Monthly Economic Update: May 2017

HD VEST
FINANCIAL SERVICES®

U.S. Equity Returns

INDEX	May	3 Mo	1 Year	3 Year	5 Year	10 Year
Russell 1000 Value TR USD	-0.10	-1.30	14.66	7.70	14.67	5.15
Russell 1000 TR USD	1.28	2.41	17.48	9.83	15.37	7.01
Russell 1000 Growth TR USD	2.60	6.16	20.27	11.92	15.98	8.77
S&P 500 TR USD	1.41	2.57	17.47	10.14	15.42	6.94
Russell 2000 Value TR USD	-3.11	-3.56	21.00	7.34	13.67	5.31
Russell 2000 TR USD	-2.03	-0.83	20.36	8.00	14.04	6.40
Russell 2000 Growth TR USD	-0.91	2.11	19.71	8.59	14.36	7.39

For the month of May, markets were mixed despite data continuing to show economic and earnings growth. Major policy change expectations seem to have diminished due to continued controversies surrounding the Trump administration and infighting among various wings of the Republican party. Earnings and revenue continue to show growth as the number of companies in the S&P 500 beating EPS and revenue estimates are above 5 year averages. Over the past 3 months, large caps have outperformed small caps. The growth style indices continue to lead value style indices as we move near the end of the second quarter.

Returns as of 5/31/2017

Source: Morningstar Direct

International Equity Returns

INDEX	May	3 Mo	1 Year	3 Year	5 Year	10 Year
MSCI EAFE Value NR USD	2.32	7.38	18.44	-0.30	9.85	-0.11
MSCI EAFE NR USD	3.67	9.23	16.44	1.53	10.21	1.06
MSCI EAFE Growth NR USD	5.07	11.16	14.40	3.29	10.49	2.15
MSCI AC Europe NR USD	4.62	12.61	17.04	-0.19	10.25	0.50
MSCI Japan NR USD	3.01	3.71	15.02	6.97	10.43	1.07
MSCI United Kingdom NR USD	4.62	8.57	11.44	-2.12	7.15	0.58
MSCI Portugal NR USD	9.30	17.54	19.58	-11.31	2.14	-8.50
MSCI Ireland NR USD	1.94	9.35	4.11	3.13	13.21	-8.82
MSCI Italy NR USD	5.34	17.68	17.51	-6.30	8.96	-6.24
MSCI Greece NR USD	13.89	28.78	6.59	-38.29	-11.86	-27.58
MSCI Spain NR USD	4.66	21.64	26.44	-3.27	14.10	-1.32
MSCI EM NR USD	2.96	7.87	27.41	1.62	4.54	2.28
MSCI Brazil NR USD	-5.01	-9.33	42.21	-5.73	-4.18	-1.34
MSCI Russia NR USD	-6.29	-4.49	17.39	-4.88	-0.96	-4.45
MSCI China NR USD	5.28	10.39	30.60	8.38	8.90	4.94
MSCI India NR USD	1.76	9.92	19.97	5.91	10.78	3.22

The status of trade agreements appears to be one of renegotiation as opposed to revocation. Improving growth estimates for economies outside of the U.S. as well as the U.S. dollar slightly weakening, which provided favorable currency translation effects, led to generally stronger relative returns for international markets.

Selected emerging markets have outperformed developed markets but overall emerging and developed markets have had similar returns.

Returns as of 5/31/2017

Source: Morningstar Direct

Fixed Income Returns

INDEX	May	3 Mo	1 Year	3 Year	5 Year	10 Year
Barclays US Aggregate 1-3 Yr TR USD	0.17	0.42	1.02	0.97	0.98	2.43
Barclays US Agg Bond TR USD	0.77	1.49	1.58	2.53	2.24	4.46
Barclays Global Aggregate TR USD	1.55	2.85	0.77	-0.08	0.89	3.66
Citi WGBI USD	1.71	3.18	-0.46	-0.69	-0.16	3.44
Barclays US Corporate High Yield TR USD	0.87	1.81	13.58	4.73	7.31	7.46
Credit Suisse Leveraged Loan TR USD	0.38	0.90	7.59	3.72	5.00	4.20
Barclays Municipal 1-3 Yr TR USD	0.29	0.48	0.96	0.85	0.93	2.13
Barclays Municipal Interm 5-10 Yr TR	1.49	2.62	1.72	3.04	2.89	4.75
Barclays Municipal TR USD	1.59	2.55	1.46	3.49	3.31	4.58
Barclays HY Muni TR USD	1.53	2.45	4.60	5.06	5.42	4.46

Since December, rates have remained relatively steady with the 10-year treasury rate trading in a narrow range from 2.15% to 2.6%. May saw another small decline in the 10-year Treasury rate as the 10-year started May with a 2.28% rate and finished with a 2.15% rate. That rate has changed little over the previous 3 months. As the next slide shows, credit spreads were slightly narrower for the month, resulting in positive returns on the US Aggregate and marginally stronger returns for the High Yield index. For the trailing three months, fixed income indices were positive, with outperformance in lower credit qualities.

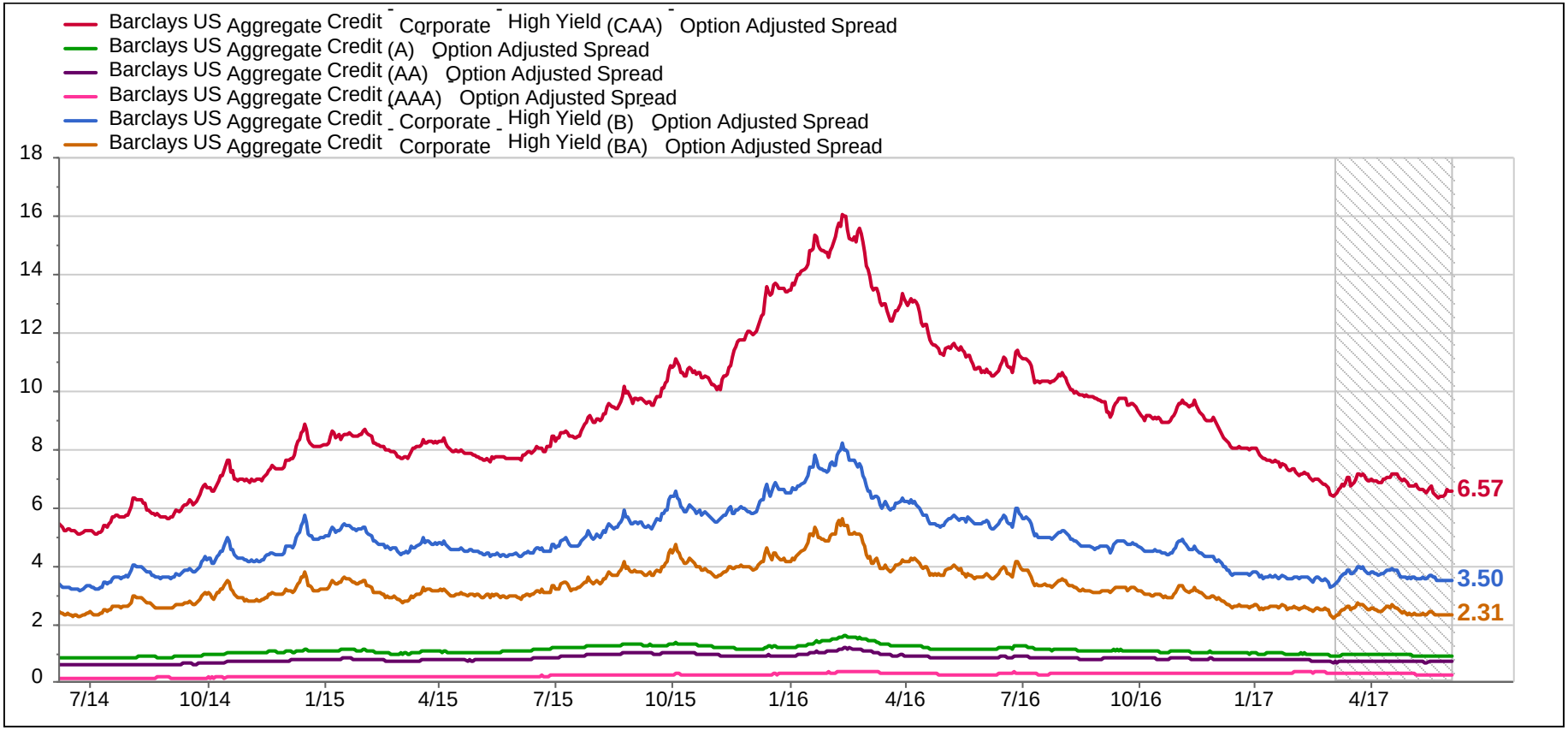
Municipal debt was positive again. Intermediate-term municipals were the strongest relative performer for the month as rates slightly declined during May. Within municipals, the strongest relative performer for the last three months has been intermediate municipals.

