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MONTHLY MARKET UPDATE

January 2017

Economic data were widely positive through the January, while growth for the fourth quarter of 2016 disappointed. The Federal Reserve stayed put after raising rates in December, waiting on developments on the fiscal side to determine their next move. Equities continued to benefit from a Trump Bump, while international outperformed on dollar weakness. Consumer confidence and small business confidence remain near post-recession highs and should continue to fuel the economic expansion.

Key Economic Statistics*	Period	Level	Vs. Prior
Manufacturing Economy Strength	Jan	56.0	Stronger
Service Economy Strength	Jan	56.5	Weaker
Monthly Jobs Report	Jan	227k	Stronger
National Unemployment Rate	Jan	4.8%	Higher
Annualized Quarterly GDP Growth	Q4 – 1st	1.9%	Weaker
Personal Consumption (Spending)	Q4 – 1st	2.5%	Weaker
Inflation–CPI ex.Food/Energy	Dec	2.2%	Higher

** See disclosure for underlying economic indicator definition. FactSet*

The Trump Bump Continues to Lift Stocks

Key Index Performance*	1 Mo	3 Mo	YTD	1 Yr	3 Yr	5 Yr	10 Yr
Equities							
Large Domestic Companies S&P 500 Total Return Index	1.90	7.76	1.90	20.04	10.85	14.09	6.99
Small Domestic Companies Russell 2000 Total Return Index	0.39	14.72	0.39	33.53	7.89	13.00	6.93
International Developed Companies MSCI EAFE Index	2.90	4.30	2.90	12.03	0.71	6.04	0.97
Emerging Market Companies MSCI EM Index	5.47	0.84	5.47	25.41	1.44	0.19	2.49
Taxable Fixed Income							
Short Term Bonds Barclays U.S. 1-3 Year Aggregate Index	0.19	-0.16	0.19	0.97	0.92	0.92	2.52
Intermediate Term Bonds Barclays U.S. Aggregate Bond Index	0.20	-2.04	0.20	1.45	2.59	2.09	4.37
High Yield Bonds Barclays U.S. Corporate High Yield Index	1.45	2.83	1.45	20.77	4.92	7.03	7.49
International Government Bonds Citigroup World Government Bond Index	1.01	-4.32	1.01	1.25	-0.94	-1.08	3.24
Tax Exempt Fixed Income							
Short Term Municipals Barclays Municipal 1-3 Year Index	0.48	-0.01	0.48	0.31	0.69	0.82	2.16
Intermediate Term Municipals Barclays Municipal 5-10 Year Intermediate Index	0.91	-2.03	0.91	-0.93	2.77	2.40	4.50
High Yield Municipals Barclays High Yield Municipal Index	1.40	-3.31	1.40	3.85	5.43	5.44	4.14
Real Assets							
Commodities Bloomberg Commodity Index	0.14	3.30	0.14	13.83	-11.31	-9.37	-5.58
Global Real Estate Dow Jones Global Select REIT Index	-0.48	1.57	-0.48	8.62	9.71	9.67	2.59

** All data as of 01/31/2017. See disclosures for underlying index definitions. Periods longer than one year represent annualized performance.*

Economic Update

2017 is starting off with more of the same – lackluster but positive economic growth accompanied by significant optimism that the future will show stronger growth. Capital markets have reflected a shift to optimism since the presidential election as investors bet that businesses will benefit from a more favorable regulatory regime. However, it's not just optimism, the economic data is consistent with continuing growth in the economy.

Both the service and manufacturing economy are growing quickly by historical standards. Within manufacturing, this is a turnaround from levels consistent with contraction as recently as last August. Today, the manufacturing sector is growing with the ISM Manufacturing index increasing every month since August and reaching levels above 55 for January. The labor market also showed continued improvement as the January headline jobs number actually surprised to the upside with 227,000 new jobs. The unemployment rate rose through January as workers who had given up on searching for jobs came back to the labor market in anticipation of finding work.

Despite the trend towards strengthening experienced in both the manufacturing and service economy through the late stages of 2016, the initial estimate of fourth quarter GDP did disappoint at only 1.9%. The headline level of growth may be somewhat misleading. The good news in the report is a rebound in business spending, and continuing strength (though at slightly weaker level) of consumer spending. In fact, were it not for the negative contribution of net exports, growth would have matched the third quarter at approximately 3.5%. However, as mentioned, net exports were negative as strength in the U.S. dollar drove imports and hurt exports. So far in 2017, the dollar has actually weakened relative to some foreign currencies, so the weakness may reverse or at least diminish.

Both consumer confidence and small business confidence are at their highest levels since before the Great Recession. The business confidence pickup is particularly notable, especially with the uptick in business spending through the fourth quarter. The question is whether business spending can be sustained on a go-forward basis and finally contribute consistently to economic growth. The current estimate for 2017 GDP growth is roughly 2.3%, which is more of the same mediocre growth we've experienced for several years. However, with the incoming administration and significant uncertainty around policy changes, there likely is a wide potential range of growth around that estimate. Certainly the Trump administration believes growth can be much faster than that level, while detractors anticipate the policies will result in lower growth.

While Trump has been inaugurated, none of the significant promises of the campaign have been fully implemented. The Affordable Care Act has not been repealed as the GOP and administration struggle with what seems like a lack of clarity for a replacement. In recent news interviews, President Trump has actually walked back the timeline on repeal, suggesting the transition could stretch into 2018. Some executive orders have started to undo policies of the Obama administration, such as executive orders to initiate reviews for permitting of the Keystone and Dakota Access pipelines. Of course it is too early to know what the impact and unintended consequences might be.

