Asset Strategy Consultants

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We are pleased to present Market Review, featuring a discussion of the Capital Markets during the First Quarter 2017 and a summary of historical performance for the major asset style passive indices for the period ending March 31, 2017. We hope you find the information useful and helpful in your investment considerations.

We welcome your comments.

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Asset Strategy Consultants

Founded in 1991, Asset Strategy Consultants provides investment consulting services to institutional clients representing over $7.8 billion under advisement. Headquartered in Baltimore, ASC has offices throughout the East Coast.

First Quarter 2017

Market Review

MACROECONOMIC ENVIRONMENT

The "risk-on" theme persisted through the first quarter as improving economic data trumped elevated geopolitical uncertainty, both in the U.S. and abroad. Economies in the U.S. and Europe continued to gain traction and the U.S. entered its 93rd month of expansion. At the same time, important and potentially divisive elections in Europe, an impeachment in South Korea, heightened tensions with North Korea, innuendo around Russia, civil war in Syria, the Brexit trigger, and an unconventional and inexperienced administration in the U.S. did not rile investors.

The S&P 500 surged 6.1%—its best quarterly performance since the fourth quarter of 2015—as expectations for lower taxes, reduced regulation, and other pro-growth reforms helped propel U.S. equity prices to new highs. Non-U.S. stocks also posted strong returns, and emerging market equities beat developed markets. U.S. Treasury yields were range-bound leading to fairly flat returns, and the riskier sectors in fixed income posted the best results. Commodities were the lone area to deliver a negative return, hurt mostly by oil prices falling due to concerns over stockpiles in the U.S.

Economic data in the U.S. were generally strong in the first quarter. Unemployment fell to 4.7% and private nonfarm payroll growth was robust. Consumer Confidence, as measured by the Conference Board, hit its highest level since December 2000. Fourth-quarter GDP was revised up to 2.1% (year-over-year). Personal consumption expenditures growth was revised up to 3.5% and before-tax corporate profits grew 9.3% year-over-year. However, dollar strength was reflected in trade figures as exports fell 4.5%. Housing data also continued to show strength; U.S. single family home starts approached a 10-year high. The Composite Housing Market Index (National Association of Home Builders-Wells Fargo) jumped 9.2% during March, representing the largest gain since June 2005. Inflation edged up with February's headline CPI figure at 2.8% (year-over-year), the fastest rate in five years, and core CPI (excluding food and energy) at 2.2%. The Fed's favored measure, the Personal Consumption Expenditures Price Index, grew 2.1% year-over-year, the

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most since April 2012. Excluding food and energy, the Index was up 1.8% (year-over-year), nearing the Fed's 2.0% target. Wage growth also picked up; average hourly earnings grew 2.8% (year-over-year) as of February. In a widely expected move, the Fed raised rates in March by 25 bps, bringing the Fed Funds rate to 0.75% - 1.0%. The Federal Reserve Board expects two more rate hikes this year. Markets were unfazed and both stocks and bonds rallied.

The most notable events overseas were on the political front. On March 29, U.K. Prime Minister Theresa May officially notified the European Council of the U.K.'s intent to withdraw from the European Union (EU). Details of this withdrawal will be negotiated over the next two years. The U.K. has been part of the EU for more than 40 years and negotiating the terms of this "divorce" will not be straightforward. Trade and immigration are the thorniest issues and require resolution before the country's EU membership ends in March 2019. A high-profile election in the Netherlands ended with the mainstream ruling party retaining power and the anti-EU party falling short. Similarly, France's presidential elections will be held in April and May, with far-right contender Marine Le Pen making a bid for power.

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Additionally, the outcome of the German federal election to be held in September of this year is far from certain. Finally, South Korean President Park Geun-hye was impeached and removed from office in March; elections will be held in May.

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EQUITY MARKET RESULTS

The S&P 500 Index has lodged gains for eight consecutive calendar years, and the first quarter continued on that trajectory. The Index climbed 6.1% while the tech-heavy NASDAQ gained 10%. In the Tech sector, the "FANG" collective drove results: Facebook (+24%), Amazon (+18%), Netflix (19%), and Google (+8%). Solid quarterly earnings and expectations that President Trump's pro-growth agenda will be executed translated into strong investor sentiment. Growth stocks outperformed value by a wide margin across the capitalization spectrum; the most pronounced difference was in large caps (R1000 G +8.9% vs. R1000 V +3.3%). Large cap stocks also broadly outperformed small (R1000 +6.0% vs. R2000 +2.5%). Small cap value was the only segment to post a negative return (R2000 V -0.1%) for the quarter after leading in 2016 (+31.7%). Within the S&P 500, the Tech sector performed the best (+12.6%). Health Care—the worst performer in 2016—rebounded with an 8.4% return. The worst performing sectors for the quarter were Energy (-6.7%) and Telecom (-4.0%). Pre-tax corporate profits grew sharply in the fourth quarter at 9.3% year-over-year, the fastest gain since 2012.

