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MONTHLY MARKET UPDATE

March 2017

Economic data generally continued to strengthen through March. Survey measures of economic activity remained strong and consumer confidence moved higher. The Federal Reserve raised rates at their mid-March meeting. Equity markets were positive for the quarter but paused in March as the GOP controlled Congress was unable to pass a repeal of the Affordable Care Act, casting doubt on other policy initiatives which have boosted equities.

Key Economic Statistics*	Period	Level	Vs. Prior
Manufacturing Economy Strength	Mar	57.2	Weaker
Service Economy Strength	Mar	55.2	Weaker
Monthly Jobs Report	Mar	98k	Weaker
National Unemployment Rate	Mar	4.5%	Lower
Annualized Quarterly GDP Growth	Q4 – 3rd	2.1%	Stronger
Personal Consumption (Spending)	Q4 – 3rd	3.5%	Stronger
Inflation–CPI ex.Food/Energy	Feb	2.2%	Lower

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

The Trump Rally Pauses

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	0.12	6.07	6.07	17.17	10.37	13.30	7.51
Small Domestic Companies Russell 2000 Total Return Index	0.13	2.47	2.47	26.22	7.22	12.35	7.12
International Developed Companies MSCI EAFE Index	2.75	7.25	7.25	11.67	0.50	5.83	1.05
Emerging Market Companies MSCI EM Index	2.52	11.45	11.45	17.22	1.18	0.81	2.72
Taxable Fixed Income							
Short Term Bonds Barclays U.S. 1-3 Year Aggregate Index	0.06	0.41	0.41	0.74	0.98	0.95	2.42
Intermediate Term Bonds Barclays U.S. Aggregate Bond Index	-0.05	0.82	0.82	0.44	2.68	2.34	4.27
High Yield Bonds Barclays U.S. Corporate High Yield Index	-0.22	2.70	2.70	16.39	4.56	6.82	7.46
International Government Bonds Citigroup World Government Bond Index	0.15	1.55	1.55	-3.65	-1.20	-0.58	3.03
Tax Exempt Fixed Income							
Short Term Municipals Barclays Municipal 1-3 Year Index	-0.01	0.88	0.88	0.63	0.79	0.87	2.12
Intermediate Term Municipals Barclays Municipal 5-10 Year Intermediate Index	0.20	1.91	1.91	-0.10	2.94	2.78	4.47
High Yield Municipals Barclays High Yield Municipal Index	0.23	4.06	4.06	4.31	5.46	5.64	4.29
Real Assets							
Commodities Bloomberg Commodity Index	-2.66	-2.33	-2.33	8.71	-13.91	-9.54	-6.22
Global Real Estate Dow Jones Global Select REIT Index	-1.83	0.66	0.66	0.03	8.08	8.92	2.77

** All data as of 03/31/2017. See disclosures for underlying index definitions. Periods longer than one year represent annualized performance.*

Economic Update

As the first quarter closed, economic indicators continued to point to relatively stronger economic growth. The manufacturing economy took a wider lead versus the service economy, staying at a level above 57. The service economy slowed more than expected, but remains above a level of 55, indicating the growth remains strong. In combination, both indices are consistent with strengthening economic growth.

For the full quarter, the labor market posted strong job gains. That faltered somewhat in March as gains slowed from the above 200,000 mark to only 98,000 new jobs. Some have argued that this result is actually due to a stronger than expected February jobs market which resulted from a warmer than normal February.[1] This may have pulled March's jobs into February. Regardless, the overall unemployment rate declined to 4.5%, the lowest level of the recovery so far. With wages accelerating, limited layoffs, and survey based measures suggesting hiring should remain strong, the labor market continues to tighten. This will be one point of consideration as the Federal Open Market Committee evaluates the pace of interest rate hikes throughout the remainder of the year.

Consumer confidence climbed again through March, reaching the highest level since 2000. Small business confidence also remains high. In combination, this is supportive of a self-reinforcing virtuous cycle where confidence drives both consumer and business spending, which returns more income to workers and drives businesses to continue hiring, which drives the unemployment rate lower making everyone feel a little better about the economy, which drives consumer confidence higher, etc., etc.

