FIRST QUARTER REVIEW

The optimism that began in the fourth quarter of last year has carried over into 2017. Surges in business and consumer confidence have been driven by the belief that a healthy consumer along with regulatory and tax reform could push U.S. economic growth above the current 2.0% path. This outlook, in conjunction with some tangible improvement in economic data and a rebound in company earnings, helped push equity markets higher. The S&P 500 gained 6.1% in the first quarter, led by companies in the Information Technology and Health Care sectors. The rally in stocks occurred mostly in January and February with the market pausing in March and into early April as investors waited for progress on the new Administration's goals. While the equity markets rallied to start the year, interest rates moved in a narrow range. Short-term interest rates were modestly higher on the prospect of further rates increases, while longer-term rates fell modestly.

MAINTAINING POSITIVE OUTLOOK FOR THE YEAR

We are maintaining our positive outlook for 2017 based on the strength of the consumer and the potential for improved business investment. Our base-case remains an economy that can grow near the 2.0% annual rate supported by consumer spending, steady gains in the housing sector and an increase in government spending (at the federal, state and local levels). The potential for greater business investment driven by tax reform and regulatory relief could provide further upside to U.S. growth. The path to above-trend growth will depend a great deal on reforms from Washington, which is uncertain in both timing and magnitude. However, we remain optimistic that some potentially bipartisan reforms are possible. Equity market volatility has been relatively low for the past several months, but is likely to move higher as investors deal with rising geopolitical tensions, elections in France, Germany and Italy, the negotiations for the U.K exit from the European Union, and an extremely partisan environment in Washington and across the U.S. In either the base-case or higher-growth case, we see positive economic growth and rising corporate profits which should support moderate gains in the equity market for the year.

The Health of the U.S Consumer is Strong.

Even as we move towards the eighth year of the U.S. economic recovery, the labor market continues to make solid gains. The unemployment rate fell to 4.5% in March, the lowest level since May of 2007. While the pace of job growth must ultimately slow down as we near full employment, significant numbers of new jobs are being added each month. For the first three months of this year, 533,000 new jobs were added versus 588,000 in last year's first quarter. We are seeing more significant declines in jobs in the retail sector, as many major brick and mortar stores are closing unprofitable locations. These losses are being offset by better than expected gains in construction and ongoing strength in the services and healthcare industries. Wages are moving moderately higher and the gains are increasingly being seen across all income levels. Consumer credit card debt has increased a bit, but is still low and is well within manageable levels relative to incomes. The housing sector is showing consistent, positive gains and even with moderately higher interest rates, home affordability remains reasonable.

Will Business Confidence Lead to Business Investment?

While the consumer has been the primary driver of the economic recovery, business investment has been an inconsistent contributor. In the aftermath of the financial crisis, many companies chose to build cash balances and return profits to shareholders through dividends and buybacks, rather than to take risk and invest for future growth. While there are many reasons for this to have occurred, it is clear that the uncertainty of the regulatory environment and high U.S. tax burden contributed to the reticence to invest. Business confidence, both at small companies and large multi-national corporations, has been somewhat muted during most of the recovery, but more recently has moved towards record levels. The prospect of corporate tax reform, as well as regulatory relief, has lifted business confidence over the past few months. Historically, significant moves in confidence have translated to higher spending going forward. We have seen some pickup in manufacturing activity driven by increased demand and better pricing power. It may take some time for the impact to be fully felt, but we appear to be heading in the right direction. It is important to remember that a significant portion of the regulatory reform can be accomplished with the government agencies and does not require Congressional action.

Governing in a 50/50 Nation Requires Patience

As the new Trump Administration nears its first 100 days in office, it has certainly learned that campaigning and governing are very different, especially in today's highly partisan environment. President Trump and the GOP Congress have put forth a very aggressive legislative agenda for the year, starting with reforming the Affordable Care Act (ACA). We saw early in this process that moving legislation forward Washington is a difficult task, requiring a consensus from many different factions on both sides of the aisle. The inability to get some type of healthcare reform passed into law does raise questions about the rest of the Trump agenda. However, we still believe there is room to find consensus and accomplish certain objectives. On corporate tax reform, there is some bipartisan support for reducing the corporate rates in order to improve the competitiveness of U.S. companies. In addition, some form of tax relief on foreign earned profits is likely to pass, particularly if it is used in part to fund infrastructure spending. Again, legislators on both sides seem to be in agreement that we are long overdue for investment in U.S. infrastructure. We are hopeful that Washington can focus on areas of common support and make decisions that benefit the broader economy, creating real outcomes that can produce long-term benefits.

Monetary Policy: Normalization Underway, Will Balance Sheet Reduction Follow?

The Federal Open Market Committee (FOMC) voted to raise its short-term rate by 0.25% in March to a range of 0.75%-1.00%. This follows a similar increase in December and is the third rate hike since the process began in December of 2015. The committee continues to forecast a total of three rate hikes for 2017 and an additional three in 2018. At that pace, we would end 2018 with the Federal funds rate in a range of 2.0%-2.25%, still well below the long-term average of 3.50%. The committee has also begun discussions to reduce its $4.4 trillion (T) balance sheet. Prior to the start of the recession in 2008, the Federal Reserve held approximately $700-800M in Treasury securities on its balance sheet. Through three subsequent quantitative easing programs the Fed purchased approximately $2.5T of U.S. Treasury debt and $1.7T of mortgage debt. There have been no new purchases since October of 2014 and the balance sheet has held at $4.4T since that time. The Fed could reduce the balance sheet by allowing bonds to mature and not replace them, through outright sales or some combination of the two. While the details and timing of any reduction remain unknown, this should just be considered another step in the processes of normalization of rates and restoring the balance sheet to a more usual level.

The Global Economy is showing signs of Improvement

The optimistic outlook for growth is not limited to the U.S. We are seeing signs of improvement on a global basis driven in part by accommodative central banks, lower energy costs and the benefits of a weaker currency. Japan is seeing solid demand from overseas, increased tourism, as well as gains in domestic consumer activity. After years of reducing capacity and fighting deflation, Japanese manufacturers are experiencing strong new orders and higher prices for manufactured goods. Europe is also showing more broad-based signs of health. Unemployment rates are declining across the Euro-area, manufacturing activity is increasing, and both business and consumers are increasingly more confident in the future. Germany's GDP rose at the fastest pace in 5-years and Eurozone GDP of 1.7% in 2016 outpaced that of the U.S.

IMPACT ON YOUR INVESTMENTS

The long-term fundamentals of the U.S. economy remain intact and we still believe there is room for an acceleration in growth. After flattening out over the last two years, corporate earnings have begun to accelerate and we expect positive earnings growth in 2017 and into 2018. The recovery in the energy markets will help support this growth. While there are many risks and uncertainties around the globe, we continue to focus on the long-term outlook rather than short-term noise in order to make sound investment decisions on your behalf. Given our positive outlook, we do not foresee making any major changes to your portfolio over the near-term. We continue to look for opportunities to add stocks to your portfolio that can offer strong growth prospects as well as stocks with good income generating characteristics. As the yields available in the fixed income market increase, we will look to make further investments in individual bonds.