

# CAPITAL MARKET REVIEW

First Quarter 2017



## The Economy

We have a new administration who has promised to take us in a new direction. The outline of which most investors have pronounced positive, with their actions if not otherwise. But, ultimately it is about what actually happens and not just promises. Deregulation is no different than increased regulation in that it should not be about the amount as much as it is about getting it right. The tax code is not just about rates and deductions. How is income defined in the first place? Is all this trade talk about isolationism or are we talking about cracking down on partners that have been cheating? Details matter.

Until those details get sorted out we believe that the market rally is likely to slow. Patience is in order. As investors we should not overreact to rumors, partisan bickering, or even one page policy proposals. We are just going to have to wait and see.

In the meantime let's stay focused on making prudent decisions. Policy matters in investing, but it is not the only thing that matters. Quality companies will navigate the changing environment. Selecting those companies from the bottom up is the prudent way to invest.



***"It's the little details that are vital. Little things make the big things happen." - John Wooden***

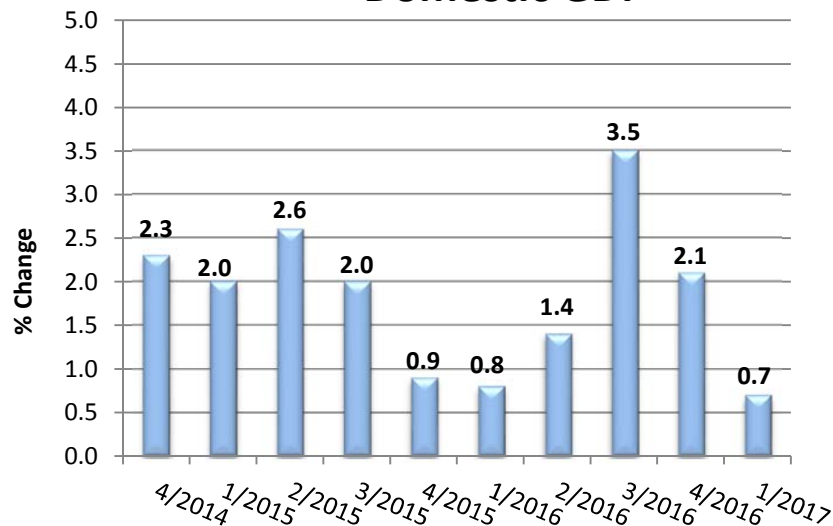
# The Economy

The 4<sup>th</sup> quarter 2016 GDP growth came in at 2.1 percent and first quarter is 0.7%. The optimism for more pro-growth policies remains strong and sentiment levels have risen, but we remain in the familiar pattern of slow first quarters.

The official unemployment rate dropped to 4.5 percent in March. Jobs growth slowed a little but the labor market is looking strong.

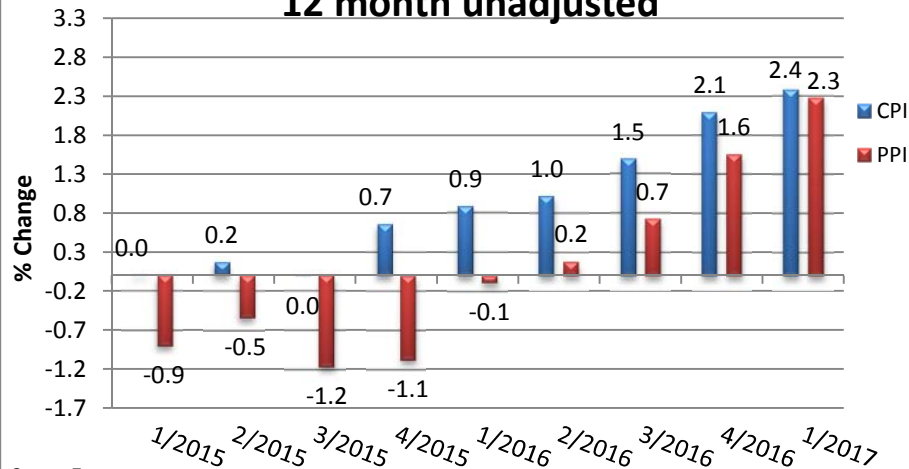
Inflation has kicked up and the 12 months ending March gave us a reading of 2.4 percent. The Fed continues to raise rates as this is now above their 2 percent target. Thus far that has gone along with greater optimism. Time will tell if that continues.

