2017 First Quarter Review & Outlook

Market Review

Equities

The U.S. stock market posted its biggest quarterly gain since the last quarter of 2015—extending the fourth quarter post-election rally—lifted by a brightening economic outlook and rising confidence among businesses, consumers and investors. The Dow Jones Industrial Average posted a 4.7% gain, while the broad S&P 500 Index jumped 6.1% over the past three months. Despite a range of uncertainties across the globe including elections in Europe and a fledgling Trump administration, the first quarter of 2017 was the least volatile in more than half a century. The CBOE Volatility Index (known as Wall Street's "fear gauge") recorded its second lowest quarterly average on record, according to the WSJ Market Data Group.

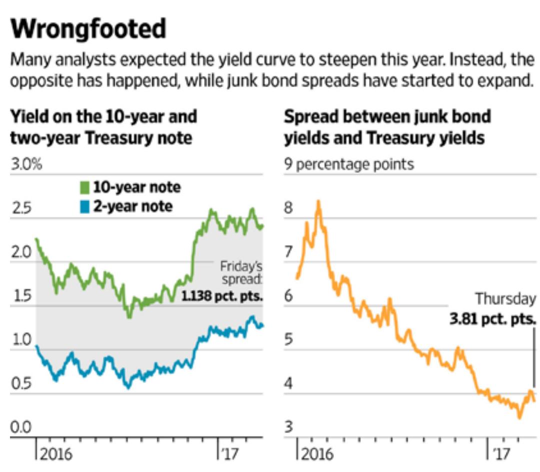
Nevertheless, during the last month of the first quarter the stock market saw losses as growing uncertainty arose over whether the Trump administration could indeed enact a pro-business/economic growth agenda. That doubt hurt sectors of what had been known as the "Trump trade," such as financials and energy. Highlighting that uncertainty was the failure of the Trump administration and House Republicans to pass a promised health care bill to repeal and replace the Affordable Care Act (otherwise known as Obamacare).

> *An investor must know that it is this money ($12 trillion on global central banks' balance sheets) that now keeps the system functioning. Without it, even 0% policy rates are like methadone—cancelling the craving but not overcoming the addiction.*
>
> —Bill Gross, Janus Capital Group portfolio manager; legendary bond investor

Fixed Income

Long-term Treasury yields, which are largely driven by the U.S. economic and inflation outlook, declined modestly for the first quarter, following a sharp rise in the wake of the November election of Donald Trump. The 10-year U.S. Treasury yield fell from 2.45% at the end of 2016 to 2.40% on March 31, thus gained somewhat in price. Over the same period short-term yields, which are more influenced by Federal Reserve monetary policy, alternatively rose as Fed officials had made clear that they expect to continue raising the fed-funds rate through the rest of the year (as they did in March). While the yield curve, like all market indicators, is subject to the ebb and flow of investor sentiment, economic data and political developments; a "flattening" yield curve can be of concern because it can serve as an early signal of both a slowing economy and overpricing of riskier investments.

The average yield difference on junk-rated corporate (non-investment grade) bonds relative to U.S. Treasurys was 3.81 percentage points, having climbed from 3.44 percentage points during March. While this difference (or "spread") is still relatively very narrow, the increase is a sign that investors are viewing junk bonds as riskier than investment grade debt, therefore showing there's less confidence in future stock market prices.



Global Market Performance

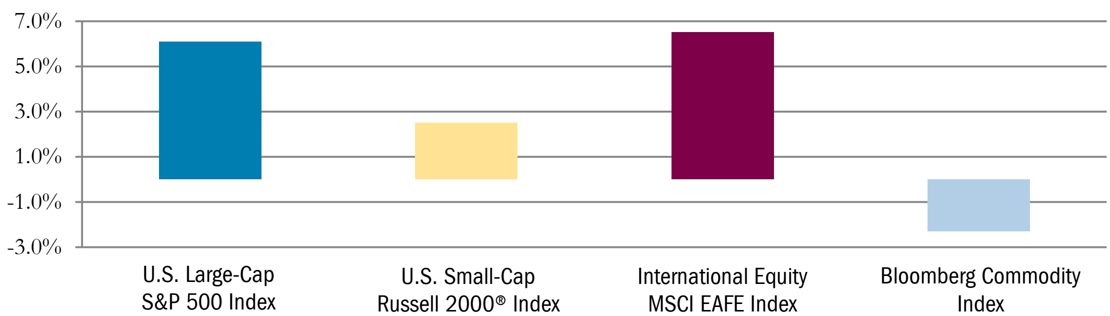
The broad stock S&P 500 Index advanced by 6.1% for the first quarter (dividends reinvested). The Russell 2000 Index of small-company stocks gained 2.5% for the past three months, underperforming large company stocks after outperforming in late 2016 with investor expectations of higher returns under a pro-business Trump administration. The tech-heavy Nasdaq Composite jumped 9.7%, by far the best performer of major U.S. indexes. The best performing sectors for the quarter were technology, consumer discretionary and health care. The worst performing sectors were energy, telecom, and financials.