The equity market's subdued volatility in the first quarter was also noteworthy. The S&P 500 Index had more than 100 days without a 1% decline prior to March 21 when the Index sank 1.2%—the longest stretch since 1995—and only two days during the quarter saw such moves. The VIX, which measures the implied volatility of S&P 500 Index options, closed the quarter at 12, well below its long-term average (since 2004) of roughly 20. At the same time, valuations are lofty (as measured by several oft-cited metrics), potentially painting a scenario for rocky times ahead.

Overseas, the MSCI EAFE Index (+7.2%) modestly outperformed U.S. markets. Dollar weakness bolstered results; in local terms the Index gained just +4.7%. Gains spanned multiple countries including Spain (+14.8%), Germany (+8.4%), the U.K. (+5.0%), France (+7.3%), and Japan (+4.5%). Emerging markets bested developed (MSCI EM USD: +11.4%; MSCI EM Local: +7.8%) and were also helped by dollar weakness. Countries with the top performance included India (+17.1%), Mexico (+16.0%), Korea (+16.8%), China (+12.9%), and Brazil (+10.4%). Russia fared the worst (-4.6%), pulling back from a 55% gain in 2016. ■

FIXED INCOME MARKET RESULTS

U.S. Treasury yields were relatively range-bound in the first quarter despite a Fed hike in March. The 10-year U.S. Treasury hit an intra-quarter high of 2.62% on March 13 and closed the quarter at 2.40%, five basis points lower than at year-end. TIPS performed relatively well as expectations for future inflation climbed. The 10-year breakeven spread (the difference between nominal and real yields) was 197 bps as of quarter-end, and the Bloomberg Barclays TIPS Index gained 1.3% for the quarter. The Bloomberg Barclays Aggregate Index earned 0.8%; within the Index, corporate bonds outperformed like-duration Treasuries, with BBB-rated credit (+1.7%) posting the strongest returns. Mortgages underperformed Treasuries on a duration-adjusted basis, as expectations that the Fed would begin to trim its reinvestment in the sector weighed on the market. The Bloomberg Barclays High Yield Index gained 2.7%, with lower-rated bonds again outperforming higher-rated issues.

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Overseas, rates were generally modestly higher. However, broad-based dollar weakness boosted returns. The U.S. dollar lost nearly 5% versus the yen and depreciated to a lesser extent versus other developed markets currencies. The Bloomberg Barclays Global Aggregate Index returned 1.8% (unhedged) versus 0.4% for the hedged version. Consistent with the risk-on theme evident across asset classes, emerging markets debt outperformed developed markets. The JPM EMBI Global Diversified Index ($ denominated) gained 3.9% and the local currency JPM GBI-EM Global Diversified Index was up 6.5%.

The Bloomberg Barclays Municipal Bond Index gained 1.6%. Consistent with other sectors, lower-quality issues outperformed. Relatively light issuance and strong demand provided a solid technical backdrop. Concerns over the impact of potential tax reform were assuaged by the Trump administration's focus on health care and its struggles executing on planned agenda items. While troubled credits remain (Illinois, New Jersey, Puerto Rico), fundamentals more broadly remained stable to improving. ■

REAL ASSETS RESULTS

After rising more than 50% in 2016, Brent crude prices fell 7% to $52.83 in the first quarter. The S&P GSCI Commodity Index lost 5.1%. However, MLPs posted positive returns for the quarter (Alerian MLP Index +3.9%). REITs were essentially flat (MSCI REIT: +1.0%) and gold was up nearly 9%. U.S. TIPS also did well (relative to nominal U.S. Treasuries) as expectations for future inflation climbed. The Barclays U.S. TIPS Index returned 1.3% for the quarter. ■

CLOSING THOUGHTS

We entered 2017 with U.S. stock markets at record highs, interest rates rising, and historically low volatility. The first quarter saw a continuation of most of those themes, with rising interest rates being the exception. While economies in the U.S. and Europe continued to gain traction, investors exhibited a high degree of complacency. Valuations are stretched by many measures across asset classes and markets have experienced extraordinarily low volatility, relative to historical norms. However, many risks lurk and there is no certainty that the pro-growth policies envisioned by enthusiastic market participants will come to fruition. Given the sanguine view reflected in market prices, we encourage clients to temper expectations for returns and brace for more volatility, which we expect to increase from current levels. Much uncertainty remains with respect to the scope, implementation, and timing of Trump's agenda, and myriad other geopolitical issues are confronting the world, as well. As always, Asset Strategy Consultants encourages investors to maintain a long-term perspective and prudent asset allocation with appropriate levels of diversification. ■