Returns as of 5/31/2017

Source: Morningstar Direct

Corporate Spreads vs. U.S. Treasuries

Chart reflects option adjusted spreads of AAA through CAA U.S. corporate bonds.



Credit spreads narrowed slightly during May bringing them closer to the March lows. Higher credit qualities where mostly unchanged. In aggregate, spreads were little changed over the proceeding three months, resulting in positive returns to credit over that time frame.

Source: FactSet as of 6/6/2017

Real Asset Returns

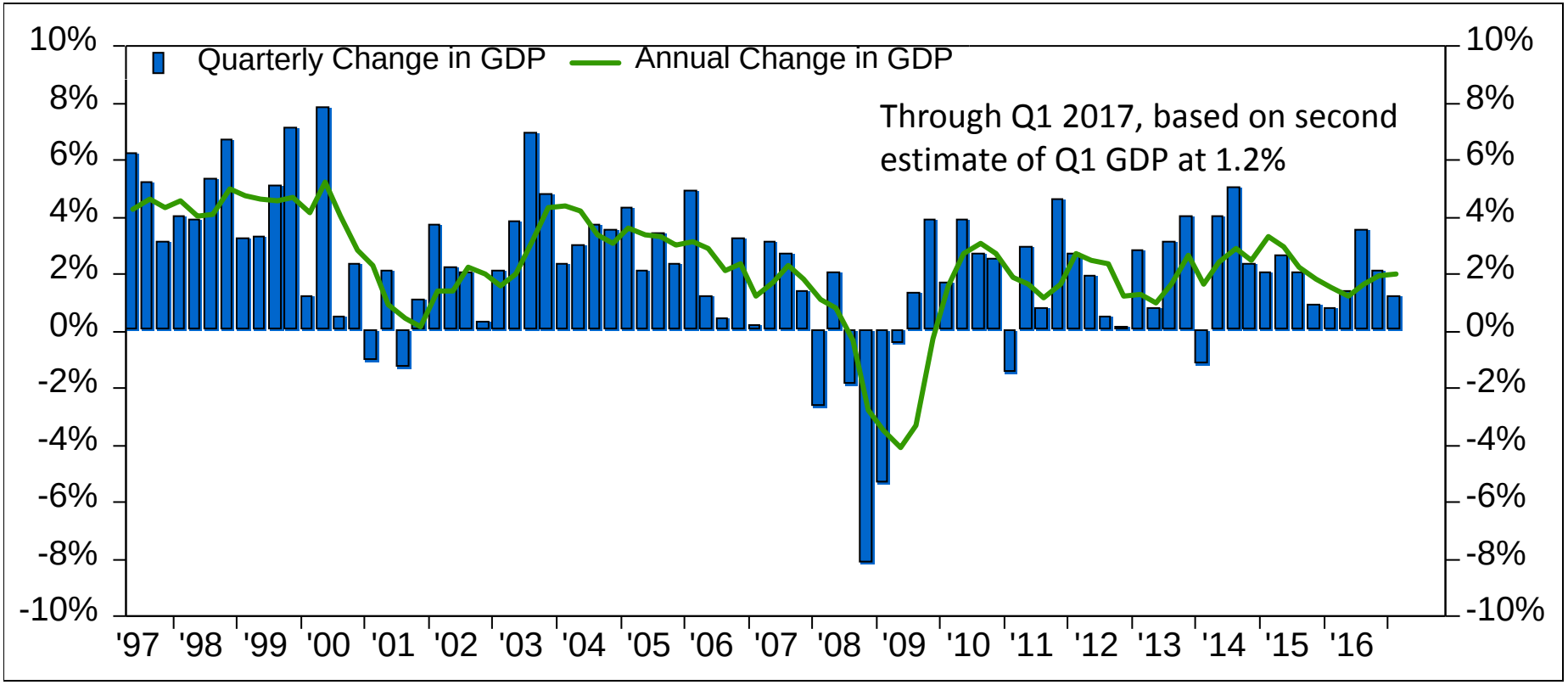
INDEX	May	3 Mo	1 Year	3 Year	5 Year	10 Year
DJ Gbl Select REIT TR USD	0.25	-1.18	1.05	5.91	9.65	2.71
DJ US Select REIT TR USD	-0.55	-3.58	1.40	7.48	9.65	4.14
Bloomberg Commodity TR USD	-1.33	-5.40	-2.45	-14.58	-8.24	-6.61
Alerian MLP TR USD	-4.52	-6.97	6.24	-9.32	2.57	5.90

Global REITs were positive for the month, while US REITS, commodities, and the MLP index were negative. Active managers with a global mandate generally outperformed REIT indices as measured by Morningstar category averages.

Returns as of 5/31/2017

Source: Morningstar Direct

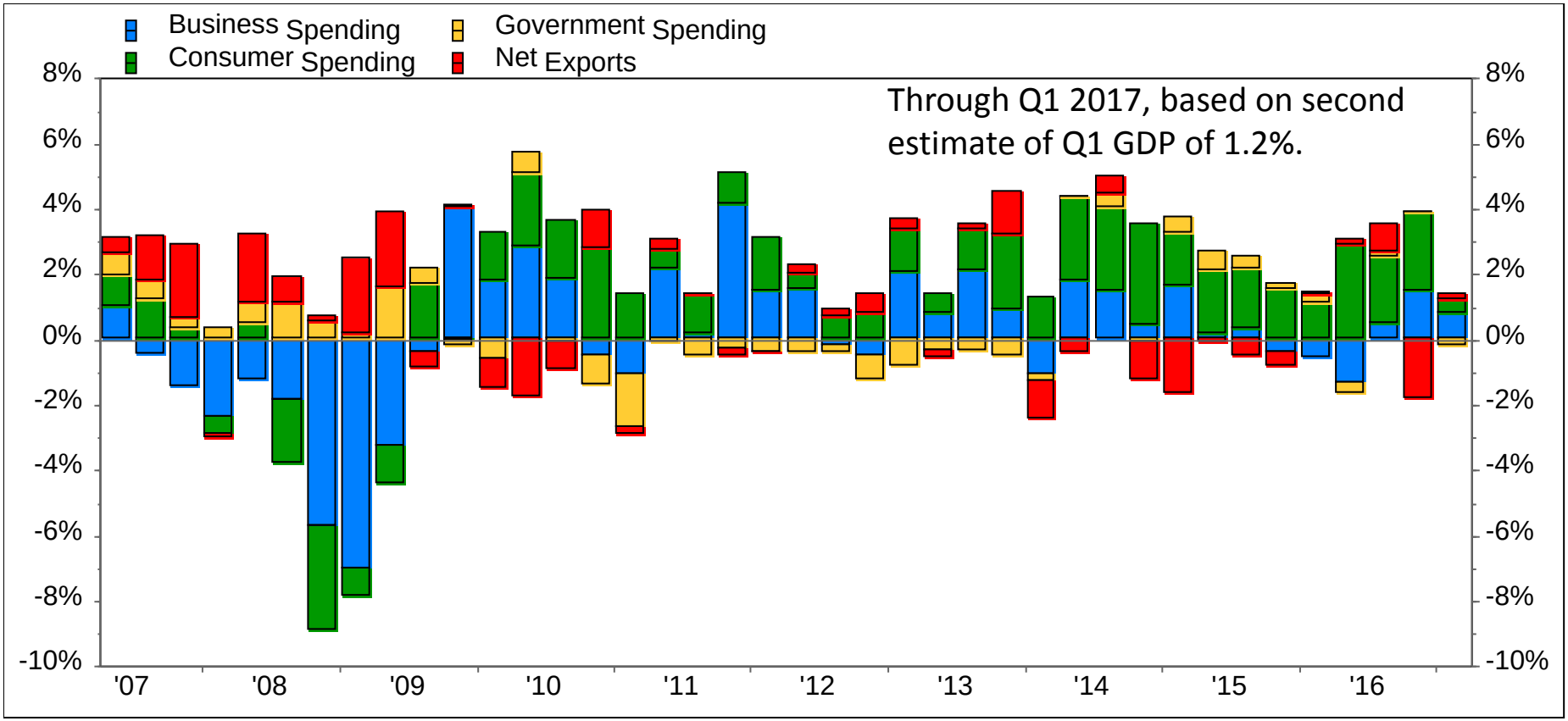
GDP Growth



The second estimate of first quarter GDP came in at 1.2% which was above expectations for a 0.8% growth rate. The average growth rate for the year was 2% which was consistent with the first estimate. GDP Growth for 2017 is expected to average 2.2% while expectations for 2018 are for it to average 2.5% before falling back to a 2.1% growth rate in 2019.