Developed international stocks gained 6.5% in the first quarter as measured by the MSCI EAFE Index (in U.S.-dollar terms), slightly outperforming U.S. stocks as signs of steady economic growth continued to be evident, and buoyed by international equity funds posting its third highest quarterly investor inflows in recorded history. The pro-European Union Netherlands parliament election results also helped investor confidence that upcoming western European elections may also not swing to anti-EU governments.

The MSCI Emerging Markets stock index jumped 12% in the past three months to a nearly two-year high at March end, led by rallies in China, South Korea and India. Investors are once again piling into emerging markets (EM) equities, drawn by an improving global economic outlook and favorable stock valuations versus developed markets. Emerging market stocks are trading at a 26% discount to those in developed markets, based on estimated earnings over the next 12 months, according to analysts at UBS Wealth Management. A weaker dollar is also helping EM prices as well.

Natural resources and other commodities fell 2.3% for the first quarter as measured by the Bloomberg Commodity Index. The index measures the collateralized returns from a basket of 23 commodity futures contracts representing the energy, precious metals, industrial metals, grains, and livestock sectors. Weakness in the energy sector and agricultural goods led the downturn. Precious metals, however, gained in price, helping stem losses in the index. A weak dollar was also an aid to values as commodities are typically priced and traded in U.S. dollars.

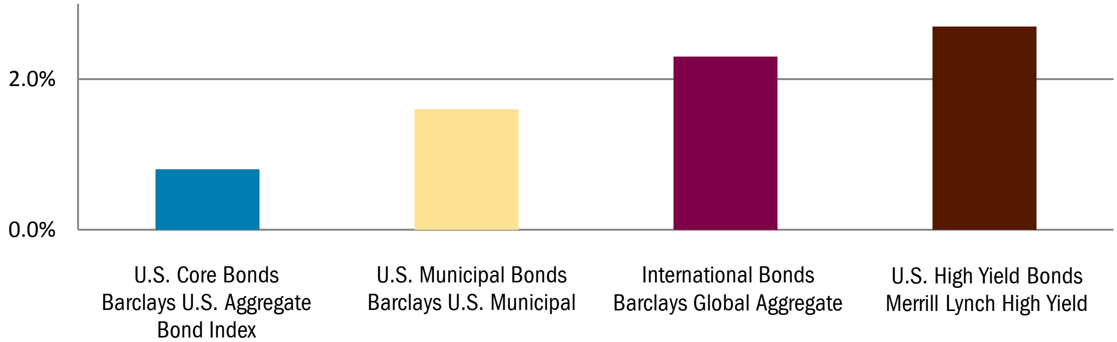
GLOBAL EQUITY AND COMMODITY MARKETS
Q1 2017



Despite the Federal Reserve raising the fed funds target rate by 0.25% to 1.0% in March, bond prices held steady for the first quarter. The rate hike was expected by investors, and concerns over the implementation of the pro-business Trump agenda helped bond purchases at quarter end. Along with the sale of existing bonds, new issue investment-grade and junk-rated companies sold more than $490 billion of bonds in the quarter; the most of any quarter on record according to Dealogic.

With first the euphoria and then pessimism in the equity markets, the Barclays U.S. Aggregate Bond Index of high-quality government and corporate bonds ended up only 0.8% in the quarter. Although credit spreads (the difference between high-quality and junk bond yields) loosened somewhat during the quarter, non-investment grade (junk bonds) still rose 2.7%, as measured by the Bank of America/Merrill Lynch High Yield Master Index. State government municipal bonds gained 1.6% for the past three months as measured by the Barclays Capital Municipal Bond Index. The failure to replace and repeal Obamacare for now was seen by investors as also a setback for tax reform (lowering of taxes), which helped improve demand for these tax-free dividend debt securities. The Barclays Capital Global Bond Index was up 2.3% ended March 31, due mainly to stabilized emerging market growth and favorable currencies versus the U.S. dollar.