## Domestic GDP



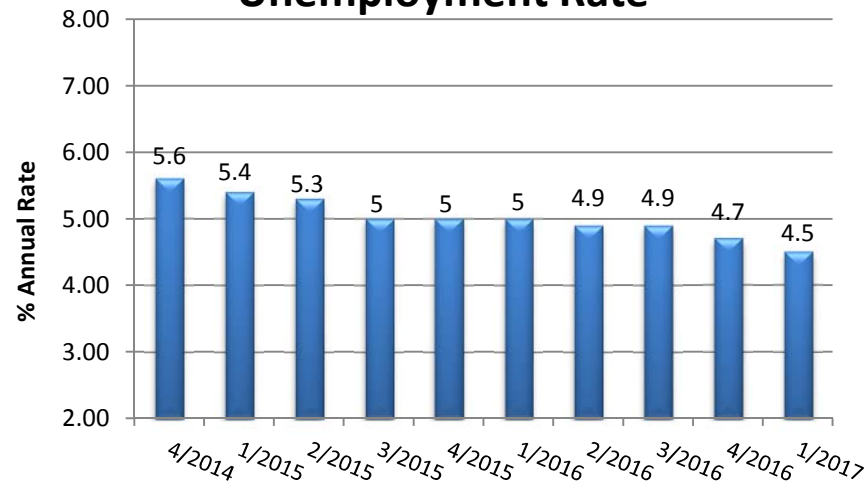
Source: Factset

## Inflation Indicator 12 month unadjusted

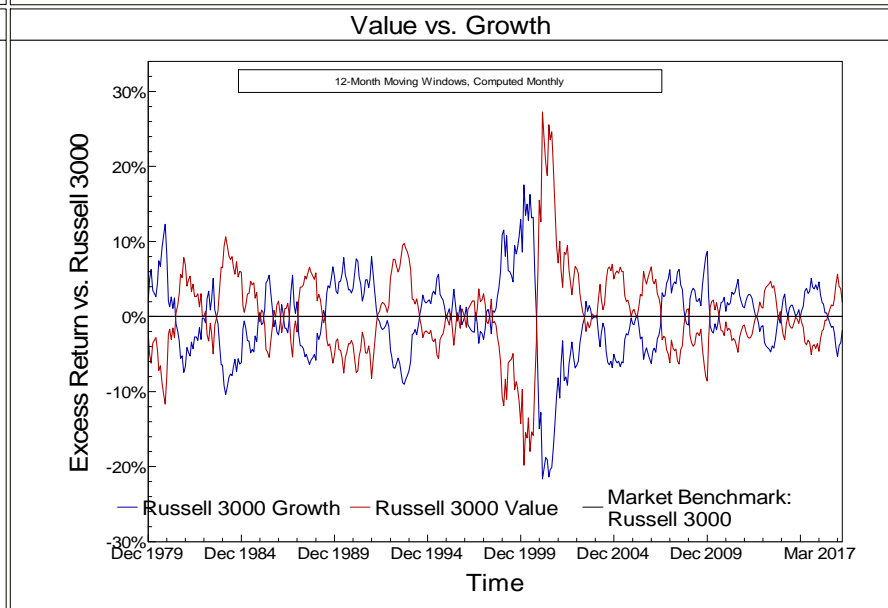
