

OCTOBER 2017

THE AIRWAYS ADVISOR™

A NEWSLETTER FOR AMERICAN PILOTS



Leading Authority on Successfully Investing Your 401k Plan

CAPTAIN'S BRIEFING:

- **CHANGES** in all the 401K models.
- **CHANGES** in all the RSP models.
- ***IMPORTANT:** Wells Fargo is considered a competing fund with All Weather, Cons. Fund and BrokerageLink—exchange with another fund instead of rebalancing!

Make sure you are keeping track of your trade dates for the 30-day hold period!

Captain's Table - The Crash of 1987

Go to page 6

RSP UPDATE: The election window will be open through Nov. 17, 2017.

Details for the election window and instructions for how to make a distribution election are provided in decision guides that were mailed to RSP participants, on the 401k site and **our summary on page 8.**

Hurricanes Harvey, Irma, and Maria wreaked havoc within a few weeks of each other. Houston was hit with historic rainfall from Harvey, and much of Florida was ravaged by wind damage from Irma. But Puerto Rico suffered the most out of the Caribbean islands with Maria making landfall in September. The U.S. territory was already struggling economically, and it was only a few months ago that Puerto Rico Electric Power Authority (PREPA) filed a form of bankruptcy. The bankruptcy was intended to initiate the long process of restructuring \$9 billion of its debt. Puerto Rico's

poverty rate exceeds 40% of its population, and now the entire island was out of power and is in dire need of aid. The Federal government is being called on for emergency assistance, and President Donald Trump made a trip to the island in just the last few days.

The economic impact of major recent disasters

Katrina 2005	Sandy 2012	Andrew 1992	Ike 2008	Ivan 2004	Rita 2005	Wilma 2005
\$160b	\$70b	\$48b	\$35b	\$27b	\$24b	\$24b

US ECONOMY

Plenty of data came in during September, and broadly the data is positive and paints a healthy picture of the U.S. consumer. The final reading of Q2 GDP came in at 3.1%, which was above the estimates of 3.0%. Consumer confidence and sentiment readings also came in very strong at 119.8 and 95.3 respectively. Consumer spending is a big part of GDP growth, so these numbers are more than meaningful. Unemployment remains low at 4.4%, and looking at data about home loan delinquency also paints a positive picture of American households. In 2011, about 8.44% of home loans were delinquent, and today that figure stands at 4.24%.

The economic impact of the hurricanes will be critical to monitor. Natural disasters disrupt some business activities, but they also create other types of economic activity. Insurers will take a hit. Oil production was disrupted in the Gulf. Travel and leisure in Florida will surely take a sizable hit. But there are now an estimated 1 million vehicles in the Houston area that will need to be replaced, which is a nice tailwind for the auto makers. Home builders and contractors will be busy rebuilding, and manufacturing suppliers will have to pick up the slack too. Manufacturing PMIs (Purchasing Managers' Indexes) and Markit services PMIs are holding solidly in the 50s (any readings above 50 are positive), and rebuilding efforts could help keep PMIs in this range.

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"You're flying toward an unknown financial future— WE HAVE CHARTS!"

INTERNATIONAL

The United Nations unanimously voted for additional sanctions on North Korea, and in a major blow to the country, Chinese banks have been charged to stop dealings with North Korea. Speaking of China, economic data looks rosy there with increases in both exports and imports. Eurozone services and manufacturing PMIs came in solid for September. Flash services PMI was up to 55.6 vs. 54.8 estimated, and flash manufacturing PMI came in at 58.2 vs. 57.2 estimated. And job creation in the Eurozone was the second highest seen over the past decade.

Economic growth from the world's larger countries is looking stronger, but there are various issues to monitor. U.K. Prime Minister Theresa May finally proposed an amount for the U.K.'s divorce settlement with the European Union. It was \$20 billion, a much lower figure compared to early estimates of up to \$100 billion. The U.K. has to press forward to find an amicable trade relationship with the EU. May also threatened a trade war with the U.S. after the U.S. slapped punitive tariffs on Bombardier's British-built aircraft. This is an example of why lawmakers argue about protectionist tax policies because while the policy may try to encourage U.S. manufacturing, it could come at the cost of losing friendly trade relationships with other countries.

