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ECONOMIC UPDATE

The Federal Reserve's willingness to raise interest rates this week, despite continued sluggish growth evident in published data for January and February, no doubt reflects a general improvement in financial conditions as evidenced by *open market indicators* as well as the strengthening of *forward looking* economic data. The ISM manufacturing and non-manufacturing *surveys*, Leading Economic Indicators (LEI) and our firm's proprietary Economic Model are all signaling stronger growth ahead, supporting our view that an uptick in growth is likely.

The first quarter is beginning to resemble the pattern of previous years, where GDP growth at the start of the year has, on a number of occasions, come in markedly weaker than expected despite no obvious deterioration in the outlook. Recall, for example, the weakness of first-quarter GDP growth last year along with the volatility in financial markets stemming from the slowdown in China, caused the Fed to shelve plans for four rate increases that year and in the end to hike only once in December. The key difference now, however, is that not only have financial conditions improved markedly, with the stock market at a record high and inflation picking up, but survey evidence has also shown remarkable strength. The ISM surveys are consistent with GDP growth of more than 3.0%, while the March Empire State and Philly Fed surveys released last week were also encouraging. The strength of these surveys supports our view of GDP growth above 2.0%, possibly as strong as 2.5% this year.

Beyond the leading indicators, two other notable trends have emerged. First, there has been a marked turnaround in the three main goods-producing sectors of mining, manufacturing and construction. Employment growth in these sectors hit a two year high in February, far outstripping employment growth in the services sector. Clearly, some of the strength in payrolls over the past few months can be explained by a weather-related boost to construction hiring as construction added

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almost 100,000 jobs in January and February alone. That said, the recent turn-around in the goods producing sector has not been due solely to construction. Mining and manufacturing also recovered after a prolonged period of weakness over the past few years largely due the collapse in oil prices in 2014 and 2015. With oil prices now gradually recovering, and global growth picking up, both sectors are now experiencing something of a renaissance.

A second notable trend in recent months has been an improvement in the quality of jobs being created. Figures show that employment growth in sectors paying above-average wages has recently strengthened to an 18 month high, while below-average wage hiring has weakened. This shift will partly explain the pick-up in annual wage growth, which recently hit a seven year high at 2.9%.

EQUITIES

While monetary policy may have briefly captured investors' attention in the days leading up to the Fed meeting, now that the Fed is "out of the way" their focus is likely to return to political developments in Washington, prospects for GDP growth and corporate profits reports which, over the longer term, drive stock prices. At this point, healthcare seems deadlocked with little or no chance of the current repeal/replace proposal capable of passing both the House and the Senate. Already, we are hearing of possible revisions to the plan as originally presented. While the stock market may not necessarily care about healthcare, investors are watching it closely to gauge the prospects for tax reform. Investors are still giving Ryan/McConnell/Trump the benefit of the doubt but this patience will begin to ebb if healthcare remains unresolved into next month, increasing the possibility of market volatility in the interim.

The direction of the economy remains supportive of equities but investors will have to wait a few more weeks to parse first quarter earnings and guidance given during conference calls. S&P 500 earnings estimates for this year remain around $135 per share range implying a 17.7 x's price/earnings multiple for 2017 and 16.5 x's 2018 per share earnings estimated at $145. While not overly expensive, given the current level of interest rates, stocks are not cheap. We believe Washington will eventually enact legislation to reduce corporate and personal income taxes, find a pathway for the repatriation of funds currently trapped overseas on corporate balance sheets, reduce regulation and appropriate funds for infrastructure spending. This should add a few dollars per share to those S&P 500 earnings estimates, bringing price/earnings multiples back to less stretched levels of valuation. Consequently, equity portfolios under our supervision remain fully invested with concentrations in economically sensitive sectors including, energy, financials, industrials and technology. We also target up to 15% of the equity portfolio in investments domiciled abroad in both developed and emerging markets where we believe there to be attractive relative valuation.

FIXED INCOME

Bond portfolios under our supervision remain conservatively laddered with maturities of corporate obligations targeted to average one year. As interest rates normalize, longer-dated bonds, which we have avoided, will experience a loss of principal diminishing total returns on these investments.

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