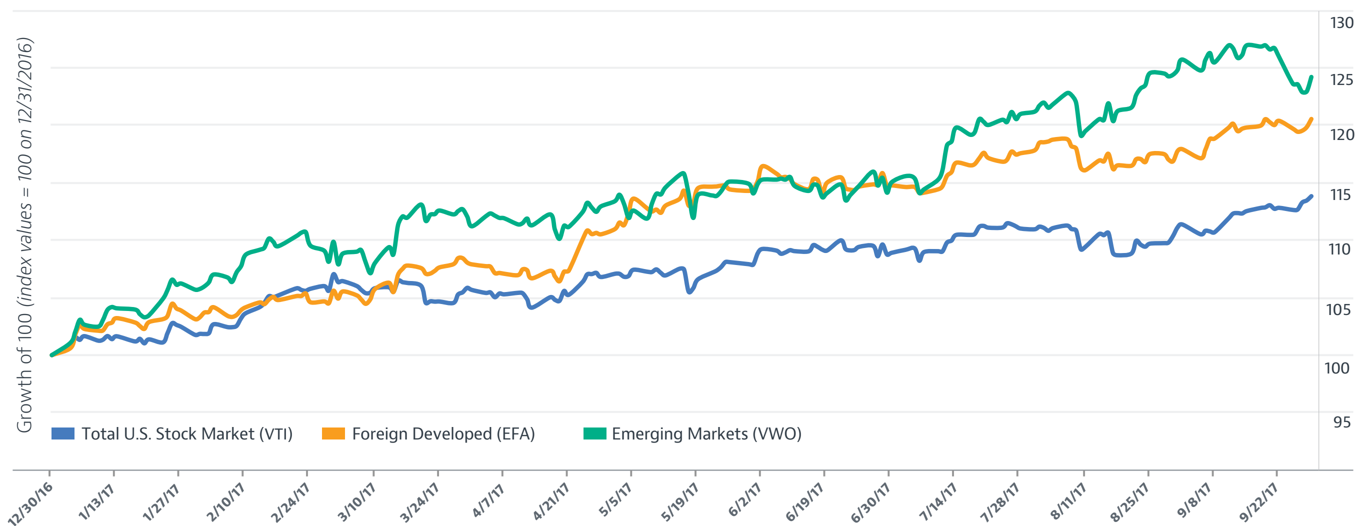
Q3 2017 ETF PERFORMANCE[2]



TRAILING 1-YEAR ETF PERFORMANCE[2] (09/30/16 - 09/30/17)



EQUITY ETF PERFORMANCE[3] (12/31/16 - 09/30/17)



Capital Markets Outlook

Ten years ago this week, the global stock market peaked. It then slowly declined for about a year before the crescendo of the Lehman bankruptcy and near collapse of the financial system. The S&P 500 hit an intraday low of 666 on March 9, 2009—a decline of nearly 60%. Even so, $1 invested in the S&P 500 at the very top on October 9, 2007, would be worth about $2 today. It is a good reminder that investing in companies tends to create wealth over time, but the ride can be volatile and uncomfortable.

The nine-year-old bull market added another solid quarter to the history books in Q3. As usual, there are scary new headlines—North Korea, the separatist movement in Spain and a horrific mass shooting—but the fundamental backdrop for capital markets hasn't significantly changed.

Valuations remain elevated - but not extreme. Economic growth and corporate earnings are solid - but not exciting. Meanwhile, major central banks, including the Fed, have taken their foot off the gas and are contemplating periodic light taps on the brakes.

A possible concern is a flattish yield curve. Even as the Fed has lifted short-term rates away from zero, longer-term rates remain stubbornly low and the spread between the 2-year Treasury and 10-year Treasury yield is now just about 1%. Historically, flat or inverted yield curves have often been precursors for recession and declining stock prices. An oft-cited reason is that banks are less incentivized to lend in such environments. But today, low corporate bond yields are providing cheap financing for most publicly traded companies, and smaller firms have more access to private equity capital and nontraditional lenders.

