

ELECTION RALLY CONTINUES

The post-election rally in US stocks continued into the first quarter of 2017. US equities posted their 6th consecutive quarter of gains, with the S&P 500 up approximately 6%. The NASDAQ was the top performer, returning 9.8% for the quarter. Returns have been fueled by expectations for de-regulation and corporate tax reforms, coupled with a rebound in corporate earnings and strong consumer confidence.

After underperforming US stocks for most of the last 3 years, international equities had a turn to shine in Q1 2017, with both developed and emerging markets outperforming. Emerging markets more than doubled the S&P 500 return with the MSCI Emerging

Markets index up 13.24%, rebounding from a recessionary period and fears over trade policy.

Bond yields in the US had moved up significantly in the last quarter of 2016, but the pain has not been distributed equally across bond maturities. With another rate increase by the Federal Reserve in March, short maturities were affected the most, but longer bonds experienced little change. The 10 year US Treasury yield closed the quarter at 2.4%, just where it was at the end of 2016. Although the Fed is expected make two additional rate increases in 2017, markets appear to be pricing in less aggressive rate movement.

Index	2017 (through 3/31)
S&P 500	+6.07
DJIA	+5.19
EAFE (Int'l)	+7.25
BC Ttl Bond	+0.82

Dow Jones Relative Risk Benchmarks

Conservative	+1.73
Moderate	+4.57
Aggressive	+6.99

2017 OUTLOOK

FIXED INCOME/BONDS — The story has not changed much regarding fixed income. We expect rates to gradually climb higher, however the process may be uneven and longer than initially believed. The yield curve has been flattening, with short-term rates moving higher, but long-term rates remaining relatively unchanged. Given the relatively small additional yield but large additional interest rate risk carried by long bonds if rates move more dramatically, we favor intermediate maturities. While we remain cautious, we seek to balance interest rate risk and yield, with a portfolio of bonds that carry less sensitivity to rising interest rates but are not completely hedged.

US EQUITIES — Despite appearing somewhat expensive, US equities remain well below record valuation levels, with economic conditions supportive of higher prices. Expectations are for a 9.1% increase in earnings for first quarter 2017. The overall unemployment rate is low, wages are growing, and consumer confidence is at a 16-year high. Given the recent run-up in prices, we remain cautiously optimistic, recognizing that US stocks may be vulnerable to a correction if the expected reforms do not happen, or earnings come in soft. We continue to favor technology, consumer discretionary, and bank stocks as areas of opportunity.

INTERNATIONAL EQUITIES — Patient investors are finally being rewarded for holding foreign stocks, which have been a drag on diversified portfolios for a few years. We have been favoring international equities for some time, believing that their cheap relative valuation could not last forever and prices would inevitably rise. It is hard to say if the recent outperformance in foreign stocks is the new trend, but we have many reasons to believe it could continue. Improving global growth, continued fiscal stimulus and a recovery in emerging markets from recession are supportive of further gains. Protectionist trade policy and a stronger dollar remain risks, however we feel they are likely overblown.

Our View — Stay positioned for rising rates with exposure to intermediate bonds to enhance portfolio yield.

Our View — Remain cautiously optimistic, with technology, consumer discretionary and banks as opportunities.

Our View — Maintain exposure to foreign stocks, which remain cheaper than the US.

CORPORATE TAX REFORM



The US has one of the highest corporate tax rates in the world at 35%. President Trump has proposed lowering the corporate tax rate to 15%. Although many of the largest US corporations do not pay the top rate, it is projected that on average every 5% cut in the corporate tax rate would cause a 4% increase in earnings per share growth, (UBS) therefore the proposed 20% cut could translate to a 16% increase in earnings. The effective tax rate for many large US companies after deductions is 15-17%, therefore small- to mid-sized companies, which typically pay higher effective rates, may stand to benefit more from corporate tax reform.



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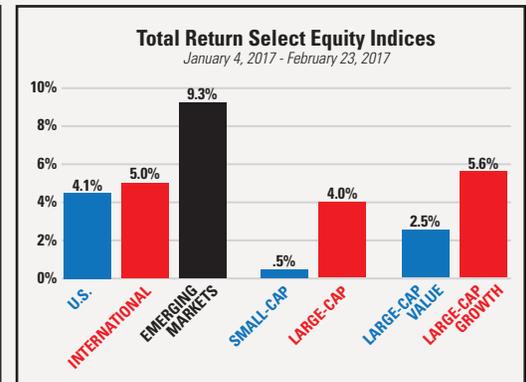
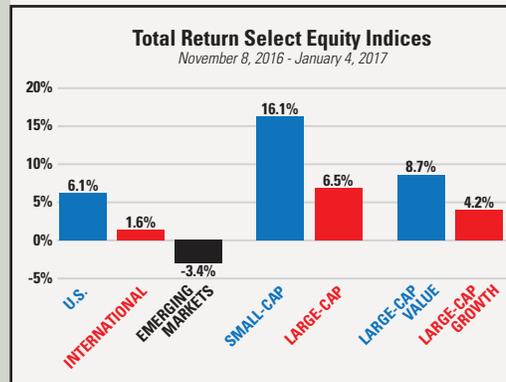
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A TALE OF TWO RALLIES

After the election, the US stock market took off under the belief that tax reform, fiscal stimulus, and regulatory reform would benefit small cap companies, industrials, and financial and energy companies respectively. International equities struggled in the last quarter of 2016 as protectionist trade rhetoric caused uncertainty. Bond yields skyrocketed in fear of inflationary expansionary policy.

The rally continued into the first quarter of 2017, however investors changed focus as the new President and Congress battled over health care. Failure to reach a compromise on health care stoked renewed fears of political gridlock and worries as to whether President Trump can deliver on his other campaign promises. In the end, firming corporate earnings drove gains for this quarter and may have prevented political anxieties from causing an equity correction.

The S&P 500 is now trading at around 21 times trailing earnings, slightly expensive relative to historical averages but certainly not at a record level. The rally seemed to lose steam in March, and it appears a catalyst will be needed to move markets higher. Compromise in Washington may be key to propel the economy and markets forward.



Source: Bloomberg, 2/23/17. Returns are represented by the following indices: US is represented by the S&P 500 Index, International is represented by the MSCI ACWI ex-U.S., Emerging Markets is represented by the MSCI Emerging Markets Index, Small-Cap is represented by the Russell 2000 Index, Large-Cap is represented by the Russell 1000 Index, Large-Cap Value is represented by the Russell 1000 Value Index and Large-Cap Growth is represented by the Russell 1000 Growth Index.

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