PRELIMINARY RETURNS FOR VARIOUS PERIODS: 1Q17

	Month Ending			Last	Last	Last 3	Last 5	Last 10
	31-Jan	28-Feb	31-Mar	Quarter	Year	Years	Years	Years
Capital Growth								
Russell:3000 Index	1.90	3.70	0.10	**5.70**	**18.10**	9.80	13.20	7.50
Russell:1000 Index	2.00	3.90	0.10	**6.00**	**17.40**	10.00	13.30	7.60
Russell:1000 Growth	3.40	4.20	1.20	**8.90**	**15.80**	11.30	13.30	9.10
Russell:1000 Value	0.70	3.60	(1.00)	**3.30**	**19.20**	8.70	13.10	5.90
Russell:Midcap Index	2.40	2.80	(0.20)	**5.10**	**17.00**	8.50	13.10	7.90
Russell:2500 Index	1.40	2.40	(0.10)	**3.80**	**21.50**	7.40	12.60	7.70
Russell:2500 Growth	2.40	3.00	0.70	**6.30**	**19.80**	7.20	12.20	8.50
Russell:2500 Value	0.50	1.90	(0.80)	**1.60**	**23.10**	7.60	12.90	6.80
Russell:2000 Index	0.40	1.90	0.10	**2.50**	**26.20**	7.20	12.40	7.10
Russell:2000 Growth	1.60	2.50	1.20	**5.30**	**23.00**	6.70	12.10	8.10
Russell:2000 Value	(0.70)	1.40	(0.80)	**(0.10)**	**29.40**	7.60	12.50	6.10
S&P:1500	1.80	3.80	0.10	**5.70**	**17.70**	10.20	13.30	7.70
S&P:500	1.90	4.00	0.10	**6.10**	**17.20**	10.40	13.30	7.50
S&P:1000 Index	1.00	2.30	(0.30)	**3.10**	**22.00**	9.40	13.60	8.90
S&P:400 Mid Cap	1.70	2.60	(0.40)	**3.90**	**20.90**	9.40	13.30	9.00
S&P:600 Small Cap	(0.40)	1.60	(0.10)	**1.10**	**24.60**	9.50	14.20	8.80
MSCI:ACWI ex US	3.50	1.60	2.50	**7.90**	**13.10**	0.60	4.40	1.40
FTSE:All Wld x US Idx	3.40	1.70	2.60	**7.90**	**13.90**	1.50	5.10	2.20
MSCI:EAFE	2.90	1.40	2.80	**7.20**	**11.70**	0.50	5.80	1.10
MSCI:EM	5.50	3.10	2.50	**11.40**	**17.20**	1.20	0.80	2.70
MSCI:ACWI	2.70	2.80	1.20	**6.90**	**15.00**	5.10	8.40	4.00
Fixed Income								
Blmbg:Aggregate	0.20	0.70	(0.10)	**0.80**	**0.40**	2.70	2.30	4.30
Blmbg:Multiverse	1.20	0.50	0.20	**1.90**	**(1.00)**	(0.20)	0.70	3.50
Blmbg:US Universal	0.40	0.80	0.00	**1.10**	**1.90**	3.00	2.80	4.50
Blmbg:Gov/Credit	0.30	0.80	(0.10)	**1.00**	**0.50**	2.70	2.50	4.30
Blmbg:Credit 1-5 Yr	0.40	0.40	0.10	**0.90**	**1.70**	1.90	2.20	3.80
Blmbg:Corporate High Yld	1.50	1.50	(0.20)	**2.70**	**16.40**	4.60	6.80	7.50
Blmbg:HY Ba/B 2% Iss Cap	1.20	1.20	(0.20)	**2.30**	**13.00**	4.50	6.50	7.00
ML:1-3 BB US HY CP	0.40	0.50	0.10	**1.00**	**7.20**	3.80	5.30	6.50
Blmbg:Muni 1-10 Yr	0.80	0.70	0.10	**1.60**	**0.20**	2.30	2.20	3.80
Blmbg:Muni 1-15 Yr	0.70	0.70	0.20	**1.50**	**0.10**	2.80	2.70	4.10
Blmbg:Muni 5 Yr	1.00	0.80	0.00	**1.90**	**0.30**	2.00	2.10	3.80
Blmbg:Muni 7 Yr	1.00	0.80	0.20	**1.90**	**(0.10)**	2.90	2.70	4.50
Blmbg:Municipal Bond	0.70	0.70	0.20	**1.60**	**0.20**	3.50	3.20	4.30
Blmbg:US TIPS	0.80	0.50	(0.10)	**1.30**	**1.50**	2.00	1.00	4.20
Blmbg:Glob Agg ex USD	1.90	0.30	0.30	**2.50**	**(3.90)**	(2.70)	(1.10)	2.60
S&P:LSTA Levg Loan	0.60	0.50	0.10	**1.10**	**9.70**	3.60	4.60	4.50
3 Month T-Bill	0.00	0.00	0.00	**0.10**	**0.40**	0.20	0.10	0.70
Real Assets								
Blmbg:US TIPS	0.80	0.50	(0.10)	**1.30**	**1.50**	2.00	1.00	4.20
Blmbg:Commodity TR Idx	0.10	0.20	(2.70)	**(2.30)**	**8.70**	(13.90)	(9.50)	(6.20)
MSCI:REIT Idx	0.00	3.50	(2.40)	**1.00**	**3.20**	10.10	9.80	4.70
FTSE:NAREIT Equity Index	0.10	3.40	(2.30)	**1.20**	**3.60**	10.30	10.00	4.80
US DOL:CPI All Urban Cons	0.60	0.30	--	**--**	**--**	--	--	--

DISCLAIMER AND SOURCES

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