MARKET COMMENTARY


**Market Review 2017 1Q:** Continuing the momentum from the strong finish of 2016, U.S. stocks reached new highs during the first quarter. Growth expectations gathered momentum and business confidence surged. Economic data remained steady, providing a foundation for greater asset gains despite a lack of progress in Washington on stimulative fiscal policy. Large cap stocks, as represented by the S&P 500 Index, advanced 6% outperforming small and mid-cap companies. Global equities enjoyed significant gains despite increasing political risk as pivotal elections approached in France and as the U.K. officially launched the two-year process to remove itself from the European Union. Patient investors were finally rewarded as International developed stocks outpaced U.S. equities, the MSCI EAFE Index returned +7.2%. Emerging markets stocks rallied to post their best quarterly increase in five years. Reassuring economic data from China, higher prices for industrial metals and a weaker U.S. dollar all contributed to gains. The MSCI Emerging Markets Index surged over 11% to its highest level since June 2015.

**1Q17 INDEX TOTAL RETURN PERFORMANCE**

| | YTD 2017 | 1 YEAR | 3 YEAR | 5 YEAR | 10 YEAR | | YTD 2017 | 1 YEAR | 3 YEAR | 5 YEAR | 10 YEAR |
|---|---|---|---|---|---|---|---|---|---|---|---|
| US EQUITY INDEX | | | | | | FIXED INCOME | | | | | |
| S&P 500 Large Cap | 6.07% | 17.2% | 10.4% | 13.3% | 7.5% | Barclays Municipal Bond | 0.21% | 3.76% | 2.30% | 2.24% | 3.76% |
| Russell Mid Cap | 5.10% | 16.8% | 8.3% | 12.9% | 7.8% | Barclays US Aggregate Bond | 0.82% | 0.37% | 2.64% | 2.27% | 4.14% |
| Russell 2000 Small Cap | 2.48% | 26.2% | 7.3% | 12.4% | 7.2% | Barclays US Corporate High Yield | 16.39% | 16.39% | 4.56% | 6.82% | 7.46% |
| WORLD EQUITY INDEX | | | | | | OTHER | | | | | |
| MSCI ACWI All World | 6.84% | 15.13% | 5.29% | 8.52% | | Dow Jones REIT | -0.34% | 0.91% | 9.66% | 9.15% | 4.05% |
| MSCI EAFE Established Markets | 7.23% | 11.60% | 0.42% | 5.74% | 0.97% | S&P GSCI Commodities | -5.19% | 7.55% | -23.43% | -15.80% | -9.86% |
| MSCI EM Emerging Markets | 11.31% | 16.55% | 0.63% | 0.21% | 2.04% | Alerian MLP Index | 4.26% | 32.32% | -9.51% | -0.08% | 5.79% |

**data as of 3/31/2017*

Within fixed income, investors earned positive returns in almost all segments despite tightening U.S. monetary policy. In March, the Fed hiked rates for the second time in as many quarters. The market anticipates that the central bank will follow through with its projection to raise short-term interest rates two more times this year. Treasury yields have settled into a new range, with the 10-year Treasury closing the quarter at 2.40%, down from 2.45% at year end, but up from 1.78% a year ago. Municipals, after months of softness related to the threat of tax reform, rebounded nicely as demand remained strong. Commodities were the only major asset class to post a negative return for the quarter, as crude oil, natural gas, and gasoline all traded off year-end levels.

**Looking Forward:** Since the end of the quarter, markets have been roughly flat as they digest gains with a leery eye focused on the economy, earnings, geopolitics and seasonal factors. Below we'll examine each of these topics.