Source: FactSet

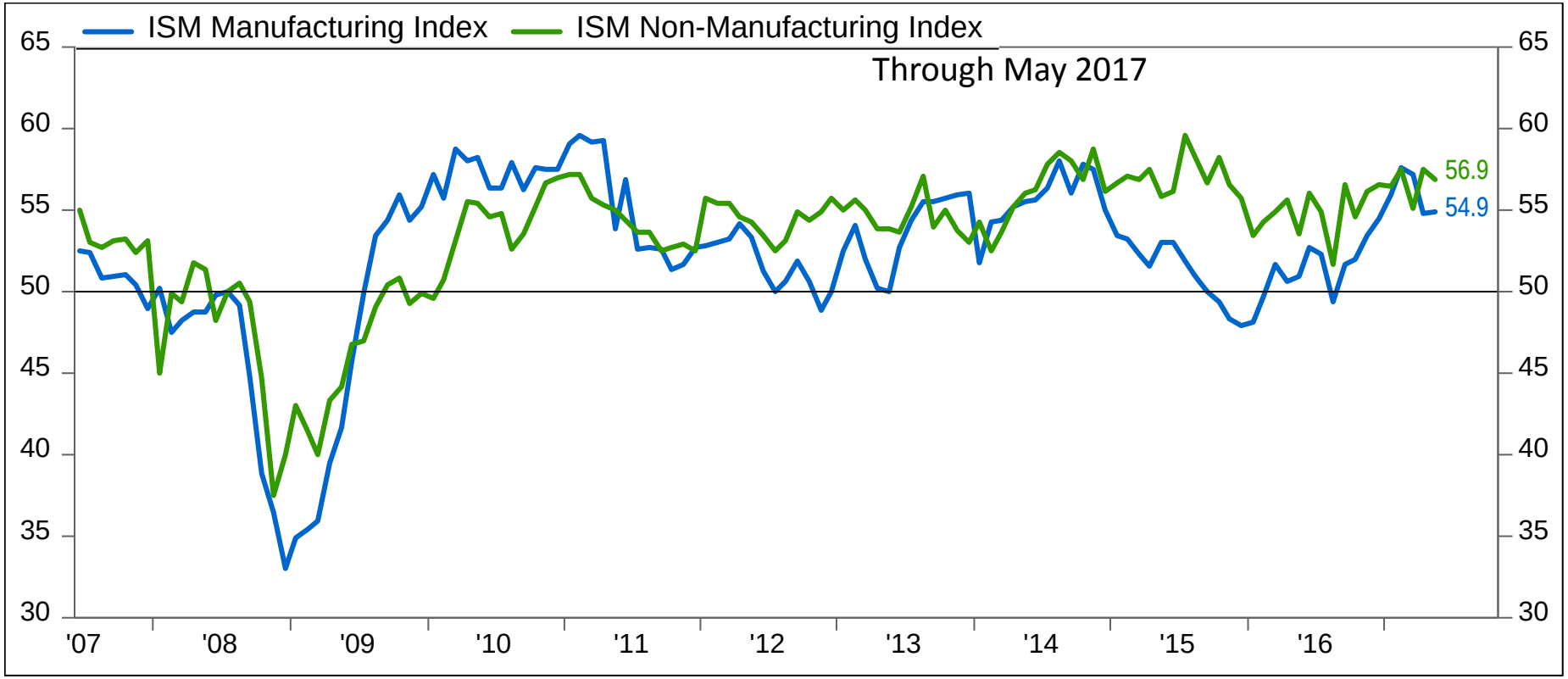
Contribution to GDP Growth



Q1 GDP first revision saw upward revisions in nonresidential fixed investment, consumer spending, and government spending. This was partially offset by a downward revision to private inventory investment.

Source: FactSet

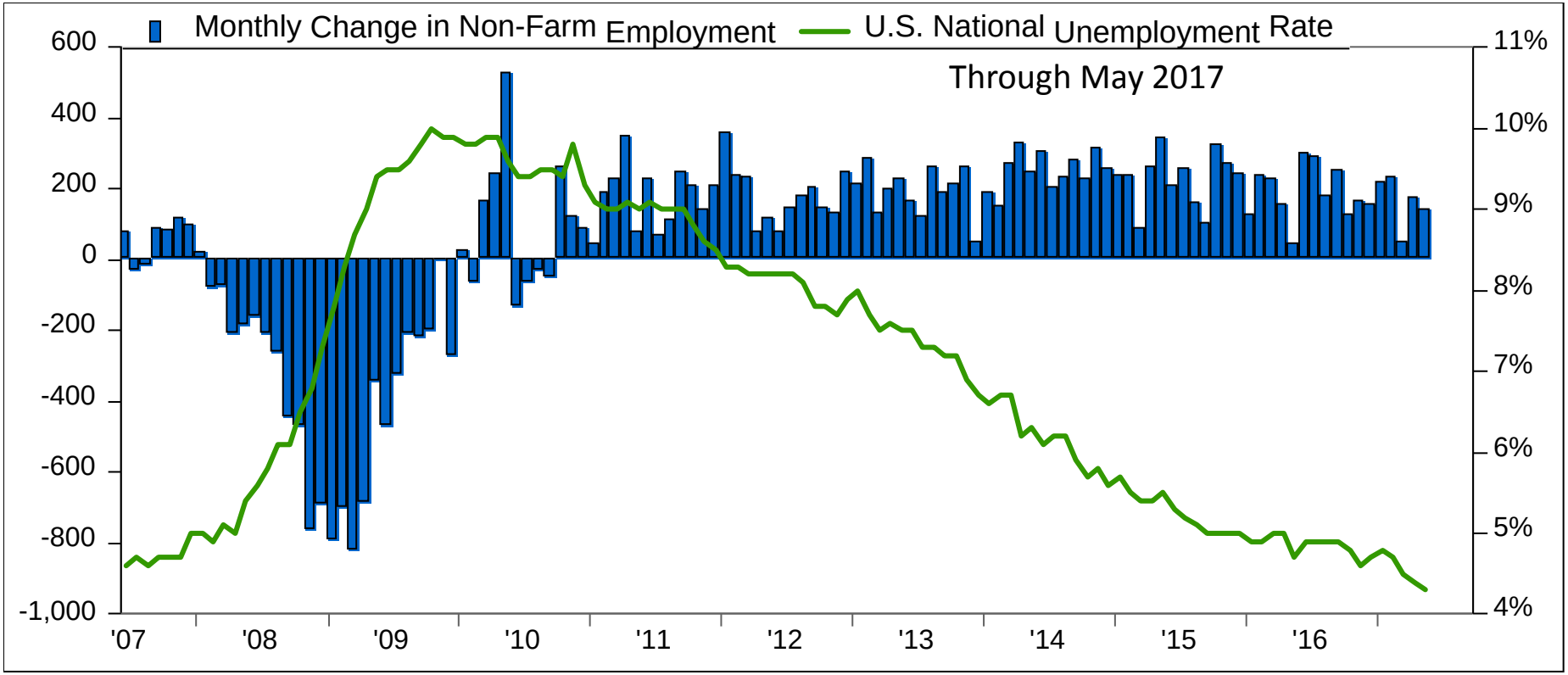
ISM Manufacturing and Non-Manufacturing Indices



The Manufacturing recovery continues as the ISM Manufacturing index remained in expansionary territory with a 54.9 reading The Service index remained in robust expansionary territory with a 56.9 print which was a decrease from the previous month's 57.5 value. Both levels are indicative of continuing growth.

