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MONTHLY MARKET UPDATE

February 2017

Economic data generally strengthened through February. Survey measures of economic activity and consumer confidence moved higher. The Federal Reserve did not meet in February, but statements by various Fed members suggest the Federal Open Market Committee is eying another move in March. Equity markets continued to run up in anticipation of a friendlier regulatory environment while the news cycle continued to be dominated by partisan rhetoric directed at Trump administration policies.

Lofty Expectations vs. Growing Uncertainty

Key Economic Statistics*	Period	Level	Vs. Prior
Manufacturing Economy Strength	Feb	57.7	Stronger
Service Economy Strength	Feb	57.6	Stronger
Monthly Jobs Report	Feb-Est	186k	Weaker
National Unemployment Rate	Feb-Est	4.7%	Lower
Annualized Quarterly GDP Growth	Q4 – 2nd	1.9%	Same
Personal Consumption (Spending)	Q4 – 2nd	3.0%	Stronger
Inflation–CPI ex.Food/Energy	Jan	2.3%	Higher

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

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	3.97	8.04	5.94	24.98	10.63	14.01	7.62
Small Domestic Companies Russell 2000 Total Return Index	1.93	5.20	2.33	36.11	6.93	12.89	7.22
International Developed Companies MSCI EAFE Index	1.43	7.94	4.37	15.75	-0.62	5.16	1.03
Emerging Market Companies MSCI EM Index	3.06	8.94	8.70	29.46	1.35	-0.37	2.86
Taxable Fixed Income							
Short Term Bonds Barclays U.S. 1-3 Year Aggregate Index	0.16	0.41	0.35	1.04	0.93	0.94	2.46
Intermediate Term Bonds Barclays U.S. Aggregate Bond Index	0.67	1.01	0.87	1.42	2.64	2.24	4.28
High Yield Bonds Barclays U.S. Corporate High Yield Index	1.46	4.83	2.93	21.83	4.72	6.84	7.49
International Government Bonds Citigroup World Government Bond Index	0.39	0.72	1.40	-1.24	-1.28	-0.82	3.04
Tax Exempt Fixed Income							
Short Term Municipals Barclays Municipal 1-3 Year Index	0.41	1.11	0.90	0.46	0.77	0.87	2.15
Intermediate Term Municipals Barclays Municipal 5-10 Year Intermediate Index	0.79	2.67	1.71	-0.36	2.68	2.56	4.46
High Yield Municipals Barclays High Yield Municipal Index	2.38	5.26	3.82	5.17	5.54	5.76	4.28
Real Assets							
Commodities Bloomberg Commodity Index	0.21	2.15	0.34	15.95	-13.02	-9.82	-5.87
Global Real Estate Dow Jones Global Select REIT Index	3.03	6.95	2.54	11.69	8.85	10.12	2.90

** All data as of 02/28/2017. See disclosures for underlying index definitions. Periods longer than one year represent annualized performance.*

Economic Update

Economic indicators continued to show strength through February. The actual results of economic growth are starting to match the opinion polls which anticipated strength following the Trump election. However, some of the forward looking projections may be overdone with an unrealistic expectation for the implementation of and the positive impact of regulatory and tax reform.

Both the service and manufacturing indices climbed to recent highs and currently are in a range that historically has been consistent with more robust economic growth. At 57.7, the manufacturing index is at its highest level since late in 2014. Notably, it slightly edged out the service index, which itself is at the highest level since late in 2015. While the manufacturing economy is smaller than the service economy, the rebound is particularly important for two reasons. First, it wasn't too long ago that the manufacturing economy actually was in recessionary territory, so the reversal to strong growth is both unexpected and a welcome relief. Second, Trump campaigned in part on saving the U.S. manufacturing economy, and whether his administration is responsible or not, there definitely is a current recovery in manufacturing which will be attributed to his administration and could boost confidence in the White House.

The labor market has continued to improve as well. At the time of this writing, the February jobs report has not yet been released, but expectations suggest the labor market will add a reasonable number of positions and the unemployment rate may tick down slightly.

In addition to these measures of the economy, consumer confidence has climbed to the highest level since 2001. Therein should lie both excitement for the engagement of the consumer to keep the recovery going, and fear of the forward looking blindness of consumers as a group. The last three times that consumer confidence was roughly at today's level, the U.S. economy had entered or was about to enter a recession. That should not be read as a prediction of recession, but rather a caution to be wary of group euphoria, particularly when it may be grounded in predicted events which may fail to transpire.

What are the predicted events underlying the economic optimism? It seems that regulatory reform and tax reform are the main considerations. The Trump administration has already moved, via executive orders, to rescind or reform many regulations of the Obama administration. From a business perspective, there are likely to be actual realized benefits from lowered compliance costs from a friendlier regulatory environment. However, that does also present the possibility that excesses can start to build as businesses exploit the newly created holes in regulations.

Tax reform has the potential to provide a much more significant impact, but realization of that goal also calls for actual legislation instead of presidential executive action. With the partisan environment of the last several years seemingly getting worse, not better, the probability of getting the most significant tax reform since Reagan was in office through Congress is declining day by day. If the campaign promises ultimately do not become realities, it is unclear what the impact on markets and on consumer confidence might be.

The Federal Reserve is, of course, paying attention to all the economic data as they determine how to manage the monetary side of the economic ledger. With strong economic growth and more signs of inflation popping up, the probabilities of a rate hike in March have completely reversed from roughly 80% expectation of no move to over 80% expectation of a hike.[1] This sets up a potential stand-off

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[1] CMEGroup.com

between the Fed and the Trump administration. The administration would like to use fiscal policy, including tax reform, to boost the rate of economic growth in the U.S. The Fed, by contrast, must make sure economic growth does not accelerate so fast that it becomes inflationary. The situation may evolve into the economic equivalent of hitting the gas while pulling the handbrake.

Capital Markets Update

Global equities have continued to rally in support of stronger forecasted economic growth and earnings. The question is whether markets are getting too far ahead. The S&P 500 currently trades at nearly 22x trailing earnings, a premium of roughly 37% relative to historical averages. Market bulls argue that the valuation is supported in stronger earnings growth expectations. As of March 2nd, consensus FactSet growth expectations for the S&P 500 is to go from effectively zero growth in 2016, to 9.8% growth for 2017 and 11.9% growth in 2018. Of course at least some of that optimistic outlook is grounded in the same uncertain predicted events covered above. If those events do not come to fruition, U.S. markets may experience earnings growth disappointed and valuation contractions to match more moderate expectations.

By contrast, foreign markets are trading at more reasonable valuations despite only slightly discounted growth expectations. The relative discount in valuations likely reflects more political instability, particularly in Europe where various political groups are challenging the status quo of the European Union and Eurozone. The relative discount could also reflect uncertainty regarding developing trade policies from the U.S. Of course, this valuation gap has persisted for much of the last decade as the U.S. recovery outpaced many foreign economies. Just because there is a discount doesn't mean there is an immediate opportunity to exploit the discount. There are, however, many quality companies domiciled internationally and we continue to believe global exposure will pay off in the long run.

Within fixed income, markets were broadly positive through February as rates did not move much and credit spreads generally narrowed. Despite relatively low return expectations in fixed income, particularly if rates move up further, we continue to believe fixed income serves as an important risk diversifier in portfolios.

As we approach the end of the first quarter, there seems to be an uneasy balance between lofty expectations and increasing uncertainty that those expectations will be met. 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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The views and opinions presented in this update are those of Jaco Jordaan and not of HD Vest Financial Services® or its subsidiaries.