Market Commentary | Q1 2017

Overview

Riding the momentum following the presidential election, stocks surged for much of the first quarter of 2017. Buoyed by the anticipation of tax cuts and policies favorable to domestic businesses, some indexes reached historic highs throughout the quarter. At the end of January, the Dow reached the magic 20,000 mark for the first time, while the tech-heavy Nasdaq gained almost 4.50% for the month. The trend continued in February, as stocks posted solid monthly gains. The Dow closed the month with a run of 12 consecutive daily closings that reached all-time highs. The S&P 500 also achieved a milestone — 50 consecutive trading sessions without a daily swing of more than 1.0%. At the close of trading in February, each of the benchmark indexes listed here posted year-to-date gains, led by the Nasdaq, which was up over 8.0%.

March began with a bang but ended with a whimper. The Dow closed the first week of the month at over 21,000, while the Nasdaq gained over 9.0% year-to-date. However, energy stocks slipped as the price of oil began to fall. Entering mid-March, investors exercised caution pending the potential Fed interest rate hike and the push for a new health-care law. Following its mid-March meeting, the Fed raised interest rates 25 basis points, while the move to replace the ACA with a new health-care law failed for lack of congressional support.

For the quarter, each of the equity indexes listed on the table below (except the Russell 2000 Value) posted impressive gains over their fourth-quarter closing values. The S&P 500 achieved its largest quarterly gain in almost two years. Long-term bond prices increased in the first quarter with the yield on 10-year Treasuries falling 6 basis points. Gold prices also climbed during the first three months of the year, closing the quarter at $1,251.60 — about 8.5% higher than at the end of the fourth quarter.

International Markets

A relatively positive stream of eurozone economic data helped international stocks post gains for February. Both manufacturing and service sectors accelerated during the month, while eurozone job creation reached a 10-year high. In Great Britain, Prime Minister May continued to push forward with Brexit amid pushback from Parliament and protestors. Nevertheless, the UK delivered written notice to the president of the European Union, formally beginning the process of leaving the EU. This action now opens a two-year window for Britain to negotiate the terms of its exit. One of the potentially contentious issues that will be addressed is whether, and how much, Britain will pay to leave the bloc. In Japan, retail sales increased 1.0% for the month, although the fourth-quarter GDP growth slowed from the previous quarter.

The Economy

Employment: February's employment report showed continued strengthening in the labor sector with 235,000 new jobs added in the month, on the heels of 238,000 new jobs added in January. Job gains occurred in construction, private educational services, manufacturing, health care, and mining. The unemployment rate dipped to 4.7% — down from 4.9% a year earlier. There were 7.5 million unemployed persons in February. The labor participation rate inched up 0.1 percentage point to 63.0%. The average workweek was unchanged at 34.4 hours in February. Average hourly earnings increased by $0.06 to $26.09, following a $0.05 increase in January. Over the last 12 months ended in February, average hourly earnings have risen by $0.71, or 2.8%.

GDP/Budget: Expansion of the U.S. economy slowed over the final three months of 2016. According to the Bureau of Economic Analysis, the fourth-quarter 2016 gross domestic product grew at an annualized rate of 2.1% compared to the third-quarter GDP, which grew at an annual rate of 3.5%. Growth in the GDP was slowed by downturns in exports, federal government spending, and business investment. A positive from the report is the rise in consumer spending, which increased 3.5% over the prior quarter. An indicator of inflationary trends, the price index for gross domestic purchases increased 2.0% in the fourth quarter, compared to an increase of 1.5% in the third quarter.

As to the government's budget, the federal deficit for February was $192 billion. Over the first 5 months of the fiscal year, the deficit sits at $385 billion, which is 0.7% below the same period of time last year.

Inflation/consumer spending: Inflation, as measured by personal consumption expenditures, reached the Fed's 2.0% annual target in February. For the 12 months ended in February 2017, personal consumption expenditures expanded at a rate of 2.1%. Core PCE (excluding energy and food) increased 1.8%. For February, PCE climbed 0.1%, while core PCE rose 0.2%, following a 0.3% monthly increase in January. Personal income (pre-tax earnings) rose 0.4% for the month, and disposable personal income (income less taxes) enjoyed a 0.3% increase over January. For the 2016 calendar year, personal income increased 3.6% from the 2015 annual level, compared with an increase of 4.4% in 2015. Disposable personal income increased 3.9% in 2016, compared with an increase of 3.8% in 2015. In 2016, PCE increased 3.9% compared with an increase of 3.5% in 2015.

