SILVERCREST
ASSET MANAGEMENT GROUP

Economic & Market Insights

SPRING/SUMMER 2017 ISSUE

Introduction

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ROBERT TEETER
CHAIRMAN OF INVESTMENT POLICY AND STRATEGY

Regardless of your view of the many U.S. presidential inaugurations that have taken place since 1789, we hope you have a favorable view of this inaugural issue of Silvercrest's Economic & Market Insights.

We aim to provide two publications per year, discussing issues that are timely and relevant for investors. The Silvercrest professionals sharing insights on these topics bring a depth of experience and a variety of expertise.

30 YEARS – Average experience of Investment Policy & Strategy Group
25 YEARS – Average experience of managers of Silvercrest proprietary investment capabilities
30 YEARS – Average experience of Silvercrest Portfolio Managers

Our Equity and Fixed Income Portfolio Managers, Roger Vogel and Patrick Bittner, will share insights from their respective strategies.
POST-ELECTION EQUITY RALLY, Page 7. MUNICIPAL BOND UPDATE, Page 8.

Sorting through the impact and feedback of strength or weakness in the U.S. dollar is not a simple exercise. Strategist Patrick Chovanec provides some color on how investors should be thinking about the U.S. dollar.
A CONVERSATION ON THE U.S. DOLLAR, Page 11.

We will also provide some context on the current economic and market environment through a short collection of charts. Hopefully each will provide at least 1,000 words of value.
ECONOMIC & MARKET OVERVIEW, Page 2.

Over the next few months, we expect to hear a lot about the nuanced and important budget reconciliation process taking place in Washington, D.C. Patrick Chovanec provides a detailed picture of this process and what we might expect.
BUDGET RECONCILIATION, Page 6.

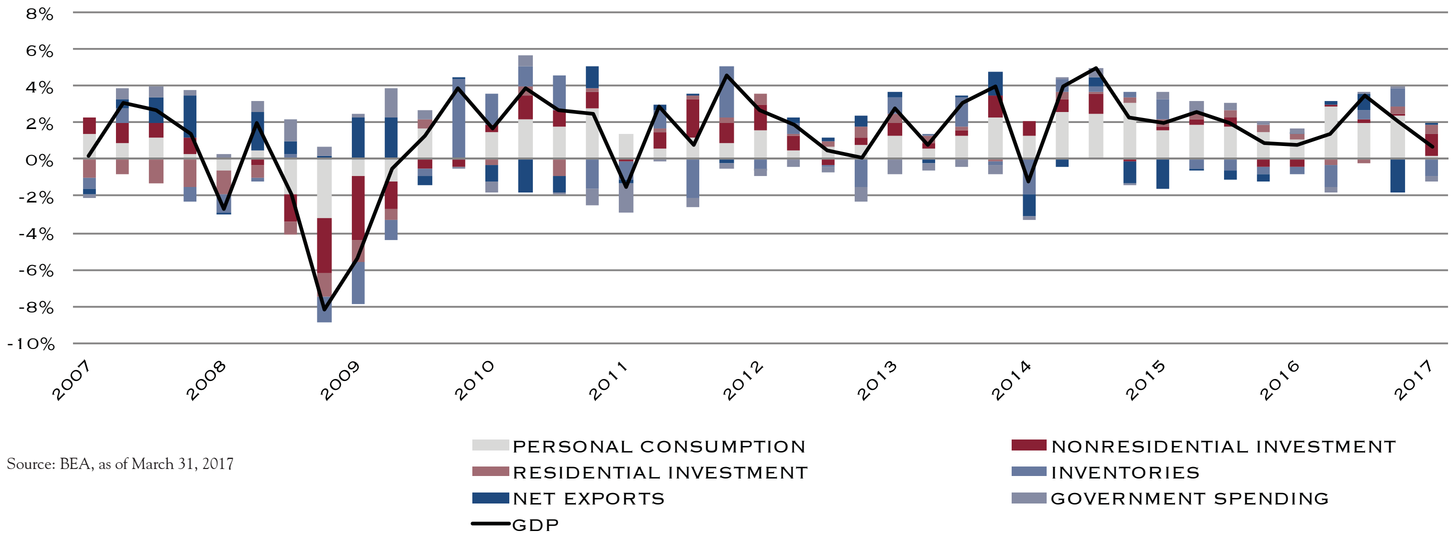
Anyone reading a newspaper has heard the multitudinous criticisms of hedge funds. With apologies to Shakespeare and others, hedge funds are not good or bad. But what are they? In our view, it's best to define an objective before reaching for a tool. As Martin Loeser explains *"The primary reason we invest in hedge funds is to get exposure to strategies, risk premia and asset classes that are not easily accessible via other mechanisms."*
WHAT TO MAKE OF HEDGE FUNDS, Page 9.

Finally, tying it all together, the Silvercrest Investment Policy & Strategy Group provides insight on asset allocation from our most recent quarterly review.
INVESTMENT OUTLOOK SUMMARY, Page 12.