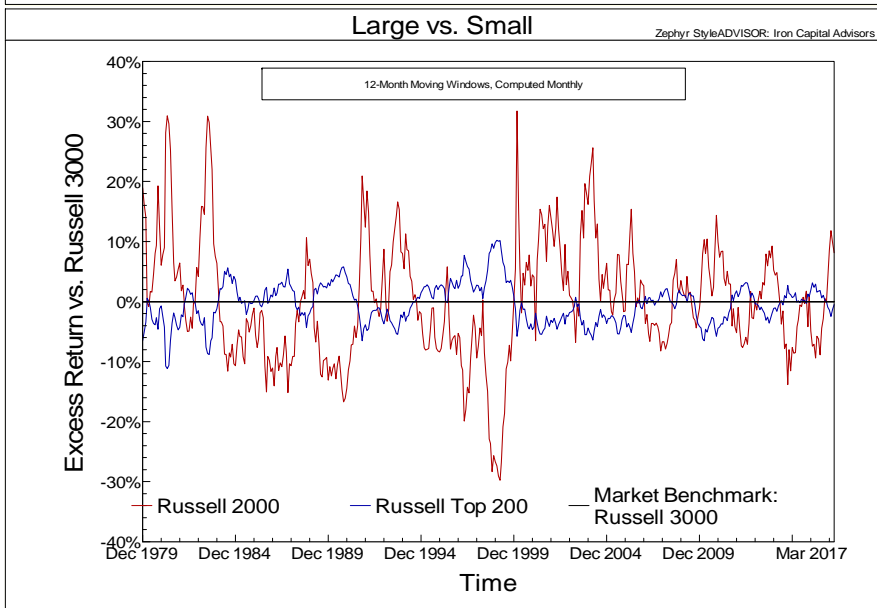
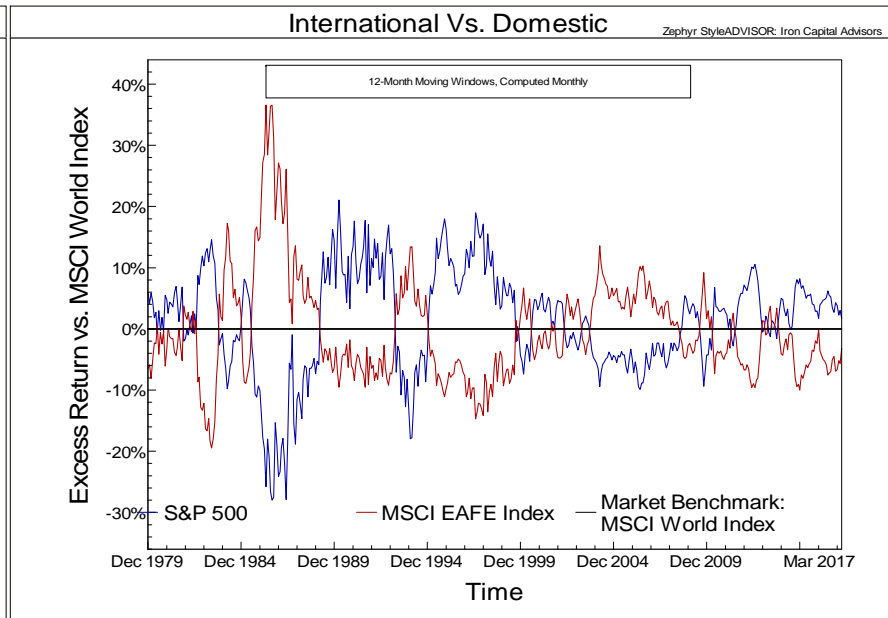
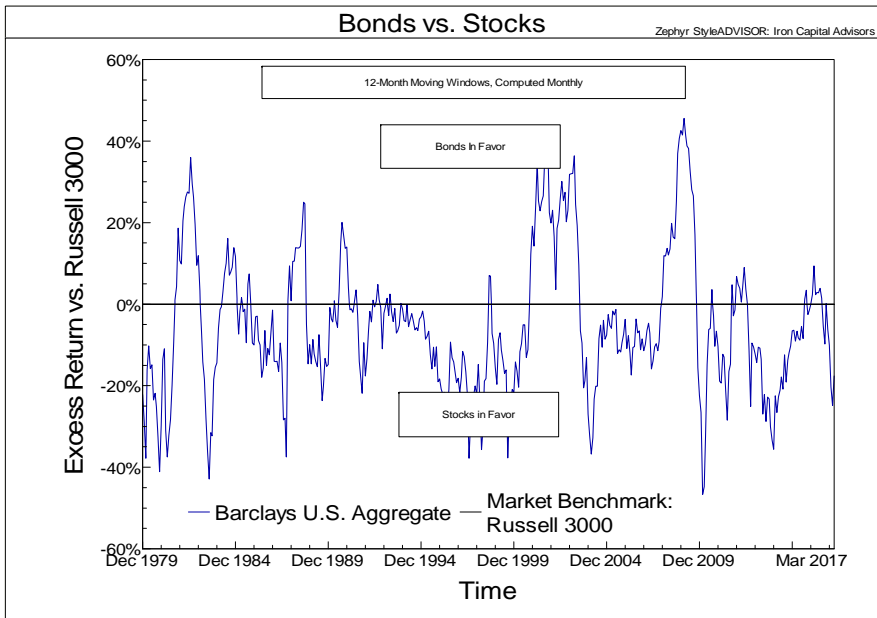