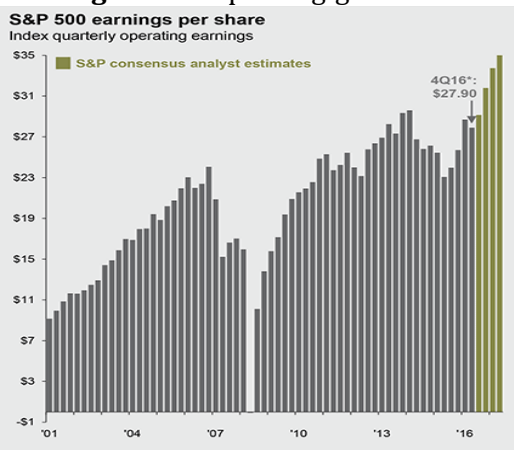
**The Global Economy:** Just prior to the US presidential election, signs of a positive turn in economic growth began to occur in the worldwide economy. Manufacturing Purchasing Managers Indexes (PMIs), which correlate very well to overall economic growth, have turned broadly positive and show signs of continued

momentum. The Heat map to the right (Green = acceleration, Red = contraction), illustrates a steadily improving economic backdrop. We are in a much better environment than we were in six months ago as the super tanker economies of the US and Europe gradually move toward better economic growth with China not far behind.