Economic & Market Overview

GDP CONTRIBUTIONS

Quarterly



Source: BEA, as of March 31, 2017

While GDP growth has moderated following the significant decline and recovery during the financial crisis, it continues to oscillate, frustrating all efforts to produce consistent and higher growth.

Starting at a growth rate near 2.0% in late 2007 at the outset of the crisis, GDP growth turned negative for several quarters before starting a largely positive and long-lived, yet range-bound journey through the first part of 2017.

The major components of GDP, as well as economic sectors have often been out of sync, preventing growth from becoming too hot or too cold.

In the chart above, we show major contributors/detractors to GDP.

This illustrates that while overall GDP growth rates have generally remained in a tight positive range, the contributors have continued to change in both direction and magnitude.

This long, slow recovery has provided a supportive backdrop for appreciation in equities.

U.S. EMPLOYMENT

The long, slow recovery in GDP has supported not only equity values but a recovery in employment as well.

Significantly, both the unemployment rate and the number employed have recovered to pre-crisis levels. In the absence of strong wage growth or consumer re-leveraging, consistent expansion in payrolls has been a key driver of consumption growth in this recovery. As the U.S. economy approaches full employment, wage gains—supported by productivity gains—will have to play a larger role in sustaining growth.

INITIAL JOBLESS CLAIMS

TOTAL U.S. EMPLOYMENT

(millions employed, 16 years and older)

Source: Bureau of Labor Statistics, as of April 2017

In the first part of 2017, as markets continued to advance, we have heard comparisons to 2000. To investigate, we decided to take a trip back in time using historical data. Dated data can be somewhat spotty and suspect, but we are able to get enough of a look for some basic comparisons on valuation between March 2000 and May 2017.

The first step was to determine the current and prior drivers of return in the S&P 500 as measured by attribution. We identified the top 20 contributors to the S&P 500 returns. These are displayed in the table below, ranked by their attribution impact, calculated as allocation in the index multiplied by return.

PRICE/EARNINGS

TOP 20 ATTRIBUTION WITHIN S&P 500 VALUATION STATISTICS

MARCH 2000

TICKER	COMPANY NAME	PRICE / EARNINGS
MSFT	Microsoft Corporation	64.1
CSCO	Cisco Systems, Inc.	150.7
GE	General Electric Company	42.1
WMT	Wal-Mart Stores, Inc.	39.0
QCOM	QUALCOMM Incorporated	140.5
NRTLQ	Nortel Networks Corporation	98.1
ORCL	Oracle Corporation	130.0
TWX	America Online, Inc.	183.6
JAVA	Sun Microsystems	103.1
C	Citigroup Inc	18.6
YHOO	Yahoo! Inc.	457.8
INTC	Intel Corporation	46.2
EMC	EMC Corporation	86.4
CBS.A	Viacom Inc.	--
LU	Lucent Technologies Inc.	43.7
VIAV	JDS Uniphase Corporation	184.3
HD	Home Depot, Inc.	51.6
MSI	Motorola Inc.	26.9
AIG	American International Group, Inc.	30.0
TXN	Texas Instruments Incorporated	68.3
	Average	103.4
	Weighted Average	**89.0**
	Average (ex Yahoo)	83.7
	Median	68.3

MAY 2017

TICKER	COMPANY NAME	PRICE / EARNINGS
AAPL	Apple Inc.	16.67
FB	Facebook, Inc. Class A	28.44
AMZN	Amazon.com, Inc.	139.98
MSFT	Microsoft Corporation	22.75
GOOGL	Alphabet Inc. Class A	28.15
GOOG	Alphabet Inc. Class C	27.46
PM	Philip Morris International Inc.	23.00
V	Visa Inc. Class A	27.35
HD	Home Depot, Inc.	21.65
CSCO	Cisco Systems, Inc.	14.46
ORCL	Oracle Corporation	17.28
JNJ	Johnson & Johnson	17.41
CMCSA	Comcast Corporation Class A	19.72
AVGO	Broadcom Limited	15.21
PCLN	Priceline Group Inc	25.68
MCD	McDonald's Corporation	22.55
BAC	Bank of America Corporation	13.06
MDT	Medtronic plc	18.34
BA	Boeing Company	19.74
ADBE	Adobe Systems Incorporated	34.15
	Average	27.7
	Weighted Average	**30.4**
	Average (ex Amazon)	21.7
	Median	22.1

Source: Factset, as of May 5, 2017

Economic & Market Overview (continued)

In March 2000, weighted average P/E (Price/Earnings) of the top 20 companies was 89.0. In May 2017, the weighted average P/E of the top 20 companies was 30.4. Similarly, excluding the highest P/E stocks (Yahoo and Amazon), or just taking median or a simple average, shows that the key drivers of return in 2000 were significantly more expensive than in 2017.

It is especially challenging to conduct a deep dive into data integrity and the many assumptions that are made in collecting historical data. However, there is enough signal in the noise to highlight the meaningful valuation disparity between today and 2000.

While there may be other reasons to compare today to 2000, valuation of the key contributors to the S&P is not one of them. ETF's may be responsible for a lot of flows to the S&P, but they are not yet driving 2000-style valuation.

