ECONOMIC OUTLOOK REPORT – 1Q-2017
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Review of 1Q-2017 Markets

Unlike 1Q-2016, during which U.S. equity markets experienced an -11.0% correction, 2017 has started out on a strong note. U.S. Large cap stocks finished the quarter up considerably (S&P 500 index +6.07%). This performance was a continuation of the “Trump Rally” that began after last November’s election. Interestingly, U.S. Treasuries have clearly stabilized after several months of volatility that was capped by the Fed’s December rate hike. The 10-Year U.S. T-Note traded in the 2.40%-2.65% during 1Q, but since quarter-end it has rallied back noticeably to the **2.17%** level as of today’s date.

Political wrangling in Washington between the Administration and Congress over the ACA and immigration policy reminded the markets that political dysfunction is likely to prolong the process of transition for these weighty issues. Agenda challenges are also likely for less controversial items that include corporate and individual tax reform, infrastructure spending and the related battle over a 2017 budget agreement.

2Q-2017 Economic Outlook

U.S economic fundamentals have continued to improve, particularly in the areas of **corporate earnings and revenue growth**. After an earnings recession that resulted in five consecutive quarters of negative year-over-year earnings growth through 2Q-2016, things turned slightly positive in 3Q-16. This recovery trend continued when 4Q-16 corporate profits rose 6.4% overall along with a 4.9% growth in top-line revenues. Analysts are forecasting 6.2% earnings growth in 1Q17 on roughly 6.0% growth in revenues. A continuation of this positive trend would bode well for U.S. equity markets through the rest of this year.

The U.S. **economy** grew at a moderate pace of 1.9% for the final quarter of 2016, which was the slowest fourth-quarter pace since 2011. This brought GDP for 2016 up to a modest 1.6%. Analysts are expecting GDP to hover around 2.0% throughout the coming year. This would be a healthy rebound, but still well below *“normal”* expansion levels.

The **U.S. employment situation** remains strong with monthly non-farm payroll growth still averaging around 200,000. The unemployment rate continues to improve, now hovering in the 4.5%-4.7% range. Jobless claims averaged around 235k, or roughly 12.0% below levels of a year earlier. The continued strength in the employment outlook should help bolster the critical elements of consumer spending and wage growth. Such performance should contribute to further corporate income and revenue growth. All of the preceding would provide further support for equity market performance in 2017.

In terms of the **global energy** situation, production cuts agreed upon by OPEC late last year do not seem to be having their desired effect as crude inventories continue to rise. After retreating to the 480MM barrel level last fall, U.S. reserves have steadily climbed back to new record levels around 530MM barrels. U.S. shale's nimble production capability is much to blame for this increase in reserves. As the growing rig count keeps elevating domestic production, there will continue to be downward pressure on oil prices for the foreseeable future.

Finally, the **global economy** continues to improve largely due to strengthening in EEU economic data. The ECB's delayed deployment of QE continues to prove successful in slowly returning the region to growth. Concerns over the impact of Brexit have receded for now, but will likely return to focus on the upcoming French presidential elections. *The more immediate geo-political concerns that must be confronted by the U.S. and global economies are 1.) strained U.S./Russia relations over Assad's atrocities in Syria and 2.) the ever-worsening nuclear threat posed by North Korea's Premier Kim Jong-un.*

STRATEGIC MARKET OUTLOOK

The equity markets remains optimistic over proposed tax cuts, potential boosts to infrastructure spending and much-anticipated reductions in regulatory burdens for business. However, the critical failure at quarter-end to pass revisions to healthcare legislation did plant doubts about the administration's ability to implement some of its "key" policies. All things considered, however, U.S. economic fundamentals continue to be sound. ***Therefore we will continue to view any downside market volatility in the coming quarter(s) as equity buying opportunities***.

For now, the Fed remains committed to rate normalization at a pace that will reflect clear consideration for the "moderate" nature of the current U.S. economic expansion. With the rate bumps in both December and March, it may be difficult for the Fed to maintain a very aggressive pace in their tightening cycle. The risk bias for rates in the coming 1-2 years, however, is still clearly to the upside. ***In light of these facts, liquidity reinvestment in fixed income securities will continue to reflect rate-sensitive characteristics for the foreseeable future***.