**Global Purchasing Managers' Index for manufacturing**

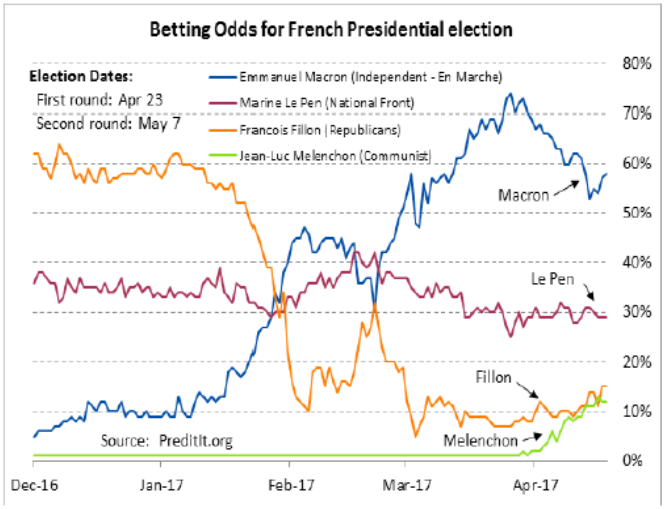
| | Apr'15 | May'15 | Jun'15 | Jul'15 | Aug'15 | Sep'15 | Oct'15 | Nov'15 | Dec'15 | Jan'16 | Feb'16 | Mar'16 | Apr'16 | May'16 | Jun'16 | Jul'16 | Aug'16 | Sep'16 | Oct'16 | Nov'16 | Dec'16 | Jan'17 | Feb'17 | Mar'17 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Global | 50.8 | 51.1 | 50.9 | 50.8 | 50.5 | 50.4 | 51.0 | 51.0 | 50.7 | 50.9 | 50.0 | 50.7 | 50.2 | 50.1 | 50.4 | 51.0 | 50.7 | 51.0 | 51.9 | 52.0 | 52.7 | 52.7 | 53.0 | 53.0 |
| Developed Markets | 52.1 | 52.4 | 52.1 | 52.5 | 52.4 | 52.1 | 53.0 | 52.6 | 52.0 | 52.3 | 50.9 | 50.9 | 50.4 | 50.2 | 50.9 | 51.5 | 51.3 | 51.6 | 52.9 | 53.2 | 54.0 | 54.4 | 54.6 | 53.9 |
| Emerging Markets | 49.3 | 49.5 | 49.2 | 48.8 | 48.3 | 48.3 | 48.9 | 49.1 | 49.2 | 49.2 | 48.8 | 50.0 | 49.5 | 49.5 | 49.3 | 50.1 | 49.9 | 50.0 | 50.7 | 50.7 | 51.3 | 50.8 | 51.3 | 51.6 |
| U.S. | 54.1 | 54.0 | 53.6 | 53.8 | 53.0 | 53.1 | 54.1 | 52.8 | 51.2 | 52.4 | 51.3 | 51.5 | 50.8 | 50.7 | 51.3 | 52.9 | 52.0 | 51.5 | 53.4 | 54.1 | 54.3 | 55.0 | 54.2 | 53.3 |
| Canada | 49.0 | 49.8 | 51.3 | 50.8 | 49.4 | 48.6 | 48.0 | 48.6 | 47.5 | 49.3 | 49.4 | 51.5 | 52.2 | 52.1 | 51.8 | 51.9 | 51.1 | 50.3 | 51.1 | 51.5 | 51.8 | 53.5 | 54.7 | 55.5 |
| UK | 52.3 | 52.2 | 51.5 | 52.3 | 51.8 | 51.3 | 54.9 | 52.5 | 51.3 | 52.3 | 50.9 | 51.2 | 49.7 | 50.7 | 52.5 | 48.2 | 53.5 | 55.2 | 54.6 | 53.5 | 56.0 | 55.4 | 54.5 | 54.2 |
| Euro Area | 52.0 | 52.2 | 52.5 | 52.4 | 52.3 | 52.0 | 52.3 | 52.8 | 53.2 | 52.3 | 51.2 | 51.6 | 51.7 | 51.5 | 52.8 | 52.0 | 51.7 | 52.6 | 53.5 | 53.7 | 54.9 | 55.2 | 55.4 | 56.2 |
| Germany | 52.1 | 51.1 | 51.9 | 51.8 | 53.3 | 52.3 | 52.1 | 52.9 | 53.2 | 52.3 | 50.5 | 50.7 | 51.8 | 52.1 | 54.5 | 53.8 | 53.6 | 54.3 | 55.0 | 54.3 | 55.6 | 56.4 | 56.8 | 58.3 |
| France | 48.0 | 49.4 | 50.7 | 49.6 | 48.3 | 50.6 | 50.6 | 50.6 | 51.4 | 50.0 | 50.2 | 49.6 | 48.0 | 48.4 | 48.3 | 48.6 | 48.3 | 49.7 | 51.8 | 51.7 | 53.5 | 53.6 | 52.2 | 53.3 |
| Italy | 53.8 | 54.8 | 54.1 | 55.3 | 53.8 | 52.7 | 54.1 | 54.9 | 55.6 | 53.2 | 52.2 | 53.5 | 53.9 | 52.4 | 53.5 | 51.2 | 49.8 | 51.0 | 50.9 | 52.2 | 53.2 | 53.0 | 55.0 | 55.7 |
| Spain | 54.2 | 55.8 | 54.5 | 53.6 | 53.2 | 51.7 | 51.3 | 53.1 | 53.0 | 55.4 | 54.1 | 53.4 | 53.5 | 51.8 | 52.2 | 51.0 | 51.0 | 52.3 | 53.3 | 54.5 | 55.3 | 55.6 | 54.8 | 53.9 |
| Greece | 46.5 | 48.0 | 46.9 | 30.2 | 39.1 | 43.3 | 47.3 | 48.1 | 50.2 | 50.0 | 48.4 | 49.0 | 49.7 | 48.4 | 50.4 | 48.7 | 50.4 | 49.2 | 48.6 | 48.3 | 49.3 | 46.6 | 47.7 | 46.7 |
| Ireland | 55.8 | 57.1 | 54.6 | 56.7 | 53.6 | 53.8 | 53.6 | 53.3 | 54.2 | 54.3 | 52.9 | 54.9 | 52.6 | 51.5 | 53.0 | 50.2 | 51.7 | 51.3 | 52.1 | 53.7 | 55.7 | 55.5 | 53.8 | 53.6 |
| Australia | 48.0 | 52.3 | 44.2 | 50.4 | 51.7 | 52.1 | 50.2 | 52.5 | 51.9 | 51.5 | 53.5 | 58.1 | 53.4 | 51.0 | 51.8 | 56.4 | 46.9 | 49.8 | 50.9 | 54.2 | 55.4 | 51.2 | 59.3 | 57.5 |
| Japan | 49.9 | 50.9 | 50.1 | 51.2 | 51.7 | 51.0 | 52.4 | 52.6 | 52.6 | 52.3 | 50.1 | 49.1 | 48.2 | 47.7 | 48.1 | 49.3 | 49.5 | 50.4 | 51.4 | 51.3 | 52.4 | 52.7 | 53.3 | 52.4 |
| China | 48.9 | 49.2 | 49.4 | 47.8 | 47.3 | 47.2 | 48.3 | 48.6 | 48.2 | 48.4 | 48.0 | 49.7 | 49.4 | 49.2 | 48.6 | 50.6 | 50.0 | 50.1 | 51.2 | 50.9 | 51.9 | 51.0 | 51.7 | 51.2 |