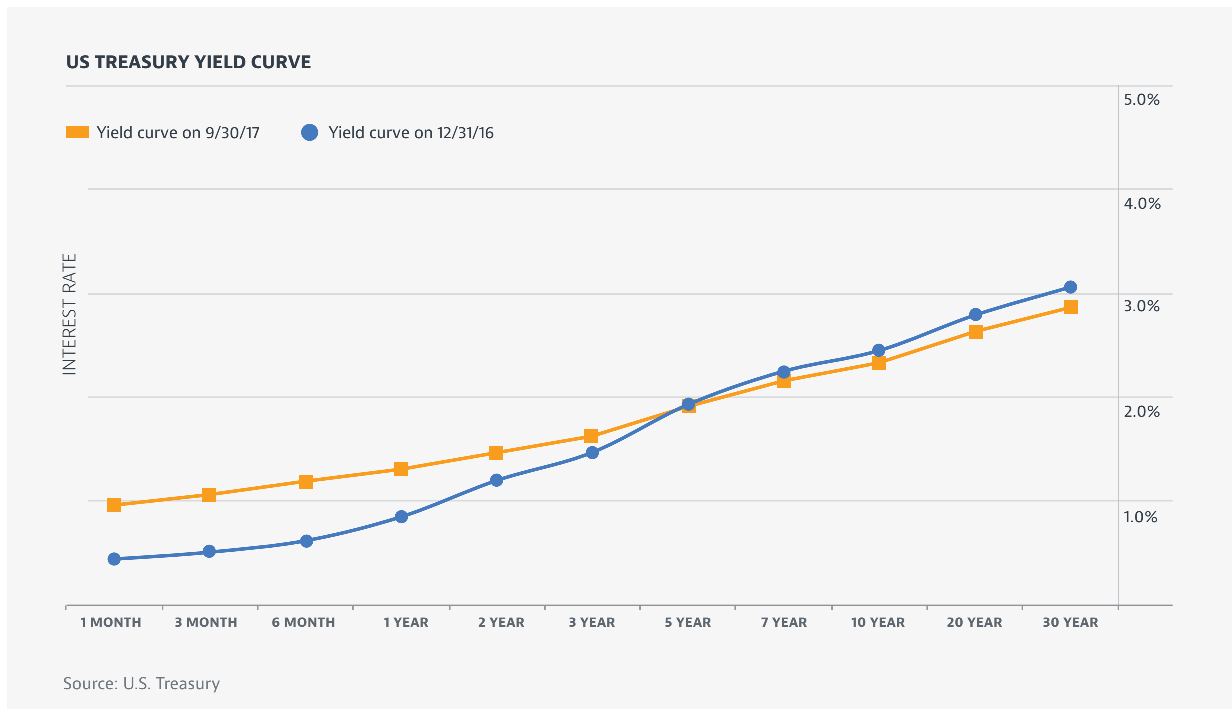
PAGES 5-6

[1] Source: Xignite. The FAANG Index is represented by equally weighted FB, AAPL, AMZN, NFLX, and GOOG (total return).

[2] Source: Xignite. Indices represented by VTI, VEU, AGG, VNQ, IAU, and DBC (total return).

[3] Source: Xignite. Indices represented by VTI, EFA, and VWO (total return).

Rising short-term rates create a headwind for stocks, but bull markets typically don't end until there is an economic slowdown or event that reduces the availability of credit/liquidity. The timing of such things is very difficult to predict, but we don't see any critical warning signs yet.

