MacroView

March 31, 2017

Quarterly Review & Outlook

> ***"A portfolio that contains too little risk can make you underperform in a bull market, but no one ever went bust from that; there are far worse fates."***
> ***– Howard Marks***

Hopefully Howard Marks' assertion above delivers some level of solace to investors that have yet to fully embrace the idea that we are indeed in a long-term secular bull market. We're now 8 full years removed from the generational market bottom formed on March 9th, 2009 during the depths of the financial crisis. And while the market has more than tripled since that time, the psyche of the average investor has yet to fully heal. Because of this, many investors have operated with a "one foot out the door" mentality in recent years and found it difficult to truly re-commit to a strategic, long-term investment allocation.

In the 1st quarter of 2017, we continued to see this theme play-out but must also admit that we did observe a few cases where investor optimism took hold.

The commentary within will offer a detailed look at the various markets/asset classes we cover along with an assessment of the current investment landscape (valuations, the economy, politics, monetary policy, investor sentiment, technicals, seasonality, volatility, etc).

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Source: Standards & Poor's (S&P 500); MSCI benchmarks (country returns). All performance is measured in USD. See important disclosures and definitions included with this publication.

(Chart from RW Baird)

U.S. Equity Markets

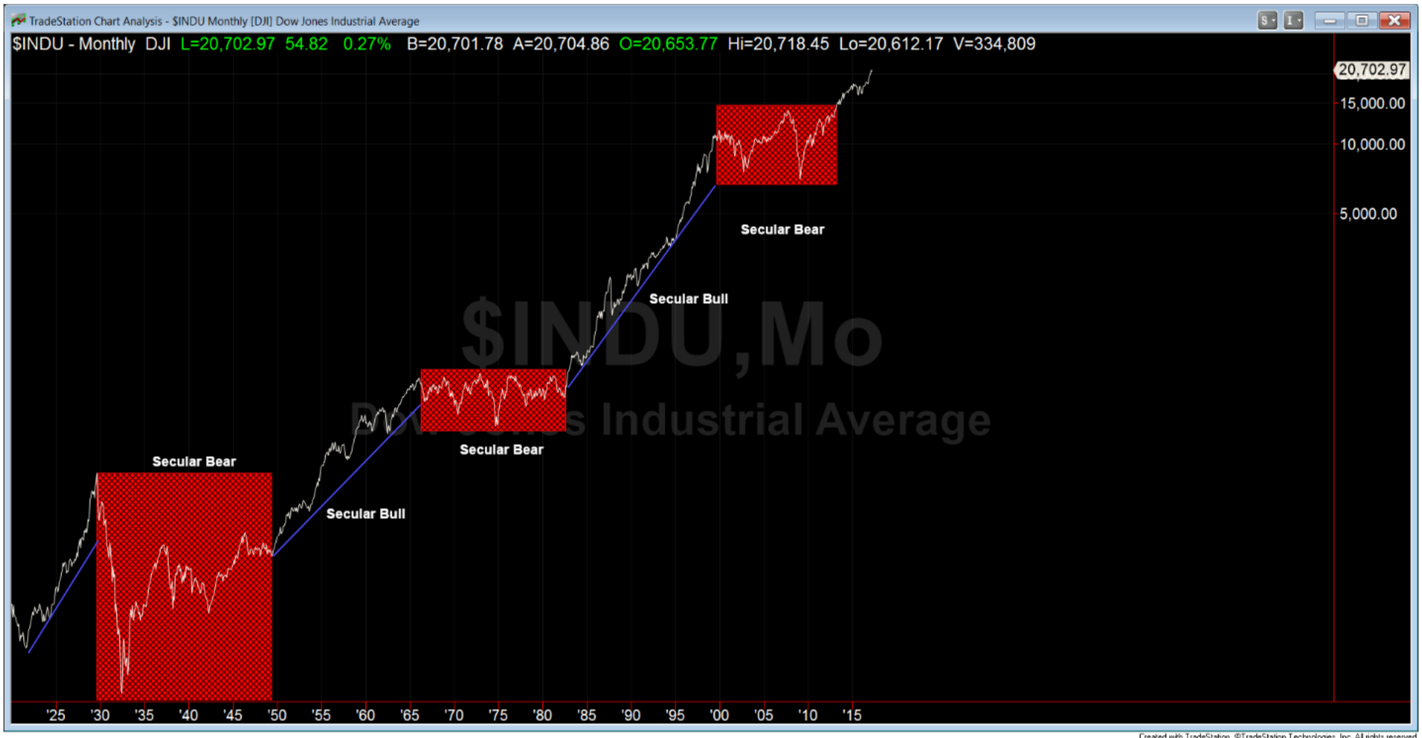
As of March 31, 2017

	Trailing Returns (%)						5-Year Risk Stats		Other Metrics			Representative
	Last Qtr	YTD	1-Year	3-Year	5-Year	10-Year	Std. Dev.	Max. Loss	P/E	EPS Gr.	Div. Yld.	Benchmark
Bellwethers												
S&P 500	6.1	6.1	17.2	10.4	13.3	7.5	10.2	(8.4)	21.2	0.6	2.1	*S&P 500*
DJIA	5.2	5.2	19.9	10.6	12.2	8.1	10.7	(9.0)	19.8	4.6	2.5	*Dow Jones Industrial Avg.*
Market Cap												
Mega	6.6	6.6	16.5	10.9	12.5	7.2	10.5	(8.5)	21.1	2.3	2.3	*Russell Top 50*
Large	6.4	6.4	17.6	10.6	13.3	7.5	10.3	(8.6)	22.8	5.3	1.7	*Russell Top 200*
Mid	5.2	5.2	17.0	8.5	13.1	7.9	11.0	(12.8)	22.7	5.9	1.8	*Russell Midcap*
Small	2.5	2.5	26.2	7.2	12.4	7.1	14.4	(16.8)	22.0	4.4	1.6	*Russell 2000*
Micro	0.4	0.4	27.8	4.9	12.4	5.4	15.5	(21.0)	19.9	(2.1)	1.4	*Russell Micro Cap*
Style												
Value	3.0	3.0	20.0	8.6	13.1	5.9	10.7	(10.4)	19.0	0.1	2.5	*Russell 3000 Value*
Core	5.7	5.7	18.1	9.8	13.2	7.5	10.5	(8.8)	21.3	4.2	2.0	*Russell 3000*
Growth	8.6	8.6	16.3	10.9	13.2	9.0	10.8	(8.8)	23.8	10.0	1.8	*Russell 3000 Growth*
S&P 500 Sectors												
Consumer Discretionary	8.5	8.5	13.2	12.6	16.3	10.6	12.0	(8.0)	19.7	8.0	1.6	*S&P 500/Cons. Disc.*
Consumer Staples	6.4	6.4	6.2	11.3	12.9	10.6	10.2	(7.5)	20.5	2.8	2.8	*S&P 500/Cons. Staples*
Energy	(6.7)	(6.7)	14.3	(5.0)	1.7	3.4	16.6	(38.7)	27.9	(21.3)	2.9	*S&P 500/Energy*
Financials	2.5	2.5	32.6	11.7	15.4	0.2	14.2	(15.2)	14.9	3.1	1.9	*S&P 500/Financials*
Health Care	8.4	8.4	11.6	10.1	16.7	10.4	12.1	(13.1)	19.3	9.7	1.8	*S&P 500/Health Care*
Industrials	4.6	4.6	18.4	9.9	14.2	8.2	11.7	(11.3)	19.4	0.4	2.3	*S&P 500/Industrials*
Information Technology	12.6	12.6	24.9	16.8	14.6	11.4	13.3	(9.4)	21.6	2.7	1.6	*S&P 500/Info. Tech.*
Materials	5.9	5.9	19.2	5.6	9.5	5.8	15.1	(22.7)	18.7	(6.3)	2.2	*S&P 500/Materials*
Telecomm	(4.0)	(4.0)	1.7	7.9	10.3	5.2	14.0	(12.6)	15.4	(0.3)	4.7	*S&P 500/Telecomm*
Utilities	6.4	6.4	7.1	11.3	12.1	6.7	13.5	(12.8)	17.6	(3.1)	4.2	*S&P 500/Utilities*

Source: Morningstar Direct. Performance greater than one year is annualized. Performance is represented by the benchmark listed in the "representative benchmark" column. See important disclosures and definitions included with this publication.