The GOP and administration's failure to repeal and replace the Affordable Care Act could cut into some of that confidence. In part, the recent boost in confidence is based on expectations of changes to the tax and regulatory environment businesses face. That confidence may fade if the failure on the ACA translates to lowered expectations of success for additional reforms. Fortunately, reforms are not the only reason why markets have been relatively stronger as earnings have returned to stronger growth boosted by growth in revenues (see Capital Markets Update below).

As the economy has continued to strengthen, the Federal Reserve has taken note particularly as it regards inflation. The most recent statement gave indications that inflation is starting to move closer to the Fed's long run goal. That, along with a tightening labor market, may give the Fed enough reason for 2 or 3 more moves this year. Fed funds probabilities provided by CME Group currently indicate a roughly 65% probability of a hike in June, with reasonable odds of additional increases in September and December. Many strategists believe the Fed will pause at one of these meetings, but a lot of that will be driven by data. If inflation picks up further, the Fed may be more preemptive in their policy movements.

Beyond the Fed Funds rate, which is a short term interest rate the Fed sets as it implements its monetary policy, the minutes of the March meeting indicate the Fed is considering starting to wind down its balance sheet. It seems like ages ago that the Fed was engaged in Quantitative Easing or QE. This involved the Fed purchasing bonds, particularly longer dated mortgage bonds, to drive interest rates lower farther out on the yield curve. Since the Fed stopped purchasing bonds, they have maintained the balance sheet by reinvesting interest and principal repayments. If they start to unwind the balance sheet, that will increase the supply of bonds in the market and that should result in interest rates starting to tick up. The next several meetings will be scrutinized for more hints of Fed tightening.

[1] "Pace of Hiring Slows in Mixed Jobs Report," Wall Street Journal, April 7, 2017

Capital Markets Update

For the quarter, global equities continued to rally. Early in March, the Dow Jones Industrial Average briefly climbed above 21,000 before settling back for the remainder of the month. The inability of the administration and the GOP in Congress to take action on the ACA moved domestic equity markets to March lows. In almost a complete opposite movement, international markets outperformed on the failure as the dollar declined and it the failure implied less likelihood of major trade policy changes.

International companies generally outperformed domestic companies for the month and quarter. Small companies lagged large domestic companies in a reversal 2016's outperformance. Emerging markets outperformed the broad developed equity indices for the quarter.

As mentioned above, the anticipated policy changes from the Trump administration are not the only reason for the recent stock run. Earnings have, in fact, come back relatively strong and expectations for continuing earnings growth have boosted stocks. Of course the expectations portion may have some overlap to the influence of policy on earnings, but earnings are expected to grow even in the near term. For all of 2017, earnings growth on the S&P 500 is expected to come in near 10%. Importantly, the early earnings growth expansion following the depths of the recession was driven by margin expansion instead of actual revenue growth. Today, the anticipated earnings growth is largely and finally being driven by growing revenues as the aforementioned consumer confidence numbers are driving sales. Revenues for the S&P 500 are expected to grow 5.3% for 2017, suggesting the earnings expansion can become self-sustaining.

This does not necessarily mean market expectations should follow as valuations are arguably rich at nearly 22x trailing earnings. However, barring surprises the earnings dynamic may provide a floor to any shocks. Despite stronger recent performance, international and emerging valuations continue to look attractive relative to domestic securities.

Within fixed income, markets were relatively flat through March, but broadly positive through the quarter as interest rates declined slightly and credit spreads generally narrowed.

We have previously commented on the uneasy balance between lofty expectations and increasing uncertainty that those expectations will be met. March did very little to change the balance, and may have even marginally shifted to negative policy expectations with the ACA failure. Following the Trump election, repeal of the ACA seemed almost a certainty, and yet today it seems like a near impossibility. This illustrates the need to remain diversified and not place a speculative bet on specific policy related outcomes.

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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