Sometimes they do ring a bell at the top.

Recently, the Fed announced that nearly all banks had passed their stress tests and that we would never again see a financial crisis. Banks immediately raised their dividend targets and the market knee-jerked higher. It appears to us that the Fed declared victory and is moving on. To what you say? It seems that they (Yellen, Fischer and Dudley) are looking to their legacy and would like to say “mission accomplished.” Their mission would be to normalize interest rates and its balance sheet (or at least be down that path) before handing the Fed over to the inevitable Trump appointees that will take over the Fed. If true, this would signal higher short term rates due to Fed raises. It would also imply higher long term rates as they are impacted by short term rates and as the Fed sells large portions of their longer dated Treasuries. All of the above should drive equities lower as higher interest rates and taking out liquidity are both equity negative.

Recently, (6/27) Fed vice-chair Stanley Fischer noted:

*FISCHER: 'NOTABLE UPTICK IN RISK APPETITES' IN ASSET MARKETS
*FISCHER: EQUITY P/E RATIOS ARE NEAR TOP OF HISTORICAL LEVELS
*FISCHER: HIGH ASSET PRICES MAY LEAD TO FUTURE STABILITY RISKS
*FED'S FISCHER SAYS CORPORATE SECTOR 'NOTABLY LEVERAGED'
*FISCHER SAYS IT WOULD BE FOOLISH TO THINK ALL RISKS ELIMINATED
*FISCHER CALLS FOR 'CLOSE MONITORING' OF RISING RISK APPETITES

We think that the Fed is now more interested in leaning against the markets, rather than stimulating them, as they have done for the past 8 years.

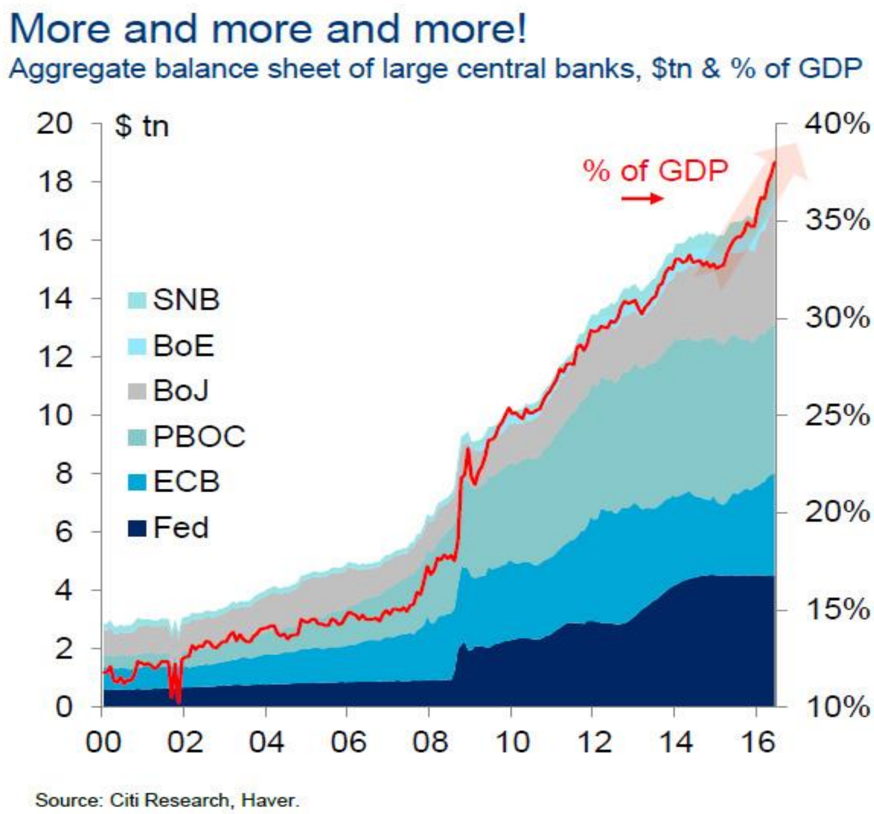
Morgan Stanley apparently agrees as Chetan Ahya, global co-head of economics states:

> “Rather, financial stability risks will hold the key: In the 2004-07 episode, as inflation was well-behaved, the pace of monetary tightening by central banks was slower than warranted, which resulted in a build-up of financial stability risks as financial conditions stayed easy, private sector leverage in both the non-financial and financial sector rose sharply and asset markets were buoyant.