**Earnings:** The improving global economy has resulted in both higher expected and reported corporate earnings which have been quite supportive of stock prices. There is much chatter about the elevated valuation levels in today's equity markets. However, significantly rising profits bring lower valuations. We will require earnings follow through. Any disappointments from the lofty expectations illustrated below will lead to a spate of downside volatility, though it is our contention that pullbacks will be shallow. First quarter earnings reports are just beginning to stream in and so far, so good.




**Geopolitics:** One fly in the ointment that can derail the steady progress of economic growth and improving earnings is the geopolitical scene. Here in the U.S., we are 100 days into the Trump administration, and markets are still hoping that talk of tax cuts, infrastructure spending and decreased regulation will lead to actual progress and legislative victories. Markets are less concerned with deliberations regarding health care reform and border walls and will exact a price if these issues continue to be prioritized. In our experience, politics can impact the markets at the margin and certainly add to volatility, but they are not a driver. We tend to give one party eight years in the White House and then we turn things over to the other party. There is a pendulum effect—regulation or taxes increase for eight years, then decrease for eight years. The markets adapt to this cycle.

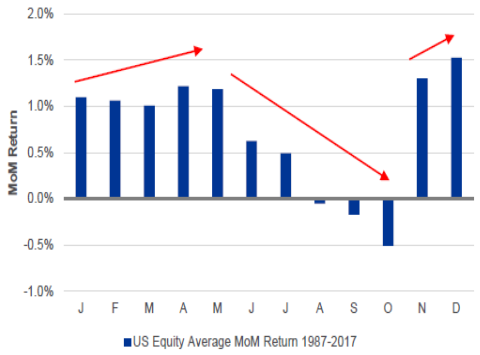
Outside the U.S., North Korean sabre rattling and chest thumping can certainly take a disturbing turn at any moment. On a saner note, elections in Europe, particularly in France, are also a major concern. While markets were relieved with the first place showing of the pro-business candidate Emmanuel Macron, a loss to Marine Le Pen in the run-off election on May 7th would be quite a blow to business interests in Europe. A Le Pen government would be seen as both protectionist and anti-European Union (EU). On the heels of the UK's recent plans to leave the EU, similar loud rumblings from French citizens would lead to a tough ride for European stock and bond prices in the short term. If Le Pen were to be elected, she