A normal decline can occur at any time. It would certainly be very normal for a 10% correction to occur. However, a more serious bear market would likely require fuel from things like a recession, inflation or excesses, such as those seen in valuation in 2000 or credit markets in 2007.

We will continue our quest to identify any meaningful excesses that may sow the seeds of a serious decline. In the meantime, it is wise to prepare for a normal decline with proper allocation and reasonable expectations.

As with most trips down memory lane, there are numerous interesting observations in these tables. Surely 20 years from now, today's top 20 will look different as well.

RELATIVITY IN MARKETS

As can be seen in the table (below), in 1987, the earnings yield (inverse of P/E ratio) on the S&P 500 was less than half the yield of the Barclays Aggregate Index. Similarly in 1999, the earnings yield on the S&P 500 was again below 50% of the yield on the Barclays Aggregate Index. However, at the end of Q1 2017, the S&P earnings yield was 140% of the yield of the Barclays Aggregate Index. No data are fully predictive, yet this is a relevant exercise in that many market observers compare current equity valuation data to the long-term historical averages. That approach is relevant, but it is also important to dig deeper to understand the full market and economic backdrop that contributed to that long-term average.

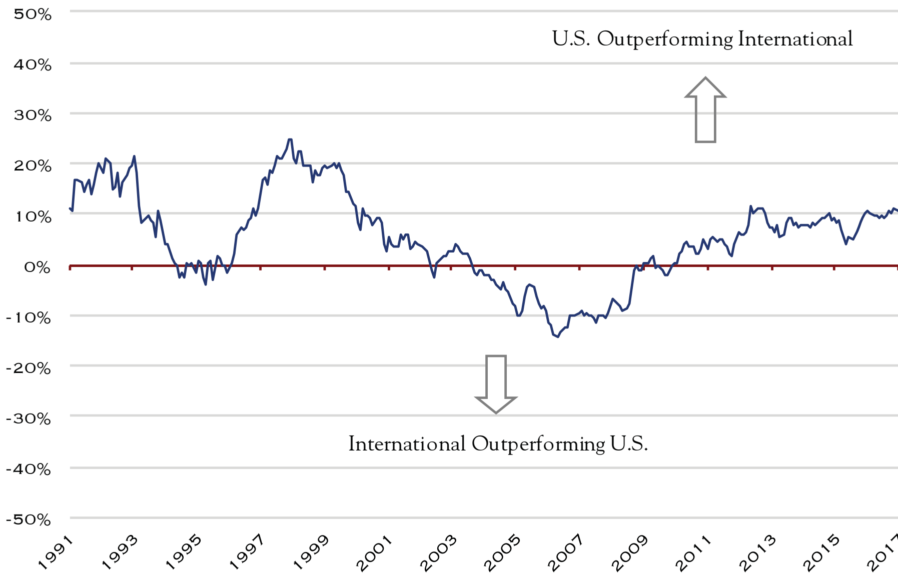
	S&P EARNINGS YIELD	UST 10 YR YIELD	INFLATION (Y/Y)	BARCLAYS AGG.YTW
9/30/1987	4.47%	9.59%	4.40%	10.60%
12/31/1999	3.41%	6.44%	2.70%	7.70%
Current	4.72%	2.39%	2.40%	3.33%
Average	6.86%	6.53%	4.09%	7.63%

Source: Bloomberg, as of March 31, 2017

While some elements of current market conditions may resemble prior time frames, it does not appear that the valuation of broad equities is in the same relative positon as they were in 1987 or 1999. Surely, a decline can come at any time and for any reason. However, a resemblance of some metrics to 1999 or 1987 does not appear to be a likely potential culprit.

U.S. vs INTERNATIONAL

Rolling 3-Year Return



Source: Bloomberg, as of March 31, 2017

As shown in the chart, on a rolling three-year basis, U.S. equities have generally outperformed international markets for much of the past 25 years. While valuations in some international markets have perhaps become compelling, other issues remain such as demographic challenges and geopolitical risk factors. The emerging markets component within international markets does offer favorable demographics and present tense growth, but comes with an additional dose of volatility. Despite these challenges, international equities can be a good diversifying source of risk/return. Further, certain international markets offer a less crowded environment for active managers to identify and invest in high-quality companies, at compelling valuations.

NOMINAL BROAD DOLLAR INDEX

Weekly as of April 2017

Source: Federal Reserve, as of March 31, 2017

On page 11, Patrick Chovanec undertakes a Q&A on the nuances of the U.S. dollar and impact of strong and weak dollar. The chart on the left sets the backdrop of the trade weighted major currencies dollar index. Dollar strength/weakness has tended to ebb and flow in multi-year cycles. Patrick's commentary provides some insight on how to think about the action and reaction impact of moves in the U.S. dollar.

