First Quarter 2018

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			Total Return	
Index	**3/31/2018**	**12/31/2017**	**2018 YTD**	**Q1 2018**
Dow Jones	24,103.11	24,719.22	-2.5%	-2.5%
S&P 500	2,640.87	2,673.61	-0.8%	-0.8%
Nasdaq	7,063.44	6,903.39	2.6%	2.6%
S&P 400 Midcap	1,878.77	1,900.57	-0.8%	-0.8%
Russell 2000	1,529.43	1,535.51	-0.1%	-0.1%
Yield on 10-Year Bond	2.74%	2.41%		

Source :FactSet

Investment Summary

After one of the best January performances in history, the equity markets sold off for the balance of the quarter, resulting in the first quarter showing slightly negative returns for most of the major indices. In our last update, while largely bullish on the equity markets, we laid out four concerns that we thought could cause the long-overdue sell-off in the near-term. Specifically, we cited (a) potential inflation concerns; (b) rising interest rate concerns; (c) protectionist trade talk from President Trump; and (d) slowing economic growth in China. Unfortunately, three of these concerns were indeed the primary causes of the market declines in the quarter, as inflation and interest rate fears drove the market swoon in February and, more recently, President Trump's tough tariff talk and China's subsequent response triggered March (and early April) declines. While the recent weakness has not been fun, we remain quite enthusiastic about the equity markets. Indeed, while we are not dismissive of these issues, we believe that corporate earnings growth is the ultimate driver of stock prices, and the outlook for such growth remains strong, with 18% growth expected in 2018 and 11% expected in 2019. Admittedly, circumstances can change relatively quickly, but if earnings growth comes in anywhere close to these levels, then equity markets should do quite well.

At the same time, as we saw in the first quarter, we expect volatility to increase in 2018. In addition to the issues noted above, we are mindful that the US mid-term elections are approaching, and a potential change in control in the House of Representatives and/or the Senate could raise concerns about any roll-back of the deregulation and other efforts that have largely been positive for companies to grow their businesses. Based on history, even in years with meaningfully positive returns, "normal" volatility typically consists of: (a) one short-term decline of 10% or more; and four (4) short-term declines of 5% or more. The first quarter saw one decline of over 10%, and two declines of over 5%, highlighting the return of volatility in the markets. In our last update, we noted our ongoing evaluation of additional asset classes for client portfolios as a way to mitigate increasing volatility. In that context, we expect to provide clients with some exposure in other asset classes where we believe it could lessen the risk in portfolios.

As for the fixed income markets, interest rates increased steadily throughout the first quarter as the economy appears poised to accelerate and early signs of potential inflation emerged. The Fed, under the leadership of newly-appointed Chairman Jerome Powell, raised the Fed Funds rate by another 0.25% in March (as expected) and continues to suggest that gradual rate increases are likely in the coming quarters. The Street expects another two rate hikes from the Fed in 2018. We continue to believe that the improving economy should result in upward pressure on rates, with the yield on the US 10-Year Treasury likely rising to the 3.0 to 3.25% range by yearend.

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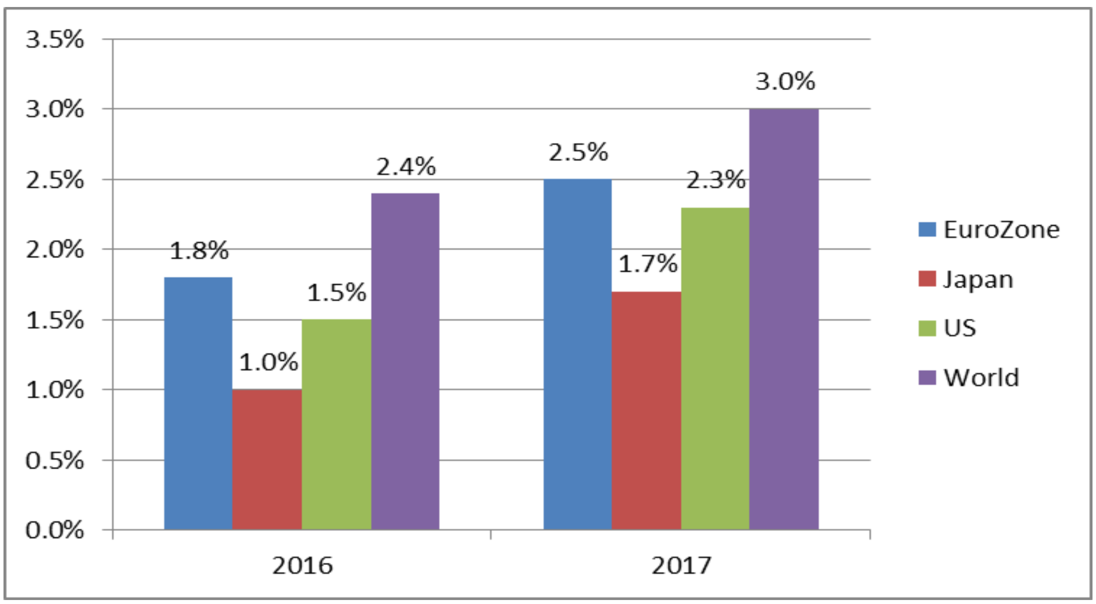
Economy