The prices companies receive for goods and services trended higher in February as the Producer Price Index climbed 0.3% for the month. Year-over-year, producer prices have increased 2.2%. Energy prices have played a large part in the upward movement of the PPI, climbing 0.6% in February. The PPI less food and energy has risen 1.5% for the year, after climbing 0.3% in February.

Consumer prices also increased marginally in February, climbing 0.1%. However, consumer prices are up 2.7% for the year, a mark that is not only well above the Fed's 2.0% target for inflation, but stands as the highest rate of growth in almost five years. Even the core rate, which excludes energy, is holding steady at 2.2% since February 2016.

Housing: The housing sector proved to be a mixed bag in February as the sales pace of existing homes slowed while new home sales increased. Higher home prices and a lack of available homes for sale are the main reasons for the drop in the sales of existing homes, which fell 3.7% to a seasonally adjusted annual rate of 5.48 million, down from January's revised annual rate of 5.69 million, according to the National Association of Realtors®. However, February's sales pace is still 5.4% above a year ago. The median sales price for existing homes was $228,400 — up 7.7% from January. Total housing inventory at the end of February increased 4.2% to 1.75 million existing homes available for sale, but is 6.4% lower than a year ago (1.87 million) and has declined year-over-year for 21 straight months. Conversely, the Census Bureau's latest report reveals a spike in new home sales. Sales of new single-family homes increased 6.1% in February to an annual rate of 592,000 — up from January's rate of 558,000. The median sales price of new houses sold in February was $296,200, while the average sales price was $390,400. The seasonally adjusted estimate of new houses for sale at the end of February was 266,000. This represents a supply of 5.4 months at the current sales rate, which is up from 262,000 homes available (supply of 5.4 months) in January.

Manufacturing: One of the reasons the Fed raised interest rates in March was the increase in manufacturing production. The Federal Reserve's monthly index of industrial production (which includes factories, mines, and utilities) remained at the same level in February as the prior month, held down by another weak month for utilities. Unseasonably warm weather prompted utility production to fall 5.7% in February following a 5.8% drop in January. However, manufacturing production increased 0.5% month-over-month, which is the largest increase in monthly volumes since July 2015. At 104.7% of its 2012 average, total industrial production in February was 0.3% above its level of a year earlier. Capacity utilization for the industrial sector declined 0.1 percentage point in February to 75.4%. As for durable goods, the latest report from the Census Bureau shows new orders increased 1.7% in February from the prior month. Excluding the volatile transportation segment, new durable goods orders gained a lackluster 0.4%. Orders for core capital goods (excluding defense and transportation) dropped 0.1% for the month, but are up 2.7% over February 2016.

Oil: The price of crude oil (WTI) closed March at $50.85 per barrel, after spending much of the month hovering around $48.00 per barrel. The national average retail regular gasoline price was $2.314 per gallon on February 27, 2017, $0.018 higher than the January 30 price and $0.531 more than a year ago.

Imports and exports: The advance report on international trade in goods revealed that the trade gap narrowed by 5.9% in February. The overall trade deficit was $64.8 billion in February, down $4.1 billion from January. Exports declined 0.1% to $126.8 billion, $0.1 billion less than January exports. Imports fell 2.1% to $191.6 billion, $4.2 billion less than January imports. The prices for U.S. imports of goods advanced 0.2% in February, led by higher nonfuel import prices, which more than offset lower fuel prices. U.S. export prices rose 0.3% in February, after advancing 0.2% in January. Export prices haven't recorded a monthly decline since the index fell 0.8% in August 2016.

Consumer sentiment: The Conference Board Consumer Confidence Index® for February rose 3.2 points to 114.8. Consumers expressed confidence in the job market, which increased expectations for the economy in general. The Surveys of Consumers of the University of Michigan Index of Consumer Sentiment dipped from a 10-year high of 98.5 in January to 96.3 in February. Nevertheless, consumers continued to express optimism about current economic conditions, as the Current Conditions Index has been trending upward since December 2016.