Budget Reconciliation

PATRICK CHOVANEC
CHIEF STRATEGIST

President Trump and Republicans in Congress have an ambitious agenda, including changes to health care, personal and corporate taxes, and spending on infrastructure and defense—changes that, if enacted, could move the needle for investors. But because they lack a filibuster-proof 60-seat majority in the Senate, Republicans are reliant on a special process called "budget reconciliation", which is immune to filibuster, to pass most of their agenda absent Democratic support. Budget reconciliation, however, has a number of restrictions and drawbacks that could severely limit what the U.S. Congress is able to accomplish in the rest of this year. Here are a few points for investors to consider, as the year progresses:

1) Budget reconciliation bills are restricted to measures that directly affect revenues, spending, and debt. Under the so-called Byrd Rule, no other policy provisions can be included. That presents a big problem on health care, where Republicans can use reconciliation to gut the financial provisions of Obamacare, but can't replace it with anything attractive—or even functional—through a budget bill alone.

Contrary to oft-repeated rumors, a reconciliation bill may add to the budget deficit.

2) Contrary to oft-repeated rumors, a reconciliation bill may add to the budget deficit. The Bush tax cuts in 2000, for instance, were passed using reconciliation. When the Democrats gained control of Congress in 2006, they passed a new rule barring reconciliation from adding to the deficit, but both the House and Senate have since rescinded it. What remains in place, however, is an older rule preventing a reconciliation bill from adding to the deficit beyond the years covered by its budget resolution. That's why the Bush tax cuts could only be temporary, and had to be later extended. That might not be a problem for relatively modest changes in tax rates, meant to stimulate the economy; it may be another if you're planning on altering the basic structure of the tax code. The last major tax overhaul, in 1986, was permanent—but only because it was bipartisan and revenue-neutral. This one probably won't be, which could raise a lot of issues.

In other words, until they pass—or abandon—health care, they're facing a big legislative logjam that makes it hard to make much serious progress on the tax front.

3) Congress can only pass a maximum of three reconciliation bills for each budget year: one each dealing with revenues, spending, and the debt ceiling—though any bill dealing with both revenues and spending (like the "repeal and replace" of Obamacare) counts as two bills. Luckily for Republicans, they didn't pass a 2017 budget last year, so by passing a 2017 and 2018 budget this year, they can get two bites of the apple. Their plan was to pass a 2017 budget resolution that made a provision for changes to health care (which they did), then a 2018 budget resolution that makes a provision for tax cuts and reform. The problem is that their health care bill has only just made it to the Senate, where it faces further delays and major changes, assuming it can pass at all. Meanwhile, Congress can't adopt a 2018 resolution to start work on taxes, because doing so would erase the 2017 resolution. In other words, until they pass—or abandon—health care, they're facing a big legislative logjam that makes it hard to make much serious progress on the tax front.

Of course, most of these rules are ones Congress has created, and could change if it wished to. Congress could scrap the Byrd Rule, pass an extra-long budget resolution, or even get rid of the Senate filibuster. The Trump White House tentatively floated the last idea, which several Senators immediately shot down. So, it's likely these rules will continue to operate, in some form, and could place real constraints on the Republican majority's ability to deliver on goals which, from a distance, might seem a lot easier to achieve.

Post-Election Equity Rally

ROGER VOGEL
MANAGING DIRECTOR

The election year of 2016 was uncharacteristically volatile. While returns started out weak, the end result was far removed from the pessimism that dominated investor psychology for the first seven weeks of the year, with the equity bottom reached back in February of 2016. The presidential election in November 2016 triggered a sharp equity revaluation, aided by the Federal Reserve's 25 basis-point rate increase at its December 2016 meeting. The Fed's move was the first interest-rate hike in a year and only the second increase in more than a decade! U.S. equities rallied throughout this period as investors sold off long-dated bonds in anticipation of post-election economic growth, inflation and employment gains, lower taxes, more spending on the nation's infrastructure and less business regulation.

As we made our way through the first quarter of 2017, optimism that the new administration will usher in business-friendly policy changes continued to drive positive and broad-based market sentiment. Large market-capitalization issues performed better than small-cap stocks, as evidenced by the returns of the Russell 1000 large cap Index of +6.0%, Russell 2500 mid cap Index of +3.8% and Russell 2000 small cap Index of +2.5%. Growth beat Value as evidenced in the Russell 3000 Value Index's +3.0% performance lagging that of the Growth at +8.6%. Low-quality stocks—those with negative earnings, low returns on capital and high leverage—produced better returns (+5%) than their high-quality counterparts (+4%) for the first quarter, due chiefly to their strong return in January's post-election stock euphoria.

We expect more volatility as political wrangling, geo-political tensions, and positive, but relatively tepid economic growth intersect.

U.S. equity returns continued to exceed those of fixed income classes in the first quarter: investment grade corporate bonds and long-term Treasuries both rose +1.4%. In a risk-on, growth-oriented environment, it's no surprise that the metal commodities outpaced equities: gold jumping +8%, silver rising nearly +14%, and economically sensitive copper appreciating nearly +6%.

Looking around the world, equity markets were similarly strong as the MSCI World Index (excluding the U.S.) appreciated +5% in local currency and rose +8% when measured in U.S. dollars.

The implication being that responsible companies almost surely won't commit capital until tax and regulatory changes are clarified.