STOCKS

Volatility increased in August, and there was about a week of carryover into September before the S&P 500 rediscovered the uptrend, finishing the month 2.1% higher. International developed country stocks, as measured by the MSCI EAFE, finished up 2.5% for the month, and year-to-date results for the benchmark are just over 20%. Emerging markets stocks are also showing impressive YTD results at 25.4%, but September was a flattish month with MSCI Emerging Markets Index losing about -0.5%.



Possibly the most interesting nuance of these asset class returns is that U.S. small company stocks, as measured by the Russell 2000, surged 9.6% from mid-August lows. Discerning the why's behind these moves is sometimes difficult, but investors may be optimistic that a possible tax deal will translate to better earnings for these companies.

CENTRAL BANKS

The results of the September Fed meeting were two-fold: unchanged rates and more language on the process of unwinding the Fed's massive balance sheet. Let's take a moment to look at the people that make up the Fed. At present, only 10 of the 12 seats on the Federal Open Market Committee (FOMC) are occupied, and Janet Yellen's term as Fed Chair will be up next year. Early in September, Fed vice chair Stanley Fischer announced his resignation for personal reasons.

The Fed hasn't had its full complement of governors since 2013, and there has been at least one vacancy for 85% of the past decade. President Trump is in position to nominate a new Fed Chair and other new members, but it's unclear what monetary policy plans would change as a result. In any case, he'll be able to tip the balance and put "his folks" in power, and uncertainty about those impending appointments may lead to market volatility next year.

Velocity Composite Fund Score™ Ranking

American 401k Plan					
Ticker	Fund Name	Score	YTD	1MoPerf	3MoPerf
-	US Sm Cap Gr Stk Idx	1154	16.93%	5.47%	6.26%
-	US Lg Cap Grth Stock	1138	29.62%	0.54%	6.83%
-	US Lg Cap Stk Idx	1104	14.27%	2.07%	4.49%
-	US Mid Cap Stk Idx	1103	9.44%	3.92%	3.24%
-	US Small Mid Cap Stk	1090	12.29%	2.67%	2.30%
-	High Yield Bond Idx	1062	6.58%	0.80%	1.83%
-	US Lg Cap Val Stock	1051	12.12%	3.76%	3.65%
-	US Sm Cap Val Stk Idx	1046	5.91%	7.09%	5.13%
-	US Lg Cap Val Stk Idx	1038	8.03%	2.95%	3.12%
-	Target Date Fund 2060	1025	16.82%	1.67%	4.63%
-	Intl Dev Mkts Stock	1024	20.27%	2.53%	5.44%
-	International Stock	1015	23.26%	2.15%	6.08%
-	Target Date Fund 2055	976	16.80%	1.67%	4.63%
-	Target Date Fund 2045	972	16.80%	1.67%	4.64%
-	Target Date Fund 2050	969	16.81%	1.67%	4.64%
-	Target Date Fund 2040	961	16.65%	1.64%	4.58%
-	Target Date Fund 2030	915	14.45%	1.33%	4.02%
-	Target Date Fund 2035	914	15.58%	1.51%	4.30%
-	Post Retirement	904	9.01%	0.55%	2.67%
-	Target Date Fund 2025	873	13.50%	1.19%	3.77%
-	Target Date Fund 2015	860	10.87%	0.83%	3.14%
-	Target Date Fund 2020	784	12.38%	1.01%	3.50%
-	Emerging Markets Stk	772	28.43%	-0.38%	7.88%
-	US Lg Cap Gr Stk Idx	698	20.72%	1.31%	5.89%
-	Inflation Protection	654	1.88%	-0.63%	0.91%
-	Diversified Bond	585	3.74%	-0.15%	1.13%
-	US Bond Index	584	3.23%	-0.46%	0.87%

Definitions & Notes: 1. Tickers The majority of the funds in the American 401k and RSP Plans are not really mutual funds. They are composites or comingled funds, etc. **YOU WILL USE THE FUND NAME TO TRADE.** Data from proxy funds is used to make all calculations for the funds listed above. 2. The funds above were selected to work, using the model system. There are other funds in the plan that are not used. There is no reason to have multiple international or emerging market funds, for example.

