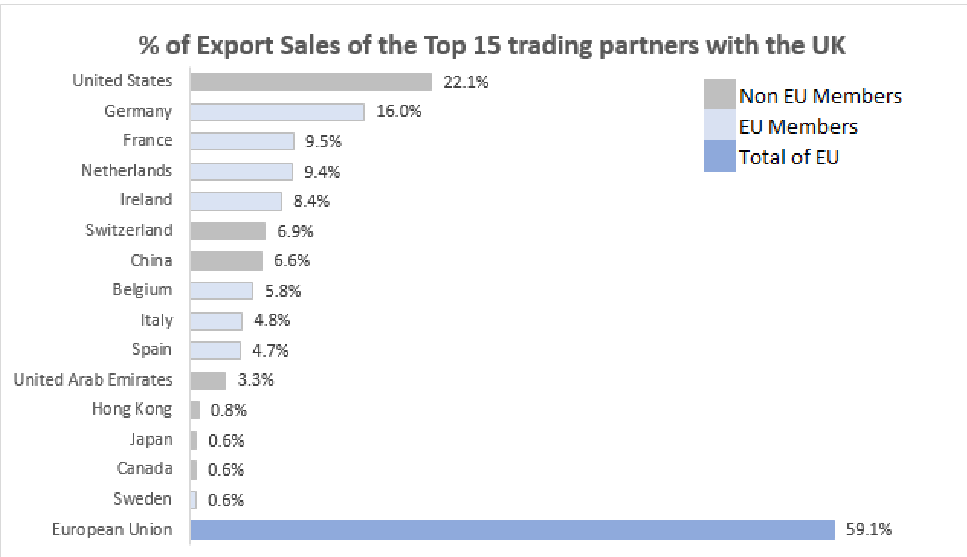
# Monthly Newsletter

## April 2017

## COMMENTARY

On March 29, 2017, United Kingdom Prime Minister Theresa May sent a letter to the European Council President, Donald Tusk, formally invoking Article 50 to start the process of the U.K. leaving the European Union. Since the June 23 vote by the people of the U.K. to leave the EU (Brexit), much has been speculated on how this would shape Europe and the effects it would have on global markets. The task at hand for EU leaders and U.K. leaders is enormous. If negotiations fail and no agreement is completed, the U.K. will by default have to trade on the World Trade Organization's terms. The U.K. is *not* seeking membership into this single market, which is centered on the four freedoms: 1) Free Movement of Goods, 2) Freedom of Movement for Workers, 3) Right of Establishment and Freedom to Provide Services, and 4) Free Movement of Capital. The first and fourth of the four freedoms are the most impactful as they have ended the custom tariffs and promoted intra-community trade with free movement of goods and capital. Trade within the EU accounts for a large part of imports and exports between the members. Both parties have every reason to negate a free trade agreement, but (and it's a big but!) the U.K. has zero interest in the second of the four freedoms, which is the immigration part. So here's the game: the U.K. wants free trade but doesn't want free movement of immigrants. The EU wants free trade, but if it agrees to let the U.K. walk on free movement for workers, what stops another country from doing the same? Does this one vote back on June 23, 2016 put the whole European Union at risk? Or will negotiations move smoothly and make everyone happy at the end of this, making it ultimately a small blip on the radar? After the surprises 2016 brought us, the only smart bet is to not make one—in other words, we'll have to wait and see.




*Data from: http://www.worldstopexports.com/united-kingdoms-top-import-partners/*

*(cont. on reverse)*

## ECONOMIC HIGHLIGHTS

| | |
|---|---|
| **S&P 500** | 2,362.72 |
| **DJIA** | 20,663.22 |
| **NASDAQ** | 5,911.74 |
| **Oil** | $50.60/barrel |
| **Gold** | $1,251.20/ounce |
| **10 Year Treasury Yield** | 2.40% |
| **Unemployment** | 4.7% |
| **GDP** | 2.1% |
| **Consumer Price Index (CPI)** | +0.1%<br>12 month change: +2.7% |
| **Core CPI** | +0.2%<br>12 month change: +2.2% |

**US Economy -** Unemployment is under 5%, job participation rate is slowly increasing, inflation is approaching the Fed target goal of 2%, the Fed has started moving off emergency interest rate levels, and consumer confidence hit all-time highs. US Economy looks great!

**Light Crude Oil -** Oil spot prices took a hit in early March, as US companies were able to come online quicker than expected when the price got above $50. The trend is still higher for the price, but it could be a slow grind higher towards our price target.

**Average Hourly Earnings -** The one blemish in the employment numbers is the average hourly earnings. Our expectation is that as the job market tightens we would see inflation and growth out of hourly earnings. This has been slower than expected.

*(cont.)*

When our team is analyzing moves within the portfolio, we start with a top-down approach looking at how the move might affect the overall portfolio and its relationship with other asset classes. As we watch for data points and negotiations to be finalized, our team will determine if and when our best-, worst-, and base-case scenarios for Europe change. The first real example of how things could affect business came when the EU blocked Deutsche Borse's (headquartered in Germany) merger with the London Stock Exchange hours after Article 50 was received. It wasn't explicitly due to Brexit, but it's believed that the EU did not want its main stock exchange to be based outside of the EU. We expect there to be an opportunity in international developed markets with Quantitative Easing, improving balance sheets for consumers and businesses (similar to the US), but the risk of Brexit negotiations versus the reward is not tilted in the reward's favor enough to be very aggressive.

Many economic and technical indicators point to a bullish economy and stock market. U.S. large-cap stocks have been performing well the last two years and we expect this to continue but also believe that small- and mid-caps are positioned to take the lead as risk appetite increases. That said, we are currently watching the markets to increase the exposure to small-caps and reduce exposure to large-caps. We feel a shift into small-caps should benefit the portfolio over the next three to five years. An improving economy and strong balance sheets for US consumers and businesses should continue to drive the economy forward. One negative feature of a strong economy is a strong dollar, which can cause headwind for large multinational companies. This is another reason we see small-cap companies as well-positioned, as they tend to be less affected by a strong dollar.

Sector-wise, we are bullish on Technology, Industrials, and Financials, but are cautious in Utilities, Health Care, and Consumer Staples. Emerging Markets valuations look very attractive, and we do believe there will be an opportunity to benefit from these valuations, but again we are in a wait-and-see mode regarding Trump and his policies on trade agreements. Our fixed income positions have been weighted towards low duration, which historically tend to do better in a rising interest rate environment; we believe this is still the best positioning, as we think rates have more room to go. We continue to be tactically underweight to government bonds and overweight to corporate, high-yield, floating rate, and global bonds. With our daily monitoring, we'll continue to rebalance models when they fall outside their target threshold.

## Economic Highlights

| Index | 3 Mo | 1 Yr | 3 Yr | 5 Yr |
|---|---|---|---|---|
| **S&P 500** | 6.07 | 17.17 | 10.37 | 13.30 |
| **MSCI EAFE** | 7.39 | 12.25 | 0.96 | 6.32 |
| **BarCap Agg Bond** | 0.82 | 0.44 | 2.68 | 2.34 |

*Data as of 3/312017. Investments cannot be made directly into an index.*

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