April 10 2017

FIRST QUARTER 2017 IN REVIEW

GOOD DATA AND POLICY HOPE LEAD TO STOCK MARKET STRENGTH

- **U.S. economic growth has improved in Q1, though hard versus soft data remains a question.** Based on data received through March 2017, first quarter economists' consensus of real gross domestic product (GDP) growth is 1.8%, following 2% growth in the fourth quarter of 2016, 3.5% growth in the third quarter, and 1.4% growth in the second quarter. While the economic backdrop shows signs of improvement, the "soft" data derived from surveys continues to come in stronger than "hard" data that reveals actual levels of economic activity. Hard data, such as employment, durable goods orders, and housing starts were generally positive over the course of the quarter, but not as positive as soft data, such as consumer sentiment readings which are near multi-year highs. Manufacturing surveys continued to see improvement during the quarter, but the slow recovery from the impact of falling oil prices and a strengthening dollar continues. Consumers and businesses continued to look past policy uncertainty in the first quarter, though the inability to garner enough support to repeal and replace the Affordable Care Act (ACA) late in the quarter, along with concerns that tax reform may take longer than expected, could mean policy uncertainty will remain an issue in Washington, D.C.
- **Strong start to 2017 for U.S. stocks.** The S&P 500 posted an impressive 6.1% total return during the first quarter, the sixth consecutive quarterly

1 Q1 2017 AT A GLANCE

	Q1 2017
GDP*	1.8%
S&P 500 Index	6.1%
Bloomberg Barclays Aggregate Bond Index	0.8%
Bloomberg Commodity Index	-2.3%

Source: LPL Research, Bloomberg, FactSet 03/31/17

*Bloomberg consensus as of March 31, 2017.

Figures for S&P 500, Bloomberg Barclays Aggregate Bond Index, and Bloomberg Commodity Index are total returns from 12/31/16–03/31/17 (Q1).

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment.

advance. Gains, which were concentrated in January and February (March was essentially flat), were driven by a combination of an improving economic backdrop and optimism surrounding pro-growth policies out of Washington, D.C. The pause in March reflected, in part, a reconsideration of the scope and timing surrounding aspects of the Trump agenda. Concerns about the nature and timing of corporate tax reform, exacerbated by the failure to get the ACA replacement through Congress, contributed to underperformance of more policy-sensitive areas of the market such as small cap stocks and financials. Technology led all sectors, which along with weakness in financials and energy, propelled the growth style over value. International and emerging markets outpaced the U.S., based on the MSCI indexes and S&P 500, driven by a weaker U.S. dollar, steadily improving overseas economic data and earnings, lower valuations, and ebbing fears of a trade war with key trading partners.

- **Long-term rates moderate as markets await policy specifics.** The Treasury yield curve flattened as short-term yields rose due to the Federal Reserve (Fed) rate hike in March, while long-term rates moderated and gradually declined over the quarter. The Fed rate hike occurred earlier than was anticipated at the beginning of the year, but hawkish rhetoric by Fed speakers in early March drove expectations higher and the market took the rate hike in stride. Market-implied growth expectations declined slightly while inflation expectations held steady over the quarter. The Bloomberg Barclays Aggregate Bond Index returned 0.8%, outperforming Treasuries which returned 0.7% (Bloomberg Barclays U.S. Treasury Index). Economically sensitive, lower credit quality sectors continued to rally, with high yield returning 2.7% (Bloomberg Barclays U.S. Corporate High Yield Index) and bank loans gaining 0.8% (Bloomberg Barclays U.S. High Yield Loan Index). Many sectors hardest hit late last year rallied during the quarter as the post-election market reaction appeared overdone. Emerging market debt returned 3.9% (JP Morgan Emerging Markets Bond Index), preferreds rallied 5.8% (BofA Merrill Lynch Hybrid Preferred Securities Index) and high-yield municipals returned 4.1% (Bloomberg Barclays Municipal High Yield Index). The dollar's -1.8% return during the quarter benefitted unhedged foreign bonds, which returned 2.0% (Citigroup Non-US World Gov. Bond Unhedged Index) despite rising rates in many foreign developed markets.
- **Equity centric alternative investment strategies led quarterly returns.** The HFRX Equity Hedge Index gained 2.7%, as strategies benefited from the broader equity market rally, as well as the more favorable stock-picking environment on both the long and short side. The industry's overweight to the information technology (+12.6%) and consumer discretionary sectors (+8.4%) were additional tailwinds. Managed futures strategies were the main laggard, as the HFRX Systematic Diversified Index declined 2.10%. Long U.S. dollar exposure against a variety of developed and emerging market currencies weighed on returns, as did short fixed income exposure. In addition, the increase in Treasury rates that began in the fourth quarter of 2016, reversed course, leading to losses from those programs that were positioned short.
- **Energy and agriculture declines dragged commodities index lower.** The broad Bloomberg Commodity Index slid 2.3% during the first quarter, driven lower by declines

Bonds are subject to market and interest rate risk if sold prior to maturity.

Bond values and yields will decline as interest rates rise, and bonds are subject to availability and change in price.

Alternative strategies may not be suitable for all investors. The management of alternative investments may accelerate the velocity of potential losses.

in energy — both oil and natural gas — and agriculture. Oil suffered from increases in U.S. production, which offset the benefit of the global agreement between OPEC and certain non-OPEC countries to cut production. Meanwhile, a warm winter weighed on natural gas prices, though colder weather and inventory drawdowns helped prices rebound in March. Strong crop yields globally and falling lean hog prices dragged agriculture lower. Industrial and precious metals rose, led by aluminum, silver, and gold, and were supported by a weak U.S. dollar. ■

Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, geopolitical events, and regulatory developments.

