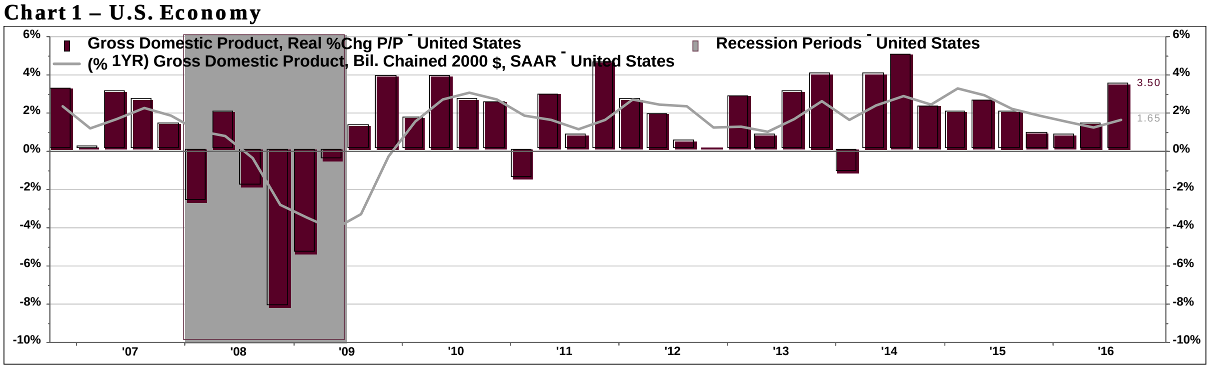
January 2017

THE ECONOMY

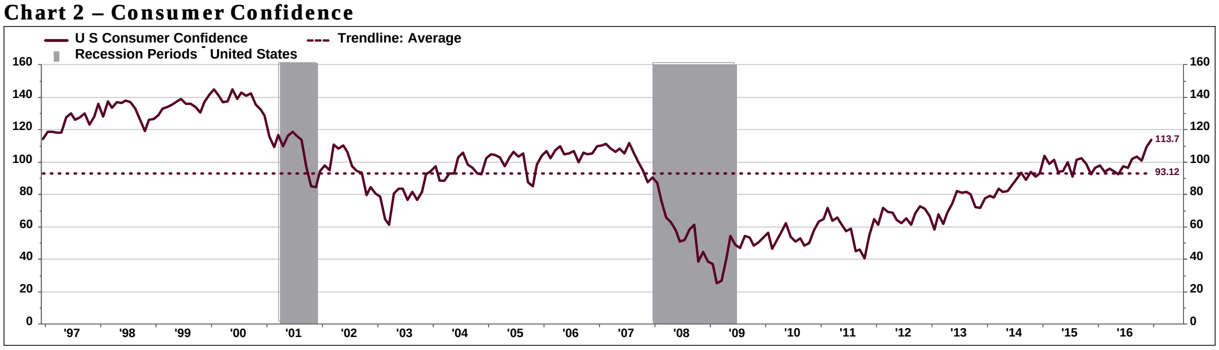
In third-quarter 2016, the third and final estimate reported by the U.S. Bureau of Economic Analysis showed the U.S. economy grew at an annualized rate of 3.5%, which is the fastest pace since third-quarter 2014. Moving into the fourth-quarter 2016, the presidential election—and all the prolific drama and outcome uncertainty—took center stage. Post-election, President-elect Trump's expected fiscal platform of lower taxes, less regulation, and stimulus spending propelled consumer confidence, business sentiment and the stock market significantly higher.

Chart 1 – U.S. Economy



Consumer confidence in November reached its highest level since July 2007 (111.9), coming in at a level of 109.4. The Conference Board November report cited "a more favorable assessment of current conditions coupled with a more optimistic short-term outlook helped boost confidence." In December, consumer confidence rose to 113.7, its highest level since August 2001 (114.0). The Conference Board December report cited "the post-election surge in optimism for the economy, jobs and income prospects, as well as for stock prices which reached a 13-year high; looking ahead to 2017, consumers' continued optimism will depend on whether or not their expectations are realized."