The Federal Reserve held off on another rate hike at the end of January, with the Fed statement providing limited new information on the potential pace of future rate hikes. Current market probabilities suggest the next hike might come in June, but the minutes from the December meeting also indicated the Fed is uncertain regarding the potential impact of fiscal stimulus from the administration. In short, it's early in 2017 and a lot of economic uncertainty remains.

Capital Markets Update

As mentioned above, domestic equities continued to benefit from the Trump Bump. Large cap equities outperformed small caps as smaller companies paused after outperforming for much of 2016. There was a rotation in sector leadership to start 2017 as Consumer Discretionary and Technology stocks have outperformed so far this year. At the same time, sectors with greater representation in value indices have lagged so far this year.

The big question for equity markets is whether earnings can keep up with valuations. From a headline perspective, the Dow Jones Industrial Average surpassed a level of 20,000 with much fanfare towards the end of January. Reviewing the more diversified S&P 500, U.S. large cap markets currently trade at roughly 21x earnings, which is a premium of approximately 30% over the long-term historical average. Forward earnings multiples are also elevated but are more reasonable. This reflects the underlying assumption that earnings growth will accelerate in 2017 and 2018, warranting the higher multiples. Current expectations are for earnings growth of 10.7% for 2017. Small companies are more expensive on a relative basis owing to faster growth expectations based on anticipation of lowered regulations.

International stocks outperformed for the month, primarily a result of the dollar reversing its recent trend and depreciating against many foreign currencies. Still, valuations continue to look relatively attractive versus U.S. equities, and earnings growth rates are expected to be slightly faster than in the U.S. Unfortunately that also comes with uncertainty which may explain the continuing lower valuations. In the next few months investors will have to potentially endure the Brexit becoming a reality, elections in France which are leaning towards populism and the potential of a Frexit, and more geopolitical risks (some of which likely will be spurred by Trump administration policies).

While equities continue to experience positive returns, fixed income investors are cautious with regards to future interest rate increases. The pace of future rate increases is in doubt as the Federal Reserve evaluates the impact of fiscal stimulus from the Trump administration. One notable change is the voting membership of the Federal Open Market Committee which, as a group, is more dovish than last year. This means the group is less likely to aggressively raise rates. Beyond interest rate policy, we believe investors should not abandon fixed income, particularly with high valuations in equities which may be exposed to shocks. Fixed income can continue to act as ballast to portfolios if there is a drawdown in equities.

As stated before, it’s still very early into 2017, and much change and uncertainty will likely be experienced through the remainder of the year. We continue to believe a diversified portfolio of stocks and bonds is a reasonable approach to the uncertainty of the future market environment. However, as always, if recent market events have you concerned, we suggest contacting your HD Vest Advisor.

Asset allocation and diversification do not assure or guarantee better performance and cannot eliminate the risk of investment losses. Your individual allocation may be different than the HDVAS sample strategic model due to your unique individual circumstances.

Disclosures:

Unless footnoted and disclosed otherwise, all economic data throughout report sourced from FactSet.

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

Small domestic companies measured by the Russell 2000 Index which measures the performance of small-cap segment of the U.S. equity universe. Small domestic companies also measured by the S&P Small Cap 600 index.

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International developed companies measured by the MSCI EAFE Index, which 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.

The Euro Stoxx index measures the performance of a subset of 12 Eurozone countries within the Stoxx Europe 600 index.

Emerging market companies measured by the MSCI Emerging Markets Index, which is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

Short-term taxable bonds measured by the Barclays U.S. 1-3 Year Aggregate, which is a subset of the Barclays U.S. Aggregate index, representing securities with 1 to 3 years remaining until maturity.

Intermediate-term bonds measured by the Barclays U.S. Aggregate Bond index, which 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.

High-yield bonds measured by the Barclays US Corporate High Yield Index, which tracks the performance of domestic non-investment grade corporate bonds.

International government bonds measured by the Citi World Government Bond Index (WGBI), which 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.

Short-term municipals measured by the Barclays Municipal 1-3 Yr index, which measures the performance of investment-grade municipal securities with 1 to 3 years remaining until maturity.

Intermediate term municipals measured by the Barclays Municipal Intermediate 5-10 Year index, which measures the performance of investment grade municipal securities with 5 to 10 years remaining until maturity.

High-yield municipals measured by the Barclays High Yield Municipal index, which measures the performance of below investment-grade municipal securities with at least 1 year remaining until maturity.

Commodities measured by the Bloomberg Commodity index, which 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.

Real estate measured by the Dow Jones Global Select REIT index, which represents equity real estate investment trusts (REITs) and REIT like securities traded globally.

Manufacturing economy strength measured by the Institute for Supply Management Manufacturing Index. A measure above 50 indicates expansion while a measure below 50 indicates contraction.

Service economy strength measured by the Institute for Supply Management Non-Manufacturing Index. A measure above 50 indicates expansion while a measure below 50 indicates contraction.

Monthly jobs report measured by the Bureau of Labor Statistics' US Employees on Non-Farm Payrolls Month over Month net change.

National unemployment rate measured by Bureau of Labor Statistics.

Annualized Quarterly GDP Growth measured by Bureau of Economic Analysis and is released as preliminary (1st estimate), revised (2nd estimate) and final over the course of a quarter.

Personal Consumption growth measured by the Bureau of Economic Analysis and represents final market value of all goods and services produced in the U.S.

Annual Inflation Rate measured by the Bureau of Labor Statistics Consumer Price Index (CPI). Value reflects year over year change in the CPI ex-Food and Energy index.

An investment cannot be made directly into an index.

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

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