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Quarterly Market Update

First Quarter 2017

Political Uncertainty as Viewed Through an Investment Lens

The overriding theme that engulfed markets during the first quarter, particularly stocks, has been Donald Trump and the general belief that he will enact policies that will spur economic growth and boost corporate profits. Never mind any lingering anxieties that his more controversial positions might detract from economic growth.

Index	March Return*		2017 QTD/YTD Return
DJIA[1]	-0.72%		+4.56%
NASDAQ Composite[2]	+1.48%		+9.82%
S&P 500 Index[3]	-0.04%		+5.53%
FTSE Developed ex North America Index[4]	+2.27%		+6.97%
Bond Yields	**Yield as of Mar 31 & Change***		**Yield as of Dec 30, 2016**
3-month T-bill	0.76%	+0.23%	0.51%
2-year Treasury	1.27%	+0.05%	1.20%
10-year Treasury	2.40%	+0.04%	2.45%
30-year Treasury	3.02%	+0.05%	3.06%
Commodities	**Mar 31 Price & Change***		**Year End 2016**
Oil per barrel[5]	$50.85	-$3.59	$53.89
Gold per ounce[6]	$1,244.85	-$10.75	$1,159.10

Sources: U.S. Treasury, MarketWatch, St. Louis Federal Reserve, CNBC
** Monthly: February 28, 2017 – March 31, 2017*

Of course, Trump can't cut taxes and boost outlays on infrastructure projects simply by decree. He's only half of the equation; Congress must still enact measures that reach his desk.

So, what happens if Congress deadlocks and nothing gets passed?

What if investors are front-running changes in fiscal policy that may not occur?

Well, for better or worse, Washington isn't a well-oiled machine and that was demonstrated when Republican leaders in the House pulled their bill to repeal and replace Obamacare when the votes weren't there.

Whether Obamacare should be repealed or whether the Republican replacement was the right prescription is not in the scope of this month's summary; what impacts investors is.

More importantly, investors have been anticipating a sharp reduction in the corporate tax rate. The math is simple, a lower tax rate boosts after tax earnings, which is positive for stocks. It may also induce firms to invest in various tools to boost output and productivity, which would aid economic growth.

But the inability to pass the health care bill raises the odds we might not see tax reform, as it highlighted the deep divisions within the Republican Party.

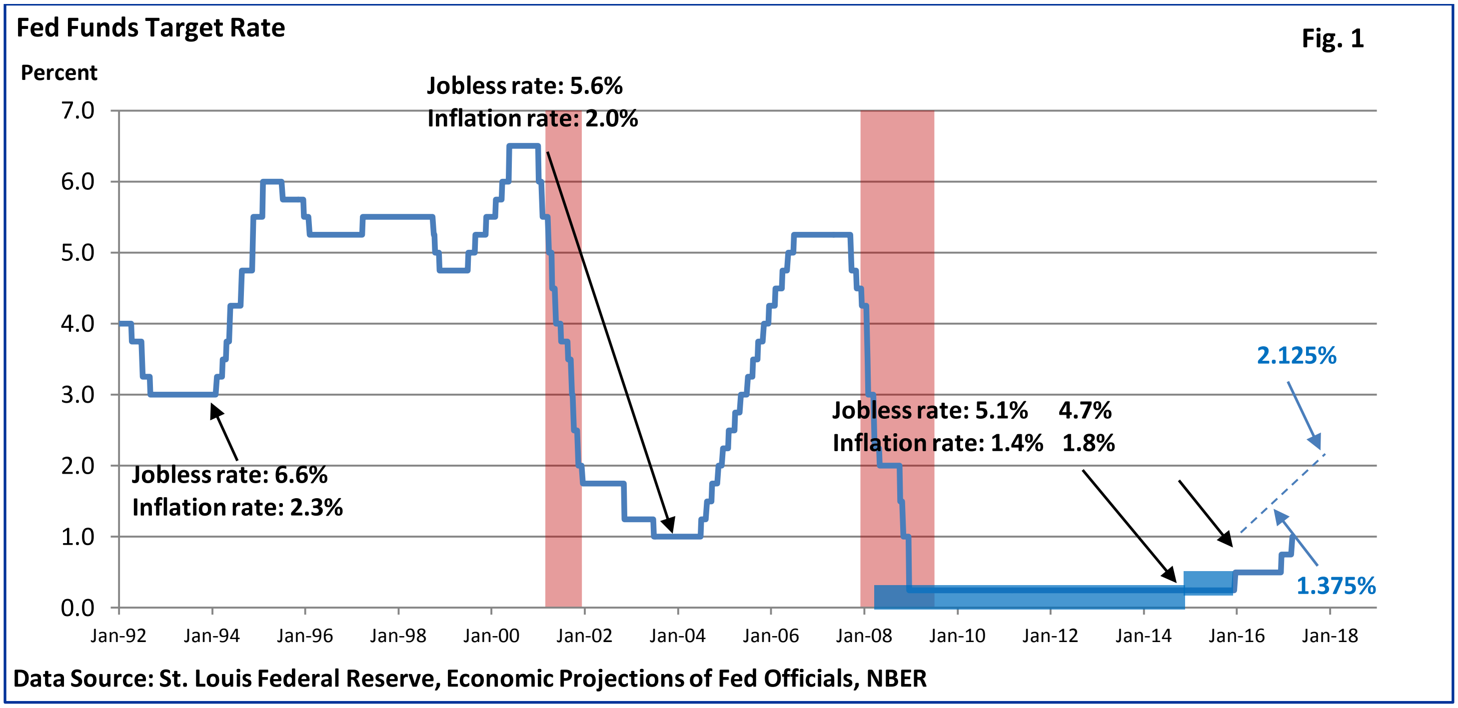
Republicans share common tax goals, including lowering rates for individuals, eliminating the alternative minimum tax, and slashing the corporate tax rate. Still, passage is not guaranteed.