> In this cycle, central banks are more watchful of financial stability risks: It is in this context that central banks now appear to be keen to lean against easy financial conditions so as to pre-empt the rise of financial stability risks. To assess financial stability risks, Fed Vice-Chair Fischer had recently highlighted the Fed's framework in a recent speech in which he highlighted the "four broad cyclical vulnerabilities: (1) financial sector leverage, (2) non-financial sector borrowing, (3) liquidity and maturity transformation, and (4) asset valuation pressures.
>
> As non-financial private sector leverage and asset valuations have risen, central banks in developed markets are therefore adopting a hawkish tilt in order to lean against the build-up of potential financial vulnerabilities.
>
> Markets will therefore have to deal with the repricing of the central bank put."

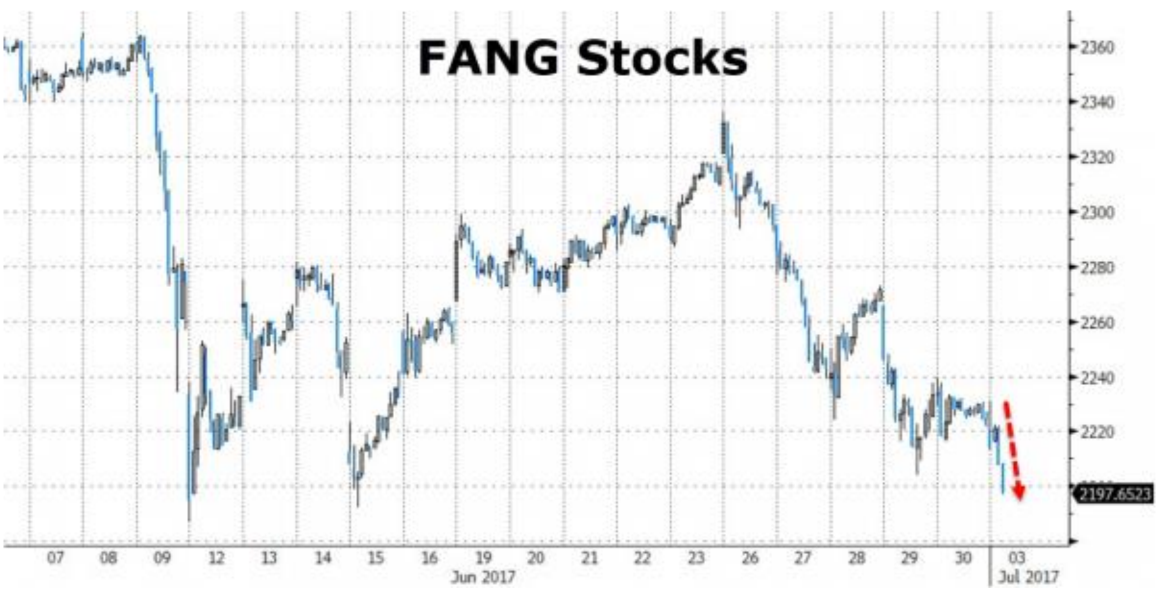
Apparently, Morgan Stanley is seeing the same things that we are.

As the Fed tightens, the European Central Bank (ECB) and the Bank of Japan (BOJ) appear to be heading in the same direction. The ECB reduced their quantitative easing from 80 billion euros per month to 60 billion euros in December. The BOJ has reduced their purchases of bonds as the supply is running out. Global central bank balance sheets have risen to nearly 40% of global GDP. There is pressure on the central bankers to normalize their balance sheets.



Fed tightening may already be impacting the highly valued tech stock area. On June 9th we saw an interesting reversal in tech stocks. The Nasdaq 100 index started the day higher, then turned around and dove the rest of the day. In the past, each dip was met by new buying and the index would be at new highs by now. But lately we have been seeing lower highs and lower lows.