(Chart from RW Baird)

As mentioned, we continue to believe stocks are in the midst of a long-term secular bull market with years left to advance. The charts below show the span and ranges of history's secular bulls and bears for the Dow and S&P 500. From this zoomed-out, monthly view, we see that relative to past moves the market could be in the early-ish stages of its ascent if this is indeed a secular bull market.



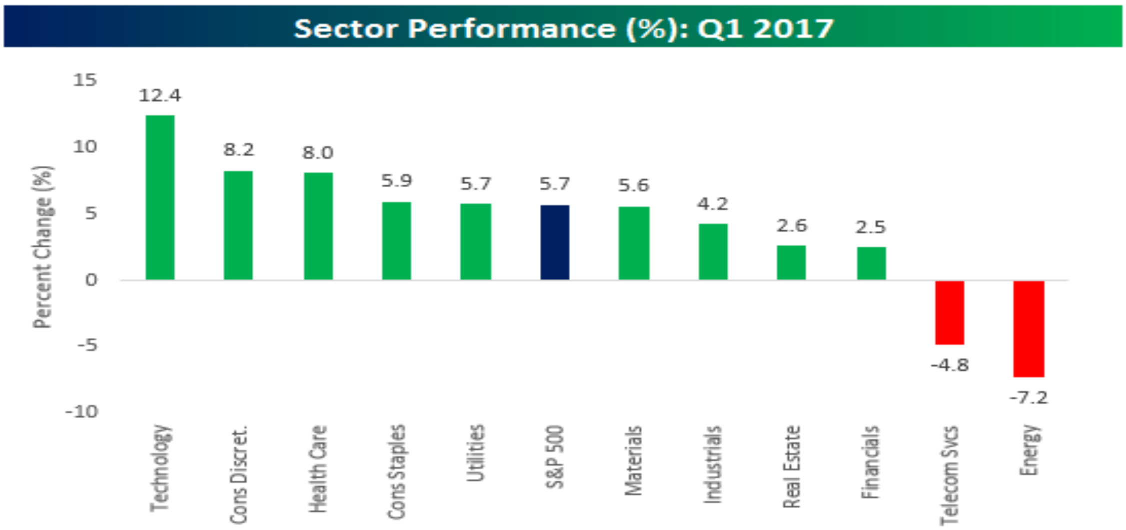
While we do believe this to be the most likely scenario in terms of a longer-term outlook, there will undoubtedly be bouts of volatility, pullbacks, corrections and even…*gasp*…a bear market along the way.

Every secular bull in history has featured its share of short-term/cyclical pauses and disruptions and we expect this one to be no different.

In the first quarter of 2017, the S&P 500 gained 6.1% as stocks were rewarded for a solid Q4 earnings season, optimistic business & consumer sentiment readings and, of course, the so-called "Trump Trade".

The daily and weekly charts above show that the S&P's surge since the November elections actually took the index above its long-term trend channel and signaled to investors that the sideways, directionless action of 2015-2016 might not be joining us in the new year. And thus far in 2017, as the S&P has kept above 2,300, that appears to remain the case. To illustrate the recent move in stocks, consider that in the nearly two-year period from December 2014 to October 2016, the S&P rose less than 3%. In the five months since the November 2016 election, the index has tacked on 11%.

Large Cap stocks outperformed mid-cap (Russell Mid Cap: +5.2%) and small-cap stocks (Russell 2000: +2.5%) during the quarter while Growth stocks clearly held favor over their Value counterparts. The Russell 1000 Growth Index climbed nearly 9% during Q1 while the Russell 1000 Value Index managed a gain of just over 3%. Not surprisingly, the traditionally more "growth-y" sectors like technology (+12.4%), consumer discretionary (+8.2%) and health care (+8%) were the victors for the quarter. Meanwhile, energy (-7.2%) and telecom (-4.8%) badly underperformed.



(Chart from Bespoke)

In terms of volatility, the S&P 500 just experienced its calmest start to a year in decades. The index had only two 1% daily moves in Q1 which made for the fewest since 1972 and well below the quarter's historical average of 13. By comparison, the first three months of 2016 featured 26 1% daily moves. Needless to say, the tempered action during the quarter helped to put the VIX index even further into the tank.

From a technical perspective, the path of least resistance remains higher. While on a shorter time frame the market peaked out in early March, the index has thus far respected its 50-day moving average and there should be significant support in the 2280-2300 area for the S&P as well.

Source: Stockcharts.com.

(Chart from Raymond James)

The largest pullback for the index in Q1 was a muted 3.25% and given the strong move higher since the presidential election we would not be surprised to see further consolidation at some point during the 2nd quarter. That being said, when we step back and look at things on a larger timeframe (weekly chart) we see that the market has plenty of support beneath it. Any meaningful pullback should entice the "buy the dip" crowd along with those not-so-patiently waiting on the sidelines to add some exposure.

Source: Stockcharts.com.

(Chart from Raymond James)

If there were one area of "worry" for US stocks right now, it would be in Small Cap land. Going into the final trading week of the quarter, the Russell 2000 sat in negative territory for 2017 after its massive post-election run up in November and December. A big bounce over the final few days of the quarter allowed the index to finish Q1 with a return of +2.5% and mask some otherwise weak behavior. While the index remains inside of a well defined, multi-year wedge formation, its end of 2016 gains took the index up against its upper boundary and it appears to be consolidating that move.

On a shorter timeframe, the Russell 2000 (IWM) daily chart shows that the index has completely stalled out. The R2K now sits well below its first quarter highs and is approaching a support zone it has test several times thus far in 2017. We'll want to keep a close eye on the Russell 2000 to see if any loss of support serves as a "canary in the coalmine" warning for the rest of the market.