Source: Factset

## Unemployment Rate



Source: Factset



## Domestic Equity Markets

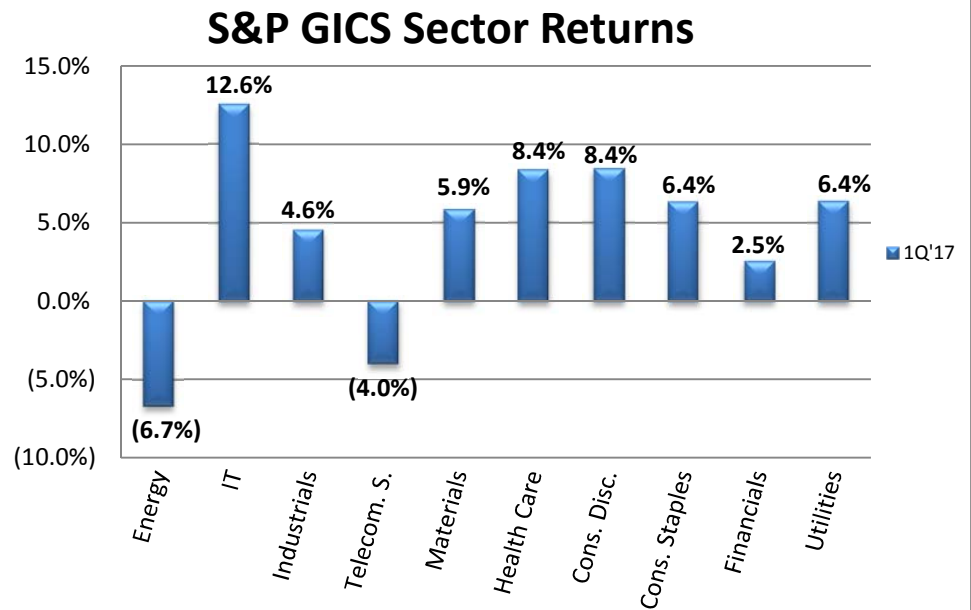
**The rally continues.** For the quarter the S&P 500 was up 6.07 percent. Growth outpaced value in a change from the early part of the rally. The Russell 1000 Growth index finished up 8.91 percent, while its value counterpart was up 3.27 percent. Small companies came back to earth as well with the Russell 2000 index finishing up 2.47 percent.

Technology was the best place to be with the sector up 12.6 percent. Telecom and energy were the only negatives. Underneath the surface there was a return to the old pattern of the FANG type stocks. We suspect this is just the ordinary ebb and flow of the market and not a permanent shift.

Much of that will likely depend on actual pro growth policies being implemented. The market often gets ahead of itself. The real world may move faster than it once did, but it still moves much slower than market moods.