During the post-election period from November 8, 2016 through March 31, 2017, across both large and small stocks, the cyclical Financial Services (+17.6%), Materials & Processing (+15.9%), Industrial/Producer Durables (+13.9%), and Technology (+13.6%) sectors jumped, while defensive Utilities (+7.9%) and Consumer Staples (+5.3%) sectors trailed. Looking ahead, we remain conscious that expansionary expectations evident in equity prices have yet to be met with delivery on political promises. We expect more volatility as political wrangling, geo-political tensions, and positive, but relatively tepid economic growth intersect.

Our recent conversations with company management teams, including more than a few with banks, provided little evidence of long-range business investments being launched, with the implication being that responsible companies almost surely won't commit capital until tax and regulatory changes are clarified. At present, management teams do not know what the tax, trade, energy, or anti-trust rules will be, leading to capital projects generally remaining on the back burner.

Municipal Bond Update

PATRICK BITTNER
MANAGING
DIRECTOR

Since the presidential election, fixed income markets have been on a roller coaster. 10-year U.S. Treasury yields jumped from 1.80%, prior to the election, to 2.60% by the middle of December on concerns that President-elect Trump's policies would inflate the economy. Diminished confidence in a quick passage of the President's agenda caused markets to recalculate the possibility of pro-growth policies and yields dropped back to 2.20% by mid-April.

Immediately after the election, tax reform fears caused municipal bonds to underperform Treasuries. Most of the pain was felt in 10-year and longer bonds. Low supply and strong demand in the beginning of the year allowed municipals to outperform. April, historically a weak month for municipals, saw near-record mutual fund inflows, low new issuance and strong demand, focused mainly in the 2-7 year part of the yield curve. May saw a continuation of this trend.

Summer typically heralds a period of strong seasonal outperformance for municipal bonds caused by supply and demand imbalances.

Summer typically heralds a period of strong seasonal outperformance for municipal bonds caused by supply and demand imbalances. Usually, more bonds mature than are issued. This net negative issuance provides strong support to the municipal market. This year, the period of net negative issuance is projected to last into the fall providing further support to the municipal market. However, talk about tax reform or pro-growth policies could roil the municipal market.

The summer also brings the possibility of the Federal Reserve raising short term rates again. Currently, internal Federal Reserve projections are predicting two more rate increases in 2017 and three more in 2018. However, fixed income markets are only pricing in one additional hike this year and one more in 2018. Though still in early stages, we are monitoring the Federal Reserve's discussions of a reduction of their balance sheet. As expectations evolve, markets will react accordingly.

This year, the period of net negative issuance is projected to last into the fall providing further support to the municipal market.

Credit quality in the municipal market remains strong with a few exceptions. Currently, Hartford, Illinois, New Jersey, Puerto Rico, and credits related to the default of a nuclear power plant builder are under pressure. Pensions and deteriorating infrastructure are still a concern. However, rating agencies have recently issued more credit upgrades than downgrades but we believe credit quality has plateaued.

Over the next few months, interest rates may be affected by the economy, FOMC actions, international intrigue and U.S. politics. Still, we see support for the municipal market due to limited supply from net negative issuance this summer and fall.

What to Make of Hedge Funds

MARTIN LOESER
SENIOR
VICE PRESIDENT

As the drumbeat of discontent against hedge funds grows louder within the financial press, assets managed by the industry remain at or near record highs. How can this apparent inconsistency be explained? Admittedly, the hedge fund industry has created an easy target on its back, with many investors having experienced frauds, unexpected side-pockets or redemption restrictions, high fees and poor performance. At Silvercrest, our team has dedicated significant resources and built a rigorous process focused on avoiding these types of problems. But the question remains, why invest in hedge funds at all? In my mind, that is somewhat analogous to asking why invest in stocks?

The primary reason we invest in hedge funds is to get exposure to strategies, risk premia and asset classes that are not easily accessible via other mechanisms.

The equity markets have also experienced frauds, bankruptcies, trading halts and excessively compensated management teams. Equities clearly offer better liquidity which can be a very valuable characteristic and some argue that hedge funds are less regulated, although that is increasingly becoming less true. These arguments somewhat miss the point though. The primary reason we invest in hedge funds is to get exposure to strategies, risk premia and asset classes that are not easily accessible via other mechanisms. Further, we seek to do it with highly experienced management teams that can be accessed as frequently as needed.

At Silvercrest, we spend less time attempting to classify hedge funds and more time determining what type of fund would best complement a specific client's portfolio and investment

By most counts, there are more hedge fund vehicles than there are actively traded public stocks in the U.S. Just as we don't expect all stocks to behave similarly, we should not expect a structured credit fund to behave like a long/short equity fund, nor should we expect that one long/short equity fund will behave like another.

