First Quarter 2017 Market Newsletter Summary

- Global stocks rose in the first quarter of 2017. Non-US stocks outperformed US stocks. Bonds rallied at the end and were up for the quarter.

- The US economy is healthy. It is growing at a slower rate than in past recoveries, however it has been growing for a longer time than before. The state of the economy favors stocks.

- Three things will influence the future direction of stocks: Politics and policies, words and actions of the US Federal Reserve and corporate earnings. We think overall, these three factors will be a tailwind for stocks in the near term.

- Overseas economies (Developed and developing) are also growing. Despite some risks, we expect this to continue.

- We are constructive on stocks especially overseas stocks which are cheaper than US stocks. We are cautious on interest rate sensitive bonds and favor bonds that are less interest rate sensitive. We like bank loans, which are to some extent immune to increase in interest rates.

- We are cognizant of the various risks that exist in the markets and have built appropriate portfolios for our clients.

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First Quarter 2017 Market Commentary

Table 1: Market indices (As of March 31, 2017)

(*Returns include dividends*)	**Quarter to date**	**Year to date**	**1 Year**	**3 Year Annualized**	**5 Year Annualized**
S&P 500	6.79%	6.79%	17.17%	10.37%	15.30%
S&P Mid Cap 400	4.76%	4.76%	20.92%	9.36%	15.32%
S&P Small Cap 600	1.35%	1.35%	24.59%	9.45%	14.25%
MSCI Emerging Markets	12.82%	12.82%	17.65%	1.55%	1.17%
MSCI EAFE	7.50%	7.50%	12.25%	0.96%	6.32%
Investment Grade Credit (C0A0)	1.42%	1.42%	3.41%	3.69%	4.04%
Non-Investment Grade Credit (H0A0)	3.18%	3.18%	16.88%	4.66%	6.85%
Bloomberg Commodity Index Total Return	-2.33%	-2.33%	8.71%	-13.91%	-9.54%
Dollar Index (DXY)	-1.82%	-1.82%	6.10%	7.80%	4.90%
Vanguard Total Bond Market Index (VBMFX)	0.88%	0.90%	0.32%	2.48%	2.16%
10 Yr Rate	2.40% 03/31/2017	2.40% 03/31/2017	1.79% 03/31/2016	2.72% 03/31/2014	2.22% 03/31/2012

Source: Standard and Poor's, ml.com, MSCI.com, Morningstar

Table 2: Recent Major US Economic Releases (These indicators have a significant impact on the stock market)

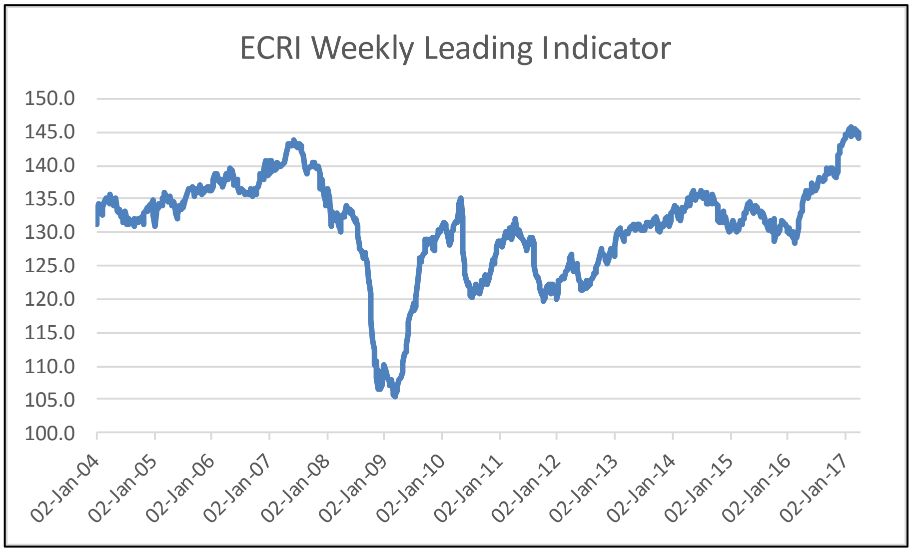
As of April 10, 2017			
	Latest Release	Recent Trend	Notes
Non Farm Employment	89,000	Positive	The job situation hit a rough patch in March perhaps because of the weather. Last month's number was revised down as well. However, the unemployment rate fell to 4.5%,the lowest since April 2007 as jobs were created even as more people entered the labor force.
Weekly Claims for Unemployment Insurance	234,000	Positive	Although less than consensus, claims for unemployment insurance fell 25,000. The four week average is down 4,500.
ISM Manufacturing Index (Over 50 points to growth)	57.2	Positive	The index points to a very healthy manufacturing sector. The trend of this index has also been strongly positive.
ISM Non Manufacturing Index (Over 50 points to growth)	55.2	Positive	Although this index is showing some signs of slowing down, the services sector is in good shape.