International Equity Markets

As of March 31, 2017

Asset Class/Region	Trailing Returns (%)						Annual Returns (%)			Benchmark
	Last Qtr	YTD	1-Year	3-Year	5-Year	10-Year	2016	2015	2014	
Broad Developed Markets										
Developed Markets (USD)	7.3	7.3	11.7	0.5	5.8	1.1	1.0	(0.8)	(4.9)	*MSCI EAFE (Net) USD*
Developed Markets (Local Currency)	4.7	4.7	18.0	7.3	10.7	2.3	5.3	5.3	5.9	*MSCI EAFE (Net) Local*
Currency Effect (USD - Local Returns)	*2.5*	*2.5*	*(6.3)*	*(6.8)*	*(4.9)*	*(1.3)*	*(4.3)*	*(6.1)*	*(10.8)*	
Broad Emerging Markets										
Emerging Markets	11.5	11.5	17.2	1.2	0.8	2.7	11.2	(14.9)	(2.2)	*MSCI Emerging Markets (Net)*
BRIC	11.6	11.6	23.7	3.0	0.7	2.3	12.4	(13.3)	(2.6)	*MSCI BRIC*
Returns by Style										
Value	6.1	6.1	16.0	(0.6)	5.6	0.1	5.0	(5.7)	(5.4)	*MSCI EAFE Value*
Grow th	8.5	8.5	7.5	1.5	6.0	2.0	(3.0)	4.1	(4.4)	*MSCI EAFE Growth*
Large Cap	7.1	7.1	12.3	(0.1)	5.4	0.9	1.1	(2.1)	(5.5)	*MSCI EAFE Large Cap*
Mid Cap	7.8	7.8	9.3	2.7	7.6	1.6	0.7	4.4	(2.1)	*MSCI EAFE Mid Cap*
Small Cap	8.0	8.0	11.0	3.6	9.2	3.0	2.2	9.6	(5.0)	*MSCI EAFE Small Cap*
Returns by Region										
Europe	7.6	7.6	10.5	(1.0)	6.3	1.3	0.2	(2.3)	(5.7)	*MSCI Europe*
Japan	4.6	4.6	14.8	6.4	7.1	0.8	2.7	9.9	(3.7)	*MSCI Japan*
Pacific (ex Japan)	11.8	11.8	18.5	2.3	5.5	4.6	8.0	(8.4)	(0.3)	*MSCI Pacific ex Japan*

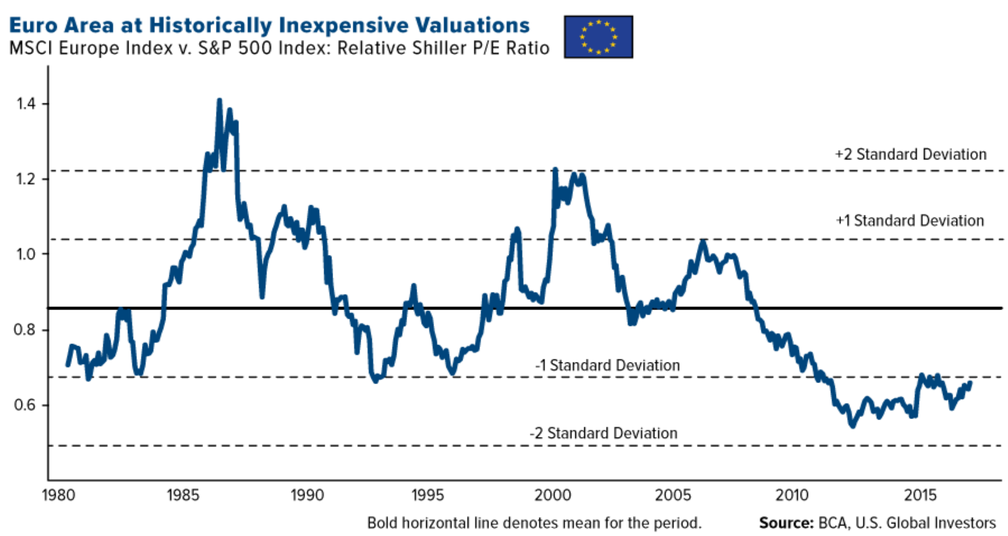
Source: Morningstar Direct; MSCI benchmarks. Performance greater than one year is annualized. Performance is represented by the benchmark listed in the "representative benchmark" column. See important disclosures and definitions included with this publication.

(Chart from RW Baird)

Looking outside of the United States, it should be noted that many international markets and benchmarks fared quite well in Q1. While the MSCI EAFE Index (EFA) remains stuck in a years-long down/sideways channel, it has recently shown some life as investors are reminded that owning some overseas exposure can boost diversification.

While it has been an especially difficult haul for many European economies & markets in recent years due to ongoing monetary and fiscal calamities, stagnating demographics and political disarray, the Euro area may now be a flashing buy relative to US stocks. The region is dealing with issues like Brexit/Article 50 trigger (2-year exit window for Great Britain to leave the EU), hotly contested elections and a lack of clarity out of the European Central Bank yet a number of markets were able to post solid gains in Q1.

From our view, there may be more gains in store for that part of the world. The chart below shows just how inexpensive European stocks continue to be on a historical basis. If one were to assume that Eurozone economies have largely bottom out, it may be an opportune time to add some exposure in this space.