US Airways RSP Plan					
Ticker	Fund Name	Score	YTD	1MoPerf	3MoPerf
-	Lg Cap Grth Equity	1091	0.67%	5.21%	21.28%
FXAIX	Fid 500 Indx IPR	1056	2.06%	4.47%	11.91%
-	Mid Cap Stock	1013	2.62%	3.88%	11.52%
-	Small Cap Equity	987	5.24%	4.39%	4.08%
-	Lg Cap Value Equity	965	2.78%	3.85%	8.03%
-	International Equity	947	2.56%	5.34%	18.30%
-	BTC LP IDX RET	918	N/A	N/A	6.64%
-	BTC LP IDX 2025	893	N/A	N/A	8.52%
-	Growth Fund	887	1.50%	3.80%	11.66%
-	Conservative Fund	856	0.55%	2.14%	6.92%
-	All Weather Fund	856	1.00%	3.01%	9.38%
-	WF Stable Fund	832	N/A	N/A	1.04%
-	Emerging Markets	747	0.62%	7.81%	26.66%
-	Bond Fund	509	-0.42%	0.74%	3.65%
-	Real Asset Fund	459	-0.49%	2.10%	3.43%

The funds in the new American 401k Plan were created for the plan and have an Inception Date of October 31, 2015. Therefore, proxies are used to calculate returns and scoring for these funds, for time periods including dates prior to October 31, 2015. The Velocity Composite Fund Score Ranking combines the Velocity (speed of advance of a fund compared to all other funds) with its Buy Point Score (how close the fund is to a recent bottom). This composite score is used to rank all available fund choices. In defined Bull Market advances, the system uses the Top 3 funds in the Aggressive model and the Top 4 in the Moderate and Conservative models. In Defined Bear Market periods, this ranking is provided for information purposes and for those who are "doing their own thing" and would like to know (hypothetically) which funds the system would buy today, if the market was a Defined Bull Market. Rankings dates are the last business day of each month.

Worry-Free Flight Path Models™ - American



Fear & Greed

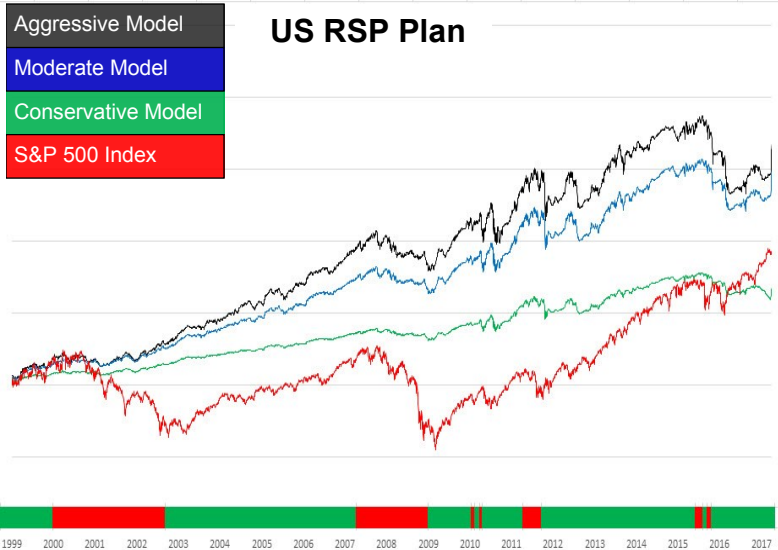
The geo-political tensions that muted investor expectations in August gave way to renewed optimism in September.

The strength of the U.S. economy and fresh hopes for business-boosting policies from Washington probably helped push the Fear & Greed needle to a reading of 90 at month-end.



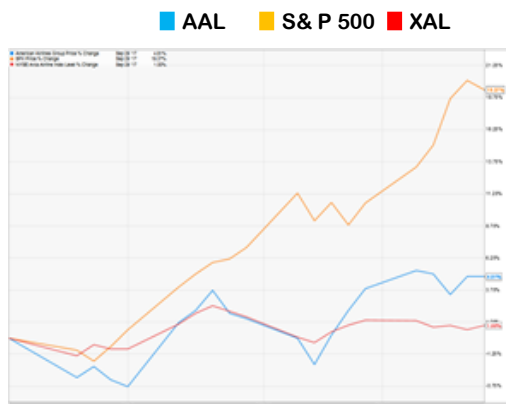
American 401k Plan (as of September 30, 2017)