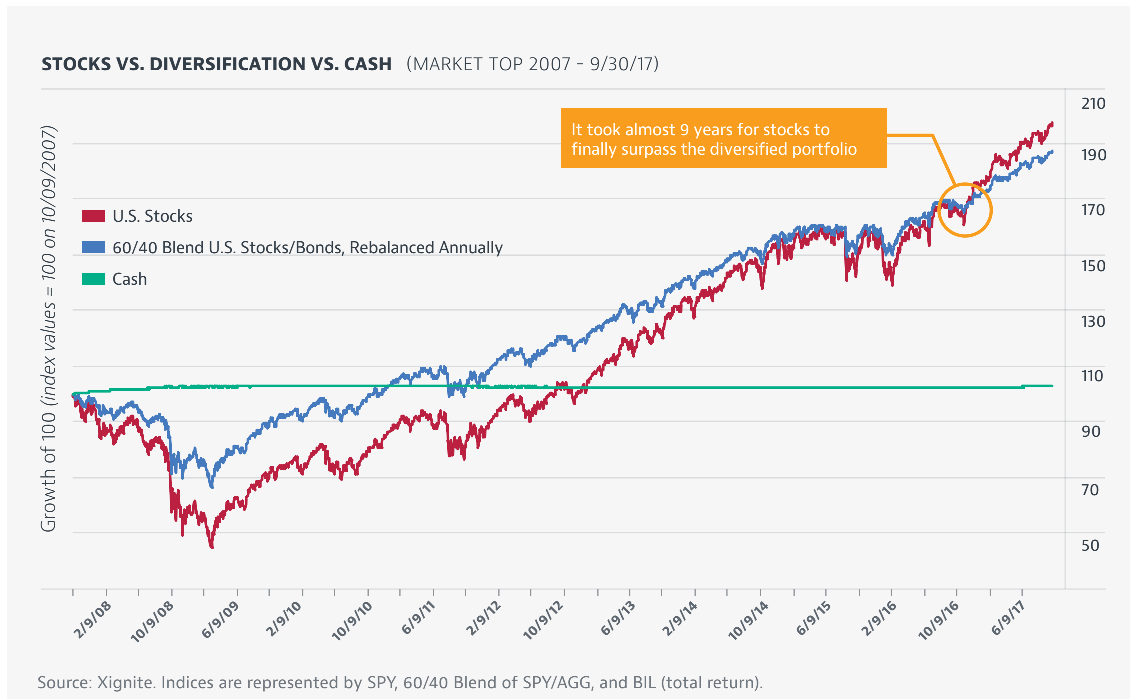


Source: U.S. Treasury

Another risk is that President Trump and the GOP fail to pass any tax reform. We wouldn't have considered this a risk a year ago, but it is likely that at least some of 2017's gains were driven by anticipation of lower corporate tax rates helping boost profitability. We still believe some tax reform is more likely than none, but barely. As far as stocks are concerned, corporate rates matter more than personal rates. On the personal side, proposals being discussed would help the very wealthy, but we don't see much impact on capital markets in the short or mid-term.

On balance, valuations alone should be enough to suggest now is not the time to be greedy. We believe it is especially important to stick with a strategic, long-term asset allocation instead of a "portfolio by chance." If your portfolio has drifted heavily into stocks, remember that the low volatility of the last couple of years is not normal. Avoiding stocks altogether is rarely a good idea, but rebalancing back to a strategic, diversified target allocation usually is.

Take, for example, a hypothetical blend of 60% stocks and 40% bonds, and compare it to a portfolio of 100% stocks. If you started at the market top in October of 2007, it would have taken almost 9 years for the portfolio of all stocks to rebound and finally surpass performance of the diversified portfolio. And it would have exhibited much greater volatility along the way, including roughly double the loss at the low point.



Source: Xignite. Indices are represented by SPY, 60/40 Blend of SPY/AGG, and BIL (total return).

Diversification is the best tool available to manage risk while maintaining upside potential. A portfolio's total allocation to stocks is the biggest driver of both return and risk, but diversification within stocks also remains important. The U.S. has dominated most of this bull market, but international stocks have a healthy lead this year and we wouldn't be surprised if the tide has shifted. A good mix of both is the best approach. At the sector level, it is important to remember what goes up the most often goes down the most. It is fine to have healthy exposure to trendy technology stocks, but it can be risky to ignore other sectors.

The Equifax Breach

In early September, Equifax announced a massive data breach. Based on conversations, it is apparent most people haven't taken any action to protect themselves. Freezing credit isn't convenient and it isn't for everyone, but it should be a consideration. We thought this would be a good opportunity to reprint key portions of a blog post written by Maxime Rousseau, our Chief Security Officer, shortly after the breach:

> News of a significant data breach at Equifax affected an estimated 143 million U.S. consumers. While this is not the largest breach of recent times, it may very well be the most damaging to American families due to the nature of the data that is now in the hands of cybercriminals. Only time will tell us what the true impact will be. Criminals usually need some time to parse through the information and organize their fraud strategies, so you may not see the effects until many months down the line.
>
> This breach does not affect Personal Capital in any direct way. Whether you are a user of our free financial tools or a client of our wealth management services, we make every effort to prevent your information being stolen, as security is a key priority for us. You can review key security measures we have in place on our Security Page, and our security team can always engage directly with clients who have specific concerns.
>
> In this day and age, the sad reality is that you need to expect assaults on your identity and cybersecurity. Identity theft can have lasting consequences on your financial health and here at Personal Capital, this is something that we care deeply about. Here are some of the things you can do right now to be in a strong defensive position to mitigate the risks associated with these types of events.

NEW CREDIT ACCOUNT FRAUD

The risk that fraudsters will create new accounts in your name, damaging your credit and possibly leaving you accountable for debt.

Sign up for the free monitoring services

> This should provide you with alerts when significant events happen. Do this before the next step, as you may be prevented from subscribing to the monitoring if your file is frozen.

Freeze your credit file

> Reach out to credit agencies (Equifax, TransUnion, Experian and Innovis) and request that your file be put on a "security freeze." This is possibly the most effective option to prevent identity theft since it will prevent anyone from opening new accounts in your name (including yourself!). Should you need to open new credit accounts for your own benefit, you would need to unfreeze and refreeze your accounts.

Monitor your credit file

> You are entitled to at least one free credit report per year. Get this now and mark your calendar for next year. Dispute any anomalies. Use services or apps that will monitor this in real time—free and reputable options include Credit Karma and Credit Sesame.

EXISTING ACCOUNT FRAUD

The risk that your existing financial services account will be taken over, putting your current assets at risk.

Actively monitor your financial accounts

- In many cases, if you spot fraudulent transactions quickly you may be able to stop or contest them. This is not convenient when you have to log in to all your financial institutions' accounts independently. This is an area where Personal Capital can help out. Using our dashboard, you can link all your important accounts and easily keep an eye on things. Review this every day or sign up for our daily review email. Respond quickly if you see suspicious activity by contacting the financial institution responsible for the account.