FIXED INCOME MARKETS
First Quarter 2017



Portfolio Review

SFC TIS portfolios overall registered positive returns for advisors and their clients for the first quarter of 2016. Our model portfolios came close in performance to the benchmark indexes despite being conservatively positioned by having an underweight in the rapidly rising stock market of late. We do not expect to outperform the benchmarks in times when the stock market is “running hot,” as it has since the election of Donald Trump. Nevertheless, as what was seen in March and over the past nearly three years, we expect we will be in a volatile stock market in the short- to mid-term, albeit hopefully trending upward long-term. In these more unstable market cycles we anticipate our model portfolios should continue to outperform.

During the quarter our alternative investments (specifically long/short equity, hedged emerging market equity, and precious metals) performed as anticipated by not only adding to portfolio gains but also lowering volatility, or the “drops” in account values. And while our bond holdings outperformed the bond benchmark, our stock positions somewhat underperformed the stock benchmark.

It is possible that we’ll experience a bear market at some point in the coming years as this bull market cycle is now 8 years old—the second longest on record, according to Bespoke Investment Group—and thus is historically due for a pullback at some point. And although cautiously optimistic, it’s best to be conservatively positioned with broad diversification in different asset classes (including alternative investments and natural resources) to lower risk while achieving a reasonable return to help advisors and their clients reach long-term goals.

"YOU KNOW YOUR PROBLEM, MONTE? THERE'S MORE TO LIFE THAN ALWAYS CHECKING HOW YOUR STOCKS ARE DOING."

Market Outlook

> *Maybe people have figured out that you can watch the news all you want and get upset, but that has nothing to do with earnings and the valuation of earnings in the stock market.*
> —Ed Yardeni, President of Yardeni Research, Inc.

After the excitement from investors for stocks post-Trump election, the markets seem to be range-bound of late over concerns if the pro-growth Trump agenda will be implemented by Congress and over ongoing geopolitical events (European elections, conflicts with Syria, Russia, North Korea, etc.). Assuming that the stimulative "Trump Trade" is now over, then economic and corporate data is expected to exert more influence on stock prices going forward, regardless of whatever changes are implemented (or not) by Congress or the Federal Reserve in the near future.

The start of the second quarter and the direction of the stock market should be more influenced by corporate earnings announcements and global economic data than domestic and geopolitical events. Analysts expect corporate earnings to record advances over prior years' earnings, and recent economic data suggests that an uptick in global activity has taken place. For the U.S. economy, the revival of the industrial and energy sectors has been the most important development, resulting in marginally lower unemployment and increasing wages. Most importantly, the economy has exhibited signs of expected future improvement over the past trending sub-2% GDP (gross domestic product) growth. This potentially positive development remains uncertain though.

Globally the progress is arguably more impressive. Europe has seen a number key economic indicators move beyond its levels in the 2009-2011 recovery and therefore fully repairing the damage of this Euro-crisis era. China has stabilized its domestic economy and returned as a pillar for regional emerging market growth. And concerns over foreign goods and services deflation has been changed to indicators of subdued healthy inflation, along with stabilizing currencies versus the U.S. dollar. This good news can be expected to be reflected in rising foreign corporate earnings, therefore may bode well in reigniting investors to buy international stocks. But only time will tell.

The outlook for investment-grade U.S. government and corporate bonds in 2017 is less favorable than stocks. Especially if improved economic and employment wage growth continue. However, as seen during recent market malaise, these bonds act as "insurance" against any negative geopolitical or economic news. As such, they're an important component to a balanced portfolio of investments. SFC TIS balanced portfolios include investment-grade bonds (though underweighted) for this reason, but also include floating rate, global debt, and non-investment grade bonds that should gain in price in a rising interest rate and/or stock market environment. The Federal Reserve held off on raising interest rates for most of 2016 before moving in December and then again recently in March. The Fed also signaled more increases are on the way, reflecting optimism about the U.S. economy. If more Fed hikes come to fruition this year, investment-grade bond prices will most likely come under pressure. So far for the year they are holding steady in price though.

In light of the above factors we remain cautiously optimistic, somewhat conservatively positioned, and well-diversified with many asset class investments in financial advisors clients' accounts. Our belief is that while the actions during the first six months or so of the Trump administration affect markets, upcoming corporate earnings and economic reports may now take center stage for stock price movements. As always, we will be observing these events and making portfolio adjustments as warranted.

We appreciate your continued confidence in our services. Your inquiries are welcomed.

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Sources: Bloomberg Commodity Index, *Tables & Charts*, December 2016; First Trust Advisors, *Quarterly Investment Overview*, October 2016; Janus Capital Group, *Investment Outlook by Bill* Gross, January 2017; J.P. Morgan Asset Management; *A review of global markets and portfolio positioning in Q4 2016*, 4Q 2016; USA Today, (multiple publications); The Wall Street Journal (multiple publications).

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