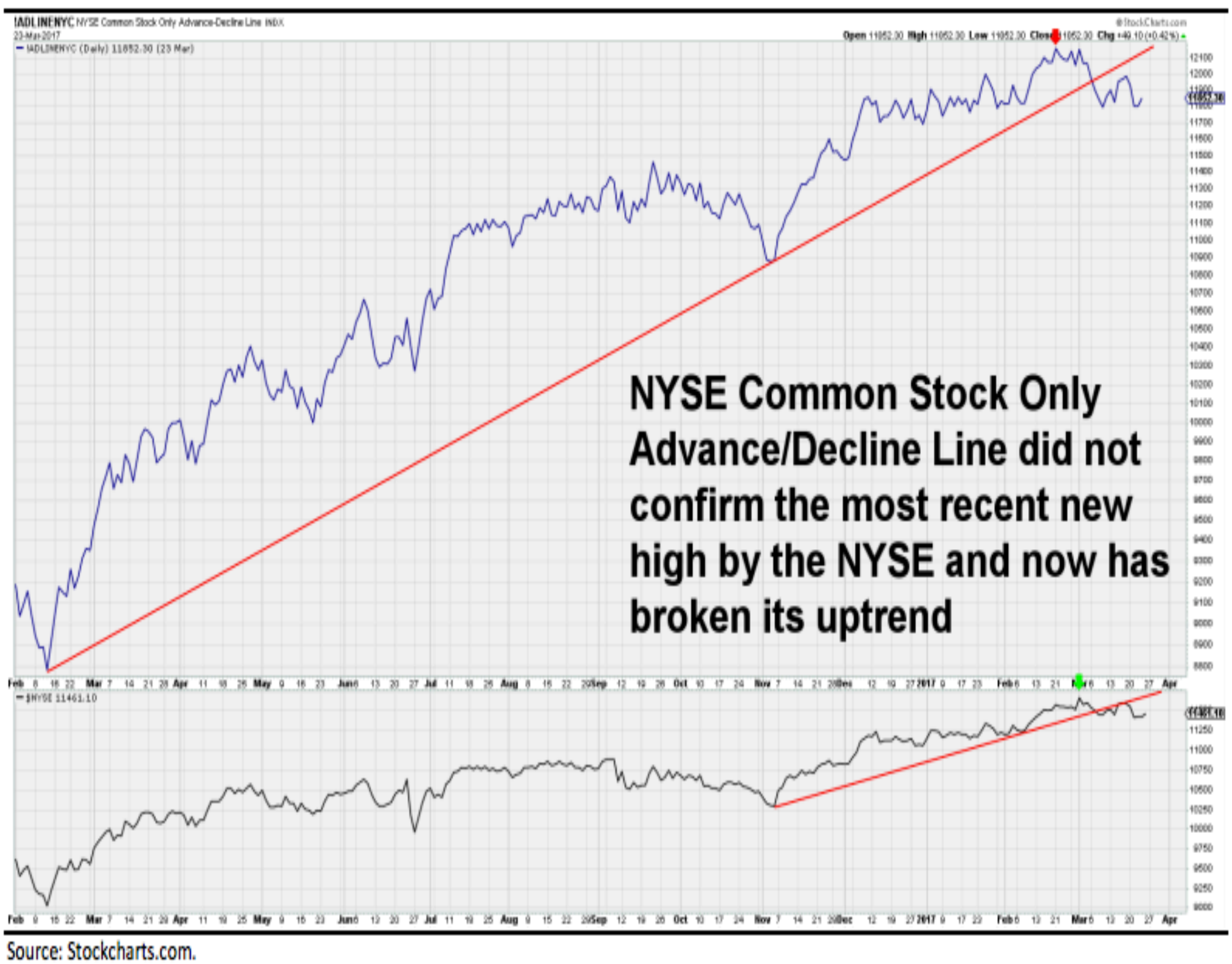


Not to be outdone by their developed international big brothers, emerging market stocks posted double-digit gains in the first quarter. Thanks to a weakening dollar, falling energy costs and a pickup in economic activity, the MSCI Emerging Markets Index (EEM) rose 11.5% in Q1.

The index is now at its highest level in nearly two years and looks poised to add further gains from both an absolute and relative standpoint. We believe the strength in Emerging Markets may be in its early stages and consideration for further exposure in 2017 could be warranted. The chart below is a monthly ratio study of the EEM vs S&P 500. After years of relative underperformance, the tides might be turning in favor of EEM as it has begun to peak above the 20-month moving average.

In technician-speak, we've started to observe a number of short-term indicators showing negative divergences. This generally suggests the market has become more susceptible to a pause/pullback over a certain timeframe. For instance, one measure we follow to gain a grasp on the breadth (aka participation) in the market, the NYSE Common Stock Only Advance-Decline Line has not been confirming the market's latest highs. The measure, which moves up when the majority of stocks in the NYSE are advancing and down when a majority are declining, has recently started to show weakness. What's more, it started doing so when the market was still making new highs. This means fewer and fewer individual stocks were themselves participating when the broad indexes were notching new highs.

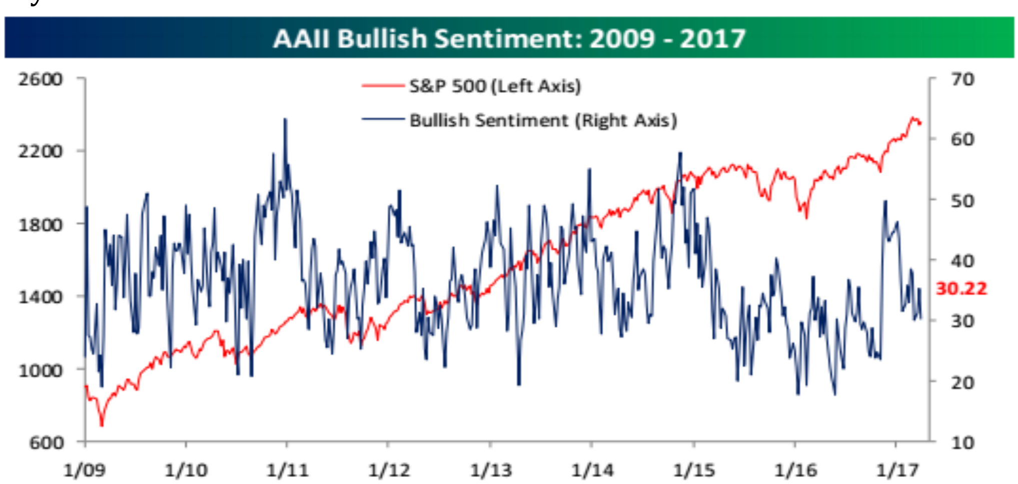
The chart below helps to illustrate this situation. The NYSE A-D Line peaked in mid-February while the NYSE index (lower pane) made it's latest high on March 1st. We'll want to keep an eye on how this situation resolves itself in the months ahead.



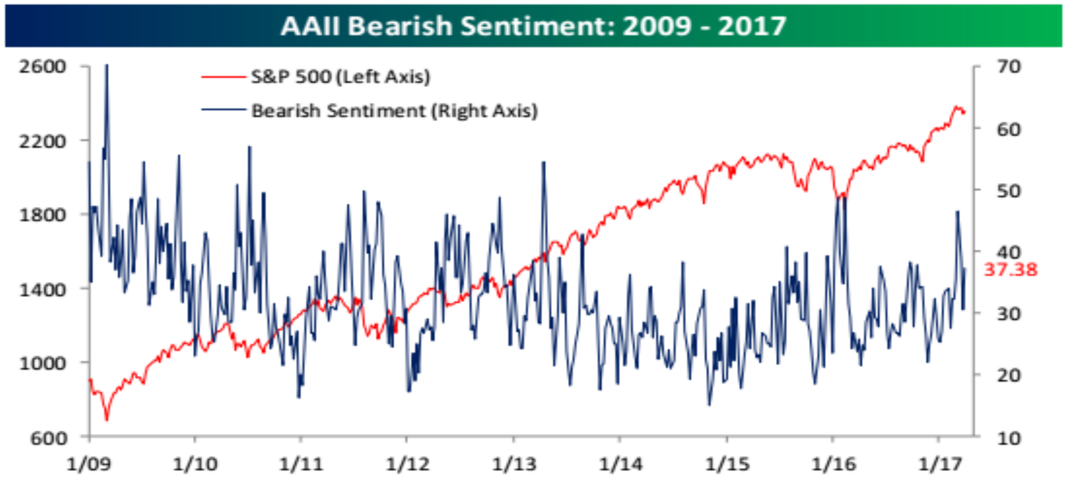
(Chart from Raymond James)

The S&P 500 has now gone over a year without at least a 10% pullback. While Q1 featured a slight uptick in volatility as the quarter came to a close, a -3.25% pullback was all we had to show for it and that was after the market had gone more than 100 trading days without a 1% down day. Regardless of the eventual cause, we absolutely see validity in the argument that the market would ultimately benefit from a 5-10% reset. Not only could it help to clear the complete lack of volatility we've seen but it may also entice those sitting in cash to start wading back in.

It's important to keep time frames in mind when considering this market. While we just argued that a small pullback might be good for the overall health of the market, the typical warning signs of a long-term top or bubble conditions simply are not present and that's why we think any near-term pullback is a buying opportunity.



The chart above lays out the path of the AAII Bullish Sentiment Index since the 2009 market bottom. The measure is a widely followed poll that gauges the collective mood of individual investors. At the end of March, the index sat at 30.22 meaning that just 30% of individual investors had a favorable view of where stocks are headed. We're now at 117 consecutive weeks where less than half of individual investors polled were in the bullish camp. Not exactly a glowing endorsement. Meanwhile, the AAII Bearish Sentiment Index continues to show that individuals are jittery about stocks. The index spiked to its highest levels in a year during the quarter and currently sits at the higher end of its recent range. This is happening while stocks continue to sit just below their all-time highs.



