Review & Outlook – 1Q 2017

In our previous Review and Outlook we wrote about the promise of President Trump's first 100 days to be dramatic. For the first 70 days that prediction has certainly been true. The Trump Administration has more executive business experience than any previous incoming administration over the past 50 years and will likely favor policies promoting free markets and boosting growth, jobs and incomes. The downside to vast private sector experience is a dearth of public sector experience which may make it more difficult to govern effectively and pass comprehensive legislation such as the repeal of the Affordable Care Act and tax reform.

As frenetic as the Trump Administration has been, the equity markets were equally and paradoxically calm in the first quarter. The S&P 500 slowly and steadily advanced, continuing the post-election rally and returning 6.3%. Surprisingly, there were only two days in which the S&P 500's price change was greater than 1%, one day up over 1% and one day down 1%. The average first quarter has featured 13.1 such days going back to 1958, making this year the least volatile since 1972.

The post-election mood carried over to the first quarter as business optimism and consumer confidence soared, 4th quarter GDP growth was revised higher to 2.1%, unemployment remained low, wage growth continued to accelerate and inflation rose above the Federal Reserve's 2% target for the first time in 5 years. In response, the Fed raised interest rates in early March and will likely raise them 2 additional times this year while deciding how to slowly and deliberately unwind the $4.5 trillion of Treasury and Mortgage-Backed Securities on its' balance sheet.

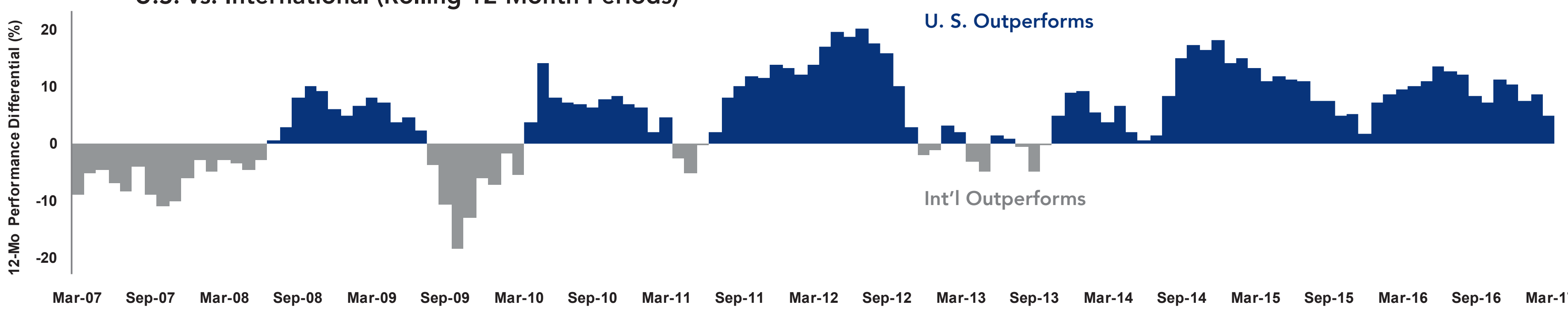
The economic prospects of Europe, Japan and China are showing signs of improvement. Britain officially triggered Article 50 of the Treaty on European Union in late March, beginning the two year negotiating window for their exit from the E.U. The terms of separation remain unclear but thus far Britain has avoided the dire economic consequences predicted by opponents of Brexit before last summer's referendum. The reelection of the Prime Minister in the Netherlands and likely defeat of nationalist Marine Le Pen in the upcoming French election are blows to the global populist movement and provide stability to the E.U.

Japanese Q4 GDP was revised upward and industrial production is growing, bolstered by ongoing monetary stimulus and a depreciated Yen. China's engineering of a "soft landing" for their overleveraged economy has been successful so far and the government accepted growth of a relatively low 6.5% this year to stabilize the financial system. Emerging markets have likewise performed well this year, aided by strong markets in India and South Korea.

While equity returns are encouraging globally, U.S. markets have outperformed International markets since the financial crisis. Although Europe appears to be stabilizing, we prefer to be "late to the party", increasing our international weighting once the recovery firmly takes root.

The equity returns in the U.S. and globally were strong in the first quarter. Since accelerating economic growth and tax relief is fully reflected in U.S. equity prices, the Trump Administration needs to start to deliver on the market's high expectations. Even in a strengthening economy, sharp pullbacks of 10% or more are not uncommon. We are anticipating a continued long-term upward trend in equity prices but a rise in short-term volatility is consistent with historical norms and increasingly overdue.

U.S. vs. International (Rolling 12-Month Periods)



Source: Morningstar Direct, Robert W. Baird & Co. Returns based on 12-month performance, calculated monthly over the most recent 10-year period.