	Performance Stats						
	YTD	1 Month	1 Year	3 Years	5 Years	10 Years	Inception
Conservative Model Annualized	7.55%	1.35%	10.69%	12.86%	31.97%	40.83%	100.40%
				4.12%	5.70%	3.48%	4.17%
Moderate Model Annualized	10.88%	1.68%	10.08%	27.48%	54.82%	79.07%	212.60%
				8.43%	9.14%	6.00%	6.93%
Aggressive Model Annualized	14.60%	1.44%	21.19%	26.81%	54.40%	89.66%	273.98%
				8.24%	9.08%	6.61%	8.07%
S&P 500 Annualized	14.24%	2.06%	18.61%	35.91%	94.44%	104.88%	145.22%
				10.77%	14.22%	7.44%	5.42%



AAL-

September was a roller-coaster ride as American Airlines stock (AAL) was down early in the month due to Hurricanes Harvey and Irma. Then the clouds cleared, the stock went on to finish out September up more than +6%, handily besting the NYSE ARCA Airline Index (XAL) and the S&P 500.



US Airways Pilots RSP (as of September 30, 2017)

	Performance Stats						
	YTD	1 Month	1 Year	3 Years	5 Years	10 Years	Inception
Conservative Model Annualized	6.22%	0.75%	5.24%	10.05%	31.87%	70.45%	79.77%
				3.24%	5.69%	5.48%	3.51%
Moderate Model Annualized	9.38%	1.11%	12.01%	20.52%	51.94%	131.89%	150.27%
				6.42%	8.73%	8.77%	5.54%
Aggressive Model Annualized	13.01%	1.65%	13.81%	23.90%	48.57%	147.74%	170.73%
				7.40%	8.24%	9.50%	6.03%
S&P 500 Annualized	14.24%	2.06%	18.61%	35.91%	94.44%	104.88%	145.22%
				10.77%	14.22%	7.44%	5.42%

American 401k

American 401k Plan Conservative Model		
Symbol	Fund Name	Allocate
-	AA Fed Credit Union	60.00%
-	U.S. Lg Cap Stk Idx	10.00%
-	US Sm Cap Gr Stk Idx	10.00%
-	U.S. Lg Cap Grth Stock	10.00%
-	US Mid Cap Stk Idx	10.00%
		100.00%

American 401k Plan Moderate Model		
Symbol	Fund Name	Allocate
-	AA Fed Credit Union	36.00%
-	U.S. Lg Cap Stk Idx	16.00%
-	US Sm Cap Gr Stk Idx	16.00%
-	U.S. Lg Cap Grth Stock	16.00%
-	US Mid Cap Stk Idx	16.00%
		100.00%

American 401k Plan Aggressive Model		
Symbol	Fund Name	Allocate
-	AA Fed Credit Union	19.00%
-	U.S. Lg Cap Stk Idx	27.00%
-	US Sm Cap Gr Stk Idx	27.00%
-	U.S. Lg Cap Grth Stock	27.00%
		100.00%

US RSP

USAirways RSP Plan Conservative Model		
Symbol	Fund Name	Allocate
-	WF Stable Fund C	60.00%
FXAIX	Fid 500 Index IPR	10.00%
-	Small Cap Equity	10.00%
-	Large Cap Growth	10.00%
-	Mid Cap Stock	10.00%
		100.00%

USAirways RSP Plan Moderate Model		
Symbol	Fund Name	Allocate
-	WF Stable Fund C	36.00%
FXAIX	Fid 500 Index IPR	16.00%
-	Small Cap Equity	16.00%
-	Large Cap Growth	16.00%
-	Mid Cap Stock	16.00%
		100.00%

USAirways RSP Plan Aggressive Model		
Symbol	Fund Name	Allocate
-	WF Stable Fund C	19.00%
FXAIX	Fid 500 Index IPR	27.00%
-	Mid Cap Stock	27.00%
-	Large Cap Growth	27.00%
		100.00%

- IN A MONTH WITH TRADES —
THE NEW FUNDS WILL BE HIGHLIGHTED IN YELLOW

- **AA 401k CHANGES** in each model.
- **US RSP CHANGES** in each model.

