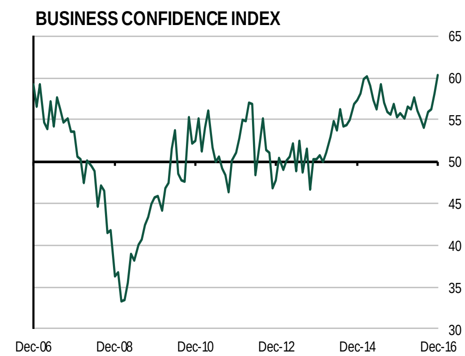
Trust & Investment Bulletin
Winter 2017

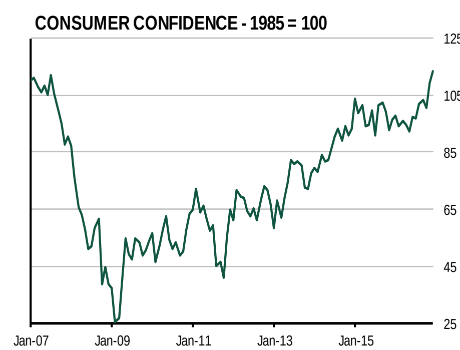
Economic Summary:

For the second time in sixth months, markets were caught wrong-footed by an election surprise. Like the so-called Brexit vote this past summer, Donald Trump's election victory proved the polls and markets wrong. This time, however the market selloff lasted less than 24 hours. Stock futures plummeted in the evening hours of election night, but by the time the markets opened on Wednesday morning stocks were already trading higher.

The Trump victory coupled with a Republican majority in congress had market participants speculating on an end to gridlock in Washington. The promise of an infrastructure bill, corporate tax reform, foreign cash repatriation, and potential deregulation all combined to send stocks higher in the days and weeks following the election. For the time being, fears of protectionism and a reversal of 70 plus years of economic globalization following World War II seem to have taken a back seat in the minds of investors.

In contrast to the surprise election results, Janet Yellen and the FOMC managed to stay on script. Buoyed by strong equity markets following the election and gradually improving economic data, the Fed voted to increase the Fed Funds rate by 0.25% at their December meeting. The final estimate of 3rd quarter GDP growth came in at 3.5%, well above the average 2% growth rate that has persisted throughout this cycle. The accelerated growth rate was short lived, however as the first estimate of 4th quarter growth came in at just 1.9%.





It does appear as though we have reached an inflection point on several fronts: sustained deflation to potential inflation, globalization to protectionism, monetary stimulus to a gradual tightening, fiscal tightening and the sequester to potential fiscal stimulus, and regulation to deregulation. Much of the impact of these changes may not be realized until late 2017 at the earliest. However, business confidence and consumer confidence have increased (Northern Trust charts right) and the potential for so-called animal spirits to kick-in could thrust the U.S. economy into a higher gear.

With the U.S. economy on fairly steady ground, risks to the economic expansion remain primarily from abroad. Tensions on trade with China and Mexico have increased significantly. Europe seems to be showing signs of growth, but debt issues in Italy and Greece, the Brexit impact, and French elections, all threaten the fledgling growth rate. Potential capital flights out of China could also upset global expansion.

Equity Summary:	4th Qtr	YTD	12 Month	3 YR	5 YR
S&P 500 (Large Cap Domestic)	3.82	11.95	11.95	8.85	14.63
Russell 2000 (Small Cap Domestic)	8.82	21.28	21.28	6.73	14.44
MSCI EAFE (International Developed)	-0.62	1.59	1.59	-1.03	7.13

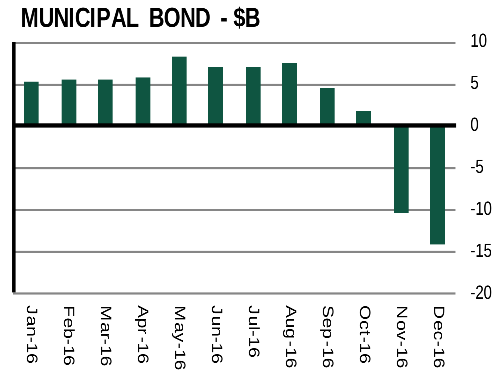
The post-election rally in U.S. equities caught most market observers by surprise. Rather than selloff on fears of uncertainty, market participants bid U.S. stocks higher. In particular, small stocks and financials led the rally. The Russell 2000 Index was up almost 9% for the quarter and over 21% for the year. The potential for corporate tax reform would have the greatest impact on small and mid-cap U.S. stocks that currently have the highest effective tax rates. Financial stocks also spiked on the potential for regulatory relief under the new administration.

International stocks continued to lag domestic issues, with a meager 1.59% return for the year. International stocks continue to trade at more reasonable Price/Earnings ratios when compared to U.S. issues. This is true for both developed and emerging markets and we continue to recommend a slight shift in allocation into these relatively cheaper stocks.

Fixed Income Summary:	**4th Qtr**	**YTD**	**12 Month**	**3 YR**	**5 YR**
BC Treasury - Bill Index	0.09	0.35	0.35	0.16	0.14
BC Municipals 5YR	-2.63	-0.39	-0.39	1.73	1.79
BC Intermediate Government/Credit	-2.07	2.08	2.08	2.09	1.85

The fourth quarter was not nearly as kind to bonds and bond mutual funds. The Fed's decision to raise rates coupled with increased inflation expectations brought on by improving economic data and Trump administration policy, conspired to send yields higher and prices lower. The 10-Year U.S. Treasury note was trading at 1.8% just prior to the election and reached a high of 2.6% in the weeks following.

Speculation for tax reform caused municipal bonds to be especially hard hit as lower tax rates make the tax-exempt interest from municipal issues less appealing. Fund flows for municipal bonds (Northern Trust chart right) dropped off dramatically following the election and the Barclays 5 Year Municipal Index lost 2.63% for the quarter.



Alternative Investments Summary:	**4th Qtr**	**YTD**	**12 Month**	**3 YR**	**5 YR**
Bloomberg Commodity	2.66	11.77	11.77	-11.26	-8.95
FTSE/EPRA NAREIT Global Real Estate	-5.77	4.62	4.62	6.12	9.66
Morningstar Broad Hedge Fund TR	1.81	4.12	4.12	3.91	4.65

Alternative investments were once again mixed for the quarter. Real estate investments are traditionally very interest rate sensitive and sold off 5.77% as interest rates soared. Commodities and hedge funds turned in a respectable quarter. Commodities finished the year up nearly 12% on improving data out of China, but remain depressed. Hedge funds finished the year up 4.12% which was consistent with recent years and their 3 year and 5 year trailing numbers. Hedge funds continue to provide returns in between fixed income and equities and their low correlations to traditional assets provide additional diversification benefits.

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