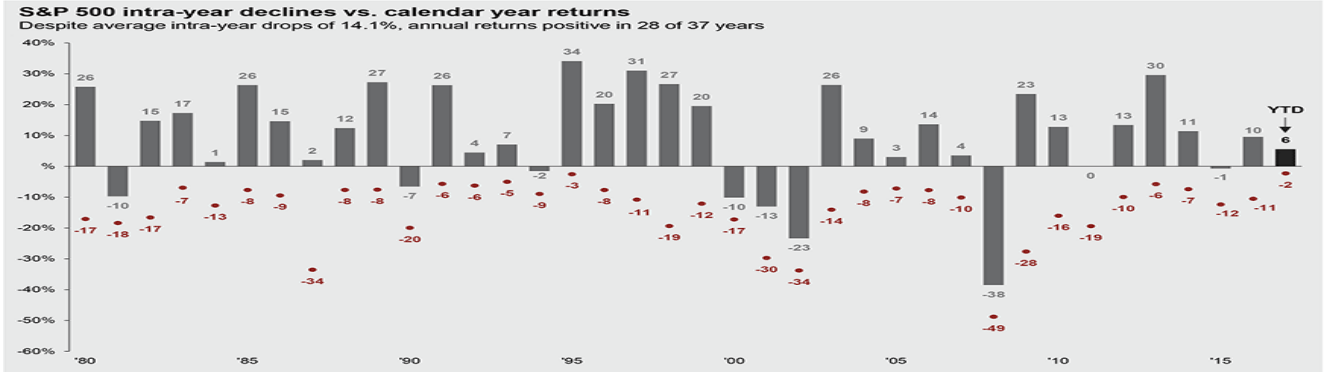

sandycove ADVISORS
37 Derby Street, Suite 5, Hingham, MA 02043
o: (617) 622-1500 | f: (617) 979-8727
www.sandycoveadvisors.com

would likely have a small margin of power and little in the way of a legislative mandate. Currently, odds favor Macron but Brexit results have taught us to be leery of polls. Note that Britain's decision to leave the EU led to an initial sharp market decline, only to be followed by higher levels shortly thereafter.

**'Tis the Season:** Due to the timing of institutional and retail cash flows, summer vacation mentalities and various unexplained factors, there is a certain seasonality to the buying and selling decisions of market participants. Post May, we enter a time when prices have historically been flat to down (see chart to the left). While we are not predicting any single major event on the horizon, we do feel it is prudent to rebalance portfolios after equities have a run-up as we have just experienced. We have been trimming our equity allocations (taking profits), so that our investors are in line with their strategic asset allocations. We are thus in good shape to allocate to equities, at better valuations, if we do see some downside in the coming months.

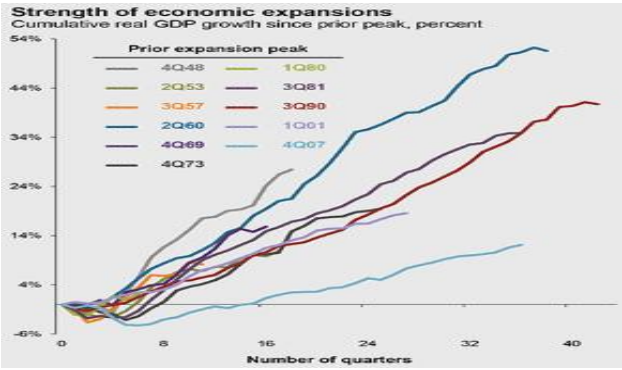



Given the constructive backdrop for equities and other risk assets, we are wise to remind ourselves that volatility is expected and equity prices have historically been quite resilient despite seasonal selling. As the chart below highlights, the market falls about 14% in any given year, but in 28 of the last 37 years the market has posted a positive annual return after each pullback. In baseball terms, that's like a batter hitting 750.




Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

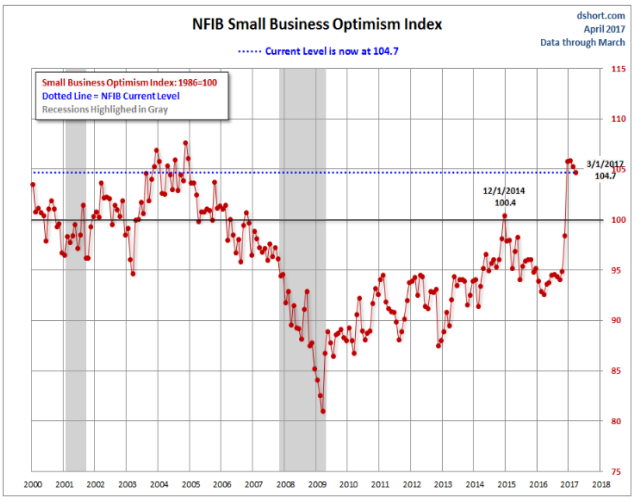
Lastly, what gives us comfort, when we look at the longer term picture, is not only an improving economy and earnings picture, but the fact that this post crisis recovery is still lagging past recoveries by such a wide margin. As the chart to the left highlights, this recovery (light blue line at bottom) has paled in comparison to expansions dating back to the 1940's.