- **READ:** Your 401k plan has trading restrictions, so you need to keep track of your buy and sell orders. Fidelity does a poor job of defining what “excessive trading” is and has expanded that definition to include all funds.

- **Future Contributions:** The models work smoothly if you direct ALL future contributions into the following, the AA Fed Credit Union for the 401K and Wells Fargo Stable Value Fund for the RSP.

***IMPORTANT:** Wells Fargo is considered a competing fund with All Weather, Cons. Fund and BrokerageLink— exchange with another fund!

APPROXIMATE Future Publication Dates

11/3/17

12/5/17

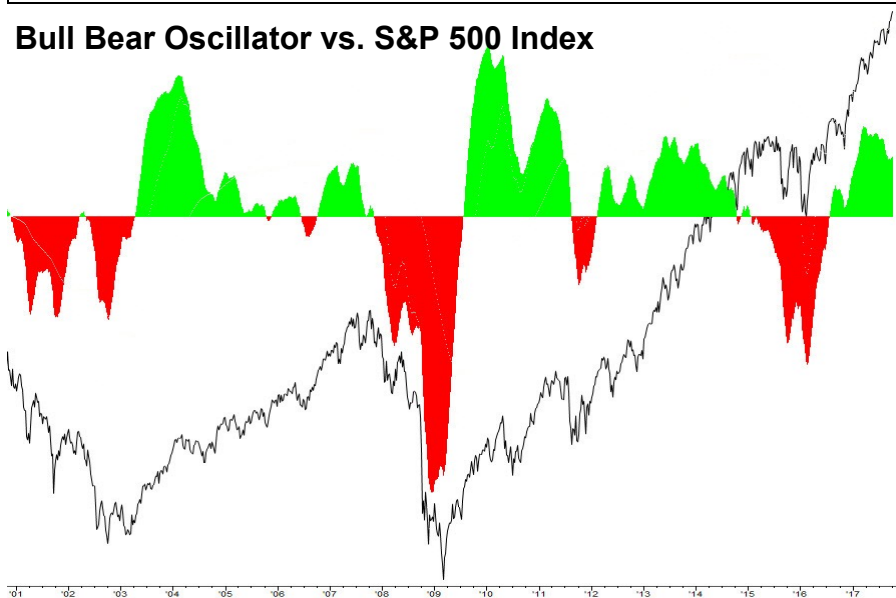
1/4/18

2/5/18

3/5/18

4/4/18

Bull Bear Oscillator vs. S&P 500 Index



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from the CAPTAIN'S TABLE

The Crash of 1987—Then and Now

It wasn't quite the Kennedy assassination, "9/11", or the O.J. verdict, events where time seemed to stand still for a few moments. But don't tell that to the Wall Street traders and advisers who lived through "Black Monday," the bloodiest day in stock market history, October 19, 1987. On that day, the Dow Jones Industrial Average plummeted 22.61%, the NASDAQ lost 11.35%, and the S&P fell by 20.46%. The unfathomable drop of 508 points had everyone asking, how could this happen? A 508 point drop today would hardly get much attention given the run-up of stock prices over the last 30 years, but what would you do if the Dow plunged over 5,000 points tomorrow? That would be today's equivalent in percentage terms. I imagine that would get your attention, and mostly likely the attention of even the most casual bystander as well.

As we approach the 30-year anniversary of Black Monday, do signs point to a similar fate for the markets? Are the conditions ripe for another major collapse? It would seem that we are long overdue for a pullback of some significance. After all, the U.S. stock market is in the middle of an unprecedented 9-year bull run, the second longest on record. The S&P is up more than 12% YTD and 270% since March 2009. Interestingly, the market was up a whopping 35.5% YTD at its high in early October of 1987, and stocks had surged 220% since August 1982 until that fateful Monday in October. Pretty similar based on these stats.

The Economy Then and Now

However, one of the most significant differences between 1987 and present day is inflation. Inflation was out of control in 1987, having **doubled** over the course of the previous year. Today, inflation lies in sharp contrast, where worries abound that it's too low. Inflation today is almost non-existent, having averaged a puny 1.3% per year over the last five years.