Source: FactSet

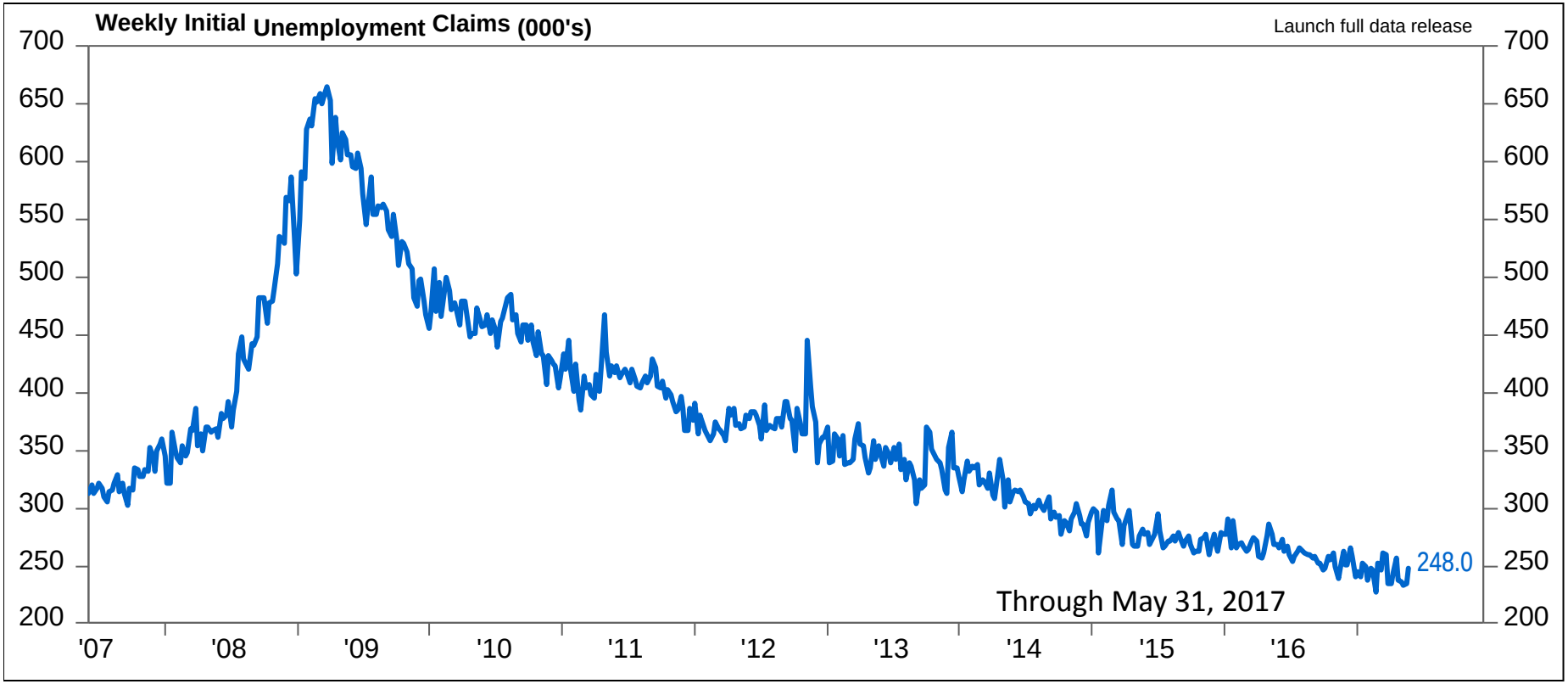
Non-Farm Payrolls and the Unemployment Rate



The May employment report came in below estimates as the economy added 138,000 jobs. This has brought the 3 month average down to an addition of 121,000 jobs per month. The overall unemployment rate declined to 4.3% which is the lowest rate the economy has seen since 2001. Beyond monthly payrolls and the unemployment rate, other signs of continuing tightening of the labor market includes rising wages and record job openings.

Source: FactSet

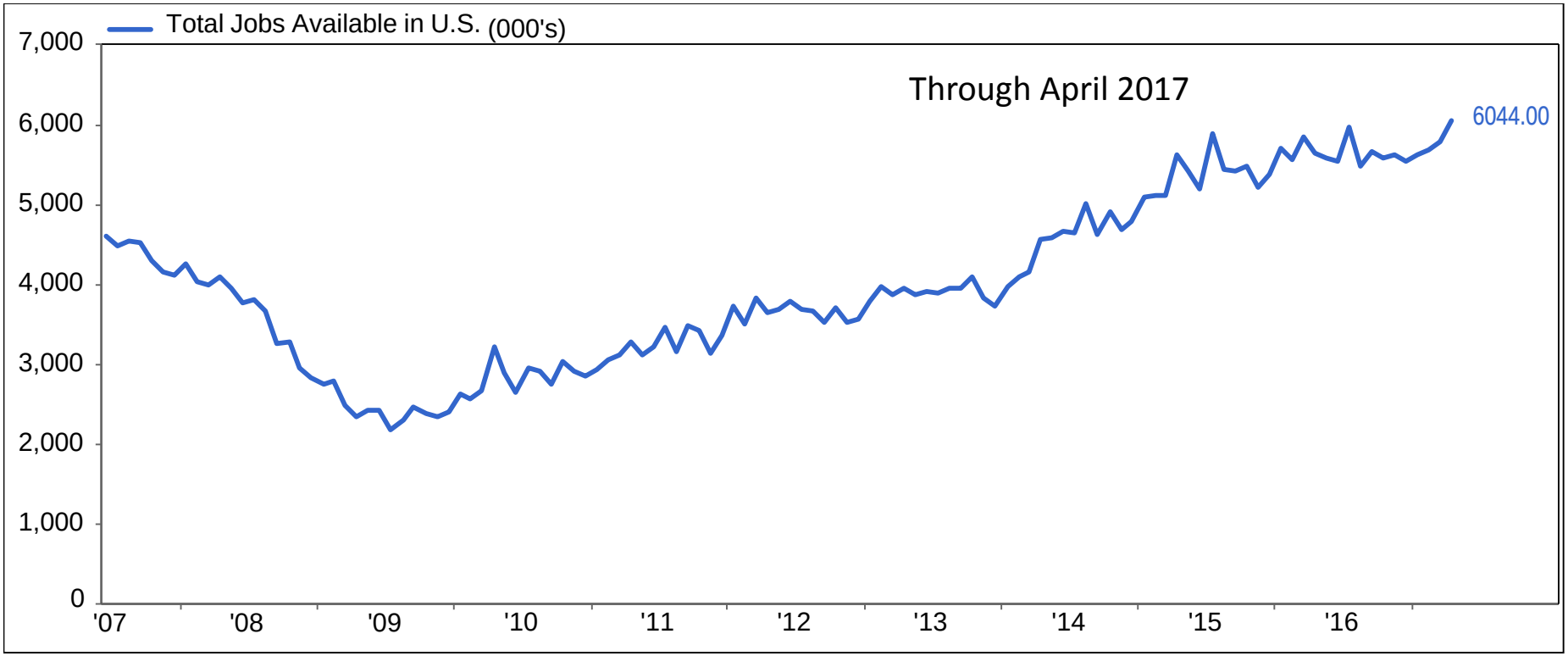
New Unemployment Filings



Over the last few years we have noted that new unemployment filings have continued to oscillate between 250,000 and 300,000 and that reports have not been significant as none have represented an outlier and all have been consistent with an improving labor market. The report has recently broken out to the downside, with a reading of 248,000 new claims in May. New filings have increased in late May after coming into the month at levels below 250,000.