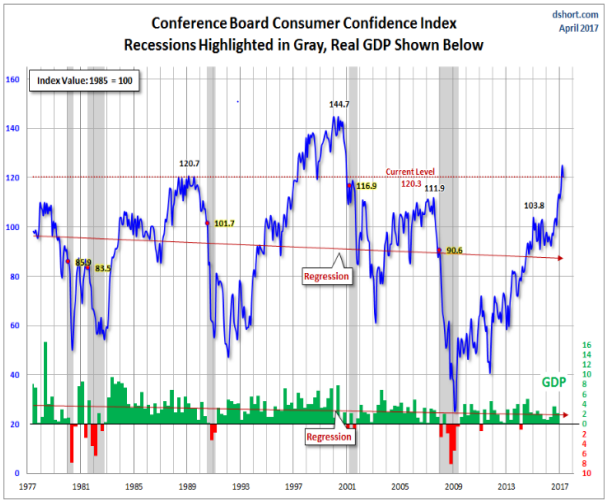



So, why would a lagging recovery give us a somewhat awkward sense of comfort? In a word: Confidence. Confidence surveys are a leading indicator for the economy. Recently we've seen a broad spectrum of economic players exhibiting increasing confidence. Consumer, CEO and small business confidence

sandycove ADVISORS
37 Derby Street, Suite 5, Hingham, MA 02043
o: (617) 622-1500 | f: (617) 979-8727
www.sandycoveadvisors.com

measures are all posting 10- 15 years highs. In the past, surging confidence has led to increased spending, higher profits and higher asset prices.




Stretched valuations, geopolitical events, negative economic surprises and numerous other factors can cause any asset class to sell off. However, as our last chart points out, over the last 15 years, investors have been well rewarded for taking a balanced and diversified approach in their portfolios. A well diversified 60% / 40% asset allocation has produced a better result than an all equity portfolio with a third less volatility.

