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FINANCIAL MARKET OVERVIEW

The U.S stock market continued advancing during the first quarter of 2017. Stocks posted a reasonable 1% gain during January and stock values jumped 5% during February. During March, overall stock prices were down 1%. By quarter-end, the overall U.S. stock prices were up about 5%.

The big surprise was the change in leadership – not the White House - but rather the types of stocks that advanced during the first quarter were just as surprising as the type of stocks that declined. The types of stocks that increased the most since the election in November through February such as infrastructure, construction, materials, defense, banks and precious metals mining stocks were the same stocks that declined the most during the month of March. Technology stocks surged. What changed?

On the day Trump's American Health Care package came up for a vote to replace Obama's Affordable Care Act in early March, it was suddenly pulled off the floor with no vote for fear that a majority approval was not going to happen. Suddenly, the recommended stocks that were widely advertised as the best place to be under the Trump Administration became the ugly ducklings. Further, if Trump was not initially successful in getting his healthcare package passed, maybe he won't get a corporate income tax overhaul package passed either. If U.S. corporate income tax rates may not be reduced from the current 35% to 15%, then maybe the rosy economic growth expectations are too optimistic as well.

Overall, U.S stock prices advanced 5% during the first quarter. Technology stocks led the way with an average 12% gain during the first quarter led by Apple stock – up 24%. Gold and silver prices were up 8% and 14% respectively during the first quarter.

International stocks (world index excluding U.S.) were up less than 2% in 2016, but reversed course and advanced 8% over the last 3 months. The Mexican Peso reversed course from a precipitous decline since November to a gain of nearly 11% during the first quarter. Emerging market stocks (small international companies) posted the largest gain of 12.5% during the first quarter of 2017 compared to a 6.5% loss during the fourth quarter of 2016.

Growth stocks also reversed course from last year's trend and outperformed value stocks by posting over twice the rate of return. Value stocks (companies that are mature, have stable sales, and pay dividends) were up over 15% and outperformed growth stocks by a margin of 7% or more in 2016. During the first quarter of 2017, value stocks earned less than half as much as growth stocks – another complete reversal over three months.

Energy companies and energy mutual funds were the best performing sector in 2016. Over the past three months, energy stocks lost over 7%. Healthcare stocks were the only sector that posted a decline in 2016 – down 4%. Over the first 3 months of 2017, health care stocks were up 8%.

Fixed income or bonds continue to rise and fall modestly in reaction to the gradual increases in interest rates with additional small increases expected for the foreseeable future. Short-term bond returns ended the first quarter with a fractional loss (-0.02%) and intermediate-term bonds posted a modest positive return of 0.73%. The 10-year U.S Treasury Note started the year paying 2.39% interest and finished the first quarter paying 2.44%.

Real estate (REIT's) prices were nearly flat during the first quarter, advancing only 0.07% during the first three months of 2017.

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The following chart displays sample returns of various asset categories during the first quarter of 2017:

1st Qtr. 2017	Index Return (***includes dividends reinvested***)
+ 4.56%	**Dow Jones Industrial Average (^DJI)**
+ 5.46%	**Standard & Poor's 500 Index (^GSPC)**
+ 5.20%	**DJ U.S. Total Stock Market (VTI)**
+ 8.48%	**Large-company stock-Growth (IWF)**
+ 2.60%	**Large-company stock-Value (IWD)**
+ 6.54%	**Mid-Size Stocks – Growth (IWP)**
+ 3.18%	**Mid-Size Stocks – Value (IWS)**
+ 5.01%	**Small-company stock- Growth (IWO)**
- 0.66%	**Small-company stock- Value (IWN)**
+ 7.90%	**International (EFA)**
+ 12.51%	**Emerging Markets (EEM)**
+ 0.07%	**Real Estate Investment Trusts (VNQ)**
	Fixed Income
- 0.02%	**Short-term U.S. Treasury (SHY)** *(includes appreciation)*
+ 0.73%	**Intermediate U.S. Treasury (IEF)** *(includes appreciation)*
	Alternative Investment Category
+ 8.31%	**Gold (GLD)**