	Latest Release	Recent Trend	Notes
Consumer Prices (Month over month change)	0.1%	Negative	Consumer prices is pointing to inflationary conditions. Since last year, consumer prices are up 2.7%. Excluding food and energy, which tend to be volatile, it is up 2.2%. These numbers are well over 2%, which is a key threshold that signals conditions are inflationary.
Producer Prices (Month over month change)	0.3%	Negative	Like consumer prices, producer prices is pointing to increasing inflation. Year over year, it is up 2.2%. Excluding food and energy, it is up 1.5%.
Retail Sales	0.1%	Positive	Retail sales are strong and improving. This indicator perked up nicely despite a slowdown in autos and a drop in gas prices because other areas were strong.
Consumer Confidence (Conference Board)	125.6	Positive	Consumer confidence is extremely strong. It has not been this strong since 2000. Hopefully, consumers will follow this with increased spending.
Durable Goods (Month over month change)	1.7%	Negative	Durable good are reasonably strong. However, excluding aircrafts and defense, core capital spending by firms is relatively weak. Business confidence has been very strong lately, so companies could spend on investments going forward.
Industrial Production	0%	Positive	Industrial production was held down by utility output. But, it has been improving recently.
Capacity Utilization	75.4%	Negative	Capacity utilization is still below the long term average of 80%. There is still slack in the economy.
Housing Starts	1.288 Million	Positive	Housing activity is strong
Home Prices (Case-Shiller 20 city Index- Month over Month)	0.9%	Positive	Home prices are stable at around the 6% level year over year.
GDP (Real, Annualized)	2.1%	Positive	GDP growth is stable. However, it has stabilized at a lower level than in the past when it averaged over 3%.

Source: Bloomberg, www.federalreserve.gov, www.bls.gov, www.ism.ws, www.nahb.org.

Stocks rose in the first quarter helped by the 'Trump trade', although a modest sell off in the end knocked them off the highs set in early March. Non-US stocks, both developed and developing, outperformed US stocks. Bonds had a late quarter rally and ended in positive territory. In the background, the US economy is quite strong (As seen in the table above). Two things to note: Although strong and improving, the overall GDP has grown by around 2% on average since the great recession of 2008-2009 as compared to an average of about 4% in previous recoveries. (On the other hand, this has been a longer than average recovery- 8 years and counting as compared to an average of 5 years). Second, there is a wide gap between expectations from and the actual hard data on the economy. Consumer and business confidence are very high, but hard data on retail sales, manufacturing, industrial production and capital investments although strong, do not match the level of confidence. Usually when there is such a wide spread between expectations and actual data, they converge towards each other, so we expect the economy to continue to grow. The ECRI index of leading economic indicators confirms this as seen in Fig 1.

Fig 1: ECRI Index of Leading Economic Indicators



Source: ECRI

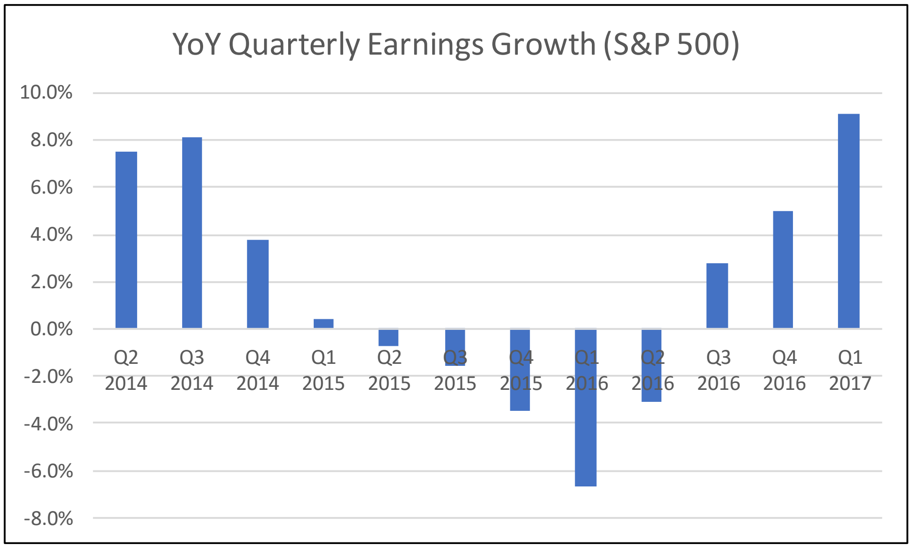
There are three important things that will influence the direction of the stock markets. Politics and policies, the words and actions of the Federal Reserve (Fed) and corporate earnings. Taken together, they are likely to benefit the markets in the near term. On the political front, the current President has a pro-growth agenda of lower taxes, reduced regulations and increased fiscal spending. With a majority in both the houses, it would seem that the administration should easily be able to pass most of his agenda through Congress. However, as we saw with the Affordable Care Act reform attempt, ruling party infighting and opposition bitterness can be significant roadblocks to the administration's plans. We think despite the early setback, the odds of the rest of the agenda (Or at least the significant parts) being passed are high as opposing groups strike a compromise and find common ground.

