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INVESTMENT PERSPECTIVES

>> FOURTH QUARTER 2017

Taking stock of your time horizon

By Michael A. Tyler, CFA
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When we prepare a financial plan for a client, we ask many questions so that we can understand the client's objectives, constraints, and values. But when we think about asset allocation strategies, one question becomes paramount: *What is your time horizon?*

It's a commonly held notion that stocks are more volatile than bonds — and over the short term, that's generally true. For example, almost exactly a decade ago — in October 2007 — the stock market hit an all-time high, only to fall 55% in the next 17 months while bond prices rose modestly. Investors with short time horizons were well protected by owning less volatile bonds.

But what about investors with longer time horizons? For them, the nature of risk changes; short-term volatility is replaced by long-term growth. The ebbs and flows of bull and bear markets tend to even out, while inflation and rising earnings provide a permanent lift to stock prices.

A long-term investor in October 2007 had to wonder about putting money into the-then-frothy stock market; yet we now know that even at its peak the stock market was still the best long-term investment option for the next decade. From that peak in October 2007 to today, stocks have returned about 7.2% per year (including dividends), compared with "risk-free" government bonds yielding 4.7%.

Compounded over that ten-year period, stocks would have doubled (despite losing half their value right at the outset), while bonds grew only 60%. Even gold did better than bonds, rising about 75% through the last decade. Other asset classes (real estate, oil, cash, etc.) were considerably worse. The real risk, over the long term, isn't volatility; it's failing to keep up with inflation.

Time keeps on slipping, slipping, slipping into the future, Steve Miller wrote. If you want your portfolio to fly like an eagle, start early and keep a healthy allocation to stocks no matter what they have done recently. Don't panic at the bottom, and don't cash out near the top. While equities may be painful over short periods, there is simply no substitute for long-term growth.

So when you think about your allocations of stocks and bonds, remember to ask yourself: Just what is *your* time horizon?

>> FOCUS ON FIXED INCOME

The Fed is alone in shrinking its balance sheet

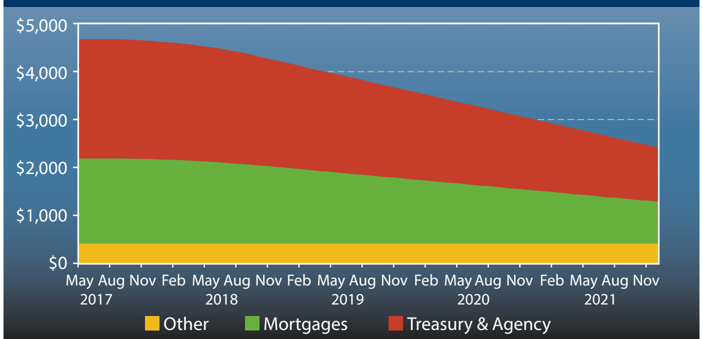
By Tom Bussone
Fixed Income Strategist,
Eastern Bank Wealth Management

After a decade of expanding its holdings of long-term securities, the Federal Reserve has started shrinking its $4.5 trillion balance sheet this quarter. The process is expected to begin at a snail's pace of $6 billion a month in maturing Treasuries, along with $4 billion a month in maturing mortgage-backed securities; the Fed plans to ramp up gradually to $50 billion per month in a year. At that pace, the balance sheet will decline by about half by 2021.

Some investors expect long-term yields to trend higher as the Fed — one of the biggest buyers of Treasuries — pares its holdings. Yet the European Central Bank (ECB) and the Bank of Japan (BOJ), among other central banks, collectively own more sovereign debt than the Fed and they have given no indications that they will terminate their own quantitative easing programs. Ongoing ECB and BOJ purchases will more than offset the Fed's actions, resulting in further growth in the global money supply. This money will likely flow into U.S. debt, since Treasuries yield considerably more than government debt in Europe and Japan. This can prevent a major bond market sell-off.

We've already seen evidence that our bond market can remain remarkably resilient in the face of the Fed's gradual tightening. The 10-year U.S. Treasury yield has traded between 2.01% and 2.63% this year; the difference of 62 basis points is the tightest trading range since 1965. We expect the low level and narrow range will hold throughout the coming year even as the Fed's balance sheet reduction gets underway.