All returns calculated using adjusted historical quotes from finance.yahoo.com

FINANCIAL MARKET OUTLOOK

With each passing year, it becomes more and more difficult for both individuals and investment advisors to remain focused and rational. There is just too much information and commentary being rapidly disseminated throughout the media – especially through the internet. *The bottom line is this*: The "theme" (what's hot, where you should invest right now or equally compelling are warnings to sell or buy now before it's too late) on Wall Street, cable television, print advertising, and articles accessed through the internet constantly changes. An investor would have to make multiple changes (buys and sells) *quickly* and *continuously* every month or several times each quarter just to keep up with the new "theme". You simply cannot take a break - the next new positive theme or warning rapidly moves on to something else even more compelling.

In the first month of 2016, the big "theme" or consensus opinion was that the Federal Reserve would raise interest rates 4 times during the year. Stocks declined 10% in the first 45 days of the year. Wall Street and other media outlets quickly warned investors to sell stocks and buy gold. Forty-five days later at the end of the first quarter, stocks had regained all of the earlier 10% loss.

In the second quarter of 2016, the same "theme" – get out of stocks – was proclaimed because citizens of England had voted (Brexit) to leave the European Union. Stocks prices dropped quickly only to fully recover 2 days later.

During the fourth quarter of 2016, stock prices were up modestly year-to-date and held firm going into the election. Media outlets had already proclaimed Clinton was the sure winner to be the next President. And, if Trump miraculously wins, the markets would crumble. Another short-lived theme that was neither worth reacting to nor worth making changes to your investment strategy.

During the first quarter of 2017, the "theme" on Wall Street was to buy stocks of companies that would benefit from the President's plan to rebuild our country's infrastructure, buy stocks of companies involved in Defense spending and buy gold while you're at it, because the world has become a more dangerous place.

In addition, buy shares of oil companies because energy companies would generally benefit from less regulation and specifically buy energy companies involved in building pipelines from Canada to the United States. Stocks of these specific types of companies above, and to a lesser extent the overall U.S. stock market, would be expected to perform well. These "theme" stocks did perform well during the first 2 months of 2017.

Emerging market (smaller country stocks) stocks were expected to decline because Trump's tough stance on renegotiating new Trade Deals would adversely impact these countries while U.S. companies would benefit from Trump's pledge to lower corporate income tax rates. And finally, the value of the Mexican Peso would spiral downward as the war of words continued about building and paying for a border wall.

During the first 45 to 60 days of 2017, stocks prices did climb. Overall, U.S. stocks were up 1% in January and 5% in February. Beginning in March, the Wall Street "theme" began to change course. Most of the companies and types of stocks mentioned above that had outperformed the overall market in the first 60 days of this year, lost all of that gain

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and more during the month of March. During March, the overall U.S. stock market was down 1%.

Infrastructure and defense-company stocks were down and energy stocks were one of the worst performing sectors. Instead of plummeting, emerging market stocks soared 12.5% during the first quarter and the Mexican Peso was up 10.8% and an index of stocks traded on the Mexican stock exchange was up 6.5%.

Now the "theme" has suddenly reversed. Since the Trump Administration could not get a replacement healthcare package passed in March, the odds of passing some kind of corporate income tax overhaul that would lower income tax rates for corporate America may have diminished as well. In 2016, healthcare stocks were the worst performing sector – falling 4% in 2016. During the first quarter of 2017, health care stocks were up 8%.

The point we are trying to make is the current Wall Street investment "theme" and subsequent media reporting are constantly changing over a very short periods of time. Any ongoing and regular attempt at following these short-lived Wall Street/media themes by making changes to your investment account holdings will not likely improve investment performance. It does increase the likelihood of losses and/or may increase your income tax liability or transaction costs.

Investors cannot pretend they don't hear, read, or feel emotional spikes from the daily news media. However, investors can choose whether or not to react to media stories by either making, or not making, changes to their investment strategy and selections.