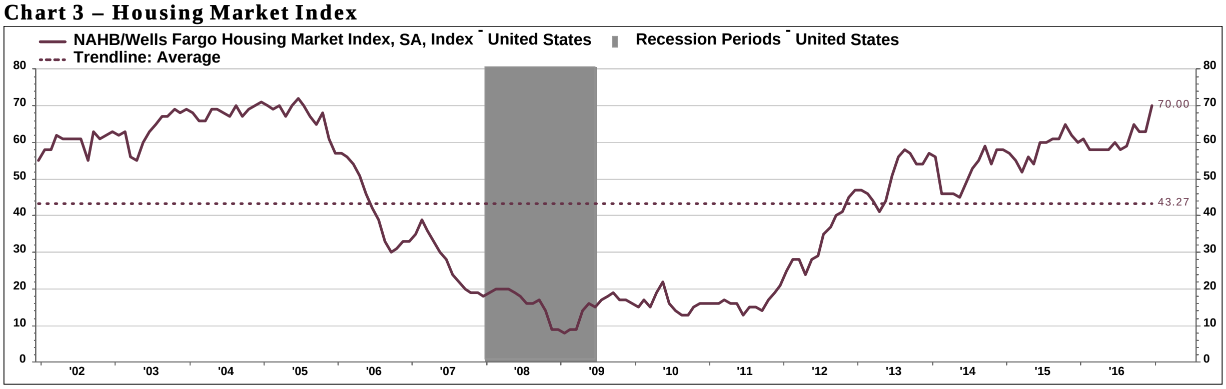
Chart 2 – Consumer Confidence



Economic optimism among small businesses and home builders rose sharply after the election. The National Federation of Independent Business (NFIB) November Small Business Optimism Index rose 3.5 points to a level of 98.4. NFIB Chief Economist William Dunkelberg said, "if higher optimism can be sustained, I expect that in the coming months we'll see an increase in business activity, such as hiring and expanding." NFIB President Juanita Duggan stated, "small business owners are clearly encouraged by the election results, but now it's time for President-elect Trump and congressional leaders to deliver. Federal taxes, regulations, and Obamacare are the three biggest impediments to running a small business in America. Small business owners have high expectations that those problems will be addressed."

The National Association of Home Builders' (NAHB) December Housing Market Index showed that builder confidence jumped seven points to a level of 70, the highest reading since July 2005. NAHB Chairman Ed Brady commented, "this notable rise in builder sentiment is largely attributable to a post-election bounce, as builders are hopeful that President-elect Trump will follow through on his pledge to cut burdensome regulations that are harming small businesses and housing affordability; a recent NAHB study shows that regulatory costs for home building have increased 29 percent in the past five years."

Chart 3 – Housing Market Index



While the U.S. economy has expanded for ten straight quarters, the pace of growth has been tepid to modest at best. It is clearly evident that consumer and business optimism and enthusiasm have risen post-election. There is anticipation that meaningful tax and health care reform, a significant reduction in oppressive regulations and an infrastructure stimulus spending package should result in higher long-term economic and employment growth.

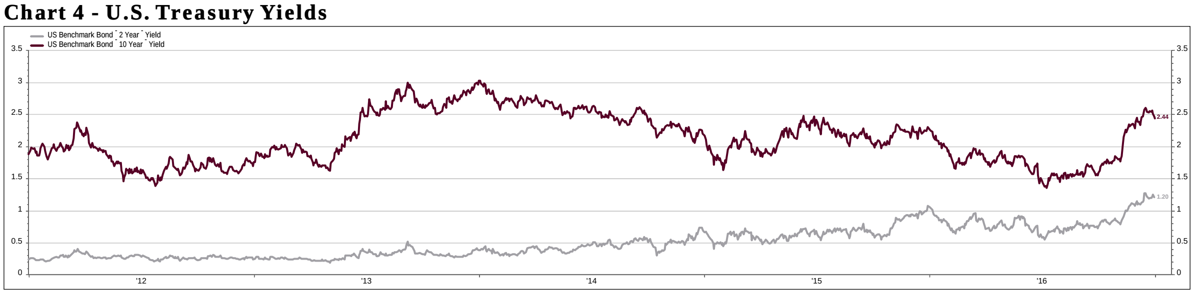
Economic projections have not moved much since the election, as economists are likely waiting to see which fiscal policies are ultimately passed and then adjust their outlooks accordingly. At present, the *FactSet* consensus estimate for 2016 and 2017 U.S. economy call for growth of 1.6% and 2.2% respectively. In mid-December, the Federal Reserve released their estimates for the U.S. economy, which showed expected growth of 1.9% in 2016 and 2.1% in 2017.