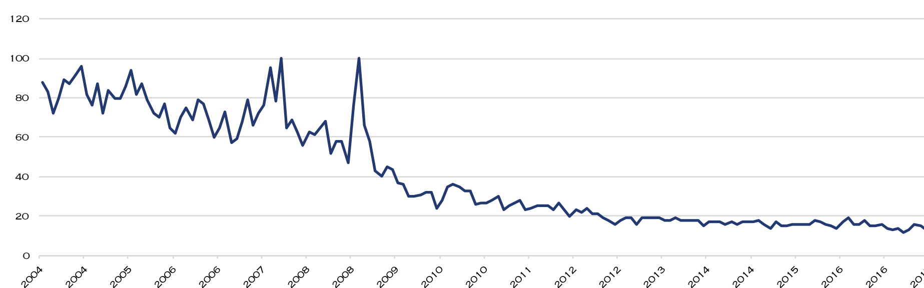
At Silvercrest, we spend less time attempting to classify hedge funds and more time determining what type of fund would best complement a specific client's portfolio and investment objectives. If a client is looking to reduce equity exposure, for example, the swapping of higher beta to lower beta investments can be instrumental as can the inclusion of other orthogonal strategies. However, it is critical to really understand the exposures and behaviors of the hedge funds being added given that hedge funds often have fairly broad mandates.

For some portfolios, highly complex hedge fund strategies can be very useful in improving risk-adjusted returns, through higher returns, correlation benefits or lower volatility. For other portfolios, similar benefits can be achieved through much simpler fund strategies as long as there are clear exposure guidelines, repeatable processes and strong organizations and infrastructure. Furthermore, many of these funds have adopted longer-term investment horizons, leading to more tax-efficiency, and additionally, fees across the industry have finally started to decline.

As the current bull market in stocks and bonds continues to mature, we welcome the opportunity to discuss the many benefits of a targeted approach to including hedge funds in your portfolio.

Interest in hedge funds has been on a steady decline. Generally negative press coverage, combined with mostly lackluster returns have damped enthusiasm for investing in hedge funds. Before writing off hedge funds, it is useful to consider three different eras in time and how they have contributed to an identity crisis in hedge fund investing.

WORLDWIDE GOOGLE SEARCH TRENDS: "HEDGE FUNDS"



Source: Google, as of May 2017

1990 – 1999

ANNUALIZED RETURNS	JANUARY 1990 - DECEMBER 1999
S&P 500 Index	15.3%
HFRI Fund of Funds Composite Index	12.6%
Bloomberg Barclays U.S. Aggregate Bond Index	7.7%

Source: Bloomberg, as of May 2017

In this era, hedge funds often took relatively high levels of risk and their returns tracked fairly closely with equities. Investor sentiment was that hedge funds were often comparable to equities. During this time, relationships and networking were key to finding the "best" managers.

2000 – 2011

ANNUALIZED RETURNS	JANUARY 2000 - DECEMBER 2011
S&P 500 Index	-1.3%
HFRI Fund of Funds Composite Index	3.3%
Bloomberg Barclays U.S. Aggregate Bond Index	6.5%

Source: Bloomberg, as of May 2017

Starting with the bursting of the tech bubble in 2000, hedge funds really began to shine. Many long/short equity funds had a well-constructed profile, characterized by being long small cap value stocks and short large cap growth stocks. As the valuation and performance disparity between these styles and market-caps converged, the result was healthy outperformance compared to equities. Many funds posted gains in 2000-2002 while equities fell as the tech bubble burst. This helped to create the reputation for hedge funds as capital protectors. However, the 2008 financial crisis struck and many funds didn't live up to, perhaps unfairly, elevated expectations. Shorts often did not provide the protection that they had in earlier market corrections and, in some cases, even compounded losses. Further, some funds had liquidity problems and there were a few noteworthy frauds.

Despite this mixed performance during the 2008 crisis, fund returns were quite solid as compared to equities during the time frame shown (below), which includes several years before and after the crisis.

2012 – 2016

ANNUALIZED RETURNS	JANUARY 2012 - DECEMBER 2016
S&P 500 Index	12.7%
HFRI Fund of Funds Composite Index	3.8%
Bloomberg Barclays U.S. Aggregate Bond Index	2.4%

Source: Bloomberg, as of May 2017

As many institutions began to realize that the characteristics of hedge funds could be additive to portfolios, the hedge fund industry continued to grow assets under management. However, with growth came some confusion over the question "what is a hedge fund?" Were hedge funds really the high return vehicles of the 1990's or were they the capital protectors of the 2000's?

CONCLUSION

The reality is that there are nearly limitless configurations of risk profile and strategy and it is no more meaningful to group all hedge funds than it is to group all mutual funds.

A Conversation on the U.S. Dollar

Excerpt from Silvercrest's Q2 2017 Market Commentary Call

PATRICK CHOVANEC
CHIEF STRATEGIST

WHICH IS BETTER FOR THE U.S., A STRONG OR A WEAK DOLLAR?

A dollar that is expensive, compared to other currencies, gives American consumers greater purchasing power, but it also makes U.S.-made goods more costly for others to buy, potentially widening the trade deficit. It also cuts into the pricing power of U.S. companies at home, as well as the value of their earnings abroad, in dollar terms. A cheaper dollar does the opposite, giving a potential boost to U.S. growth and earnings, at the expense of reducing the buying power of American consumers.

WHAT'S BEEN DRIVING THE U.S. DOLLAR LATELY?