With data now in, global economic growth accelerated in 2017, with key developed market economies including Europe and the US driving the global improvement. Chart 1 below shows the strong pick-up in growth from the major developed markets in 2017 compared to 2016. As the chart indicates, World growth improved in 2017 to a robust 3.0% from 2.4% in 2016. Encouragingly, projections from the World Bank for worldwide economic growth for 2018 have increased to 3.1% which, if realized, would be the strongest global economic growth since 2011. The primary driver for this increase is an expected pick-up in growth in emerging markets (i.e. countries like India, Brazil, etc.), which is forecast to accelerate to 4.5% in 2018, and accelerate again to 4.7% in 2019; at the same time, growth in developed market economies will likely slow as central banks increase interest rates. While trade war talk has increased sharply in recent weeks, the proposed tariffs are, collectively, immaterial to global growth. On this basis, we are actively examining exposure for our clients to emerging markets in order to benefit from the improved prospects for this asset class.

Chart 1: Economic (GDP) Growth, Selected Countries, 2016 – 2017



Source: FactSet, World Bank

For its part, the US continues to be the envy of the developed world, as economic growth is forecast to accelerate notably in 2018 to roughly 2.7% despite the Fed's likely efforts to boost interest rates and some increased caution given recent trade/tariff concerns. In large part, the US strength is due to the recently-enacted corporate tax reforms, which have given both consumers and businesses extra money in their pockets that collectively should lift growth. Indeed, virtually all measures of US economic activity continue to suggest strength, with the Unemployment Rate hitting 18-year lows in the first quarter and Consumer Confidence touching 18-year highs in the quarter. At the same time, US manufacturing activity hit 14-year highs in the first quarter, and projections for increases in corporate capital expenditures in 2018 suggest roughly 9% growth, which would be the best level since before the 2008-2009 recession. We remain encouraged about US economic growth prospects in light of this economic backdrop.

Equities

Following a strong start to the quarter, the equity markets experienced a long-overdue pullback that ultimately resulted in mildly negative market returns for most of the major averages. The S&P 500 dipped 0.8% in the quarter, which was consistent with many indices. Interestingly, the trend from 2017 favoring the more aggressive "growth" stocks continued in the first quarter, as "growth" once again outperformed the relatively "safer" high-dividend-paying stocks with the Technology sector posting among the strongest returns. The return of volatility in the equity markets in the first quarter, while a bit unsettling, is something that we expected to occur at some point. We remind investors that, even in years with robustly positive returns, the markets typically experience meaningful declines within the year, usually due to some fear that temporarily spooks investors. In the first quarter, there was no shortage of such fears, as some early signs of emerging inflation led to worries about interest rate increases. As these worries eased, they were replaced by new concerns of a possible trade war between the US and China following President Trump's proposal to increase tariffs that led to a comparable retaliatory response from China.

In spite of these concerns, we remain enthusiastic about the outlook for US equity markets in 2018. The current tough trade banter between the US and China notwithstanding, it is our expectation that corporate earnings growth should be downright robust for 2018 and 2019. Indeed, even if the current tariffs being proposed between the two countries ultimately go into effect, it would impact US and Chinese economic growth by less than 0.1% each. That is not likely something that would derail corporate earnings growth projections. Chart 2 below shows the historical earnings and sales growth for the S&P 500 and the current projected growth in 2018/2019. If the projected growth comes anywhere close to expectations, then the equity markets should perform quite well in spite of political or other short-term news headlines that seem unsettling. We remind investors that it is easy to lose sight of the corporate earnings picture when the media continually bombards us with things that appear to be important to the markets, yet have little to no impact on corporate earnings. Ultimately, corporate earnings growth is what drives stock prices.