As markets top, fewer and fewer stocks lead the way. Lately it has been the FANG stocks (Facebook, Amazon, Netflix and Google) that have been accounted for much of the performance in the S&P 500 and Nasdaq. When the lead stocks fail, it can be a signal that the markets are in trouble. Lately, the FANG stocks and much of tech has been struggling. Likewise, in May, Goldman Sachs showed that just 10 stocks accounted for 46% of the S&P 500's return for the YTD. Whether this is a minor hiccup or something more serious is yet to be seen.



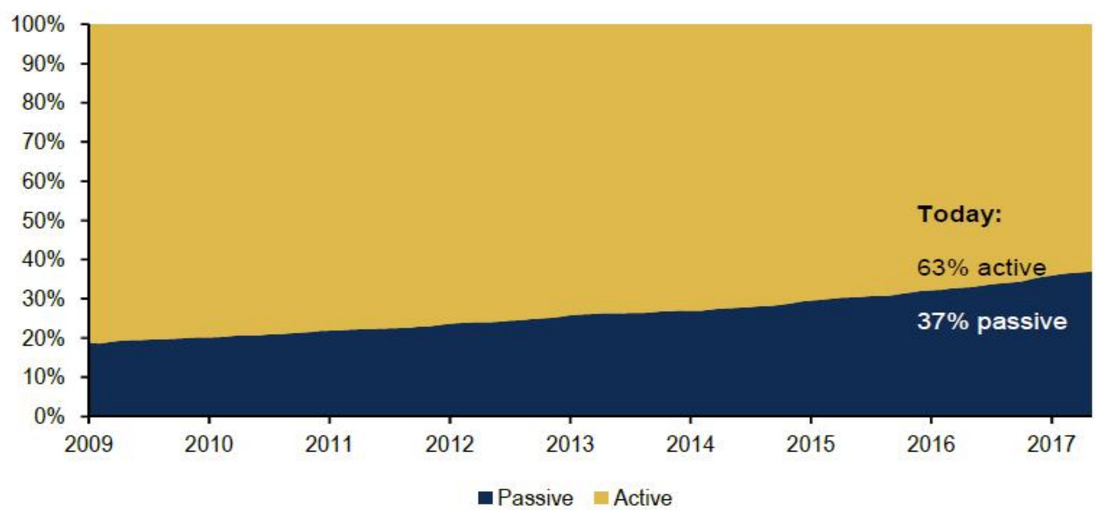
Ticker	YTD Price Perf (%)	Market Cap Created ($,bn)	% of Total	Equivalent to the Mkt Cap of:
AAPL	32%	190.4	12.7%	VZ
GOOGL	20%	109.5	7.3%	EBAY + YHOO + EA
FB	31%	102.8	6.9%	TWX + CBS
AMZN	27%	95.9	6.4%	UPS
MSFT	12%	54.8	3.7%	HPQ + SYMC
V	18%	31.6	2.1%	TGT
PM	21%	30.2	2.0%	HCA
ORCL	18%	29.6	2.0%	RHT + CTXS
HD	18%	26.4	1.8%	YUM
AVGO	31%	22.4	1.5%	LRCX
Top 10		693.5	46%	
S&P 500/Total	7%	1,499.8		

Goldman Sachs, May 10, 2017

ETFs

Exchange Traded Funds (ETFs) have increased in popularity since the financial crisis rising from about 18% of assets in US equity funds to about 37%. These funds tend to grow at the end of market cycles. In late 1999 and early 2000 the Nasdaq 100 ETF (QQQQ was the ticker then) gained popularity as the tech stock bubble grew. As people bought the ETF, the underlying stocks were bought with the highest cap stocks being bought the most. No analysis of each company was done. No weighing the merits of one company versus another. No looking at valuations. Just buy the index because it went up. Of course, when no thinking goes into the purchase of the ETF other than it went up, no thinking goes into the sale of the ETF when it goes down. But even worse is that when valuations get extreme, as did the Nasdaq 100 then, there are few buyers of falling knives, liquidity dries up and market dislocations happen.