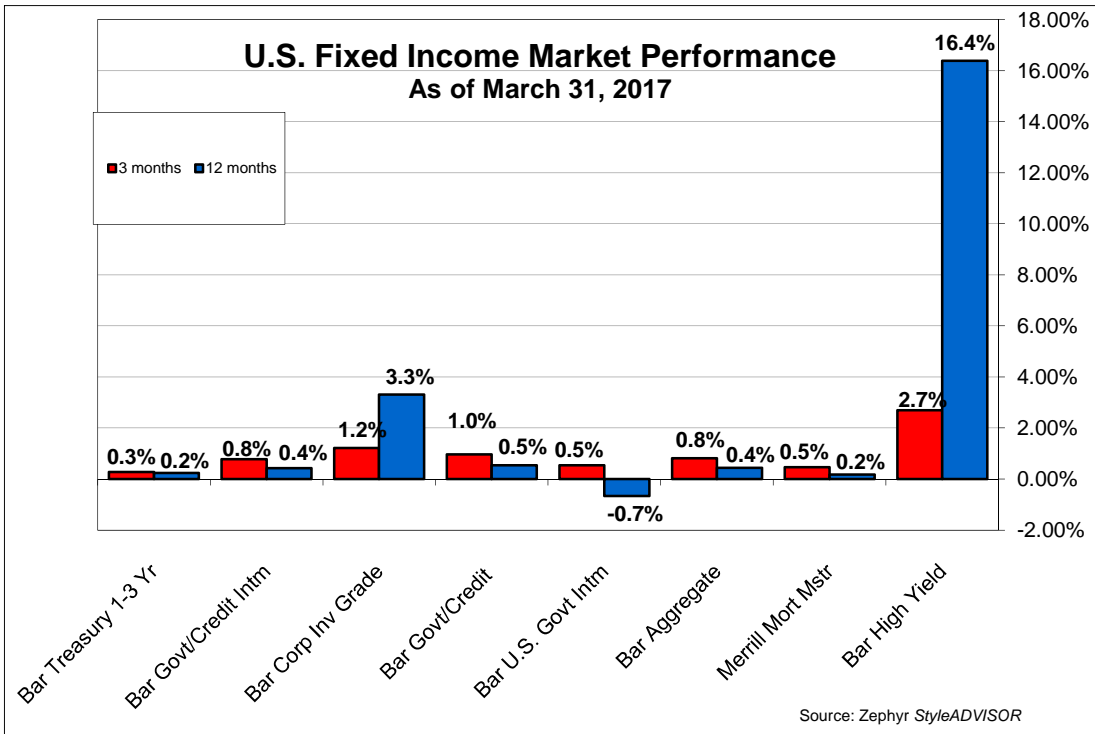
### Domestic Indices Three Months Ending March 31, 2017

	Yield	Price/Earnings	Price/Book
S&P 500	1.91%	20.0	3.05
Russell 1000 Gr	1.60%	23.9	5.89
Russell 1000 Val	2.65%	18.9	1.98
Russell Midcap	1.80%	25.2	2.73
Russell 2000 Gr	0.75%	48.2	4.14
Russell 2000 Va	2.30%	25.4	1.63