Source: FactSet

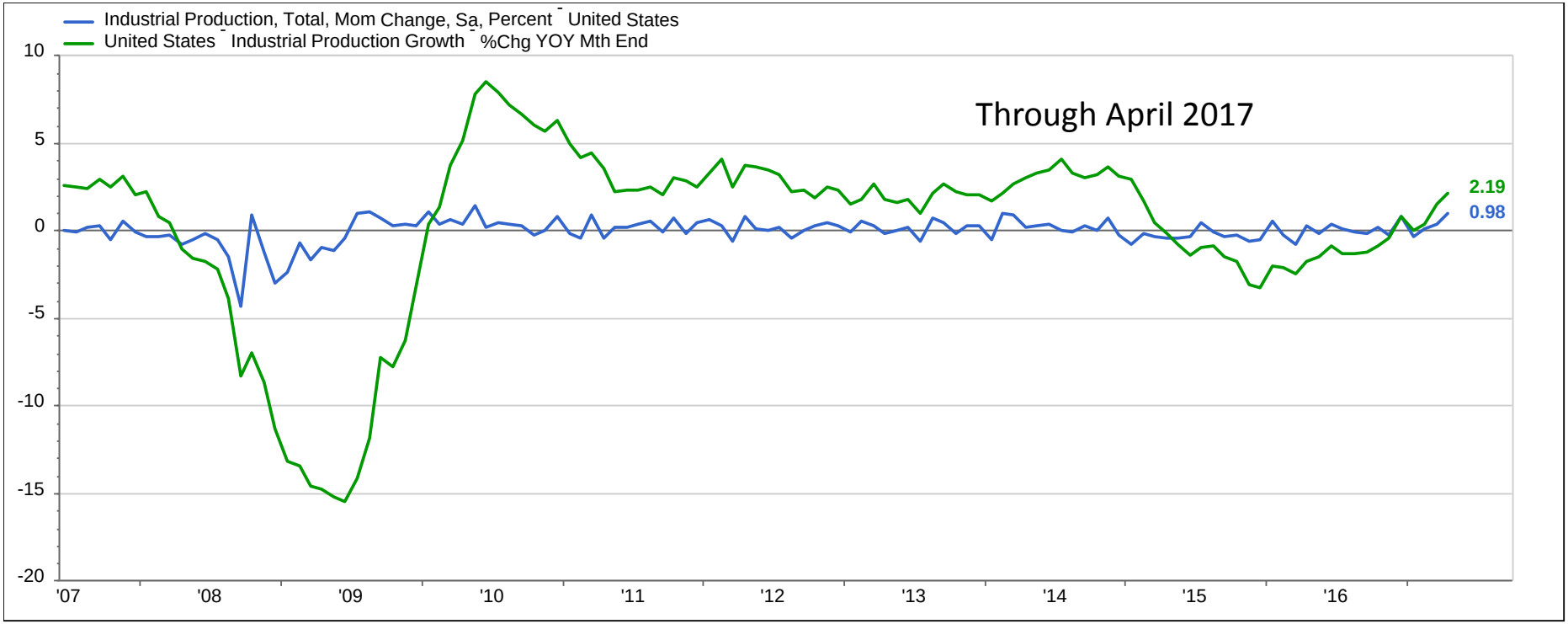
Job Openings and Labor Turnover Survey (JOLTS) Report



The latest available government JOLTS report (which tracks the number of jobs available in the economy) increased to 6 million jobs. As stated previously, that level is consistent with continuing strength in labor markets. Notably, the index appears to have breached a plateau in the mid-5-6 million jobs level.

Source: FactSet

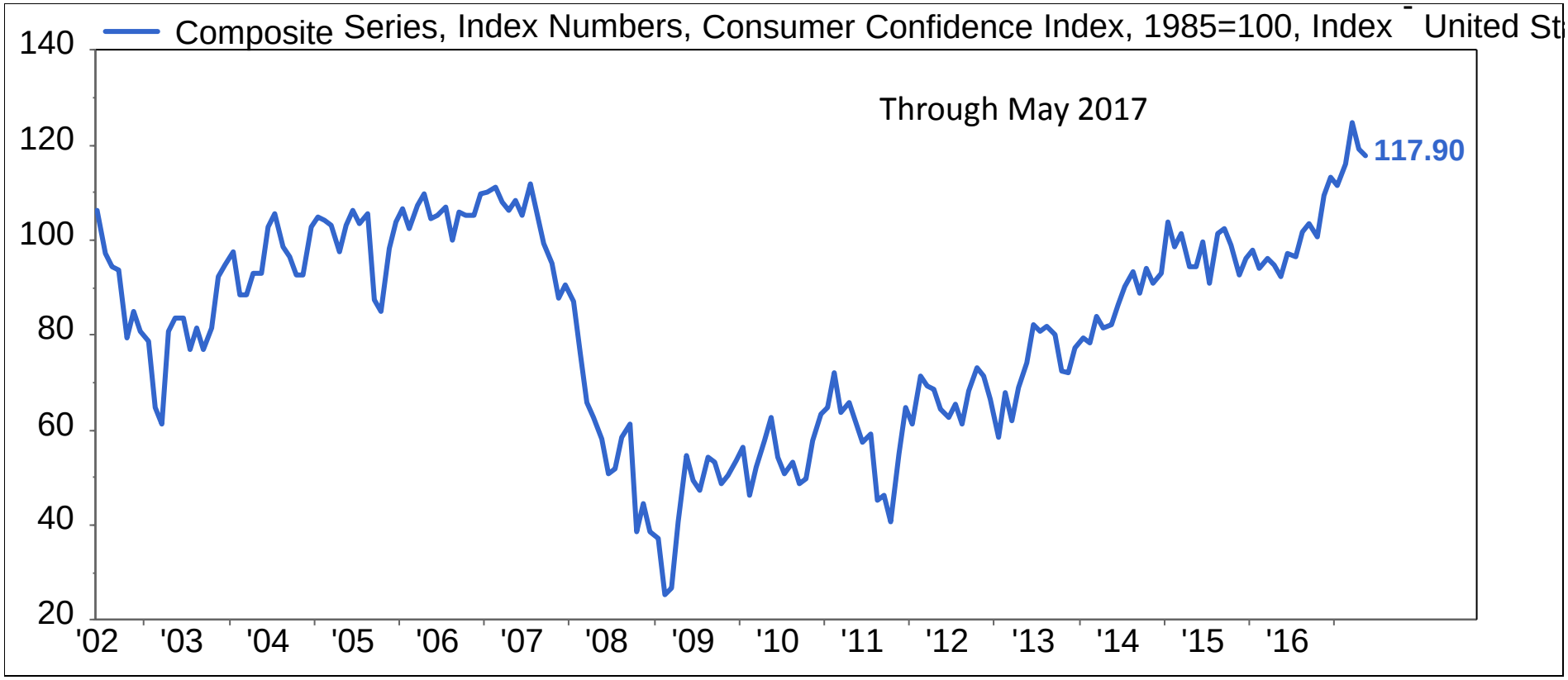
Industrial Production



Month-over-month and year-over-year Industrial Production remained slightly positive territory in April. The current absolute level of growth is neither good nor bad, but the overall trend appears to be improving. The question is whether industrial production can break out to the upside. The recent increase in the year over year growth rate is encouraging.