Market Performance

Index Performance for Period Ending 3/31/2017

US Equity Markets	Index	Quarter	YTD	One Year	3 Year	5 Year	10 Year
US Small Growth	Russell 2000 TR Growth	5.35%	5.35%	23.03%	6.72%	12.10%	8.06%
US Small Value	Russell 2000 TR Value	-0.13%	-0.13%	29.37%	7.62%	12.54%	6.09%
US Small Blend	Russell 2000 TR	2.47%	2.47%	26.22%	7.22%	12.35%	7.12%
US Mid Growth	Russell Mid Cap TR Growth	6.89%	6.89%	14.07%	7.88%	11.95%	8.13%
US Mid Value	Russell Mid Cap TR Value	3.76%	3.76%	19.82%	8.94%	14.07%	7.47%
US Mid Blend	Russell Mid Cap TR	5.15%	5.15%	17.03%	8.48%	13.09%	7.94%
US Large Growth	Russell 1000 TR Growth	8.91%	8.91%	15.76%	11.27%	13.32%	9.13%
US Large Value	Russell 1000 TR Value	3.27%	3.27%	19.22%	8.67%	13.13%	5.93%
US Large Blend	Russell 1000 TR	6.03%	6.03%	17.43%	9.99%	13.26%	7.58%
S&P 500	S&P 500 TR USD	6.07%	6.07%	17.17%	10.37%	13.30%	7.51%

US Fixed Income Markets	Index	Quarter	YTD	One Year	3 Year	5 Year	10 Year
US Multisector Bond	Barclays US Agg Bond TR USD	0.82%	0.82%	0.44%	2.68%	2.34%	4.27%
Intermediate	Barclays US Govt/Credit Interm TR U	0.78%	0.78%	0.42%	2.01%	1.88%	3.76%
Short Term Bond	Barclays US Govt/Credit 1-3 Yr TR U	0.41%	0.41%	0.71%	0.96%	0.93%	2.34%

International Markets	Index	Quarter	YTD	One Year	3 Year	5 Year	10 Year
Emerging Markets	MSCI EM PR USD	11.14%	11.14%	14.53%	-1.23%	-1.65%	0.31%
Foreign Large Blend	MSCI EAFE PR USD	6.47%	6.47%	8.53%	-2.18%	2.91%	-1.79%
World Bond	Barclays Global Aggregate TR USD	1.76%	1.76%	-1.90%	-0.39%	0.38%	3.34%

Allocation Portfolios	Index	Quarter	YTD	One Year	3 Year	5 Year	10 Year
Balanced	DJ Moderate TR USD	4.44%	4.44%	9.79%	4.72%	6.78%	5.30%
Target Date 2046-2050	S&P Target 2050 TR USD	5.51%	5.51%	14.44%	6.25%	9.45%	5.36%
Target Date 2036-2040	S&P Target 2040 TR USD	5.07%	5.07%	13.27%	5.94%	8.86%	5.24%
Target Date 2026-2030	S&P Target 2030 TR USD	4.45%	4.45%	11.47%	5.46%	7.99%	5.09%
Target Date 2016-2020	S&P Target 2020 TR USD	3.68%	3.68%	9.23%	4.89%	6.83%	4.88%
Target Date Income	S&P Target Today TR USD	2.20%	2.20%	5.03%	3.46%	4.33%	3.95%

Key Takeaways

- The U.S. economy slowed over the fourth quarter of 2016 from an annualized growth rate of 3.5% to 2.1%. Consumer spending was not the detractor as it increased 3.5% over the prior quarter.

- Inflation reached the Fed's annual target of 2% in February. Consumer prices are up 2.7% for the last year. The Fed raised the federal funds target range by 0.25% to 0.75%-1.0% at the March meeting citing that without gradual rate increases, inflation could escalate.

- Employment improved with a total of 473,000 jobs added in January and February, 2017. The unemployment rate dropped from 4.9% to 4.7% over the 12 months ended in February.

- Positive economic data from the Eurozone helped international stocks post gains for February. Job creation reached a 10-year high as both the manufacturing and service sectors accelerated. The United Kingdom has formally begun the process of leaving the European Union and now has two years to negotiate the terms of its exit.

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