The Fed raised interest rates for the second time this cycle. The Fed has also said it will unwind its massive holdings of bonds (Which was bought during the credit crisis to stabilize the markets and support the economy). This can have the same effect as raising rates (i.e. tighter monetary conditions) and bears watching. An increase in interest rates can hurt stocks- but rates are still low, inflation is contained and the Fed has said it will continue to move at a moderate pace, which means they will be careful not to adversely affect the economy and/or the stock markets. There could also be some indirect political pressure on the Fed to keep interest rates low, thus benefiting stocks.

Corporate earnings are expected to grow at a healthy clip. In the fourth quarter of 2016, earnings turned positive after declining for several quarter. Helped by stable energy prices and a weak dollar, corporate earnings are expected to continue to grow. As per Factset, earnings are expected to grow by 9.1% in the first quarter of 2017- which is the highest rate in several years. . If the economy and corporate earnings continue to grow, the rally in stocks can be sustained. While stocks are expensive based on forward P/E of about 18.9 (Based on operating earnings), it is fairly valued considering the relatively low interest rates. Market action so far this year supports this thesis. For instance, when the attempt to repeal and replace the Affordable Care Act fell through in Congress, the market did not sell off but simply shrugged off the news. Having said that, a correction is possible anytime especially since markets have melted up after the elections in November.

Like in the US, overseas economies are growing. The IMF expects developed economies to grow at 3.6% and emerging and developing nations at 3.4% in 2017-2018. PMI indices are well over 50 in the major economies, reflecting healthy manufacturing and non-manufacturing industries. The most significant event to watch overseas is Brexit. The UK triggered article 50 to set in motion its separation from the EU. As of now, Brexit has not affected either the UK or the EU. The UK was particularly helped by a weaker pound (A weak currency makes exports cheaper) and strong consumer confidence. However, there is considerable uncertainty in the region as the UK forges new relationships with its partners. Sovereign debt problems (Especially Greek debt) also pose a risk in the region. We expect the ECB to remain easy which should support asset prices.

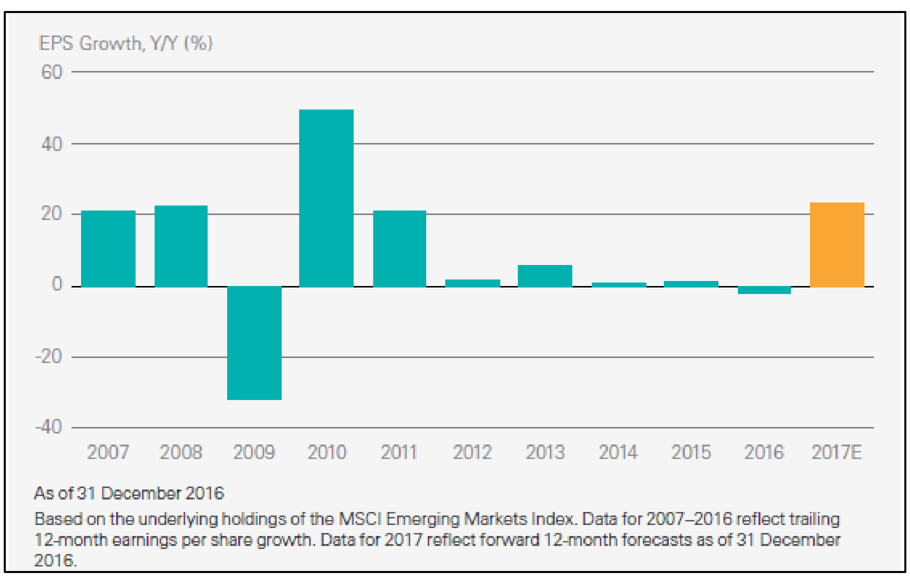
Fig 2: US corporate earnings are growing



Source: Factset

Emerging markets are benefiting from global growth and reflationary policies in the developed markets. Both, at the macro level and micro level, there is better financial discipline than in the past. This is driving acceleration of earnings growth and improvements in profitability.

Fig 3: Emerging Market Corporate Earnings are expected to grow in 2017



Source: Factset, MSCI

Asset class views

We are constructive on risk assets, especially equities. Monetary and fiscal condition should help this business cycle linger on. We are optimistic about non-US stocks, both in developed and developing markets. They are cheaper than US stocks (Forward price earnings of 14.5 and 12.5 respectively versus 18 for the US) and improvements in economic conditions and corporate profitability should support their rally.

We are cautious on fixed income especially those that are interest rate sensitive. Our fixed income managers have reduced the duration of their portfolios and are investing in areas that are less interest rate sensitive such as high yield and bank loans. Both these asset classes have relatively high yield (6% and 4.5% respectively) which should help them weather capital loss from a risk off trade. Although bank loans are immune to and in fact benefit from increasing rates, issuers are taking advantage of covenants to re-finance at a lower yield hurting performance to some extent. However, overall we expect the performance of loans to be comparable to their starting yields. An improving economy could help by reducing defaults and producing capital growth. In addition, we are picking vehicles that are trading at a discount (Such as closed end funds) to enhance the total return.

Finally, despite our relative optimism, we are aware of the various risks that face this business cycle and have constructed portfolios accordingly.

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