THE UNITED COMPANIES

Planning for the Possibilities®

Dear Clients and Friends,

April 2017

In the first quarter, equity markets continued their positive post-election momentum with the S&P 500 up 5.5% for the quarter, with all the gains concentrated in the first two months of the year. The solid performance of the equity markets broadened beyond domestic equities, as European stocks (via the EAFE Index) were up 6.5% for the quarter. Bonds continued to lag, although municipal bonds moved into positive territory, up 0.2% in 1Q.

To take advantage of the relative value opportunity, we reduced exposure to highly-valued domestic equities during the quarter, using the proceeds to increase the weight to European equities in our two primary growth models. Given the strong performance by European equities, our exposure to this segment of the market contributed positively to client returns. On the bond side, throughout the first quarter we had seen value in municipal bonds after the 2H16 sell-off. Considering this, we have added both short duration pre-refunded bonds and longer, callable high coupon bonds to portfolios. Currently, we are seeing value in FDIC insured callable step-up CDs and are adding these positions as we see opportunities.

So the question is where do equity markets go from here? We think there is support for equities to move higher from here. First, we acknowledge that equity valuations are lofty, particularly for domestic stocks. But we believe there is a solid economic underpinning to the strong post-election equity rally, and that it's more than just investors hoping the new administration will pass major pro-growth policy items such as tax reform. Two positive drivers are the economy and corporate earnings.

On the economic side, we see widespread evidence that both the US economy and the global economy are on solid footing. One data point we monitor is global PMIs, which measures the economic health of the manufacturing sector. In the U.S., the PMI has increased from 49.4 in August 2016 (consistent with a contracting economy) to 57.2 in March (strongly expansionary). In fact, the current US PMI reading is consistent with GDP growth of 4.3%, which is well above the recent trend-line. We would also note that the Citi Economic Surprise Index bottomed in October 2016 and has rebounded strongly during the period where equities have rallied. Turning to Europe, PMIs have also improved meaningfully. The Euro region as a whole has seen its PMI Index increase to 55.4 from 51.7 in August. Digging deeper, both France and Italy were in contraction territory in August and have moved into expansionary territory recently. Housing and employment trends also point to an improving economy and consumer confidence reports have been solid.

We expect corporate earnings to trend higher in 2017 after a flat 2016. Overall earnings in 2016 were hurt by an 80% decline in Energy sector earnings. The absence of such a drag in 2017 should contribute positively to earnings to the tune of 3%. For the year, the consensus earnings forecast for U.S. corporations is close to 10%, fueled by higher revenues, stock buybacks and stable margins. On revenues, there is a high correlation between GDP growth and corporate revenue increases. Again, we think the improving economy will underpin revenue growth and, coupled with the normalization of Energy earnings, drive overall earnings higher. The picture is similar in Europe, although earnings for Euro-region companies are expected to exceed that of U.S. companies this year.

On policy, the debate over healthcare reform has made it apparent that the period of gridlock in Washington may persist. The President will need to work more closely with both sides of Congress to get major legislation done, such as tax reform and infrastructure spending. The Federal Reserve policy is also a key driver, and our interest rate committee expects the Fed to raise rates two more times this year. We anticipate little change to short term rates over the near term but expect higher interest rates over the intermediate term.

Respectfully submitted by the Professional Staff at United Asset Strategies, Inc.

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