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Q1 2017 MARKET RECAP

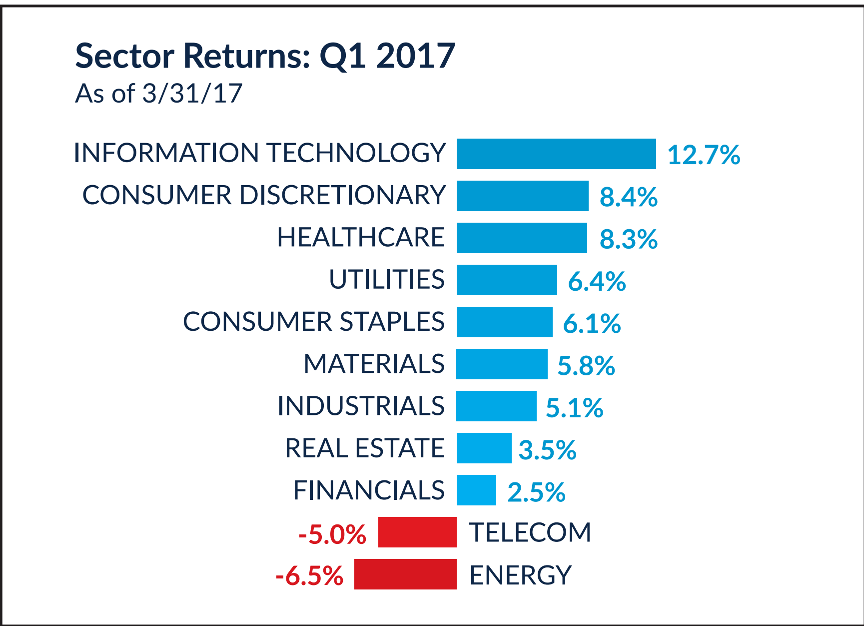
April 10, 2017

INAUGURATION, RATE HIKES, AND OFFICIAL BREXIT

The first quarter of 2017 brought with it a couple notable events, which were mostly foreseen by the markets. The presidential inauguration took place on January 20th and domestic markets reacted favorably in the following weeks. The second event was the Federal Reserve Bank's decision to raise rates in March. This hike was predicted by many, with the futures reaching nearly 100% in the days before the meeting. Like the inauguration, markets moved higher following the hike. Finally, Brexit was formally triggered on March 29 when British Prime Minister Theresa May sent formal notice to the president of the European Council, Donald Tusk. The process is expected to take 2 years and it remains to be seen exactly what that will entail.

In the US, the markets got off to a strong start in 2017, with the S&P 500 up over 7% through the beginning of March. However, things cooled off as March progressed, with the major indices posting more down days than up ones during the last month of the quarter. For the quarter, the Nasdaq Composite led the major indices, returning +9.82% while S&P 500 the was up +6.07% and the Dow Jones Industrial Average was up +5.19%. A theme that we noticed during the quarter was the relative performance of cyclical stocks and defensive stocks. In 2016, cyclicals were up +12.7% while defensives were only up +1.4%. This trend continued into Q1, with cyclicals up +7.8% but saw defensives close the gap considerably, returning +6.3%.

This cyclical/defensive parity makes sense considering how the broad indices behaved during the quarter – up strongly through the first two months before cooling off. The "Trump Bump" (the strong market performance following the election) started to unwind as reality set in. Many of the talking heads are discussing the unwind of the "Trump Trade," which seems to be coming with the realization that despite the support of a Republican government (and even that is uncertain), it is still very



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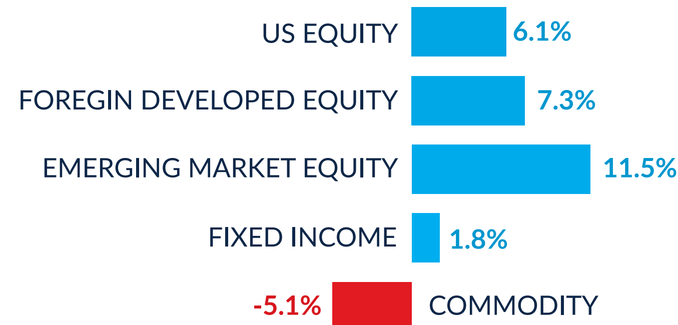

difficult to push new legislation through. This difficulty was exhibited harshly by the failure of the American Health Care Act to even be put to a vote. The failure to repeal and replace Obamacare calls into doubt more of Trump's campaign promises, most notably tax reform. It remains to be seen what will come of that, but in the meantime, the markets have reacted negatively to the uncertainty.

While the administration may have failed with the AHCA, the President has moved other areas of his agenda forward through executive orders. Travel restrictions and environmental regulations have been targets of interest to the markets, which have responded with uncanny calmness. The Volatility Index (or VIX) traded in a range of 10.5-13.5 throughout the entire quarter, which is very low. For some perspective, the VIX got above 80 during the financial crisis. In any case, it seems that the markets are fairly adept at blocking out the day-to-day noise and focusing on the bigger picture.

GLOBAL OUTLOOK

Outside of the US, Emerging and Frontier Markets led the way in the first quarter, returning +11.45% and +8.89%, respectively. Broad Developed Markets were up +7.25%. This strong performance has come on the back of more robust growth forecasts throughout the globe. Manufacturing PMI numbers have been steadily improving and markets are starting to price in more optimism.

Heading into the second quarter, we are constructive. The US and global economies should continue their upward trajectories, albeit deliberately. While the current recovery is one of the longest on record, it has also been one of the slowest, which means it could continue for quite some time as the risk of burning out is low. The consensus view is for 2 more rate hikes this year, as GDP, unemployment, and inflation have basically reached the Fed's targets.

Sincerely,

Kim David Arthur

CEO and Portfolio Manager

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