Couple these muted measures with recent institutional money manager surveys, which continue to show low stock exposure and high cash balances, and it's no wonder that many refer to this as the most hated bull market in history.

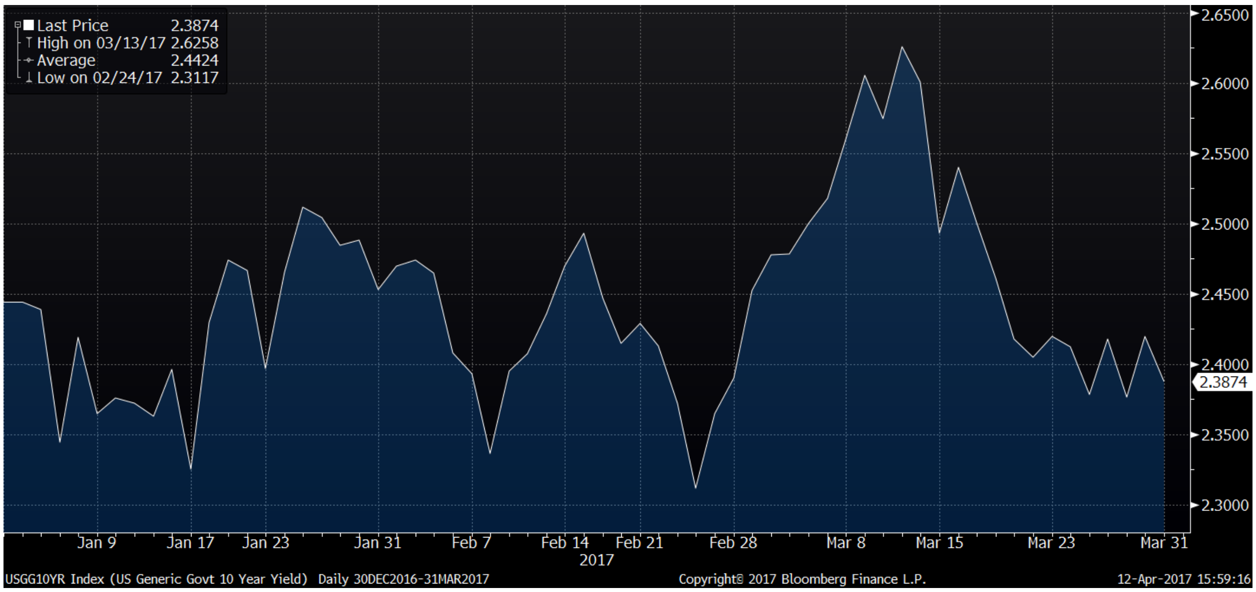
Lastly, the beginning of Q2 marks what has historically been a very favorable time of year for stocks. April checks in as the best month of the year for the S&P 500 over the last 20 years. Stocks have averaged a gain of just over 2% over the last 20 Aprils and have finished the month higher 75% of the time.

Month	# of Months	Rank Return	Average Month Return	StdDevp of Month Return	Rank StDev	Avg of Drawdown from Close	Avg of DrawUp from Close	% Higher
January	20	10	-0.50%	4.11%	5	-4.21%	3.08%	50%
February	20	8	-0.18%	4.38%	4	-3.43%	2.99%	55%
March	20	3	1.85%	4.03%	7	-3.42%	4.62%	65%
April	**20**	**1**	**2.01%**	**3.83%**	**9**	**-2.57%**	**4.03%**	**75%**
May	20	7	0.28%	3.57%	11	-3.00%	3.13%	60%
June	20	9	-0.30%	3.65%	10	-3.37%	2.74%	55%
July	20	6	0.67%	4.00%	8	-3.57%	3.66%	50%
August	20	12	-1.31%	4.67%	3	-5.00%	2.55%	50%
September	20	11	-0.61%	5.26%	2	-4.22%	3.65%	50%
October	20	2	1.86%	5.89%	1	-5.13%	4.85%	65%
November	20	5	1.47%	4.08%	6	-3.55%	3.98%	75%
December	20	4	1.47%	2.83%	12	-2.50%	3.40%	75%
Average			0.56%	4.40%		-3.66%	3.56%	

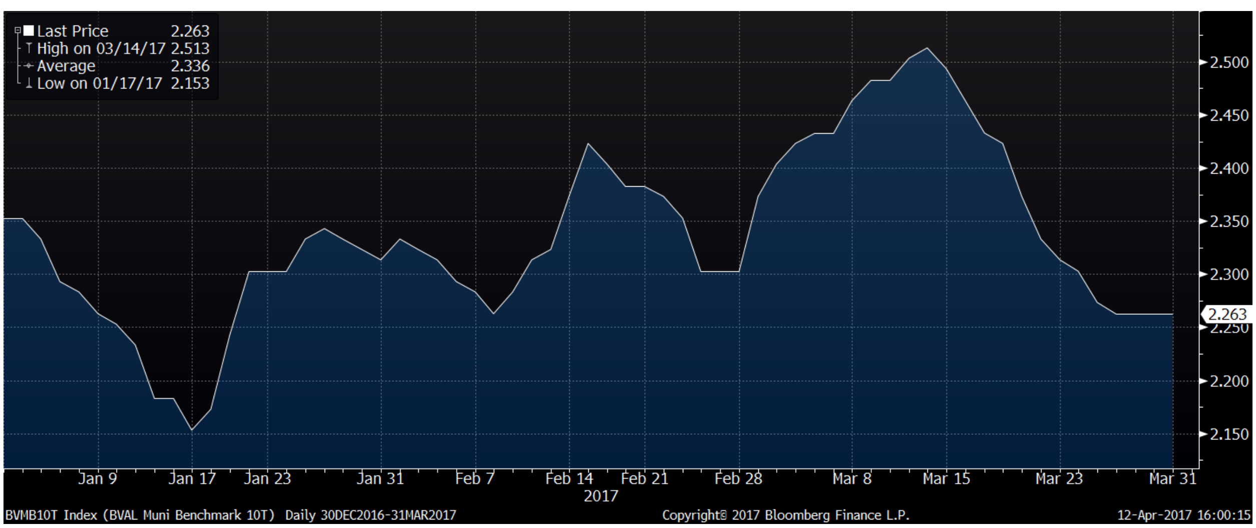
While April has shown to be a favorable month, May and June have been just the opposite. We all know the saying "Sell in May and Go Away" and the stats tend to prove that out. As summer kicks off and vacations start, it's common for volume to shrink and volatility to expand. We'll see what Q2 2017 has in store for equities.

The euphoria resulting from the anticipated pro-growth, infrastructure spending program and sweeping tax reform promised by President Trump has since turned into uncertainty after the administration notably failed to repeal Obamacare. As a result, the sharp post-election rise in interest rates caused by said euphoria calmed down during the first quarter of 2017. Once again, the many economists (armchair or otherwise) calling for a sustained period of rising interest rates were put on hold for yet another quarter.

Using the 10-year US treasury as a benchmark, interest rates during the first quarter started at 2.44%, bounced around and ultimately settled at 2.39% on March 31st.