While political noise can create volatility, the standoff with the health care bill didn't spark much of a selloff. In fact, the major indices ended the week higher following the bill's apparent demise.

Partisanship may create uncertainty at the Capitol, but investors care most about economic and profit growth as it is the long-term driver of stocks.

The Fed engages

When the year began, it appeared the Fed was gearing up for a rate hike in June. It would be the first of three expected increases in the fed funds rate.



Shaded areas mark recessions

Last Date: March 2017

Inflation rate as determined by the core PCE Price Index (excludes food and energy)

Broken line represents current forecast for the fed funds rate per the Economic Projections of Federal Reserve Board Members and Federal Reserve Bank Presidents under their Individual Assessments of Projected Appropriate Monetary Policy

Fed funds rate median projection of 1.375% at year-end 2017 and 2.125% at year-end 2018.

Forecasts are subject to change

That changed in late February, when several Federal Reserve officials, including Fed Chief Janet Yellen, strongly hinted that March was in play.

When the March 15 meeting concluded, the Fed surprised no one by announcing it was raising the fed funds rate by ¼% to a range of 0.75 – 1.0%.

Despite chatter the Fed might tweak the needle in a slightly more hawkish direction by raising projections from three rate hikes this year to four; it chose to maintain guidance at three. If that occurs, we would have a fed funds rate of 1.25 – 1.50% by the end of the year – see Figure 1.