CAPITAL MARKETS

Last October, stock markets and the nation were mired in presidential uncertainty. It is probably safe to say that most of us were more than ready for the election cycle to come to a legally acceptable conclusion. As the polls tightened leading into the election, the level of uncertainty as to who was going to be the next president rose and, as you know, markets do not like uncertainty. Stock markets were under pressure in October and the S&P 500 experienced nine consecutive daily declines leading into election week.

The week of November 6, election week, was one for the history books. On Monday, November 7, the day after FBI Director James Comey cleared Hillary Clinton from further investigation, stock markets rallied on the expectation that she would be the likely winner. On Tuesday, November 8, as election results filtered in and it was slowly becoming clear that Donald Trump was gaining momentum, U.S. stock futures tanked—with the Dow Jones declining 800 points at one point—and the price of gold rallied. On Wednesday, November 9, the stock markets opened up under pressure, but slowly began to gain steam and ended the day in positive territory. Election week ended with a noteworthy stock market rally as well as a significant backup in bond yields. The S&P 500 Index rose +3.9%, the Dow Jones Industrial Average rose +5.5% and the small-cap Russell 2000 Index rose +10.3%. The bond market, especially the long-end of the curve, came under tremendous pressure as the ten-year Treasury yield rose 37 basis points to 2.15% and the yield curve spread between the two-year and ten-year Treasury increased by 26 basis points.

Chart 4 - U.S. Treasury Yields



Post-election market action serves as an indication of expected economic and inflation growth stemming from Trump's election fiscal platform as U.S. stocks continued to rally and bond yields continued to rise. As shown below in Table 1, domestic stocks continued to rally in November and December to finish the quarter—and the year—meaningfully higher. The risk trade was on as riskier assets classes performed the best.

Table 1 – Stock Index Total Returns as of December 30, 2016

Equity	1-Month	3-Month	YTD	1-Year	3-Year	5-Year	10-Year
Russell 2000	2.80	8.83	21.31	21.31	6.74	14.46	7.07
S&P 400	2.19	7.42	20.74	20.74	9.04	15.33	9.16
Dow Jones Industrial	3.44	8.66	16.50	16.50	8.71	12.92	7.52
S&P 500	1.98	3.82	11.96	11.96	8.87	14.66	6.95
MSCI Emerging	0.22	-4.16	11.19	11.19	-2.55	1.28	1.84
NASDAQ	1.19	1.66	8.87	8.87	10.14	17.07	9.51
MSCI Developed	3.42	-0.71	1.00	1.00	-1.60	6.53	0.75

As outlined in Table 2, there was clear sector rotation last quarter as investors favored cyclical stocks in lieu of defensive stocks, with the Financial sector being the favored upside outlier. Financials benefitted from the rise in yields, which should help their net interest margins, and from anticipation of regulatory relief from the Dodd Frank Act. Also of note was the creation of a Real Estate Investment Trusts (REIT) sector in the S&P 500 Index. REITs were broken out as a subindustry of the financial sector and now represent the eleventh sector within the S&P 500. The REIT sector comprises 2.9% of the S&P 500 Index.