Like 1987, however, the Fed is in somewhat of a tightening mode, having instituted three rate hikes in the last year. But that's where the similarities end. The difference today is that rate hikes are an effort to normalize monetary policy following a near-zero rate policy set in motion after the

fallout of 2008, rather than an attempt to combat soaring inflation. Normally higher interest rates have a predictable impact on the economy, but there is nothing normal about the great Fed experiment that kicked off in 2008. Understandably, there has been considerable uncertainty and hand-wringing at many levels over the unwinding of the Federal Reserve's \$4.5 trillion balance sheet. With its intention of saving the U.S. economy from an unprecedented and historic meltdown and in an effort to preserve the financial markets, the Fed purchased bonds as part of its "quantitative easing" program, commonly referred to as QE. The central bank deemed this necessary as an additional monetary policy lever since the Fed funds rate was near zero, and there was virtually nothing that could be done on the rate front. QE was designed to have the same effect as lowering interest rates.

But now a very interesting chapter begins for the Fed and for the markets as the process of raising interest rates has been established and will soon be followed closely by the unwinding of the Fed's bond portfolio, likely to begin this year. The concerns are warranted given that the authors of this book, the Fed, can't know exactly how this story will end. No one can know because such a massive bond sell-off has never occurred before. Former Fed chair Alan Greenspan resides in the camp of those who are concerned and has warned of a bond market bubble. He worries that the unloading of fixed income assets into the market could send bond prices drastically lower, causing yields to soar. The Fed, of course, has stressed that the unwinding process will be gradual, occurring over the course of several years, and will be implemented largely by allowing maturing assets to simply run off.

Earnings and Volatility

Stock market P/E (Price/Earnings) ratios today are also similar to 1987, at the expensive end of the spectrum by historical standards. Some would even say stock prices are approaching extreme levels. According to monthly data from Nobel Prize-winning economist Robert Shiller, Ph.D., the S&P 500 P/E ratio rose from a low of 7:1 during the 1981-82 recession to a high of 18:1 right before the 1987 crash. Fast-forward to March of 2009, where stocks bottomed out at 13:1. Since then the stock market has basically done nothing but go up, and the Shiller P/E now stands at 30:1. For some perspective, the P/E is very close to the peak of 32:1 seen just before the market crash of 1929, but not quite as high as the 44:1 seen just prior to the dot-com bust of 2000-2002.

In addition to high P/E levels, many market observers today are concerned about ultra-low market volatility. The CBOE Volatility Index (VIX) is a popular measure of expected volatility for the S&P 500. Historically, the VIX average is 19.5, but so far this year, the index has averaged 11.5. Some analysts warn that low VIX levels are a sign of market complacency and point to research indicating that periods of extremely low volatility often precede market crashes.

The Dollar

Like 30 years ago, we are seeing a weakening U.S. dollar, and its value remains a highly politicized issue. In 1987, the value of the USD was closely monitored by government officials, as Japan accounted for roughly one-third of the total U.S. trade deficit. On October 14, 1987, after the release of worse-than-expected trade deficit figures, Treasury Secretary James Baker publicly suggested that the dollar needed to depreciate further. The Dow fell by 3.8% that day, beginning a four-day decline that ended with Black Monday. According to the Fed's broad trade-weighted dollar index, as of October 1987, the dollar had weakened by 11.8% from its peak in March 1985.

Today, although the dollar remains strong by historical standards, we have seen a depreciation of about 9% since the beginning of the year. As noted earlier, a weaker dollar leads to higher inflation. But the lag time of the price impact is difficult to predict. The dollar strengthened significantly following the U.S. presidential election, surging to a 14-year high on a trade-weighted basis by the end of 2016. The post-election surges in the dollar and the stock market reflected optimism for the implementation of fiscal stimulus under the new Trump administration. But as 2017 has progressed, the lack of movement on health care legislation, tax reform, and regulatory changes (on top of strong economic performance in Europe), has weighed on the dollar.

Ongoing legislative delays in Washington could continue to negatively impact the dollar and may at some point affect equities. U.S. international relations, especially rising tensions with North Korea, have resulted in higher market volatility in recent months, and the prospect of the U.S. pulling out of NAFTA is perceived as negative for U.S. stocks.