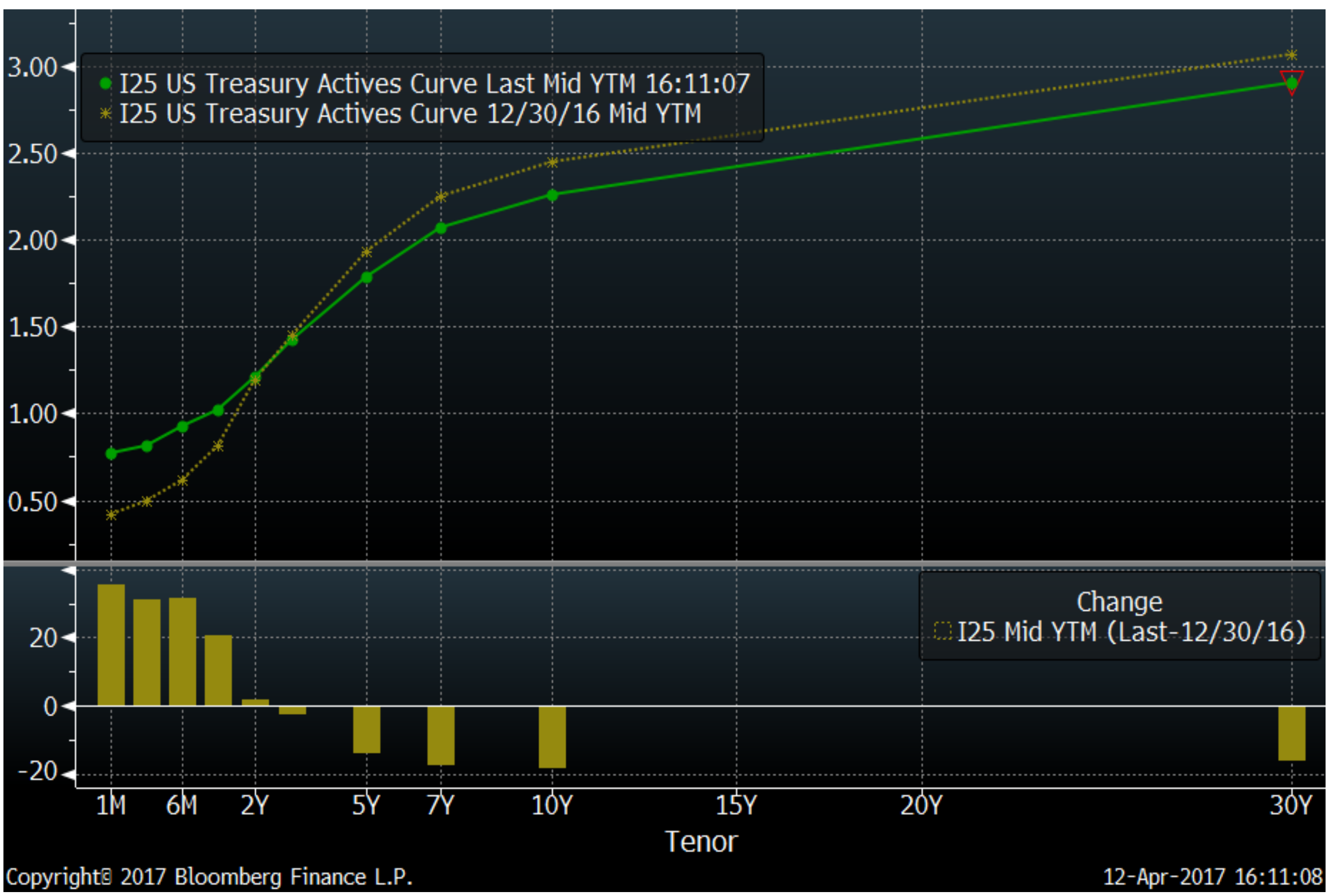
Similar movement took place in the municipal bond market, where tax reform's impact would be felt the most. The 10-year AAA municipal benchmark interest rate moved from 2.35% to 2.26%.



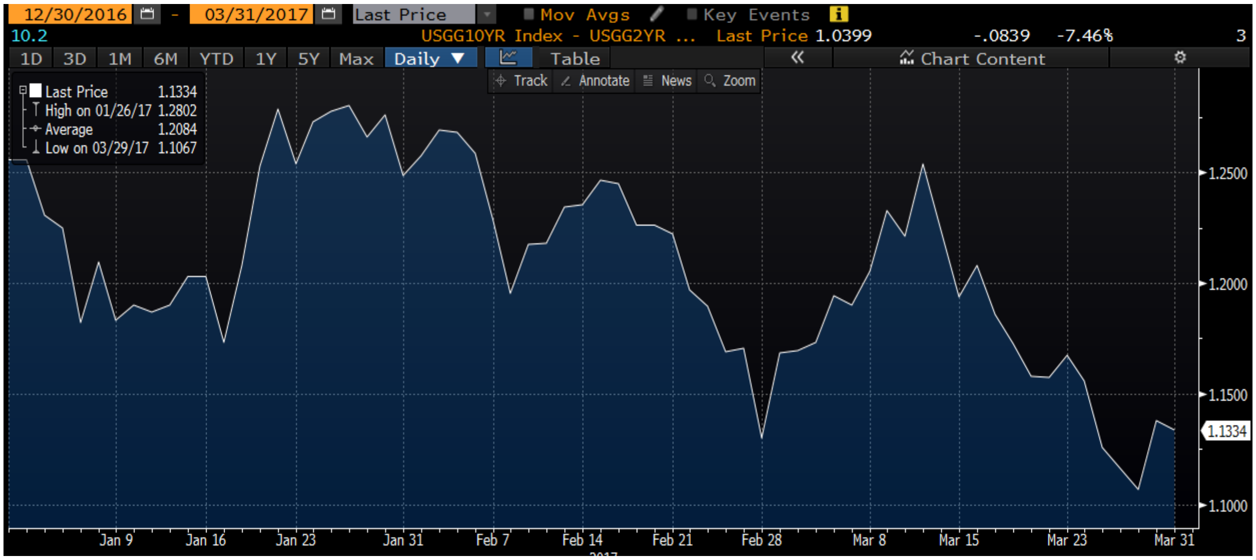
As widely expected, at their meeting on March 14th, the Fed raised the Federal Funds Rate to a target of 0.75% to 1%. However, the surprise came in the more dovish commentary (which is seen as a positive for bonds) during the ensuing press conference and the projections within. While 2 additional rate hikes were still projected for 2017, many market participants were expecting a more aggressive (hawkish) Fed to come out forecasting 3 more hikes.

This indication of a more dovish path caused a sharp drop in interest rates in the days and weeks after the meeting. Additionally, even just 2 more hikes might pose a challenge as the Atlanta Fed Forecast for Q1 2017 GDP growth continues to sink well below 1%.