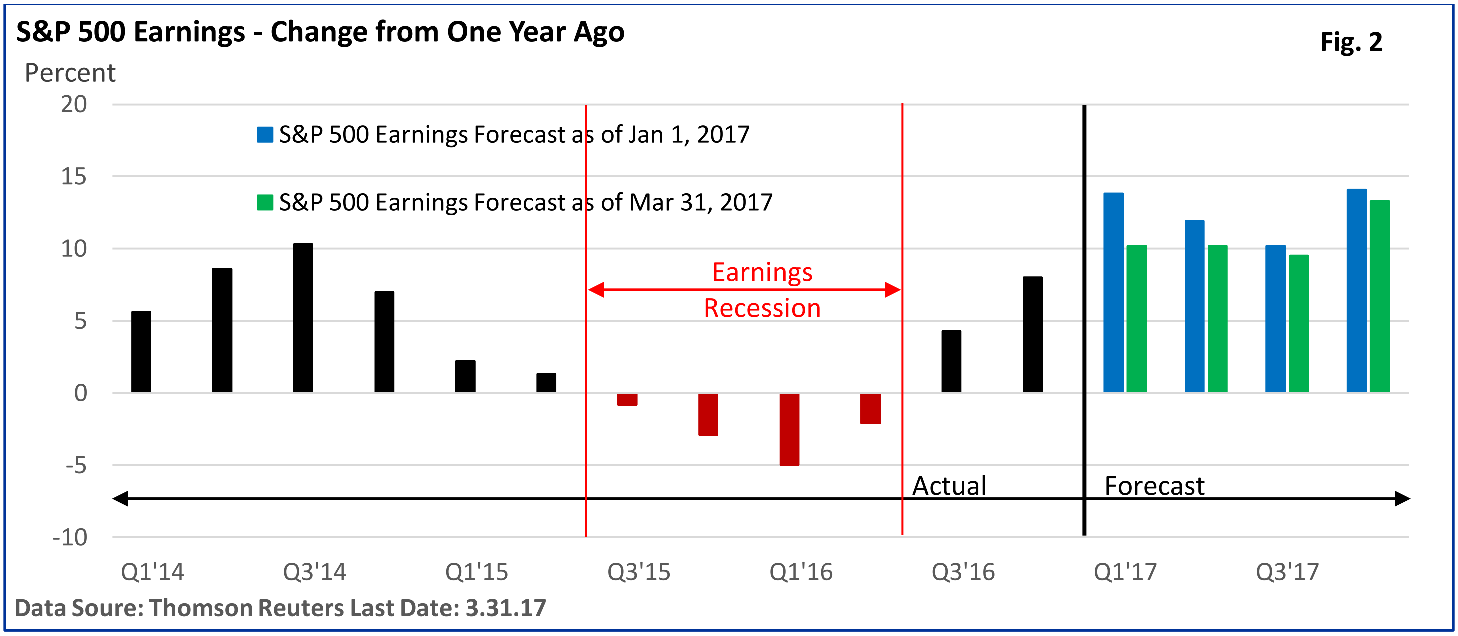
"We realize that waiting too long to scale back some of our support (low rates) could potentially require us to raise rates rapidly sometime down the road, which in turn could risk disrupting financial markets and push the economy into recession," Yellen pointed out in early March.

While she was cautiously optimistic on the economic outlook, she said expected rate increases should be "gradual."

Pumped up profits

Ultimately, it's about corporate profits, and the outlook for the rest of the year is favorable.

As of March 31, Thomson Reuters estimates earnings for S&P 500 companies, which capture about 80% of the total U.S. market capitalization (Dow Jones Indices), are expected to rise 10.2% from a year ago. That's down from an estimate of 13.8% made at the beginning of the quarter.



All forecasts are subject to change

Since the early days of the economic recovery, analysts have lowered their estimates in response to conservative forecasts issued by firms. It's an under-promise, over-deliver strategy and if we follow the same pattern this time around, firms will post their first double-digit rise in profits since Q3 2014.

According to Thomson Reuters, expect the most support to come from financials, technology, and energy. Energy played a significant role in the earnings recession, thanks to the collapse in oil prices. While prices have been shaky as of late, they are up from a year ago.

Later in the year

Anything past Q2 gets dicey and depends on several factors. Foremost, how the economy performs.

The theme that is being driven home? Be careful reacting to news items or political noise that may create temporary volatility, but fails to shift the narrative that has driven stocks from the March 2009 low.

We've seen it before: economic and political uncertainty in Europe, political gridlock at home, Brexit, China, geopolitical anxieties, and more.

When new problems crop up, and they will, uncertainty can quickly affect short-term market sentiment. But if it fails to materially dent the U.S. economic outlook, it's unlikely to have a longer lasting impact on stocks.

When might we get a more pronounced downturn? Historically, bear markets correlate closely with recessions. A recession will eventually set in, and stocks will turn down. But recessions have historically led to economic upturns and new highs for stocks. It's a pattern that's repeated itself for over 200 years.

[1] The Dow Jones Industrials Average is an unmanaged index of 30 major companies which cannot be invested into directly. Past performance does not guarantee future results.

[2] The NASDAQ Composite is an unmanaged index of companies which cannot be invested into directly. Past performance does not guarantee future results.

[3] The S&P 500 Index is an unmanaged index of 500 larger companies which cannot be invested into directly. Past performance does not guarantee future results.

[4] The FTSE Developed ex North America Index is an unmanaged index of large and mid-cap stocks providing coverage of developed markets, excluding the US and Canada. It cannot be invested into directly. Past performance does not guarantee future results.

[5] New York Mercantile Exchange front-month contract; Prices can and do vary; past performance does not guarantee future results.

[6] London Bullion Market Association; gold fixing pricing; Prices can and do vary; past performance does not guarantee future results.

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