In conclusion, 1987 and 2017 are different times, each with unique areas of concern. Today, the Fed's immense program of unwinding its bond portfolio and its unknown impact on the world's capital markets is front and center. And while no single factor indicates conclusively that a stock market correction is imminent, a rapid erosion of market confidence can occur very quickly, possibly brought on by a confluence of factors and events like we saw 30 years ago this month. The lesson should be that it's wise to have a plan in place for both good times and bad.

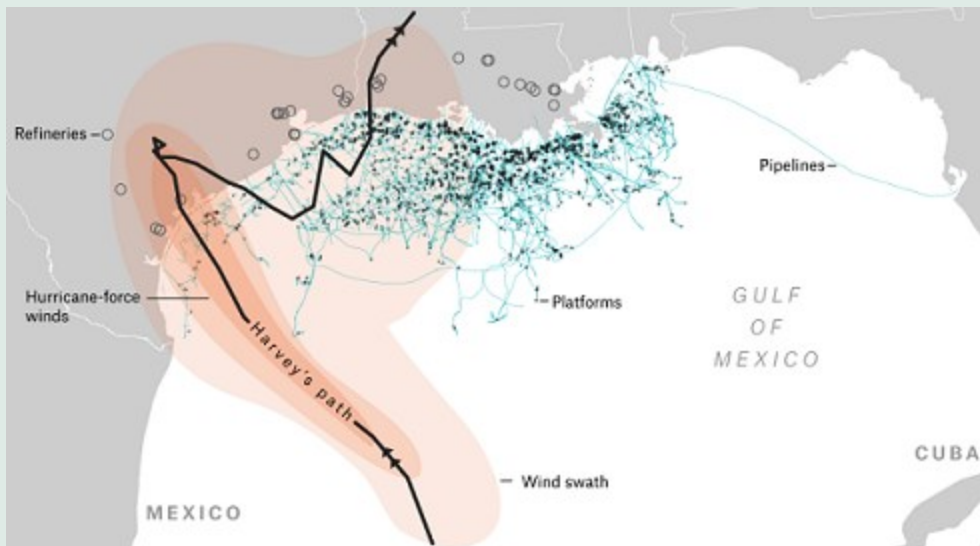
Weston

Weston Pollock, is a Managing Partner at Smith Anglin Financial, and leads the firm's marketing and business development. He regularly meets with prospective clients, counsels existing clients, participates in investment portfolio analysis and develops materials for communicating with the firm's clientele and target markets. He holds a BBA in Finance and Real Estate and numerous securities licenses and designations.

Experts at the Captain's Table: All members have a wide and varied background in all areas of wealth management. Most importantly, the members have worked extensively with professional pilots at American, Delta, Federal Express, Southwest, United – and every airline that merged into these along the way – for more than 85 years combined. They know your world, your benefits, how to retire in the best way, and what is needed at each life-stage in retirement to get you to your goal.

COMMODITIES

According to the Department of Energy, the U.S. now imports 22% less oil than it did a decade ago, and the U.S. Gulf coast was the source of 18% of U.S. oil production in 2016. Petroleum exports from the U.S. have **quadrupled** over the last 10 years, rising from 1.3m barrels-per-day (bpd) in 2006 to 5.2m bpd in 2016. Hurricane Harvey disrupted Gulf Coast oil operations, and OPEC members met in Vienna to discuss the continuation of production caps on cartel members. These factors led to a recent increase in both oil and gasoline prices.



Sources: FiveThirtyEight, NOAA's National Hurricane Center, Bureau of Ocean Energy Mgmt, Energy Info Administration

As you probably have already heard, the Retirement Savings Plan for Pilots (RSP) is being terminated this November.

The termination of this plan is actually a good thing since it gives you the opportunity to move your RSP balance to a place where you'll have more control over how it's managed, invested, and even protected against market risk. ... **But you need to act soon! ...**

KEY FACTS:

- **Your RSP distribution window is now open and closes on November 17th.**
- **Your RSP balance will be distributed according to the American 401k Service Center's pre-determined election if you don't actively make your own decision!**
- **Your RSP balance could miss time being out of the market depending on which roll-over option you select below.**

In our opinion, the Company's "default" election for your RSP balance will likely **NOT** have been your first choice. Your choices, briefly.

You can choose to have the balance of your RSP sent to one of several different places.