Chart 3: Asset split between active vs. passive US-domiciled equity funds, 2009-5/2017

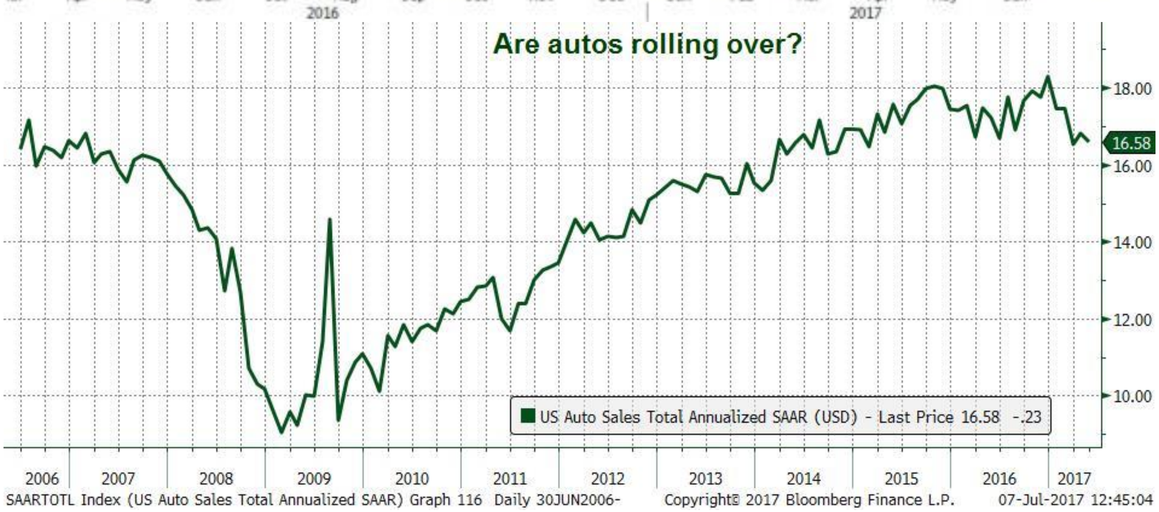


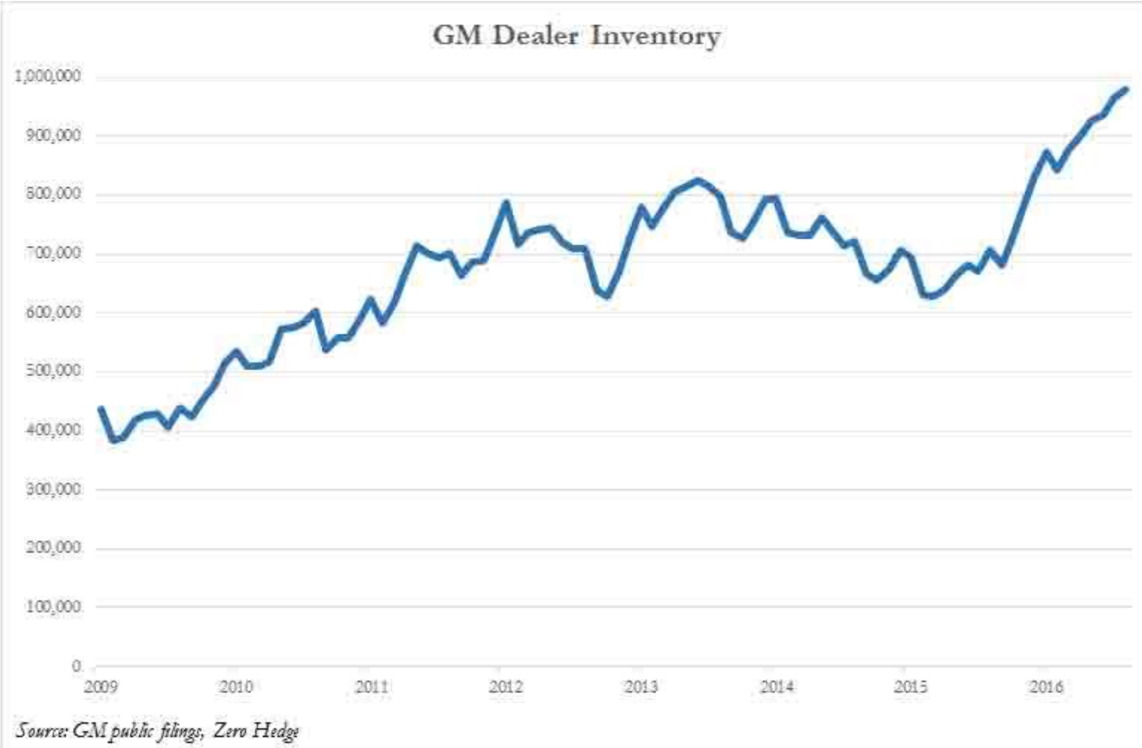
Source: Strategic Insight SimFund, BofA Merrill Lynch US Equity & US Quant Strategy