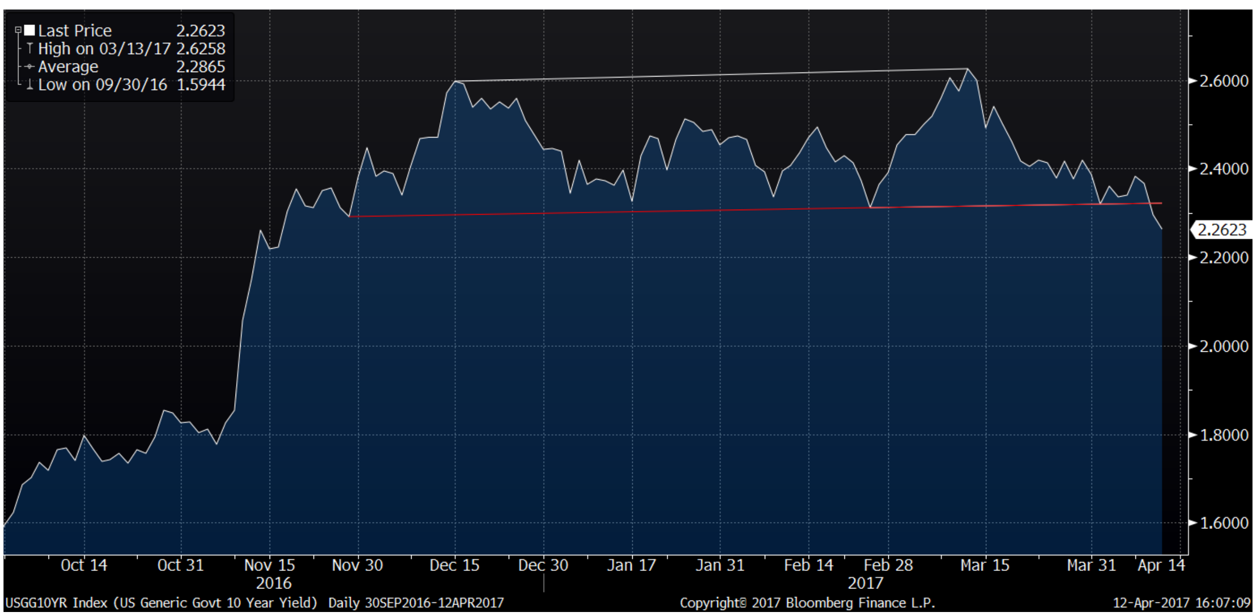
The Fed's activity, specifically the two most recent hikes in December 2016 and March, has caused a noticeable flattening of the yield curve. The green line in the chart below indicates where the yield curve is today, and the gold line indicates where the curve was at the end of 2016. Since the Fed sets their target rate on overnight loans they charge their member banks, their actions generally affect bonds with shorter maturities. Thus, short-term interest rates have risen due to the Fed's actions while longer-term interest rates have come down due to the aforementioned uncertainty regarding growth and tax reform. The steepest part of the curve continues to be approximately in the 3-10 year range. As a result, we continue to position our portfolios around this area of the curve, as we feel it offers favorable risk/reward characteristics and the most value.



Another common way to measure how much the yield curve has flattened is the difference in yield between the 2 year and 10 year treasuries. As seen below, that difference went from 1.25 to 1.13 during the first quarter.



From a technical perspective, the 10-year treasury rate has bounced around in the 2.30% to 2.60% range since the post-election spike. The below chart shows both a potential double top reached earlier this year in addition to the treasury breaking through an important resistance line of around 2.30%. The 10-year treasury continues to inch lower through the end of the quarter and into April.



Combine this with growing geopolitical uncertainty, Congressional gridlock and continued expectations of lower global growth, and the technicals and fundamentals for interest rates appear favorable to the downside (meaning bond prices increase) over the coming weeks and months.

Overall, commodities continue to behave as if they put in a long-term bottom back in early 2016. After a big push off that bottom over the first half of last year, they've remained range bound ever since. As illustrated by the chart of DBC below, it looks as if a move beyond the low 16's would be indicative of even more strength to come.

Of the more popular spaces in the commodities complex, gold and oil have generally managed to go along with the trend laid out above. Gold made highs of $1380 last June before falling all the way back to almost $1100 by year-end. So far, 2017 has featured a recovery for the yellow metal and a move above $1300 would be a positive sign. Similarly, oil looks to have put in a major bottom back in early 2016 after WTIC fell to almost $25 per barrel. Since then, it has battled along in the $40-50 range. Oil is by no means out of the woods after falling off a cliff in 2014 but perhaps the long-term, absolute lows are in.

Source: Stockcharts.com.

As mentioned in our Fixed Income Market Update, bond yields rose post-election in anticipation of sweeping tax reform, pro-growth policy, spending, and higher inflation. Those expectations stalled out a bit after the market realized that GDP growth would remain moderate at best and said policy changes coming out of Washington would be more difficult to activate than initially believed (see: failure of ACA repeal/replace legislation).

That being said, individuals/consumers appear to be the most optimistic they've been in many years. For instance, consumer confidence readings in March came in at the highest levels in 17 years. The Conference Board's Consumer Confidence Index hit 125.6, its highest mark since December 2000. People are also the most optimistic they've been about their job market and income growth opportunities in almost 15 years. The labor market continues to show improvement as well. Strong monthly job gains have dropped the national unemployment rate to 4.7%. These levels of positive economic sentiment have been missing for much of the run-up from the financial crisis.

Some other positive economic fundamentals to note:

- Jobless claims – Second lowest number in 43 years reflects an improving labor market
- New Home Sales trending higher
- Personal Income and Spending continue to improve
- ISM Services – 87th straight month of growth
- ISM Manufacturing – Feb was highest reading since August 2014
- The Conference Board Leading Economic Index (LEI) – Highest level in over a decade

What will be important going forward is to assess how the market reacts when we hit our next economic soft patch.

Also mentioned earlier, Janet Yellen and the Federal Reserve have reached a point where they appear comfortable with gradual increases to the federal funds rate. While they have maintained a dovish tone in their language, their optimism for the economy is clearly on the rise. Market participants currently anticipate two more hikes in 2017 along with the Fed continuing to taper its balance sheet. It will be interesting to see the path they take if economic growth experiences an unexpected hiccup at any point in 2017.

Looking globally, all eyes are on the upcoming European elections specifically the events unfolding in France. Current polling has centrist/independent Emmanuel Macron winning the presidency and defeating far-right populist Marine Le Pen but as we learned last fall, the pre-election polls must be taken with a grain of salt. The outcome in France along with Brexit/Article 50 being triggered in Great Britain are sure to have significant ramifications for the Eurozone and the global economy in general.

Our general belief continues to be that the market is in the midst of a long-term, secular rise. We view any near-term pullbacks to likely be an attractive buying opportunity. We opened with a quote from Howard Marks and believe it applies quite aptly to this environment. While many investors, for one reason or another, have been under-invested during the huge move off the 2009 bottom, we do not believe they've entirely missed their chance to capitalize on gains.