Source: FactSet

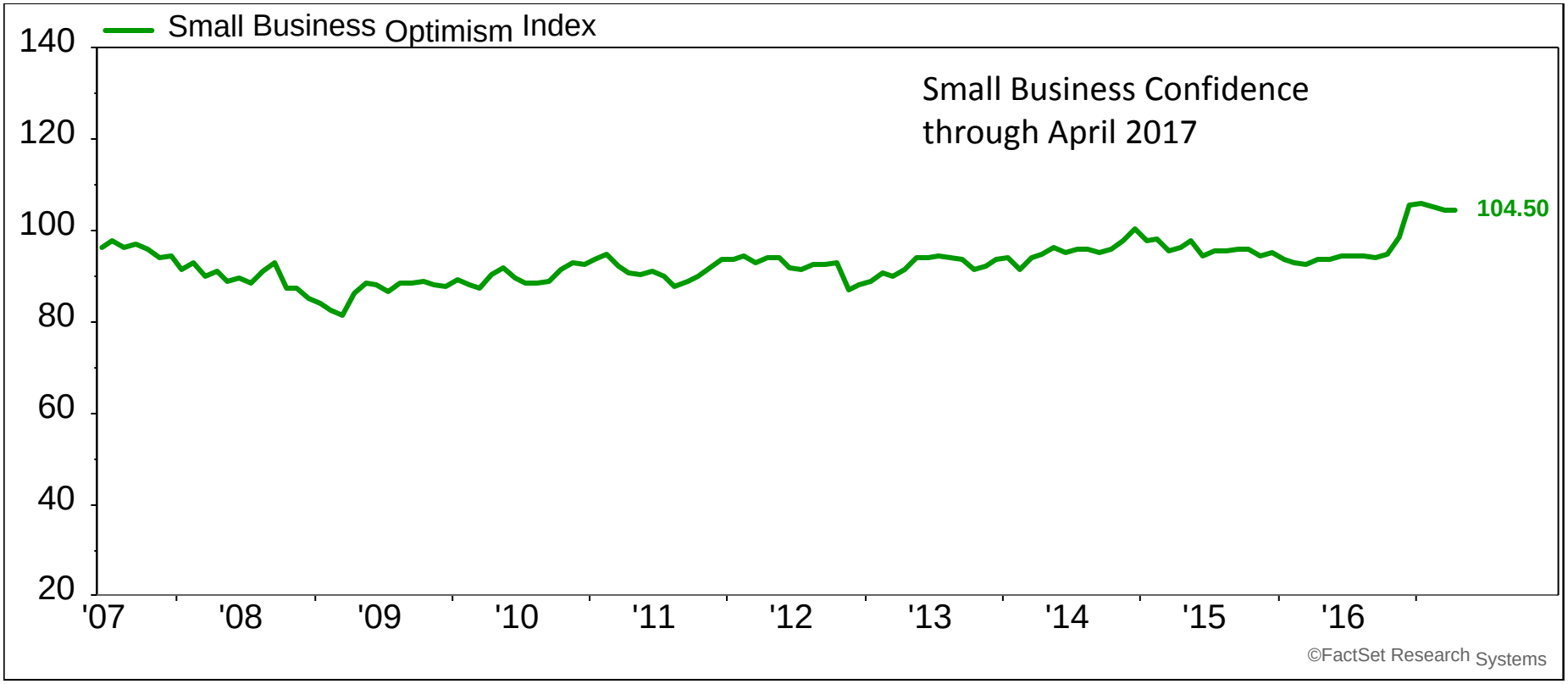
Conference Board Survey of Consumer Confidence



Consumer Confidence had been climbing since the bottom of the recession in 2009. Following the election, the pace of improvement has broken out above trend. Given the highly partisan atmosphere and seemingly divided nation, it is curious that consumer confidence keeps climbing. Reviewing the components of the survey, the drop from last month's reading is a result of consumers being less optimistic about conditions improving over the next 6 months.

Source: FactSet

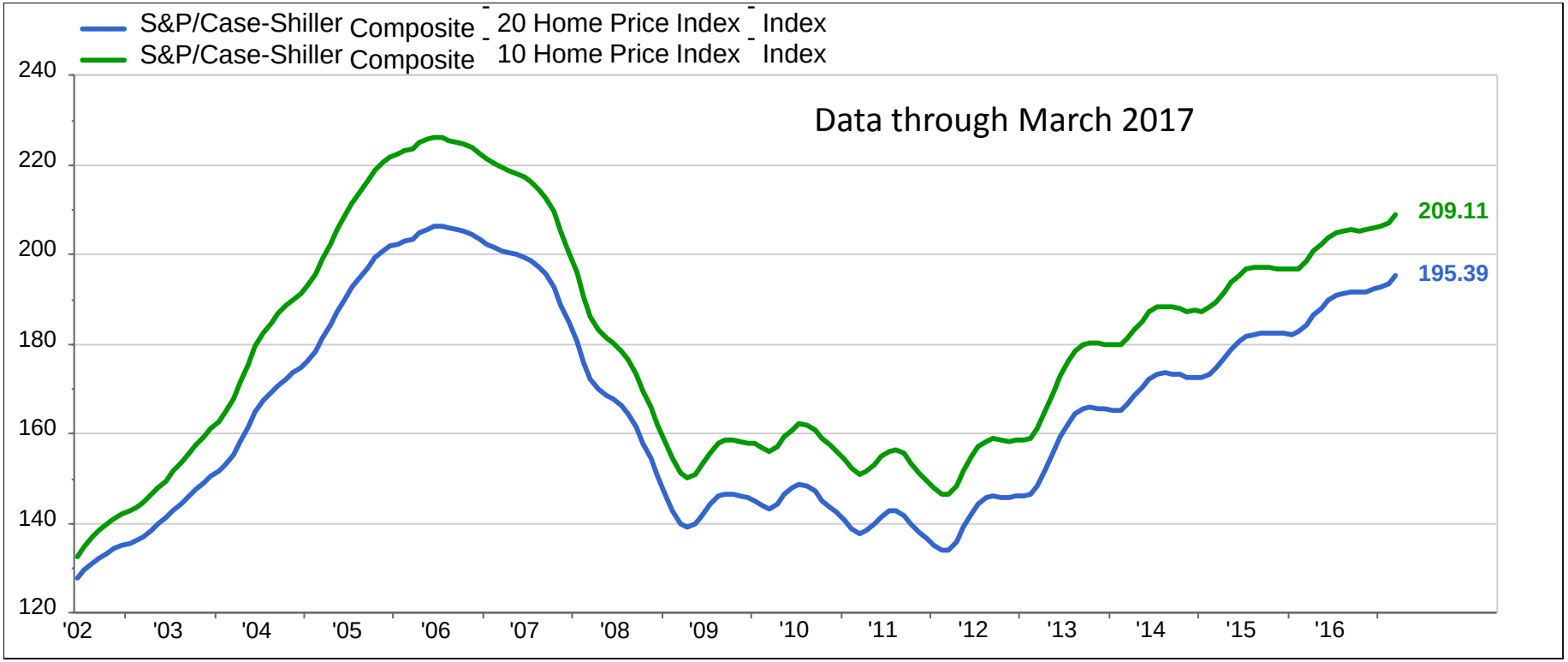
Small Business Confidence Indices



The April data for small business remains near its highest level in recent years. The index has dipped slightly due to congress failing to repeal and replace the ACA.

Source: FactSet

Home Prices



Home prices have continued to recover in line with sales volumes. The important thing to watch as interest rates move up is whether it has a dampening effect on home prices. There may be an initial increase as buyers look to buy before interest rates move too far. The indices above are as of March and so far do not show an impact of the bump in mortgage interest rates as we haven't seen rates really increase despite a hike from the Federal Reserve.

Source: FactSet

S&P 500 vs. S&P 500 EPS

FactSet EPS numbers generally include both actual reported earnings and consensus expectations for earnings for companies which have not yet reported for the period. As the graph above shows, earnings climbed through Q117 relative to 2016. The year over year blended earnings growth rate (combination of reported earnings and expectation for remaining companies) for Q1 is 14% which is the highest growth since Q3 of 2011. Importantly, unlike earnings growth early in the recovery which was driven primarily by margin expansion, the quarterly growth has been driven largely by revenue growth.