Table 2 – S&P 500 Index Sector Total Returns as of 12/30/2016

Sector	1-Month	3-Month	YTD	1-Year	3-Year	5-Year	10-Year
Energy	1.92	7.28	27.36	27.36	-2.51	3.92	4.30
Telecommunications	8.12	4.78	23.49	23.49	9.56	11.64	6.39
Financials	3.90	21.10	22.80	22.80	11.68	19.47	-0.36
Industrials	0.51	7.21	18.86	18.86	8.36	15.60	7.79
Materials	0.12	4.70	16.69	16.69	4.55	10.54	6.06
Utilities	4.94	0.14	16.29	16.29	12.59	10.35	6.98
Information Technology	1.56	1.19	13.85	13.85	13.15	16.39	9.93
Consumer Discretionary	0.06	2.31	6.03	6.03	8.59	17.82	9.63
Consumer Staples	3.17	-2.02	5.38	5.38	9.22	12.73	10.14
Real Estate	4.35	-4.41	3.39	3.39	12.11	11.38	4.29
Health Care	0.73	-4.00	-2.69	-2.69	9.24	16.80	9.58

Bond returns for the year were essentially cut in half last quarter. As noted above, the ten-year Treasury ended election week at 2.15% and continued to rise during the quarter—and at one point reached as high as 2.60%. The ten-year Treasury ended the quarter at 2.44%.

Table 3 – Fixed Income Total Returns as of 12/30/2016

Fixed Income	1-Month	3-Month	YTD	1-Year	3-Year	5-Year	10-Year
Barclays High Yield	1.85	1.75	17.13	17.13	4.66	7.36	7.45
Barclays Aggregate	0.14	-2.98	2.65	2.65	3.03	2.23	4.34
Barclays Inter Gov't/Credit	0.07	-2.07	2.08	2.08	2.09	1.85	3.84
Barclays Municipal	1.17	-3.62	0.25	0.25	4.14	3.28	4.25
Barclays Michigan Muni	1.10	-3.45	0.23	0.23	4.53	3.62	
Barclays Municipal 5-Year	0.50	-2.63	-0.39	-0.39	1.73	1.79	3.74

Treasury yields were driven higher by a combination of inflation (from higher economic growth) and protectionism (from higher tariff prices) fears. Municipals were the worst performing bond sector for the quarter and the year. In September and well into October, municipal issuance increased significantly sending muni yields higher. Post-election pressure came from higher Treasury yields and tax-reform rhetoric.

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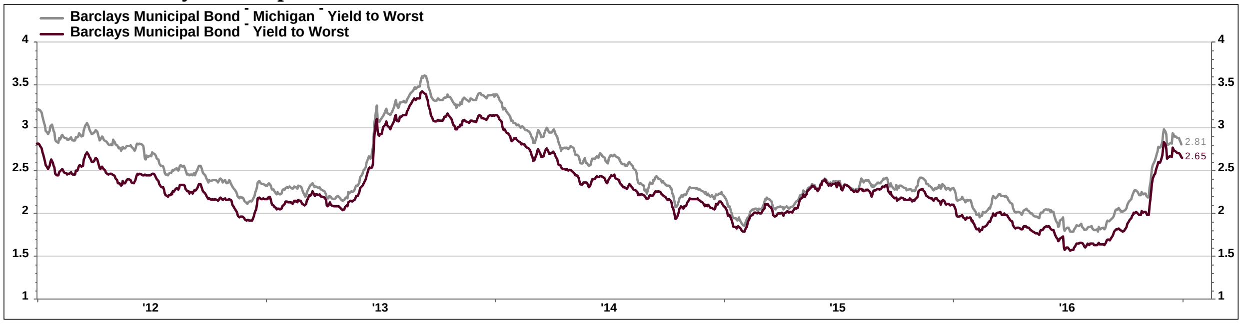
Chart 5 – Barclay Municipal Index Yields



Prior to the election, when looking at valuations on the S&P 500 Index, market participants had already priced in expected 2017 earnings growth and then some. Post-election, several stock market indices reached numerous new all-time highs, driven higher by expected fiscal reform of the new administration. Reality is going to quickly set in over the first few months of 2017 as to whether or not President-elect Trump will be able to implement his election platform fiscal policies or fail to live up to lofty sentiment and market expectations.

Prepared by Perry Adams, Senior Vice President/Director of Investments

Sources: FactSet, Barclays, U.S. Department of Commerce, U.S. Bureau of Economic Analysis, The Conference Board, National Association of Home Builders, National Federation of Independent Business