**ECONOMIC UPDATE**

**GDP**
- U.S. GDP for the fourth quarter of 2016 came in essentially at +2.1% year-over-year. This compares with the third quarter’s +3.5% growth and expectations for a +2.2% increase. As expected, exports were weaker than in the third quarter, when they were well above trend, while consumer spending and private investment were both additive to GDP.
- Expectations for the first quarter are essentially in line with the fourth quarter, about +2.2% year-over-year growth.

**MANUFACTURING**
- Manufacturing remains on solid footing, as the Institute for Supply Management’s manufacturing survey posted a 57.7 reading for February before falling back slightly to 57.2 in March. Among the underlying components, new orders, production, and prices remain above the 60 mark, and employment continues to strengthen.
- Showing similar momentum, Eurozone manufacturing PMI rose to 56.2 in March; the measure has moved higher each month for the last six. In addition, Japan’s Tankan index, which measures manufacturer sentiment, improved for the second straight quarter.

**CONSUMPTION**
- Consumer confidence is cresting cycle highs, as unemployment remains at recent lows and wages continue to rise. While survey participants expressed some anxiety around the Trump administration, the overall strength of the economy appears to be offsetting those policy-based misgivings.
- On the housing front, existing home sales slipped modestly in February, but limited supply resulting in competitive sales appears to be the cause; rising mortgage rates seem to be having little impact at this juncture.
A REVIEW OF THE MARKETS

In the first quarter, U.S. equity markets continued the momentum from the close of 2016. Economic data remained steady, providing a foundation for greater asset gains even without progress on stimulative fiscal policy. Large cap stocks, as represented by the S&P 500 Index, outperformed small and mid cap counterparts in the quarter, perhaps as a result of modest profit taking in the smaller end of the capitalization range following a strong end to 2016. Growth stocks, too, remain leaders over value stocks, as technology, consumer discretionary, and health care sectors all outperformed, while energy and telecommunications stocks posted negative returns for the quarter. Financial stocks also underperformed in the quarter after a strong surge to close out the year.

International developed stocks outperformed the U.S. in the quarter, with growth names leading the charge; the MSCI EAFE Index returned +7.3% versus +6.1% for the S&P 500 Index. Small cap equities, too, performed nicely, bouncing back from a disappointing back half of 2016. Regionally, the best performers were Asia outside of Japan and Europe outside of the U.K. Emerging market investors continue to benefit from the move to risk in the current environment, as these equities posted the best return of any major asset in the first quarter. A range-bound U.S. dollar has helped, as have expectations for accelerating global growth. The gains have been fairly widespread, save in Russia, where stocks declined in the first quarter.

Within fixed income, investors earned positive returns in almost all segments of the market, albeit with gains that paled in comparison to the equity markets. Treasury yields have settled into a new range, with the 10-year Treasury closing the quarter at 2.40%, down from 2.45% at year end, but up from 1.78% a year ago. In the quarter, credit outperformed government bonds modestly, with U.S. corporate high yield bonds besting investment grade issues. Municipal visibility of Washington, the current investment environment is quite good. We track 14 separate economic and market indicators, from monetary policy to leading economic indicators to stock market valuation. Of those, 11 are green (positive), two are yellow (neutral) and only one is red (negative). The one negative is consumer confidence, which is near all-time highs and is historically a contrary indicator.

At times of uncertainty, a good response is to review your financial strategy and your progress toward goals. If you are anxious about the stock market, a good step to consider is rebalancing back to your long-term targets. We can help you with this and perhaps ease any concerns.

GLOBAL MARKET RETURNS

Source: Bloomberg and Morningstar
LOOKING AHEAD

2017 began on the heels of a fairly euphoric move in the U.S. markets following the election of President Trump and the expectations for a meaningful bump in growth on the back of Republican-sponsored fiscal stimulus in the form of spending packages and tax reform plans. Underlying these stimulus expectations, however, was a steady improvement in economic data beginning in August of last year, and that supported the markets through the end of the first quarter, even as the risks of disappointment on the legislative landscape increased. Indeed, as we look forward to the rest of the year, it is difficult to determine how effective the Republican held Congress will be, given the different factions currently vying for an opportunity to create the legislative agenda. In addition, President Trump has several items on his docket, including a border wall, that don’t necessarily fit neatly into that agenda.