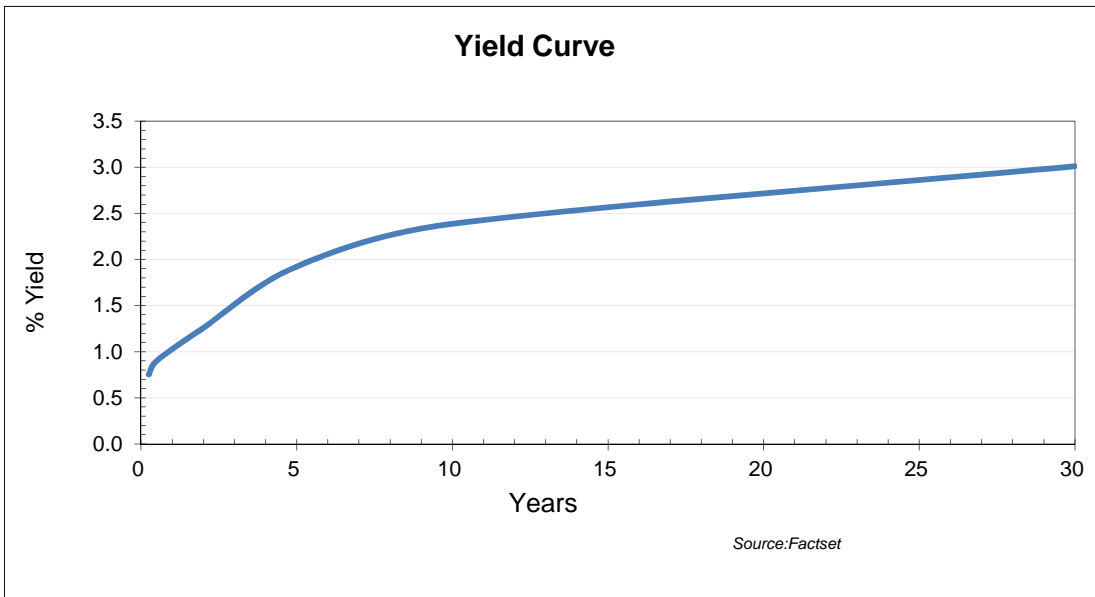
Source: Factset

# DOMESTIC FIXED INCOME MARKET



Bonds rose slightly during the quarter. The Barclays US Aggregate Bond index ended up 0.82 percent. High yield bonds ended the quarter up 2.71 percent.

We remain in the low rate trading range. Long-term not much has changed. Low rates make bonds less attractive for the long haul.



## Yield Curve as of March 31, 2017

Time to Maturity	Interest Rate
3 Month	0.75
6 Month	0.90
2 Year	1.26
5 Year	1.92
10 Year	2.39
30 Year	3.01

# INTERNATIONAL MARKETS

**International stocks rejoined the rally.** The EAFE index finished up 7.39 percent and the MSCI Emerging Markets index ended the quarter up 11.49 percent. There was a bounce back from the strengthening dollar that had hurt international investors in the prior quarter.

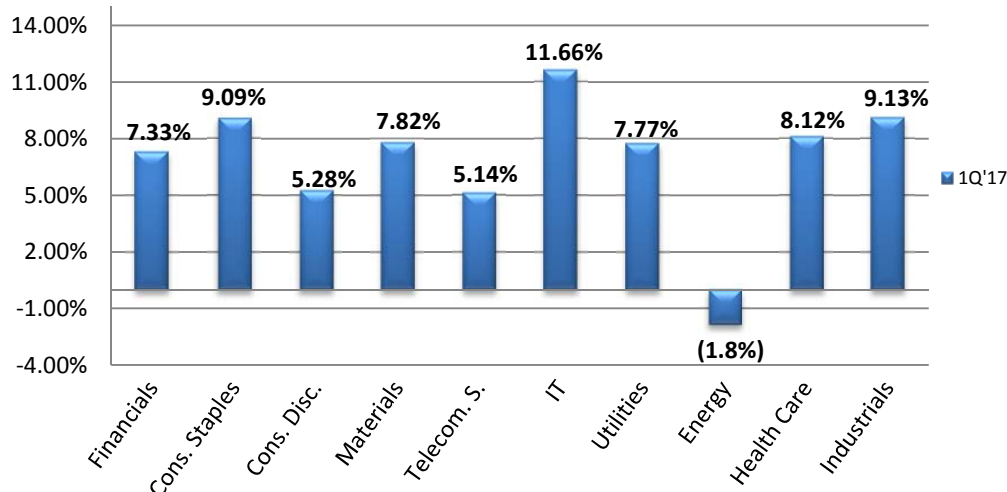
There have also been signs that the global economy is seeing better growth. The IMF has raised its outlook especially for emerging economies. They now expect growth of 3.4 percent in 2017.

The increase in nationalism notwithstanding, we live in a connected world. A good deal of this optimism is based on the ability of our new administration to actually deliver on policy promises. Like much else in the markets this puts us in the mode of wait and see.