Chart 2: Earnings/Sales Per Share Growth, S&P 500

	2012	2013	2014	2015	2016	2017	2018E	2019E
Earnings per Share	6.71%	5.17%	6.65%	-0.24%	1.20%	11.58%	18.20%	11.08%
Sales per Share	3.90%	2.48%	4.23%	-2.38%	3.16%	6.56%	6.66%	4.72%

Source: FactSet

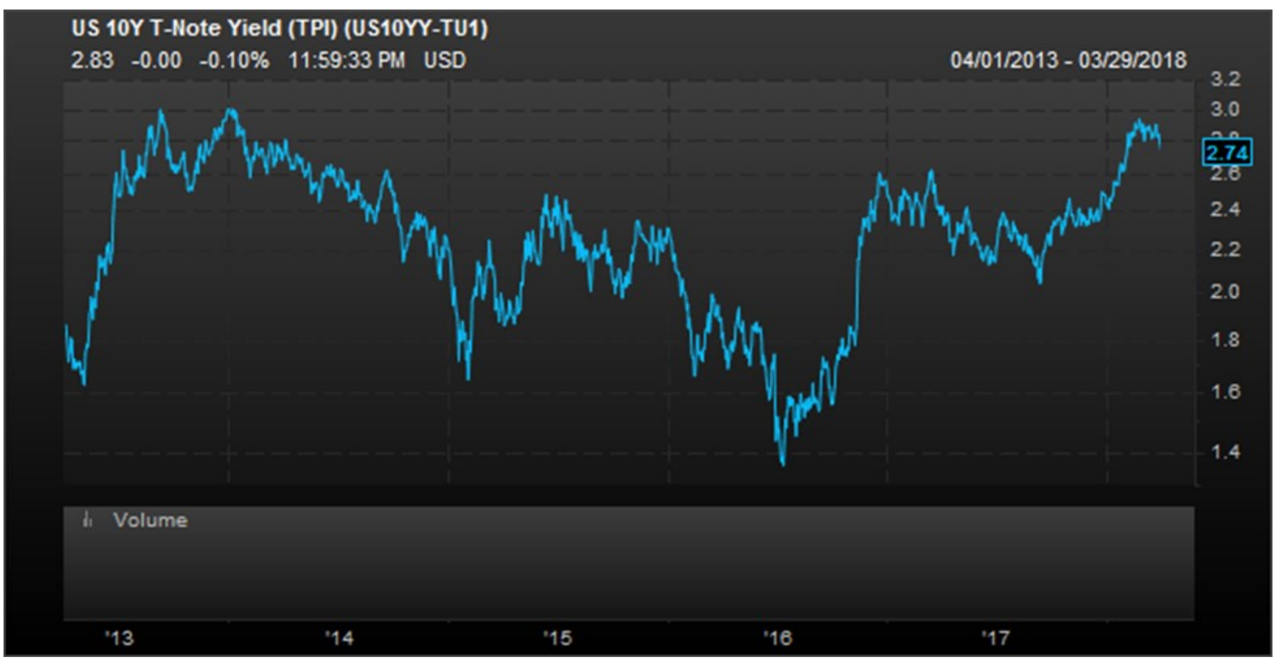
US companies will start to report their earnings results for the first quarter beginning in mid-April. While still high, expectations have lessened in recent weeks as a result of the recent market declines. If history is any guide, low expectations ahead of earnings reports often lead to positive stock prices, as companies are rewarded for better-than-expected results while not being penalized much for worse-than-expected results. We will be focused on the commentaries coming out of corporate management teams to see if the strengthening economy and corporate earnings backdrop are boosting the confidence of managers to meet or exceed their growth expectations.

Fixed Income

The first quarter saw a notable increase in interest rates on the backs of a combination of an improving US economic outlook and early signs of emerging inflation. The net result was that the yield on the US 10-Year Treasury hit its highest level since January 2014 during the first quarter, ultimately closing the quarter at 2.74% vs. 2.41% at the end of 2017. As Chart 3 below shows, interest rates have more than doubled since their lows in the summer of 2016, and we expect further upward pressure on rates as the US economy continues to improve. For its part, the Federal Reserve, under the new leadership of Chairman Powell, remains on a path of gradual rate increases. The Fed did indeed raise the Fed Funds rate by 0.25% at its meeting in March (expected), and the Fed governors have reaffirmed their expectation that there likely will be two more similar rate hikes in 2018. The Street currently projects the next rate hike at the Fed meeting in June 2018.

We remain in agreement with Street consensus that the Fed will likely raise rates another two times in 2018, though we acknowledge that US economic strength could force the Fed to hike an additional three times this year. Practically-speaking, an "extra" rate hike would likely have to occur around the mid-term elections, which historically is not something the Fed has been comfortable doing given the appearance that such actions could influence the election outcome. Irrespective, we continue to expect the yield on the US 10-Year Treasury to close 2018 between 3.0% and 3.25%. Accordingly, we continue to position bond portfolios with relatively short durations, where possible.

Chart 3: Yields on US 10-Year Treasuries, April 1, 2013 – March 31, 2018



Source: FactSet