FED SECURITIES HOLDINGS PROJECTION ($ BILLION)



The Federal Reserve plans to reduce its holdings of mortgage-backed securities and Treasury bonds by half in the next four years.

>> FOCUS ON EQUITIES

Heading into the homestretch of an unprecedented year

By Rose Grant-Brooks
Equity Strategist,
Eastern Bank Wealth Management

The S&P 500 has posted a positive total return in each of the first nine months of 2017. In the 90-plus years since Standard & Poor's first created its market indexes, there has never been a calendar year without a monthly loss. Will 2017 be the first?

The primary reason for the stock market's steady rise this year is solid earnings growth, which we expect to continue through the balance of the year and well into 2018. Markets have also been supported by the low interest rate environment, by the dollar's softening from recent highs, and by a growing economy.

An old Wall Street proverb says that the stock market climbs a "wall of worry" to advance to new highs. This year has had a bountiful crop of worrisome events worldwide, from North Korea to Iran to Spain to hurricanes in the Caribbean. At home, investors have worried about health care reform, tax policy, the Fed's gradual monetary tightening, and the ongoing political drama of the Trump administration.

The stock market has taken all of these actions in stride. In particular, equity investors seem to think that the Fed's interest rate hikes and balance sheet reduction are occurring for the correct reasons: The economy is doing reasonably well, further improvement in labor markets should occur, and inflation remains stable.

The uneasy political environment in Washington will most likely continue. Campaign promises of tax cuts, health care reform, and infrastructure investment have so far rung hollow. But a wave of deregulation across many industries has begun to increase economic growth and lead to higher earnings. Although the benefit of any potential tax or infrastructure legislation would not occur until next year, there is reason to believe some of these items will ultimately have a promising outcome.

This bull market has been longer than average, but the usual issues that cause a bull market to end — sharply higher interest rates, recession, inflation, or negative earnings growth — are not near-term concerns. With positive earnings growth, low interest rates globally, and a growing economy both at home and abroad, equity markets could be propelled higher.

>> PERSPECTIVES ON THE ECONOMY

Reading beyond the newspaper headlines to assess the real economy

By Timothy Garvey
Investment Officer,
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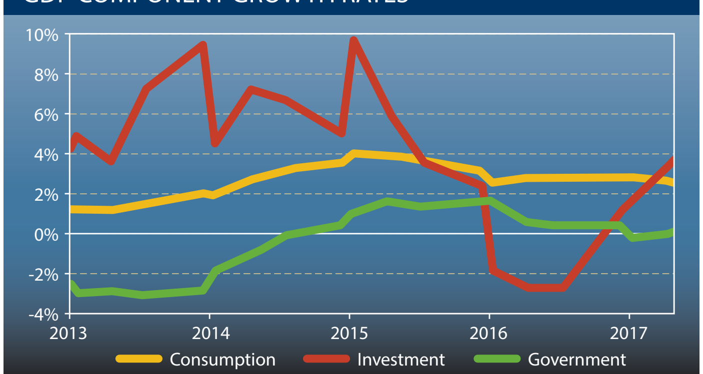
A casual reading of recent headlines could lead to a questionable prognosis for our economy. President Trump and Congress have struggled to pass any tax or health care reform. Recent hurricanes have done considerable damage, leading to the first net monthly job losses in seven years. And the Fed's commitment to raising interest rates is at odds with what traders expect. Yet despite these factors, we're seeing the stock market establish new record highs seemingly every week. The reason, we believe, is that the U.S. economy is still buzzing along quite nicely.

Real GDP for the second quarter rose 3.1%, the strongest reading in two years. Strong consumer spending and business investment are likely to sustain their momentum into year end. Labor market trends remain very healthy, evidenced by the strong employment reports this year and notwithstanding the recent hurricane-related shortfall. The payroll figures remain robust, weekly jobless claims have been at their lowest levels since the early 1970s, and the unemployment rate is at a 16-year low. Corporate earnings have grown at a double-digit pace in 2017.

In the coming months, we may not see growth quite as strong, but we do expect the positive trend to continue. Consumer spending isn't showing any signs of slowing; Harvey and Irma may even spur a new surge in spending. Surveys of manufacturing and service-sector activity are showing increasing optimism. And the dollar — down more than 10% this year — should help U.S. exports be more competitive.

GDP COMPONENT GROWTH RATES



Steady consumer spending growth and a rebound in business investment have propelled GDP growth.