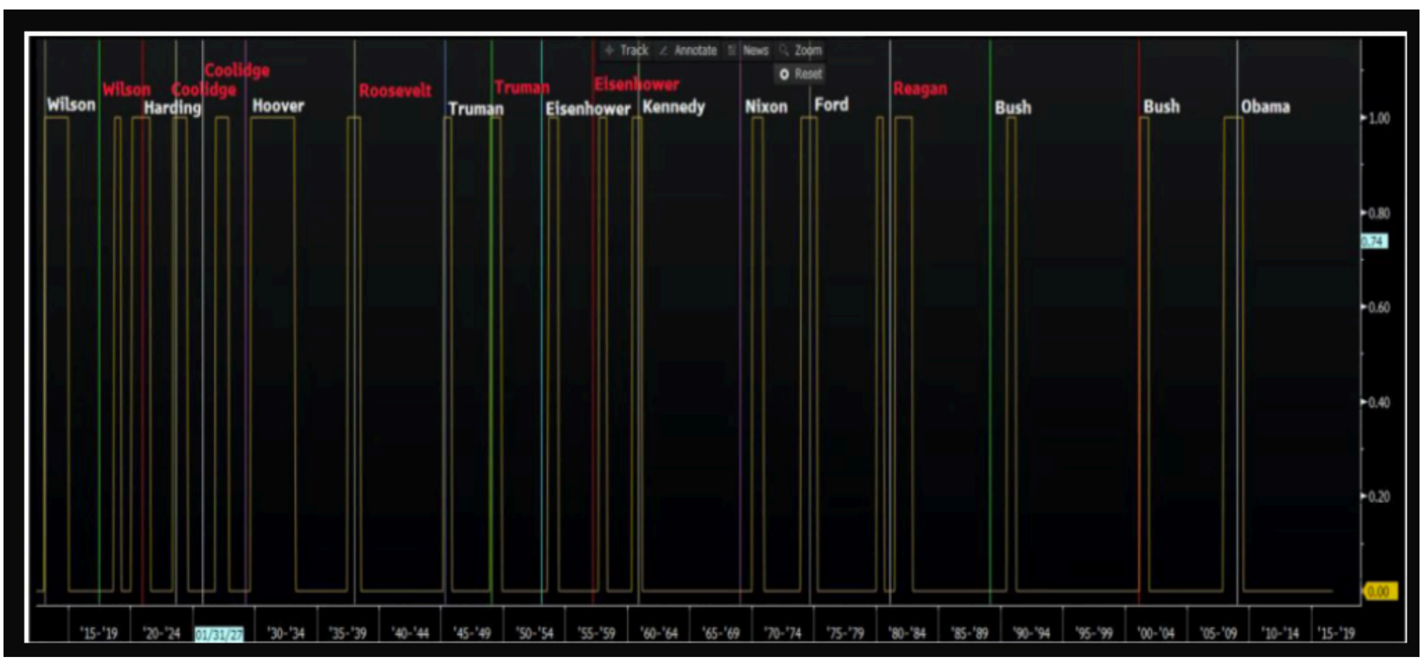
What will be important going forward is: **PATIENCE.** Investors must exhibit plenty of it as they await their chance to capitalize on attractive, long-term risk-reward opportunities. Perhaps they did underperform the market (or their next-door neighbor or their own expectations) in recent years but as Marks points out, "no one ever went bust from that."

We were recently reminded of another apt quote:

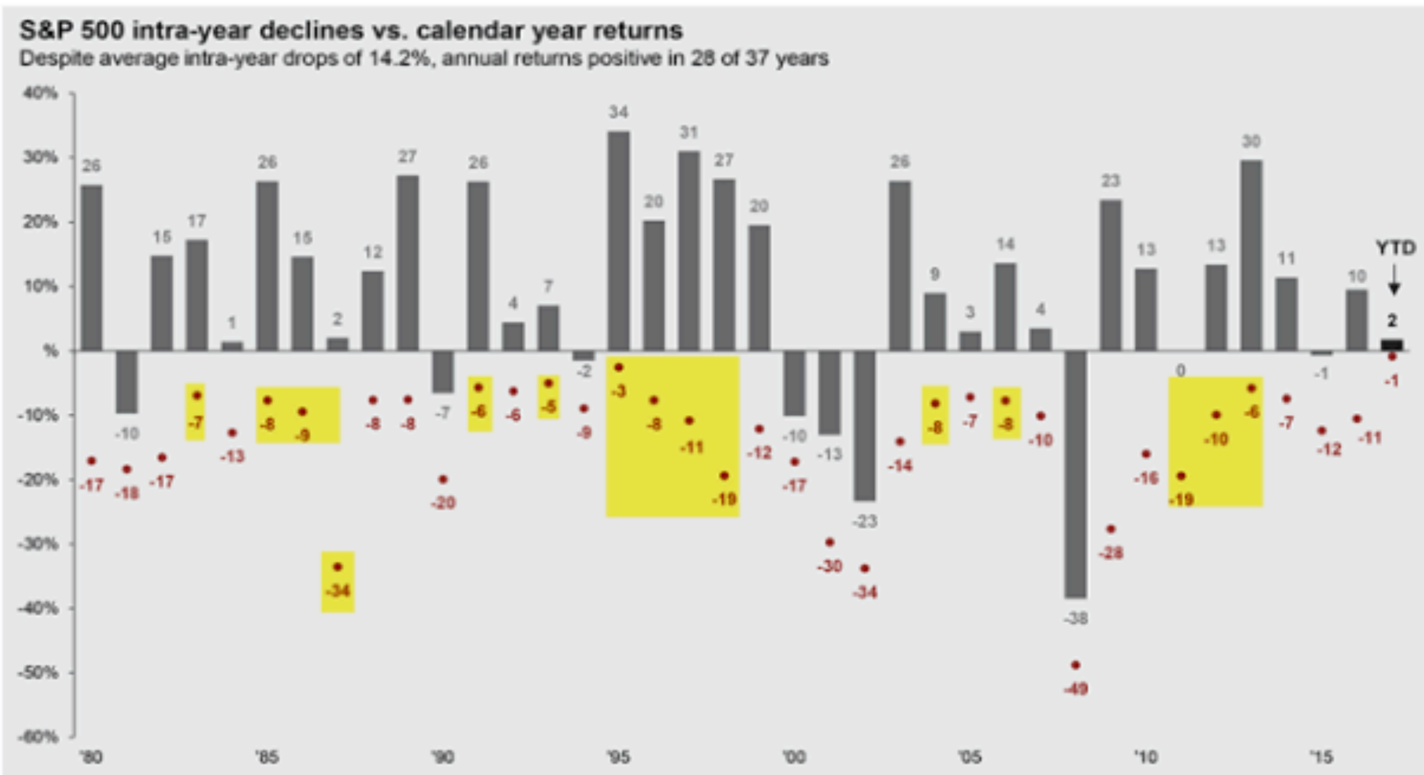
"Patience is not the ability to wait but the ability to keep a good attitude while waiting." –Joyce Meyer

Here's a little carrot of evidence on why investors must keep this frame of mind and remember that their opportunity will come. Raoul Pal of *The Global Macro Investor* recently offered a study showing that since 1910, "the US economy is either in recession or enters a recession within twelve months in every single instance at the end of a two-term presidency…effecting a 100% chance of recession for the new President. I then spent some time looking at US recessions in general, and found that every single one occurred during, or just after, an election, without exception."

He goes on to emphasize, "Every single US recession occurred around an election. Only two Presidents in history did not see a recession and they were inaugurated after single-term Presidents." The chart below shows every NBER recession since 1910. New Presidents after a two-term election are marked in white and new Presidents after a single-term presidency in red. Only Johnson and Clinton did not see a recession at all during their time in office.



Investors will be well served to have a coherent, long-term strategic vision regarding their investment portfolios over the coming years. Part of that vision will be the ability to exercise ***patience*** when implementing changes to their portfolios. Whether they've missed the entire stock market rally since 2009 or wildly outperformed the market, what's done is done and the past is the past. Their next best opportunity lay ahead of them and with a measure of patience, the market will grant them a chance to position wisely.



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2016, except for 2017, which is year to date.
Guide to the Markets – U.S. Data are as of January 31, 2017.

J.P.Morgan