Change the way you do passwords

- Most people will bore you with the usual "don't reuse passwords" or "use super-complicated passwords" in the wake of such an event. While this is not bad advice, it may fall short in providing a practical method to implement it. Here's how to effectively change how you do your passwords:

    1. Get a password manager tool; there are many out there (see Lifehacker's reviews for insight). Getting one for your phone is usually simpler and more secure versus software on your desktop computer.
    2. Secure it with a very long passphrase that you will not forget. "Matt likes to dance in the rain" is better than "5ue@1s21%."
    3. Once that is done, change all your passwords for important accounts to the long passwords that you will store in your password manager (and update your Personal Capital dashboard!).

If you implement the action plan above, you should be able to reduce the potential impact to you and your family of this data breach. We hope this helps you and your loved ones and keeps everyone's financial lives sound.

Tax Reform

Nearly a year into President Trump's term, there is no wall being built and the Affordable Care Act remains intact. But we expect President Trump and the GOP will make their best effort to enact some tax reform. The next several months will probably be the last, best shot to pass meaningful legislation.

Everything related to taxes is complicated, but the basic point of the proposals being discussed is to lower taxes for corporations and very wealthy individuals. Here are just some of the details of the latest proposal:

Elimination of AMT – Almost no one would miss AMT. And if you happen to have incentive stock options (different from the non-qualified stock options most big companies issue), the repeal of AMT may be a big benefit in terms of flexibility to exercise and hold without worrying about AMT preference.

Fewer Tax Brackets – The proposed plan would reduce the number of tax brackets from seven to three, but details are still missing on where these tax brackets start and end.

Standard Deduction and Personal Exemptions – This is where the plan is supposedly good for the middle class. The proposal would double the standard deduction to $24,000 for a married couple. The issue is that the plan also eliminates the personal exemption, which cancels most of the benefit for families with children and may actually be a negative for large families.

State and Property Tax Deductions – These would be eliminated under the current proposal but there are already signs this will be a negotiation point that will likely be given up. The most loved provision of the tax code, deduction of mortgage interest, is not currently under threat, but it would be politically very difficult to take away state and property tax deductions.

Estate Tax Repeal – This would be a big benefit for a small number of very wealthy people but doesn't impact many not in the top 0.1%. Even those with more than the current $11 million deduction can usually find ways around paying meaningful estate tax in the current system.

Lower Rate on Pass-Through Businesses – There is a lot of uncertainty of what this means. The administration has said it will take measures to prevent people from finding creative ways to change personal income to pass-through income. Ultimately, this could help small businesses if passed, but it will face a high level of scrutiny.

Lower Corporate Tax Rate – While full details are still uncertain, the plan proposes lowering the top corporate tax rate from 35% to 20%.

There is a lot more, but at this stage we don't think people should be spending much time planning for tax reform which may not even occur. This is not tax advice and we are not tax attorneys, but there are a few things to consider now:

- If you have high property tax bills and have the option to do so, you may consider accelerating payments into 2017.
- If you have incentive stock options that are priced above grant, you may consider waiting to exercise.
- If you are looking at an insurance product to reduce possible estate taxes, you may want to wait and see what happens to the estate tax.
- Existing tax management investment techniques, such as loss harvesting and tax allocation, remain valuable and should be incorporated in your strategy.

Thank you for your interest.

Sincerely,

Bill Harris, Craig Birk, and Kyle Ryan

THE PERSONAL CAPITAL ADVISORS INVESTMENT COMMITTEE

PERSONAL CAPITAL

This communication and all data are for informational purposes only and do not constitute a recommendation to buy or sell securities. You should not rely on this information as the primary basis of your investment, financial, or tax planning decisions. You should consult your legal or tax professional regarding your specific situation. Third-party data is obtained from sources believed to be reliable. However, PCAC cannot guarantee that data's currency, accuracy, timeliness, completeness or fitness for any particular purpose. Certain sections of this commentary may contain forward-looking statements that are based on our reasonable expectations, estimate, projections and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not a guarantee of future return, nor is it necessarily indicative of future performance. Keep in mind investing involves risk. The value of your investment will fluctuate over time and you may gain or lose money.

ONE CIRCLE STAR WAY, FIRST FLOOR
SAN CARLOS, CALIFORNIA 94070

999 18TH STREET, SUITE 800
DENVER, COLORADO 80202

250 MONTGOMERY ST, SUITE 700
SAN FRANCISCO, CA 94104

GO TO **WWW.PERSONALCAPITAL.COM** TO LEARN MORE ABOUT OUR FREE FINANCIAL TOOLS