The value of the dollar is driven by demand from people around the world who want dollars to buy U.S. goods or U.S. assets. The U.S. economic recovery has been stronger than in Europe or Japan, and the Federal Reserve has been starting to raise interest rates, even as those countries continue to ease. Those higher rates attract funds into the U.S., which has boosted the dollar. We saw that through 2015, in anticipation of Fed tightening. The stronger dollar was also creating significant headwinds to U.S. growth at that time, widening the trade deficit and cutting into U.S. corporate earnings.

When the Fed was more patient in raising rates than many people expected, the dollar stabilized through most of 2016, and those headwinds to growth were reduced.

WHAT DOES THIS MEAN FOR THE U.S. ECONOMY?

Those movements in the dollar are one reason we continue to see positive, if uninspiring, growth rates in the U.S., with neither a break-down or a break-out in either direction. What we're seeing is the U.S. dollar acting as a regulator on the U.S. economy. If growth gets too far ahead of the global growth rate, the dollar rises and that growth gets reined in. If growth falters, the dollar weakens and helps support it.

WHAT MOVES IN THE DOLLAR HAVE WE SEEN MORE RECENTLY?

Right after the election, the dollar surged to a 14-year high, on a broad trade-weighted basis. That's because many people expected the Trump Administration to enact policies—like tax cuts, more defense and infrastructure spending, etc.—that would boost demand, further increasing pressure on the Fed to tighten more aggressively. In the new year, as doubts have grown whether those policies will happen as quickly or smoothly as many thought, the dollar has come back down.

What we're seeing is the U.S. dollar acting as a regulator on the U.S. economy.

When the dollar surged, the headwinds to growth from a strong dollar returned. A wider trade deficit shaved −1.8 points off GDP in Q4. Since the dollar declined, those headwinds have receded—for now. The trade deficit stabilized in Q1, contributing +0.1 points to GDP growth. But this isn't about the president talking the dollar up or down. If nations could do that, in any sustainable way, we'd live in a very different world. It's policy, not posturing, that's ultimately the deciding factor.

WHAT DOES ALL THIS MEAN FOR INVESTORS?

The first thing is what it means for U.S. growth. It's not easy for President Trump to boost U.S. growth through stimulus, if that causes a stronger dollar that reins in growth. But a weaker dollar, in the face of disappointments, also helps put a supportive floor under growth.

The second thing is how exchange rate movements affect returns on non-U.S. assets. In 2016, London's FTSE 100 rose +14.4%, but because the pound fell −16.6% against the dollar, the index's value actually fell −4.6% in dollar terms. Both gains and losses to Japan's Nikkei were also largely cancelled out by fluctuations in the yen against the dollar. It is important to keep currency movements in mind when thinking about potential returns in overseas markets.

Investment Outlook Summary

From the Investment Policy & Strategy Group

The Investment Policy & Strategy Group met in April 2017 to review asset allocation.

EQUITY

Equity allocations have been maintained at a level that is slightly above the midpoint of our range for the Income, Balanced and Growth objectives. Acknowledging that equity markets have advanced, we continue to emphasize the importance of rebalancing and thoughtful deployment of cash, consistent with client risk profiles. Trailing P/E ratios are above average, yet supportive of long term returns. We maintain a constructive view of equities over the 2-4 year time-horizon based on dividend yields, positive earnings trends and continued support for earnings multiples due to historically low (albeit potentially rising) interest rates and inflation.

Acknowledging that equity markets have advanced, we continue to emphasize the importance of rebalancing and thoughtful deployment of cash, consistent with client risk profiles.

With a backdrop of recent strength in equities, as well as diminished volatility, we recognize that a normal pullback in prices would not be unexpected. However, we do not attempt to forecast short-term market behavior. The continued evolution of the political climate, Fed Policy and geopolitical issues are contributing factors to short term volatility. However, this volatility becomes less of a factor as the investor's time-horizon is extended.

Investment implementation across geography, market cap and investment style was maintained. In recognition of the potentially compelling valuations and long term return differentials, we will continue to closely examine allocations to non-U.S. equity. Many developed markets face ongoing political, demographic and growth challenges. Growth and demographics are more favorable in emerging markets, yet those markets can be impacted by "risk-off" and/or strength in the U.S. dollar. As we refresh our expected return outlooks across asset classes within equity, we will re-visit allocations as well.

FIXED INCOME

In fixed income, we continue to encourage prudence with regard to duration and credit. Cash equivalents and fixed income hedge funds are two strategies for limiting risk. We see relative value in municipal bonds for taxable investors.

In fixed income, we continue to encourage prudence with regard to duration and credit.

ALTERNATIVES

Within alternatives, customization is important. Objectives should be clearly defined and funds selected appropriately. Alternatives can be a useful tool for managing and diversifying risk in a portfolio.

Within the Growth objective, for more aggressive implementations and for those who can tolerate liquidity limitations in seeking a higher potential risk/return profile, we are incorporating two Private Equity allocations. Consistent with guidance last quarter, this allocation contains a core Private Equity allocation, as well as a more aggressive Private Equity allocation. The core allocation could consist of a multi-strategy large/mid cap private allocation, while the aggressive allocation could consist of allocations to more volatile strategies such as venture capital or growth.