It appears that the S&P 500 is beginning to act like the Nasdaq 100 in that more and more ETF and index funds own the S&P 500. BofA Merrill Lynch estimates that 24% of daily trading volume is ETFs. That may undercount the impact of the ETFs as they must buy/sell futures or the underlying stocks to true up their tracking to their benchmark. So ETF-related trading volume could be much larger than 24%. This adds to market volatility when ETFs go to sell as there are fewer buyers on the other side. Many of these ultimate buyers will be value investors and it will take much lower prices to entice them.

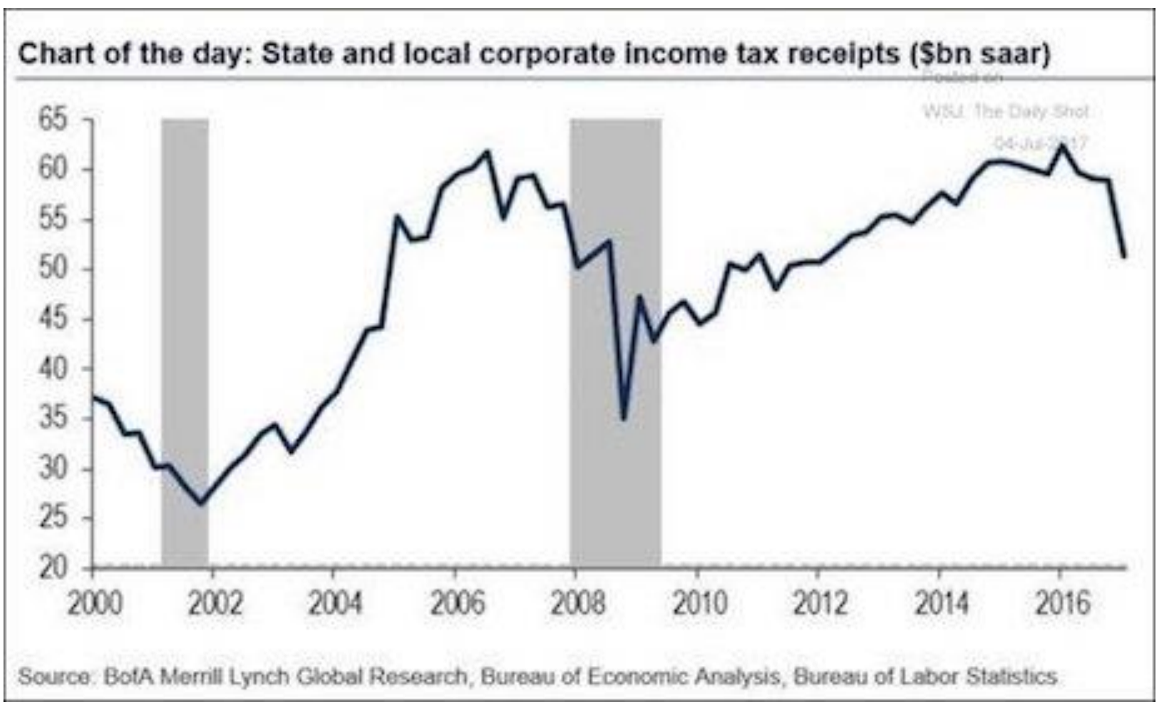
Soft vs. Hard Update

Last quarter we looked at the disconnect between the soft data (confidence surveys) and the hard data (factory and utility strength). We noted that confidence was high but reality was not. Fast forward 3 months and we note that the soft data has fallen, but surprisingly, hard data has also fallen. Auto sales have continued at their softened pace, while inventories continue to pile up (note GM).