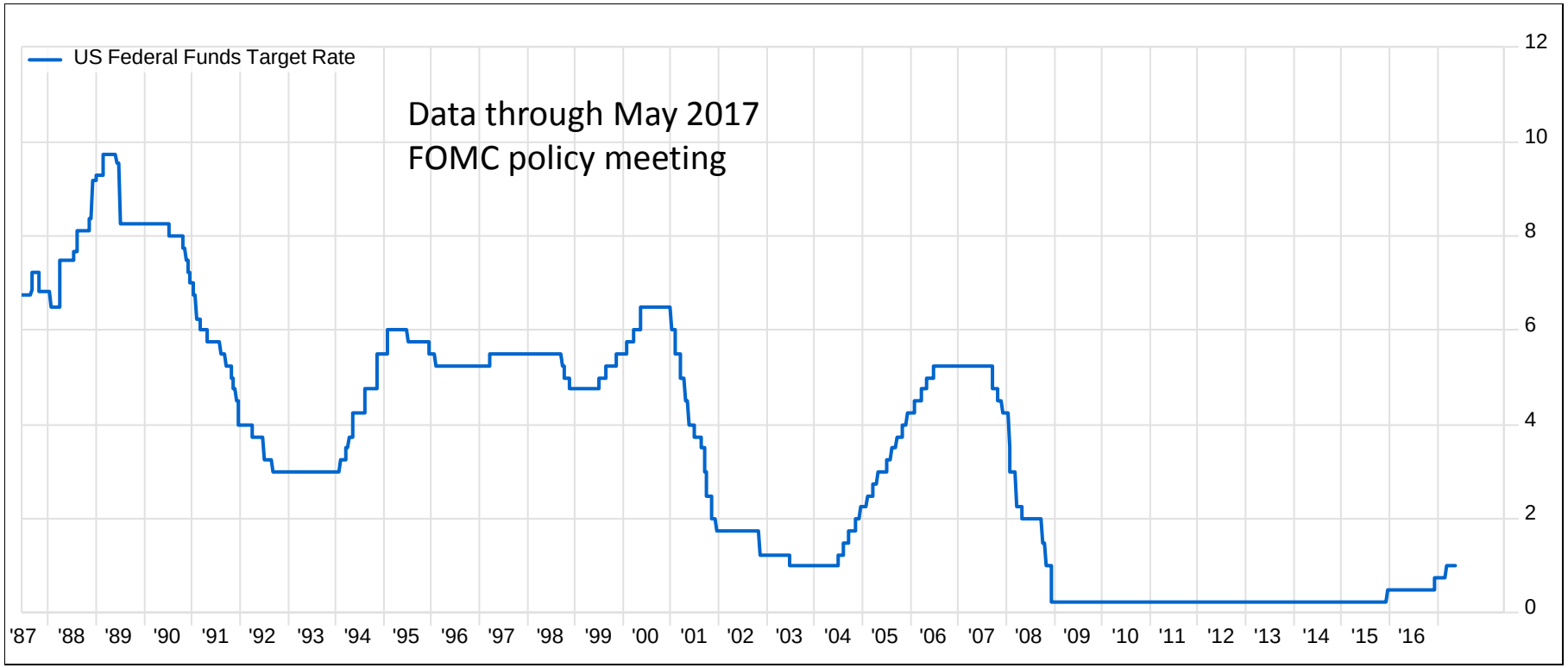
Source: FactSet

10-Year Treasury Yield

The 10-year Treasury rate peaked in December before selling off to roughly 2.3% in mid-January. Rates have generally settled into a range of 2.2% to 2.6% on the 10-year. It seems investors are waiting on the next shoe to drop. The FOMC is expected to raise rates at their June meeting which may cause yields to rise.

Source: FactSet

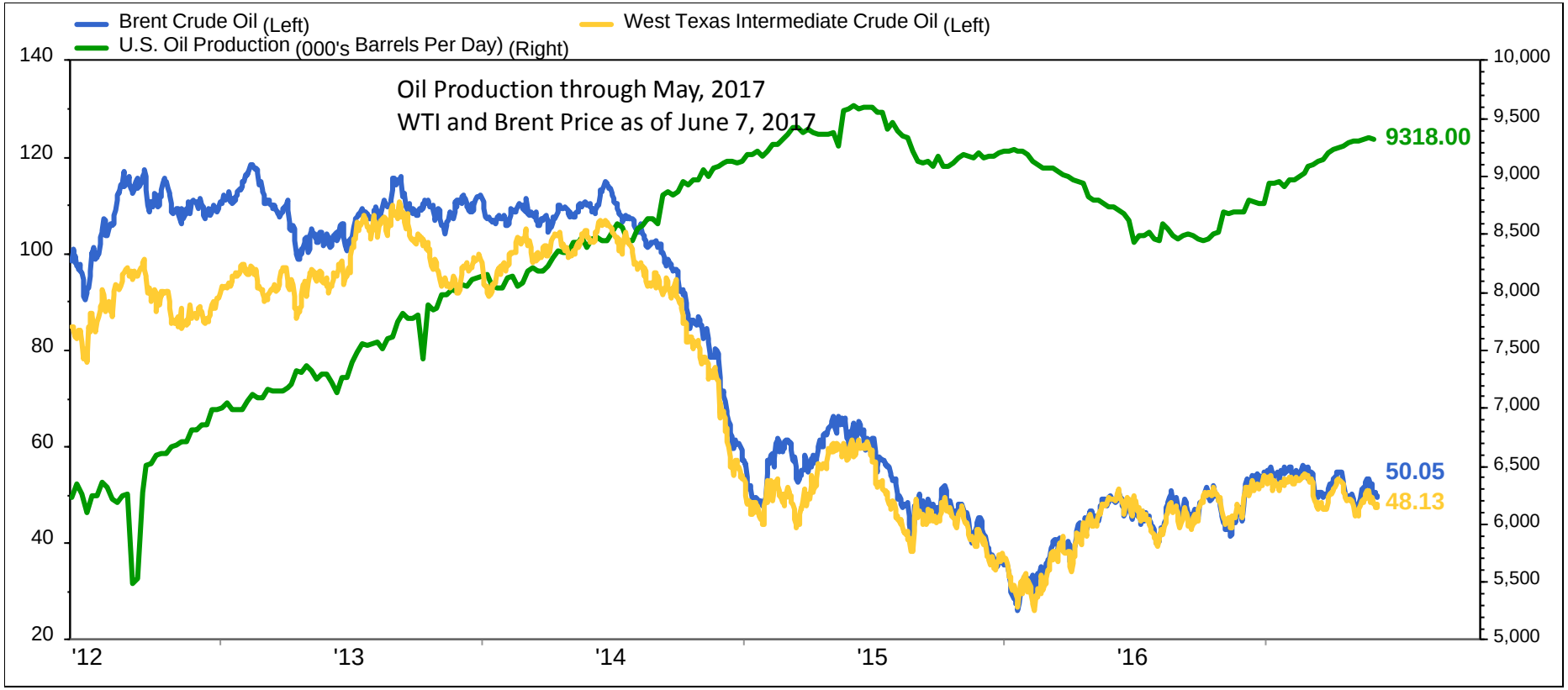
Fed Funds Rate



The FOMC left rates steady after their May meeting. The accompanying statement provided and materials suggest there could be two more rate hikes this year. According to CMEGroup.com, the probability of a rate hike at the June FOMC meeting stands at roughly 98%, with probabilities also indicating raises in September, November, and December. Investment strategists are implying there likely will be a pause for one of those three meetings.

Source: FactSet

Oil Supply and Price



Crude oil prices have been range bound as we've seen US production continue to increase. Despite OPEC's pledges to cut production, it appears as though global production will continue to increase as large oil producing nations, OPEC and non-OPEC, are fearful of losing market share to newer sources of production. Various US fields have become profitable at current price levels. The increase in efficiencies and application of advanced data analytics to improve production further has been the focus of various articles on the industry. Active rotary rigs have more than doubled since the low reached in mid-2016. There doesn't appear to be a fundamental reason for a breakout of oil prices despite a forecast for a pickup in global growth. Geopolitical risk (could of course create uncertainty and lead to an increase in prices).

Source: FactSet

Global Risks

Economic

- Fed Policy Error –In FOMC minutes, the debate seems to no longer be whether there should be further rate hikes but rather over the pace of the hikes. Some Fed officials have made recent statements to express that they feel the pace of hikes has not been fast enough while others are becoming more dovish due to a lack of inflation. With some recent softening of selected economic reports, the risk of stalling out growth from a faster pace of rate hikes becomes an issue. The Federal Reserve has also been debating the size of its balance sheet. The May meeting provided some clarity on this as they stated that the Fed would not begin trimming their balance sheet until interest rates have been normalized. A reduction in size of the Fed's balance sheet is a tightening of monetary policy that could lead to higher interest rates.
- Softening of economic data – The length of the economic recovery, which started in 2009, is starting to become a concern. Despite tightness in the labor market, we have yet to see the wage growth that would expected from a record number of openings and extremely low unemployment rates. This combined with some slight softening in reports and potential consumer stress with debt levels raises the specter that we are nearing the end of the current expansion

Geopolitical –

- Partisanship– It is clear that the Trump presidency has so far resulted in one of the most partisan atmospheres in history, not just between Democrats and Republicans, but between moderate Republicans and ultra-conservative Republicans. The pace of controversies surrounding the Trump administration hasn't slowed. This imperils his ability to accomplish his legislative goals of regulatory, tax, and health care reform. Much of the recent rally has been attributed to the expectations for regulatory relief and tax reform. As the accomplishment of those goals becomes less likely, the chance of a sell-off in equity markets increases.
- While the rhetoric surround Syria seems to have become subdued recently, North Korea continues to test international patience with continued missile tests. The potential for an escalation with North Korea seems to increase with each subsequent testing of their capabilities.