## MSCI Country Returns Three Months Ending March 31, 2017

	Return US\$ (%)	Return Local Currency (%)	Currency Effect(%)
Austria	9.09%	7.58%	1.51%
Belgium	5.15%	3.70%	1.45%
Denmark	6.57%	5.11%	1.46%
Finland	7.70%	6.21%	1.49%
France	7.35%	5.86%	1.49%
Germany	8.52%	7.02%	1.50%
Ireland	3.89%	2.46%	1.43%
Italy	6.25%	4.78%	1.47%
Netherlands	11.35%	9.94%	1.41%
Norway	1.50%	1.28%	0.22%
Portugal	8.25%	6.75%	1.50%
Spain	14.87%	13.28%	1.59%
Sweden	9.98%	8.09%	1.89%
Switzerland	8.83%	7.18%	1.65%
UK	5.06%	3.82%	1.24%
<b>Europe Total</b>	<b>7.61%</b>	<b>6.18%</b>	<b>1.43%</b>
Australia	11.01%	5.37%	5.64%
Hong Kong	13.41%	13.65%	-0.24%
Japan	4.64%	-0.03%	4.67%
New Zealand	2.33%	2.08%	0.25%
Singapore	13.48%	9.80%	3.68%
<b>Pacific Total</b>	<b>7.03%</b>	<b>2.64%</b>	<b>4.39%</b>
Brazil	10.43%	7.73%	2.70%
Canada	2.68%	2.12%	0.56%
China	12.93%	13.13%	-0.20%
Greece	-3.46%	-4.79%	1.33%
Hungary	-0.06%	-1.46%	1.40%
India	17.12%	12.06%	5.06%
Indonesia	7.08%	5.91%	1.17%
Korea	16.90%	8.24%	8.66%
Mexico	16.06%	6.10%	9.96%
Poland	17.75%	11.76%	5.99%
Russia	-4.61%	-10.63%	6.02%
Thailand	8.68%	4.28%	4.40%
<b>Emerging Markets</b>	<b>11.49%</b>	<b>7.80%</b>	<b>3.69%</b>

## Developed Int'l Sector Returns\*



Source: Harbor Capital

\* MSCI EAFE Index

# Market Forecast

## \*Forecasted Annualized 3yr Returns



## Indices Three Months Ending March 31, 2017

	Yield	Frwd Earnings Yield	**Hist. Return	***Hist. Risk Prem. + RF Rate
Large Blend	1.91%	7.57%	10.35%	6.05%
Large Growth	1.60%	6.66%	10.02%	6.05%
Large Value	2.65%	8.84%	10.51%	6.05%
Mid Cap Blend	1.80%	7.22%	11.70%	6.05%
Small Growth	0.75%	3.78%	8.10%	7.05%
Small Value	2.30%	7.47%	10.97%	7.05%
Developed Foreign	2.85%	9.59%	5.09%	4.18%
Emerging Markets	1.95%	10.08%	10.20%	5.68%
REITs	3.74%	5.84%	10.53%	4.62%
Core Bonds	2.61%	2.61%	6.36%	2.95%
High Yield Bonds	6.18%	6.18%	8.30%	4.12%

**The rally is due for a pause.** The rotation back to growth from value does not bode well for its longevity. The hope for more growth friendly policies needs to be fueled by some actual policies. We remain optimistic for the year but would not be surprised if we have a flat summer.

Emerging markets still look attractive and the rally in international stocks should have more legs.

Bonds remain our biggest concern over the long term and will until the yield on the 10 year treasury exceeds 3 percent. The run in high yield bonds will likely slow down, but not stop.

\* Weighted average using 40% earnings yield, 30% historic return and 30% historic risk premium + RF rate

\*\*Annualized 29 Yr return

\*\*\*Hist. risk premium of domestic and international equity as defined by Zephyr Style Advisor's GFD Long Term Index database except for REITs and High Yield which are based on average 20 year rolling returns of the NAREIT Equity REIT Index and the Barclays Corporate High Yield Index minus the average 20 year rolling returns of the 3-month T-Bill and scaled using proprietary data. The Current 3-month T-Bill yield (as of 03-31-2017) is added back to each risk premium.