With that said, for U.S. equities, we are most positive on the financial, energy, and technology sectors, and our portfolio managers and research analysts are looking to any potential pullbacks as opportunities to add exposure in those sectors. In addition, our team is monitoring our exposure to a negative reaction which could result from a meaningful delay in tax reform here in the U.S. In the shorter term, we are focusing on the alignment of sentiment with underlying data, as unsupported exuberance, particularly on the consumer front, could indicate that we have reached a cyclical peak. With valuations at lofty levels and heightened political uncertainty, along with typical seasonal pressures, we acknowledge that pullback of 5-10% in the coming months is a reasonable possibility, but we remain constructive on U.S. equities despite that risk.

Internationally, our view is that the opportunity has improved over the last several months. While we adopted a more cautious stance last summer following the Brexit vote in the U.K., strengthening economic data in Europe, along with continued support for Prime Minister Shinzo Abe and the Bank of Japan’s policies has provided us with further comfort that gains in developed international stocks could be forthcoming, despite the uncertainty associated with the U.K. situation. In addition, while the Federal Reserve is clearly moving to raise interest rates, which should result in a stronger U.S. dollar, stronger global growth expectations appear to be offsetting those concerns, as assets are flowing to emerging markets equities (and debt, for that matter). We remain overweight in this asset class, despite strong returns over the last several quarters, given more favorable current account balances and relatively reasonable valuations.

Within fixed income, we have been positioning our portfolios over the last year in response to both our expectations for higher rates in the future, as well as our acknowledgment that we are likely entering the later stages of the current cycle; as such we are slightly underweight bonds relative to equities. Within our taxable bond portfolios, given the strength of the economy and corporate balance sheets, our fixed income portfolio managers and analysts still favor an overweight to credit and corporate bonds, and in certain cases, we are selectively incorporating bonds of modestly lower credit quality as those opportunities are presented. From a duration standpoint, the team is allowing duration to drift a bit shorter compared to the relevant benchmarks, as the risk of higher rates has materially increased. For our municipal bond portfolios, we maintain a positive outlook on municipal credit, although issuer selection continues to be important. We are taking a neutral duration stance, still maintain an up-in-quality bias and are getting extra yield by buying callable structures. As for high yield, we are neutral in our allocation to high yield bonds, both corporate and municipal. Returns have been strong, and while we acknowledge that low interest rates have created a potential for refinancing pressures in the coming years, we believe the yield afforded offsets that risk at this juncture.

Finally, we still believe there exists an opportunity to invest in areas which show positive correlation to inflation in the near to mid term, despite the pressure experienced by these areas in the first quarter. In particular, we believe commodities and natural resource equities should benefit from such an environment, particularly if energy demand strengthens on the back of global demand; we also like global exposure to the real estate market.

Underlying these stimulus expectations, however, was a steady improvement in economic data beginning in August of last year, and that supported the markets through the end of the first quarter, even as the risks of disappointment on the legislative landscape increased.

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<tr>
<th>Asset Class</th>
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Within our taxable bond portfolios, given the strength of the economy and corporate balance sheets, our fixed income portfolio managers and analysts still favor an overweight to credit and corporate bonds, and in certain cases, we are selectively incorporating bonds of modestly lower credit quality as those opportunities are presented.
Why Invest Internationally?

Many U.S. based investors largely invest in domestic companies and institutions, whether through equity investments in U.S. companies, the purchase of debt issued by those same companies, or debt issued by state and federal governments. However, ignoring the myriad opportunities available outside the United States can potentially hinder performance in the long term.

Of course, there are arguments to this view that are worth noting. First, most large U.S. companies operate globally; in fact, there are numerous companies included in the S&P 500 Index that derive a majority of their revenue from outside of the U.S., hence U.S. investors in the index are already garnering that exposure. Behaviorally, too, investors sometimes take issue with committing capital to an area of the market that is not familiar to them and where it may be difficult to gauge success. Finally, a more recent argument has been focused around performance, as U.S. assets have strongly outperformed in the post-financial crisis era, creating a complacency around the need for foreign exposure.

Our view is twofold. One, over time, globalization has resulted in market-leading companies which are domiciled all over the world. These companies, although they may have their headquarters in Berlin or Tokyo, are likely doing significant business in the U.S. as well as in other markets in which they can be competitive and successful. Two, at this juncture, international assets are trading at attractive valuations. Post financial crisis, international and U.S. equities both rebounded; however, the sovereign debt crisis in Europe and several years of political floundering in Japan created a gap between the gains earned internationally and here in the U.S.

Several risks remain for the outlook of international stocks, not least of which is political change, particularly in the notable markets of Germany, France, and England. While we are currently underweight international developed stocks as a result of this uncertainty, we believe that the outlook is likely to continue to improve, and we encourage our clients to talk to us about why diversifying might make sense, both in the near term and longer term strategic allocation.

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