CONCLUSION

As always, we will seek to add value to client portfolios over time by rebalancing allocations in anticipation of opportunities or in reaction to market developments in order to maintain the proper balance between risk and opportunity.

– *The Investment Policy & Strategy Group*

Market Monitor

This table provides a comprehensive view of returns across various markets and time frames. It is paired with a snapshot of economic data at the start of each time frame. This allows for comparison of annualized returns for a time frame while referencing the basic economic conditions in place in various periods.

	ANNUALIZED RETURNS				
INDICATOR	1-YEAR	3-YEAR	5-YEAR	10-YEAR	20-YEAR
U.S. EQUITY					
Nasdaq	25.27%	13.47%	17.00%	9.06%	7.72%
Russell 1000 Growth	18.40%	10.17%	14.11%	7.06%	5.53%
S&P 500 Total Return	17.47%	10.13%	15.42%	6.94%	7.36%
Russell 3000 Total Return	17.69%	9.68%	15.26%	6.96%	7.61%
Russell Large Cap	15.09%	7.62%	13.03%	4.81%	5.65%
Wilshire 5000	15.41%	7.16%	12.75%	4.94%	5.85%
Russell Small Cap	18.65%	6.49%	12.46%	4.93%	6.61%
Russell 1000 Value	11.79%	5.04%	11.87%	2.47%	5.25%
GLOBAL EQUITY					
MSCI Japan	12.54%	8.07%	16.15%	-1.73%	0.07%
MSCI India	13.48%	7.48%	12.20%	6.64%	11.38%
MSCI China	28.08%	5.90%	6.09%	2.39%	-0.51%
MSCI Europe	12.63%	3.86%	9.73%	-0.48%	--
MSCI World	14.16%	3.68%	10.18%	1.69%	3.86%
MSCI United Kingdom	20.70%	2.68%	6.76%	0.97%	2.33%
MSCI Emerging	24.51%	-0.73%	2.10%	-0.09%	3.28%
MSCI EAFE	13.32%	-1.15%	7.23%	-1.79%	2.12%
MSCI Frontier	8.29%	-6.07%	1.41%	-3.60%	--
MSCI Brazil	38.21%	-8.69%	-7.32%	-4.49%	2.31%
MSCI Russia	12.87%	-8.78%	-4.20%	-6.98%	2.45%
U.S. SECTOR/INDUSTRY					
S&P Information Technology	31.80%	16.06%	16.59%	9.62%	7.18%
S&P Utilities	13.54%	11.99%	12.67%	6.71%	8.25%
S&P Consumer Discretionary	15.11%	11.66%	16.33%	8.64%	8.31%
S&P Financials	20.64%	8.72%	15.41%	-2.71%	2.62%
S&P Health Care	6.71%	8.33%	16.03%	7.54%	7.17%
S&P Consumer Staples	7.88%	7.99%	10.86%	7.40%	5.55%
S&P Industrials	19.07%	7.38%	13.97%	4.96%	5.73%
S&P Materials	13.01%	2.46%	9.28%	2.80%	4.24%
S&P Retail	-2.43%	0.35%	8.33%	7.66%	--
S&P Telecommunication Services	-4.97%	-0.32%	2.60%	-1.31%	0.53%
S&P Energy	-0.82%	-8.98%	2.81%	1.48%	7.60%

FIXED INCOME	ANNUALIZED RETURNS				
J.P. Morgan EMBI	9.74%	4.94%	5.99%	7.12%	8.63%
Barclays High Yield	13.58%	4.73%	7.31%	7.46%	7.04%
U.S. Municipal	1.31%	3.54%	3.42%	4.67%	5.40%
Barclays Investment Grade	4.19%	3.46%	3.93%	--	--
Barclays Aggregate	1.58%	2.53%	2.24%	4.46%	5.31%

		VALUE AT PRIOR TIME PERIOD				
	CURRENT	1 YR AGO	3 YRS AGO	5 YRS AGO	10 YRS AGO	20 YRS AGO
MACROECONOMIC FACTORS						
U.S. GDP	2.00%	1.60%	1.60%	2.80%	1.20%	4.60%
CPI	2.20%	1.00%	2.10%	1.70%	2.70%	2.20%
Unemployment	4.67%	4.93%	6.67%	8.27%	4.50%	5.23%
U.S. Treasury 10-Year Yield	2.20%	1.85%	2.48%	1.56%	4.89%	6.66%
S&P Earnings	$112.67	$106.81	$108.80	$95.41	$87.42	$40.03
WTI Crude Oil	$48.32	$49.10	$102.71	$86.53	$64.01	$20.88
Gold	$1,272	$1,215	$1,246	$1,563	$661	$345
U.S. Dollar Index	96.9	95.9	80.4	83.0	82.3	94.9

Source: Bloomberg, data as of 5/31/2017. U.S. GDP and Unemployment figures are as of 4/30/2017.

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