The best indicator of underlying strength or weakness under a longer-term horizon is the *direction* and *rate of change* in economic growth both domestically and worldwide. The overall stock market has already ended the 2016 calendar year with an above-average rate of return (10%) and is up an additional 5% in 2017. The overall stock market continues to rise even though the U.S. economic growth rate has stubbornly stayed below 2% or less over the past several years. Using only the recent performance of the stock market as a guide, clearly investors and Wall Street **expect** improvement in the economic growth rates both in the U.S. and worldwide.

Recently, the final reading of fourth-quarter 2016 gross domestic product was adjusted upward from a 2% growth rate to a 2.1%. Further the Conference Board's measure of consumer confidence has risen to its highest level since 2000. In addition, worldwide manufacturing activity (below average for several years) is rising at the best rate since 2014.

Maybe the stock market rally has less to do with Trump and more to do with fact the global economic activity is beginning to improve. That's the big question. Are the financial markets getting ahead of themselves, or is the gradually improving economic growth rates both in the U.S. and worldwide simply being correctly anticipated by advancing stock markets around the world?

If we remove politics, terrorism and the consensus expectations of gradually increasing interest rates from the equation, it appears the recent stock market performance is simply forecasting continued improvement in economic growth.

Investment Outlook and Recommendations

As stated in our previous newsletter, this is the scenario we think will unfold regarding the future direction of *the financial markets* – politics and social issues aside: The probability of a rising stock market ***1-2 years from now*** is higher than the probability of a lower stock market valuation. The transition will be challenging, but ultimately most of the changes outlined by the new President-elect will happen in one form or another. From a *business* and *financial markets perspective*, *better economic growth* is a must. After years of orchestrating and keeping interest rates artificially low to prevent flat or declining economic growth from getting worse, business activity, corporate earnings, consumer confidence and gross domestic product (GDP) are slowly on the rise again.

What we don't know is the timing of these changes. In the first 100 days of the new Administration, the first policy challenge was a new or replacement healthcare plan. The first attempt was not successful and didn't even come up for a vote by Congress. More tinkering will come.

The next challenge is income tax overhaul. Changing the corporate and/or income tax code will be even more difficult to pass through Congress than healthcare reform. The road is going to be a long one.

Our legislative branch, Congress, has never been more divisive in my lifetime. More time and energy is spent obstructing each other rather than working for the common good of all Americans. And, U.S. citizens are also intensely

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divided. In this type of environment, you can easily see how financial market volatility and uncertainty is only going to intensify.

The big question is: **When** will we know what the new policies (healthcare, income tax code, trade agreements, etc.) state? Expect volatility to increase during this calendar year. We have already witnessed certain sectors of the stock market rise one quarter, only to fall and be replaced by sectors that fell the previous quarter. Energy stocks went up nicely at the end of last year, only to fall the following quarter. Healthcare stocks were down considerably last year followed by an unsuspecting increase during the first quarter. International and emerging market stocks were down considerably last year, followed by the best performance of any sectors during the first quarter of 2017.

If investors try and follow the constantly changing Wall Street "themes" discussed earlier, you are going to drive yourselves crazy and today's recommended buys can be recommended sells in the following quarter. We do expect overall economic growth to improve and the stock market will make a sustained advance, but those expectations won't become reality anytime soon. Expect answers over a 1-3 year time horizon.

We will reduce our clients' money market balances and re-deploy the funds into equities over the coming months. The probability of better economic growth in the U.S. and worldwide has increased as small improvements are already underway. It's time to move on carefully. International stocks have much lower valuations compared to the U.S. and we may start there. Technology stocks should perform well over the next 4 years.

In summary, we expect to increase our clients' allocation into the same growth areas that we had reduced back in August 2015. However, we do want to be wise and prudent regarding when to execute the purchases. This change of course will take some time and terrorist acts and political obstruction can change the confidence level of investors at any time along the way.

We have identified multiple purchase selections for each client and there are many ways to invest during the transition. **Once again, we will not include any of the Blue Recommendation sheets you are accustomed to receiving at quarter-end in this mailing, but intend to include them later this year.**

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Best Regards

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