- 1. You can rollover your RSP balance to your American 401k account, or to another 401k account you may have somewhere else; or**
- 2. You can rollover your RSP balance to a new or already established IRA at Fidelity, or to an IRA you have with another custodian; or**
- 3. You can direct the Company to simply cut you a check for your RSP balance. With this election, the balance of your RSP will be sent directly to you.** (Be careful when considering this alternative as the amount sent to you is considered a taxable distribution, and if you are under 59 ½ it is subject to a 10% penalty.)

Essentially, the termination of the RSP is your chance to take control of these funds and move your RSP balance to a place where you'll have more control and a wider array of investment choices.

The process of moving your RSP balance isn't hard, but the many choices you have can create confusion. Additionally, for those of you who were a participant in the Target Balance Retirement Plan (*the version before US Airways, Inc. amended and restated the Target Benefit Plan into the current RSP*), you have another layer in the decision-making process. But again, the good news is you are being given the option to get at your RSP balance early.

Ultimately, the balance of your RSP will be transferred to an account with your name on it somewhere, or it's going to be sent straight to you in the form of a check.

So, if you want a say in how you get your RSP balance, you need to take action! Start by consulting the Plan Termination Decision Guide, or by calling Susan Patton, USPFA Administrator, at 717-569-8162 right away so she can put you in contact with a financial professional qualified to advise you on what choice is best for you.

All the best,

The USPFA Team

THE END OF THE PARTY (at least for the U.S.)

Markets peaked in Oct 2007, and it took about a year for the Financial Crisis to take hold. Lehman Brothers was the biggest player to go out of business almost a year after the market peak, and more major shake-ups and consolidation in the financial sector would soon follow. When you look at the main issues that caused the Great Recession, you can sum them all up with one word really: leverage. Sub-prime mortgages were the result of loose lending standards on top of a hot economy with rising real estate prices. Throw in corporate greed, and you end up with exotic derivatives and derivatives of derivatives of sub-prime mortgages, which were sold as new investments to people who didn't really know what they were buying. And how did we fix the problem? With more leverage.

Federal Reserve Chair Ben Bernanke announced his plan to implement Quantitative Easing (QE) in November of 2008. Quantitative Easing was the next form of stimulus from the Fed after the Fed Funds rate had been slashed from 5% in August of 2007, to less than 1% by October 2008. The Fed's QE plan involved the creation of "bank reserves" which were to be used to buy bonds from U.S. banks, mainly Treasuries and mortgage-backed securities. QE came in 3 rounds over 6 years, and the scale of the purchases was staggering: Round 1 was \$1.725 trillion, Round 2 was \$600 billion, and Round 3 was \$1.7 trillion.

Interestingly, Bernanke penned an op-ed piece in the Wall Street Journal just 8 months after QE began entitled "The Fed's Exit Strategy." Fast forward to October 2017, and we are about to see the "Exit Strategy" finally kick in. The plan is to shrink the Fed's \$4.5 trillion balance sheet initially by simply not reinvesting in new debt. Until now, cash from a matured bond was reinvested, keeping those assets on the Fed's balance sheet. Now that cash will simply "roll off" the balance sheet. It will start with \$10 billion per month and eventually increase to \$20 billion per month. Ultimately, the plan is that by reducing the Fed's role as a bond buyer, the inventory of bonds will remain higher, causing bond prices to go down, resulting in long-term interest rates going up.

According to the plan, interest rates should continue to rise in general as the global economy shows strength. Low rates and QE provided significant stimulus to aid the recovery, but they should not be relied upon anymore. We're not in the economic ICU anymore; we're on the mend and in the process of recovery, and that's great. Healthy economies translate to healthier interest rates, but that path to healthier rates can be a little rocky. Don't be surprised by bumps in the road, but also don't forget that the Fed has been nothing less than extremely cautious with policy since the Great Recession. The Fed waited 7 long years to increase interest rates by a measly 0.25%, and they don't want to mess that up now.

The Fed may be stepping aside and leaving the bond-buying party, but its counterpart in Europe, the European Central Bank (ECB), has about run out of European bonds to buy in their own version of QE. Meanwhile, in Japan, the Bank of Japan may also look to fill in the gaps by purchasing U.S. Treasuries as their version of QE may never end. The next phase of monetary policy is upon us, and we'll be closely monitoring capital markets for both intended and unintended consequences.

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