| 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | YTD | 2002 - 2016 Ann. | 2002 - 2016 Vol. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Comdty. 25.9% | EM Equity 56.3% | REITs 31.6% | EM Equity 34.5% | REITs 35.1% | EM Equity 39.8% | Fixed Income 5.2% | EM Equity 79.0% | REITs 27.9% | REITs 8.3% | REITs 19.7% | Small Cap 38.8% | REITs 28.0% | REITs 2.8% | Small Cap 21.3% | EM Equity 11.5% | REITs 10.8% | EM Equity 23.8% |
| Fixed Income 10.3% | Small Cap 47.3% | EM Equity 26.0% | Comdty. 21.4% | EM Equity 32.6% | Comdty. 16.2% | Cash 1.8% | High Yield 59.4% | Small Cap 26.9% | Fixed Income 7.8% | High Yield 19.6% | Large Cap 32.4% | Large Cap 13.7% | Large Cap 1.4% | High Yield 14.3% | DM Equity 7.4% | EM Equity 9.6% | REITs 22.6% |
| High Yield 4.1% | DM Equity 39.2% | DM Equity 20.7% | DM Equity 14.0% | DM Equity 26.9% | DM Equity 11.6% | Asset Alloc. -25.4% | DM Equity 32.5% | EM Equity 19.2% | High Yield 3.1% | EM Equity 18.6% | DM Equity 23.3% | Fixed Income 6.0% | Fixed Income 0.5% | Large Cap 12.0% | Large Cap 6.1% | High Yield 9.2% | Small Cap 20.1% |
| REITs 3.8% | REITs 37.1% | Small Cap 18.3% | REITs 12.2% | Small Cap 18.4% | Asset Alloc. 7.1% | High Yield -26.9% | REITs 28.0% | Comdty. 16.8% | Large Cap 2.1% | DM Equity 17.9% | Asset Alloc. 14.9% | Asset Alloc. 5.2% | Cash 0.0% | Comdty. 11.8% | Asset Alloc. 3.8% | Small Cap 8.5% | DM Equity 19.2% |
| Cash 1.7% | High Yield 32.4% | High Yield 13.2% | Asset Alloc. 8.1% | Large Cap 15.8% | Fixed Income 7.0% | Small Cap -33.8% | Small Cap 27.2% | Large Cap 15.1% | Cash 0.1% | Small Cap 16.3% | High Yield 7.3% | Small Cap 4.9% | DM Equity 0.4% | EM Equity 11.6% | High Yield 3.2% | Asset Alloc. 6.9% | Comdty. 19.0% |
| Asset Alloc. -5.9% | Large Cap 28.7% | Asset Alloc. 12.8% | Large Cap 4.9% | Asset Alloc. 15.3% | Large Cap 5.5% | Comdty. -35.6% | Large Cap 26.5% | High Yield 14.8% | Asset Alloc. -0.7% | Large Cap 16.0% | REITs 2.9% | Cash 0.0% | Asset Alloc. -2.0% | REITs 8.6% | REITs 2.5% | Large Cap 6.7% | Large Cap 15.9% |
| EM Equity -6.0% | Asset Alloc. 26.3% | Large Cap 10.9% | Small Cap 4.6% | High Yield 13.7% | Cash 4.8% | Large Cap -37.0% | Asset Alloc. 25.0% | Asset Alloc. 13.3% | Small Cap -4.2% | Asset Alloc. 12.2% | Cash 0.0% | High Yield 0.0% | High Yield -2.7% | Asset Alloc. 8.3% | Small Cap 2.5% | DM Equity 5.8% | High Yield 11.7% |
| DM Equity -15.7% | Comdty. 23.9% | Comdty. 9.1% | High Yield 3.6% | Cash 4.8% | High Yield 3.2% | REITs -37.7% | Comdty. 18.9% | DM Equity 8.2% | DM Equity -11.7% | Fixed Income 4.2% | Fixed Income -2.0% | EM Equity -1.8% | Small Cap -4.4% | Fixed Income 2.6% | Fixed Income 0.8% | Fixed Income 4.6% | Asset Alloc. 11.0% |
| Small Cap -20.5% | Fixed Income 4.1% | Fixed Income 4.3% | Cash 3.0% | Fixed Income 4.3% | Small Cap -1.6% | DM Equity -43.1% | Fixed Income 5.9% | Fixed Income 6.5% | Comdty. -13.3% | Cash 0.1% | EM Equity -2.3% | DM Equity -4.5% | EM Equity -14.6% | DM Equity 1.5% | Cash 0.1% | Cash 1.3% | Fixed Income 3.5% |
| Large Cap -22.1% | Cash 1.0% | Cash 1.2% | Fixed Income 2.4% | Comdty. 2.1% | REITs -15.7% | EM Equity -53.2% | Cash 0.1% | Cash 0.1% | EM Equity -18.2% | Comdty. -1.1% | Comdty. -9.5% | Comdty. -17.0% | Comdty. -24.7% | Cash 0.3% | Comdty. -2.3% | Comdty. 1.2% | Cash 0.8% |

Source: Barclays, Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management.

*Published by Sandy Cove Advisors on April 27, 2017*


sandycove ADVISORS

37 Derby Street, Suite 5, Hingham, MA 02043
o: (617) 622-1500 | f: (617) 979-8727
www.sandycoveadvisors.com