

# Fixed Market Commentary

March 31, 2017

## Trump Trade

The “Trump Trade” continued with a vengeance in the first quarter. From Election Day 2016 through March 31, 2017 the S&P 500 was up 11.3%. The stock market rally has been attributed to expectations that Trump would pursue a pro-business agenda including regulatory relief, a fiscal stimulus package, tax reform and repeal of Obamacare. The first issue that the Trump administration chose to tackle was Obamacare repeal, and it did not go well. The GOP could not agree on a replacement plan, and healthcare legislation has now been put on the back burner. This GOP family feud has called into question Trump’s ability to push transformative legislation through Congress. And the stock market may have gotten ahead of itself, pricing in too many market-friendly Trump priorities.

A related theme this quarter has been the stark contrast between “soft” and “hard” economic data. “Soft” data refers to qualitative survey/sentiment data. Based on recent surveys, the economy is booming. One measure of consumer confidence is at a 16-year high, while measures of business confidence have also soared. On the other hand, “hard,” quantifiable economic data have remained rather stagnant. This contrast is apparent in various GDP forecasts. The NY Federal Reserve’s GDP model is predicting Q1 growth of 2.8%. In contrast, the Atlanta Fed’s model expects only 0.6% growth. The reason for this large difference? The NY Fed model places a far greater weight on “soft” survey data. It will be interesting to see which model is correct.

The S&P 500 was up 6.1% in Q1, with most of that coming in the first two months of the year. The S&P hit a new all-time of 2,396 on March 17. Bond yields soared following the election. However, 10-year Treasury yields have generally remained in a narrow range of 2.4% to 2.6% following the initial spike. The 10-year closed at 2.63% on March 17, its highest yield since mid-2014. The first quarter return on the Barclays Aggregate Index was 0.82%.

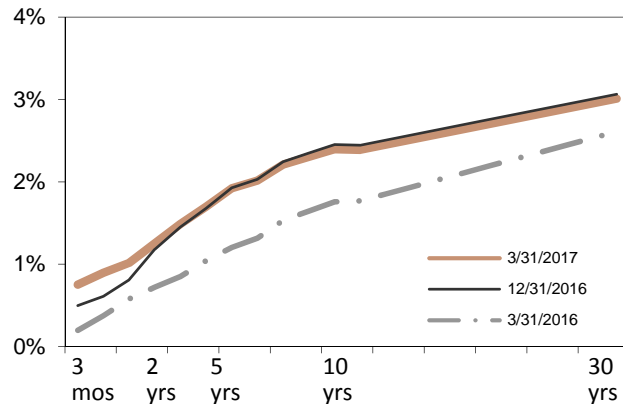
The Fed hiked the federal funds rate on March 15th, the second increase in three months. Markets were not expecting a hike up until a couple of weeks before the FOMC meeting. Suddenly, a number of Fed officials made hawkish public comments that strongly suggested a March hike. Seldom have we seen such a dramatic change in expectations as futures markets quickly corrected, pricing in a rate increase. However, the Fed probably didn’t get the result they expected as stocks prices ROSE following the March rate hike. Despite three rate hikes in the past 16 months, monetary policy remains very accommodative. Don’t forget, the Fed continues to reinvest the proceeds of maturing bonds in their \$4.5 trillion portfolio. Some analysts believe the effective federal funds rate, taking into account the size of the Fed’s balance sheet, is NEGATIVE 1.7%. This “adjusted” funds rate might explain why, since the first hike in December 2015, stocks have rallied to a degree never seen before during the first few rate increases of a tightening cycle.



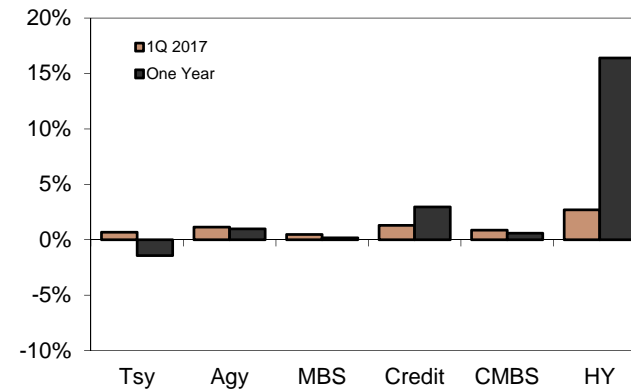
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### US Treasury Yield Curves