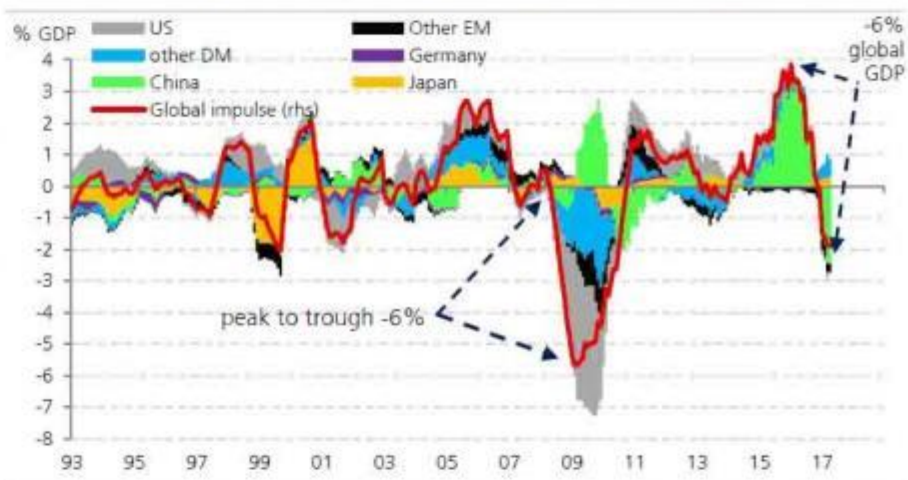
The drop in corporate income tax receipts has been striking. Note that similar drops occurred at the beginning of the 2001 and 2008 recessions.



China

China has been trying to reign in its real estate and lending bubbles. But every time there is a little pain, they loosen standards and stimulate more. Interestingly, China's leadership will change later this year. Politically this is a good time to take some pain. The old regime can take a little blame while pointing at their record of growth. The new regime has 5 years until they out of office, so they have time to make up for any problems. As seen below in green, China has been slowing its credit growth. Other countries are not picking up the growth baton. The last few times that credit decelerated like this, we were in recession.

Figure 1: The Global Credit Impulse (2nd derivative of global credit growth)



Source: Haver, UBS Estimates (complete data through March, partial data through April)

FUND INFORMATION

The fund's largest equity positions as of 6/30/2017 were US Bancorp, UnitedHealth Group and Allstate.

US Bancorp has a diversified revenue stream of various fee-based businesses (payment services, corporate trust, fund servicing, institutional trust and custody) and net interest income. Their low-teens ROE consistently ranks well above the industry median. Their peer-leading debt rating lowers their borrowing costs, giving them a pricing advantage vs. competitors. Although loan growth was off to a sluggish start in Q1, management expects it to accelerate in Q2 and into the back half of 2017. In addition, a moderation in risk-management-related costs should also help to boost profits. The shares were +0.2% in Q2 and +2.2% year-to-date.

UnitedHealth Group's insurance business is performing well with medical cost trends coming in at the low end of expectations. Their non-insurance business is experiencing rapid growth and margin improvement as they reap the benefits from large investments over the past several years. Their non-insurance services include wellness and care management programs designed to lower health care costs, information technology solutions, and pharmacy benefit management (PBM) services. The shares were +13.5% in Q2 and +16.8% year-to-date. The strong performance in Q2 was driven by a strong earnings report, which came in much better than expected. In addition, management said that earnings for the full year 2017 will be higher than originally projected.

Allstate's auto insurance business is seeing attractive profit growth fueled by rate increases, expense cuts and a re-focus on profitable business. Their homeowners insurance business should continue to generate strong underlying results as well. In addition, the company is entering the fast-growing and high-margin consumer device warranty insurance business through its recently announced acquisition of SquareTrade. This year the company reported Q4 and Q1 earnings that were much stronger than expected, helping to drive the shares +8.8% in Q2 and +20.4% year-to-date.

LOOKING FORWARD

We try to produce the best risk-adjusted returns available. As risks have increased, we have increased our protection. If risks subside or are priced in, we will gladly reduce our protection. But until the market more fully reflects these risks, we will remain cautious.

Best regards,

Thomas H. Forester

CIO and Portfolio Manager

For more complete information on the Forester Funds, including charges and expenses, obtain a prospectus by calling 1-800-388-0365 or visiting www.ForesterValue.com. The prospectus should be read carefully before investing.

The foregoing does not constitute an offer or recommendation of any securities for sale. Past performance is not indicative of future results. The views expressed herein are those of Thomas Forester and are not intended as investment advice.