## SELECTED INDEX RETURNS - PERIODS ENDING March 31, 2017

	Quarter	Year-to-Date	One Year	Three Years	Five Years	Ten Years
<b>US EQUITIES</b>						
Broad Stock Market - Russell 3000	5.74%	5.74%	18.07%	9.76%	13.18%	7.54%
Large Stocks - S&P 500	6.07%	6.07%	17.17%	10.37%	13.30%	7.51%
Dow Jones Industrial Average	5.19%	5.19%	19.91%	10.61%	12.15%	8.10%
Medium-Size Stocks - Russell Mid-Cap	5.15%	5.15%	17.03%	8.48%	13.09%	7.94%
Small Stocks - Russell 2000	2.47%	2.47%	26.22%	7.22%	12.35%	7.12%
Small Value Stocks- Russell 2000 Value	-0.13%	-0.13%	29.37%	7.62%	12.54%	6.09%
Small Growth Stocks- Russell 2000 Growth	5.35%	5.35%	23.03%	6.72%	12.10%	8.06%
Large Value Stocks - Russell 1000 Value	3.27%	3.27%	19.22%	8.67%	13.13%	5.93%
Large Growth Stocks - Russell 1000 Growth	8.91%	8.91%	15.76%	11.27%	13.32%	9.13%
<b>US FIXED INCOME</b>						
1-3 Yr Treasury (Gov't) Bonds - Barclays Capital	0.27%	0.27%	0.24%	0.73%	0.64%	2.01%
US Government Bonds Int - Barclays Capital	0.54%	0.54%	-0.67%	1.55%	1.23%	3.32%
US Corporate Inv Grade Bonds - Barclays Capital	1.22%	1.22%	3.31%	3.65%	3.96%	5.44%
Government/Credit (Corp) Bonds - Barclays Capital	0.96%	0.96%	0.54%	2.69%	2.46%	4.34%
Int Govt/Credit (Corp) Bond - Barclays Capital	0.78%	0.78%	0.42%	2.01%	1.88%	3.76%
US Aggregate Bond Market - Barclays Capital	0.82%	0.82%	0.44%	2.68%	2.34%	4.27%
Mortgage Master - Merrill Lynch	0.46%	0.46%	0.18%	2.67%	2.02%	4.17%
US Corp High Yield Bonds - Barclays Capital	2.70%	2.70%	16.39%	4.56%	6.82%	7.46%
<b>INTERNATIONAL (Measured in US Dollars)</b>						
Non-US Stocks - MSCI EAFE	7.39%	7.39%	12.25%	0.96%	6.32%	1.53%
World Stocks (includes US) - MSCI World	6.53%	6.53%	15.43%	6.12%	9.99%	4.81%
European Stocks - MSCI Europe	7.61%	7.61%	10.47%	-0.95%	6.25%	1.31%
Japanese Stocks - MSCI Japan	4.64%	4.64%	14.82%	6.36%	7.11%	0.84%
Asian Stocks (Ex-Japan) - MSCI Pacific ex-Japan	11.79%	11.79%	18.54%	2.30%	5.47%	4.63%
Chinese Stocks - MSCI China	12.93%	12.93%	19.93%	6.65%	5.86%	5.48%
Indian Stocks - MSCI India	17.12%	17.12%	18.40%	7.47%	6.26%	4.72%
Emerging Markets - MSCI EM	11.49%	11.49%	17.65%	1.55%	1.17%	3.05%
Int'l Gov't Bonds -Citi World Gov't Bond (Non USD)	2.02%	2.02%	-4.79%	-2.56%	-1.50%	2.64%
<b>REAL ESTATE</b>						
FTSE NAREIT Equity-Reits Index	1.16%	1.16%	3.56%	10.26%	9.99%	4.85%
<b>SHORT TERM INTEREST RATES</b>						
T-Bills	0.12%	0.12%	0.34%	0.15%	0.11%	0.61%

Note: Returns for periods longer than 12 months are annualized.