### Sector Index Returns



We believe that the biggest factor weighing on Federal Reserve monetary policy is the level of stock prices. Stock market valuations have become very stretched to say the least. The March FOMC minutes contained this eyebrow-raising quote: "Some participants viewed equity prices as quite high relative to standard valuation measures." In our view, the Fed would like to raise short term rates to a "normal" level, hoping to see stock valuations gradually readjust to more sustainable levels. The Fed's greatest fear, however, is triggering a big stock market sell off by tightening too aggressively. While most analyst expect at least two more rate hikes this year, all bets are off if stock prices start to tumble. If "hard" economic data does not show substantial improvement, the Fed will be hard-pressed to raise rates to a neutral level. Look for the Fed to talk very tough in the coming months in an attempt to deflate the stock market bubble, while it continues to pursue very gradual increases in the federal funds rate.

We will tactically adjust portfolio durations to take advantage of anticipated interest rate moves. Our client portfolios are underweight government securities. US Treasuries currently offer little value, but they do provide liquidity and act as a hedge against "flight to quality" buying. We are overweight credit and slightly underweight mortgage-backed securities.



# Equity Market Commentary

March 31, 2017

## First Quarter Observations

In like a lion, out like a lamb. March was a time of rest for the markets as heady five month gains began to consolidate. The bureaucratic windmill in Washington has finally collided with Trump's ambitions. Investors are taking a breather to digest what it all means. The learning curve in Washington is steep and painful but Trump has excellent survival instincts. It's obvious that the markets will be patient. Stay long.

For the quarter the S&P 500 index was up 6.06%, as Large-Cap growth companies lead the way (+8.9%). The broader Russell 3000 index was up 5.74%. Small-Caps as represented by the Russell 2000 index were up 2.47%. International markets were the winners as developed markets were up 6.8% and emerging markets up 13%.

- The *negatively* rated *Consumer Discretionary* sector rallies a little further in March, and was one of the top performers in Q1 (+8.1%). However, while there is some modest improvement, there are still too many important stocks that are negative to warm up to this sector.
- The *down trending* *Consumer Staples* sector fades in March. This sector is currently one of the most bearish as investors have shifted their interest away from defense in favor of offense. Our *sell* list has expanded and now is a great time to start reducing exposure.
- The *Energy* sector struggles to keep pace and is *downgraded* to *neutral* this month. While the signal distribution is still favorable, it is clear that this sector needs to strengthen.
- The *positively* rated *Financial* sector finally consolidates some of its recent gains. We have been patiently waiting for some short-term setback to more aggressively recommend adding exposure to this sector. While the pullbacks have been somewhat modest, they have been sufficient enough to greatly expand our *buy* interest.
- The *negatively* rated *Healthcare* sector rests in March after a couple of months of modest improvement. The good news here is that this sector appears to have halted its steady downtrend of the last two years. As a very late stage downtrend, it's possible that healthcare is poised to turn positive again in 2017, as it was up 7.9% in Q1.
- The *Industrial* sector consolidates in March, leading to an expansion of *buy* opportunities within this *positive* sector. If you've missed the "Trump Rally" in this sector, now is a good time to add exposure on the pullback.



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- The *Information Technology* sector continues to surge across all industries and market caps. While the sector was the best performer in Q1 up over 12%, the sector is getting extended in the short-term. However, there are still select areas worth looking at to add exposure.
- Consistent with the other cyclical sectors, the *Materials* sector failed to keep up with the market throughout the first quarter. Despite our *neutral* rating, we are still constructive on the sector.
- Once again, the defensive *Telecom* sector fails to answer the call of this bull market. The sector is highly oversold and will likely provide some protection against a short-term market consolidation.
- After topping out mid-2016, the *Utility* sector has been in a steep relative decline as investors have shunned interest rate sensitive stocks. Over the past couple of months the sector has stabilized a bit but the evidence is hardly enough to warrant an upgrade.
- The *International* sector continues its trend of net positive trend reversals. Although the pace has been slow, the steady improvement is very encouraging across both developed and emerging markets.

## Reversal Comments

Our trend reversal summary is positive again as fourteen (14) issues reverse upward and nine (9) issues turn downward. Thematically nothing really stands out this month. This month's number of reversals is modest again.