Disclosures

Domestic equities: The value of the fund's domestic and foreign investment will vary from day-to-day in response to many factors. Stock values fluctuate in response to the activities of individual companies, and general market and economic conditions. The prices of small and medium sized company stocks are generally more volatile than large company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.

Investing in foreign securities presents certain risks that may not be present in domestic securities. For example, investments in foreign and emerging markets present special risks, including currency fluctuation, the potential for diplomatic and potential instability, regulatory and liquidity risks, foreign taxation and differences in auditing and other financial standards. Securities in emerging markets are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments.

Fixed income securities are subject to availability and market fluctuation. These securities may be worth less than the original cost upon redemption. Certain high-yield/high-risk bonds carry particular market risks and may experience greater volatility in market value than investment-grade corporate bonds. Government bonds and Treasury bill are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and fixed principal value. Interest from certain municipal bonds may be subject to state and/or local taxes and in some instances, the alternative minimum tax. The fund's yield, share price, and total return change daily and are based on changes in interest rates, market conditions, other economic and political news, and on the quality and maturity of its investments. In general, bond prices rise when interest rates fall, and vice versa. This effect is usually more pronounced for longer-term securities. You may have a gain or loss when you sell your shares

High yield bonds, also known as junk bonds, are subject to greater risk of loss of principal and interest, including default risk, than higher-rated bonds. Investors should not place undue reliance on yield as a factor to be considered in selecting a high yield investment. These securities are rated below investment grade.

Real Estate Investment Trust (REIT) is a security that sells like a stock on the major exchanges and invests in real estate directly, either through properties or mortgages. REITs receive special tax considerations and typically offer investors high yields, as well as a highly liquid method of investing in real estate. Individuals can invest in REITs either by purchasing their shares directly on an open exchange or by investing in a mutual fund that specializes in public real estate.

P/E (Price-to-Earnings Ratio) is a valuation ratio of a company's current share price compare to its per-share earnings. It is also known as the "price multiple" or "earnings multiple."

Beta measures the risk potential of a stock or an investment portfolio expressed as a ratio of the stock's or portfolio's volatility to the volatility of the market as a whole.

Standard deviation is an indicator of the portfolio's total return volatility. The larger the portfolio's standard deviation, the greater the portfolio's volatility.

Spread sectors include all non-Treasury fixed income investments. These investments typically have an interest rate that is different from the prevailing rate on Treasury securities. The difference in interest rates is known as the spread.

Duration is a measure of the sensitivity of bond prices to interest rate changes.

Investments are subject to market risks including the potential loss of principal invested.

An investment cannot be made directly into an index .

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Disclosures (cont.) and Index Definitions

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The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower expected growth values.

The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000® Index and includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 represents approximately 92% of the U.S. market.

The Russell 1000 Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 Index companies with higher price-to-book ratios and higher expected growth values.

The Russell 2000 Value Index measures the performance of small-cap value segment of the U.S. equity universe.

The Russell 2000 Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 2000 Growth Index measures the performance of the small-cap growth segment of the U.S. equity universe. It includes those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values.

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Large domestic companies measured by the S&P 500, which is an index of 500 major U.S. large cap corporation.

Index Definitions (cont.)

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The MSCI EAFE Index is an unmanaged market capitalization-weighted index of equity securities of companies domiciled in various countries. The Index is designed to represent the performance of developed stock markets outside the United States and Canada and excludes certain market segments unavailable to U.S. based investors. USD indicates performance calculated assuming foreign holdings values are converted from currency of domicile to US Dollar. LCL indicates performance calculated assuming foreign holdings values are not converted to US Dollar.

The MSCI EAFE Value Index is a market capitalization-weighted index that monitors the performance of value stocks from Europe, Australasia, and the Far East.

The MSCI EAFE Growth Index is a market capitalization-weighted index that monitors the performance of growth stocks from Europe, Australasia, and the Far East.

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. USD indicates performance calculated assuming foreign holdings values are converted from currency of domicile to US Dollar. LCL indicates performance calculated assuming foreign holdings values are not converted to US Dollar.

The MSCI Japan measures the performance of Japanese equities.

The MSCI All Country Europe measures the performance of equities domiciled in developed and emerging European countries.

Barclay's Capital U.S. Treasury Index includes public obligations of the U.S. Treasury with a remaining maturity of one year or more.

The Barclays U.S. Aggregate Bond index measures the performance of investment grade bonds in the U.S. fixed income universe. It includes U.S Treasury issues, agency issues, corporate bond issues and mortgage-backed issues. It is unmanaged, includes reinvestment of dividends, does not reflect the impact of transaction, manager or performance fees and is unavailable for investment.

The Barclays Global Aggregate Bond Index measures the performance of investment grade fixed rate debt globally. The major components are the U.S. Aggregate, the Pan-European Aggregate, and the Asian-Pacific Aggregate. Additionally, the index contains various other investment grade fixed rate instruments not already included in the sub-components.

The Barclays U.S. 1-3 Year Aggregate is a subset of the Barclays U.S. Aggregate index, representing securities with 1 to 3 years remaining until maturity.

The Barclays U.S. Credit Index comprises the U.S. Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

The Barclays Treasury Bond Index is a capitalization weighted index measuring the performance of U.S. Treasury bonds.

The Barclays U.S. High Yield Loan index measures the performance of loans rated below investment grade in the U.S.

The Barclays Municipal index measures the performance of tax exempt bonds in the U.S.

The Barclays Municipal Intermediate 5-10 Year index measures the performance of investment grade municipal securities with 5 to 10 years remaining until maturity.

The Barclays US Corporate High Yield Index tracks the performance of domestic non-investment grade corporate bonds.

Credit Suisse Leveraged Loan index measures the investable universe of the USD-denominated leveraged loan market

Index Definitions (cont.)

The Citi World Government Bond Index (WGBI) measures the performance of 23 government bonds markets including Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Malaysia, Mexico, the Netherlands, Norway, Poland, Portugal, Singapore, Spain, Switzerland, Sweden, the United Kingdom and the U.S.

The Bloomberg Commodity index is comprised of future contracts on physical commodities which trade here in the U.S. and certain foreign markets. It measures the performance of investment in a broad basket of commodity futures contracts. The index is composed of futures contracts on 19 physical commodities. No related group of commodities (e.g., energy, precious metals, livestock and grains) may constitute more than 33% of the index as of the annual re-weightings of the components. No single commodity may constitute less than 2% of the index.

The Dow Jones Industrial Average (DJIA) is a price weighted index of 30 U.S blue-chip companies. The DJIA covers all industries with the exception of transportation and utilities.

The Dow Jones Select REIT index represents equity real estate investment trusts (REITs) and REIT-like securities traded in the U.S.

The Dow Jones Global Select REIT index represents equity real estate investment trusts (REITs) and REIT like securities traded globally.

The FTSE EPRA/NAREIT Developed Index is designed to track the performance of listed real estate companies and real estate investment trusts (REITs) worldwide.

The Standard and Poor's 500 is a capitalization weighted index of 500 leading companies in leading industries of the U.S. economy. It covers approximately 75% of the total capitalization of U.S. equities.

The NASDAQ Index is a market capitalization weighted index of common equities listed on the NASDAQ stock exchange.

The NASDAQ 100 Index is composed of the 100 largest and most actively traded securities listed on the NASDAQ stock exchange, excluding those securities in the financial sector.

The Case Shiller Composite 20 City Home Price Index measures price changes in residential sales within the 20 largest metropolitan areas in the United States.

National Association of Realtors Home Affordability Index measures whether a family earning the median income as reported by the U.S. Census Bureau could qualify for a mortgage on a property at the median price and at the prevailing interest rate, assuming 20% down payment.