A LOOK FORWARD

We expect mid-single-digit returns for the S&P 500 in 2017, consistent with mid-to-late economic cycle performance, supported by earnings acceleration and improved U.S. economic growth, as laid out in our *Outlook 2017: Gauging Market Milestones* publication.* Gains may come with increased volatility as the economic cycle ages and, in the near term, stock valuations may be pricing in an overly optimistic scenario for pro-growth policy initiatives. We expect the 10-year Treasury yield to generally be range-bound between 2.25–2.75% in 2017, with the potential for 3%, suggesting low- to-mid-single-digit returns for the Bloomberg Barclays Aggregate Bond Index. Following the March 2017 rate hike, we expect the Fed to continue its gradual normalization of interest rates — we expect two more hikes in 2017. Importantly, rising interest rates, along with a pickup in economic growth and inflation, may limit return potential.

*As noted in our *Outlook 2017* publication, we expect mid-single-digit returns for the S&P 500 in 2017 and the continuation of the nearly eight-year-old bull market, consistent with historical mid-to-late economic cycle performance. We expect S&P 500 gains to be driven by: 1) a pickup in U.S. economic growth partly due to fiscal stimulus; 2) mid- to high-single-digit earnings gains; 3) an expansion in bank lending; and 4) a stable price-to-earnings ratio (PE) of 18–19. Gains will likely come with increased volatility as the economic cycle ages.

MARKET INSIGHT QUARTERLY & MARKET INSIGHT MONTHLY

The updated quarterly edition of *Market Insight* provides a high-level overview of what occurred in the economy, stock and bond markets, commodities, and alternative strategies during the previous quarter. For more detailed performance data and commentary, we provide a monthly review in the *Market Insight Monthly* publication.

Access past issues of the *Market Insight Monthly* on the Resource Center, or here:

- January 2017 in Review
- February 2017 in Review


LPL RESEARCH
MARKET INSIGHT MONTHLY
JANUARY 2017 IN REVIEW

2 TECHNOLOGY TOPS SECTOR LEADERBOARD

S&P 500 Sector Performance, Ranked by First Quarter Returns

Sector	Q1 2017
Technology	12.6%
Consumer Discretionary	8.4%
Healthcare	8.4%
Utilities	6.4%
Consumer Staples	6.4%
S&P 500	6.1%
Materials	5.9%
Industrials	4.6%
Real Estate	2.7%
Financials	2.5%
Telecom	-4.0%
Energy	-6.7%

3 STRONG QUARTER FOR INTERNATIONAL AND LARGE CAPS

Domestic & International Asset Class Performance, Ranked by First Quarter Returns

Asset Class	Q1 2017
Emerging Markets	11.5%
U.S. Large Growth	8.9%
Large Foreign	7.4%
U.S. Mid Growth	6.9%
U.S. Small Growth	5.4%
U.S. Mid Value	3.8%
U.S. Large Value	3.3%
U.S. Small Value	0.0%

4 ECONOMICALLY SENSITIVE FIXED INCOME TOPS HIGH QUALITY

Bond Market Performance, Ranked by First Quarter Returns

Sector	Q1 2017
Preferred Securities	5.8%
Municipal High-Yield	4.1%
Emerging Market Debt	3.9%
High-Yield Bonds	2.7%
Foreign Bonds (Unhedged)	2.0%
Municipal Bonds	1.7%
Investment-Grade Corporates	1.3%
TIPS	1.3%
Bloomberg Barclays U.S. Aggregate	0.8%
Bank Loans	0.8%
U.S. Treasuries	0.7%
Mortgage-Backed Securities	0.5%
Foreign Bonds (Hedged)	-0.4%

Asset class returns are represented by the returns of indexes and are not ranked on an annual total return basis. It is not possible to invest directly in an index so these are not actual results an investor would achieve.

Bond Market Asset Class Indexes: Foreign Bonds (hedged) – Citigroup Non-U.S. World Government Bond Index Hedged for Currency; Preferred Securities – Merrill Lynch Preferred Stock Hybrid Securities Index; Treasury – Bloomberg Barclays U.S. Treasury Index; Mortgage-Backed Securities – Bloomberg Barclays U.S. MBS Index; Investment-Grade Corporate – Bloomberg Barclays U.S. Corporate Bond Index; Municipal – Bloomberg Barclays Municipal Bond Index; Municipal High-Yield – Bloomberg Barclays Municipal High Yield Index; TIPS – Bloomberg Barclays Treasury Inflation-Protected Securities Index; Bank Loans – Bloomberg Barclays U.S. High Yield Loan Index; High-Yield – Bloomberg Barclays U.S. Corporate High Yield Index; Emerging Market Debt – JP Morgan Emerging Markets Global Index; Foreign Bonds (unhedged) – Citigroup Non-U.S. World Government Bond Index (unhedged)

Sources: LPL Research, FactSet 03/31/17

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment. Past performance is no guarantee of future results.

Because of its narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

The sectors are represented by the 10 S&P 500 Global Industry Classification Standard (GICS) indexes.

Asset classes based on Russell 1000, Russell 3000 Growth and Value Indexes, Russell 2000, Russell Midcap Index, MSCI EAFE, MSCI Emerging Markets Index.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.

General Stock & Debt Equity Risks

Stock investing may involve risk including loss of principal.

Investing in foreign and emerging markets securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a nondiversified portfolio. Diversification does not ensure against market risk.

Government bonds and Treasury bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.

High-yield/junk bonds are not investment-grade securities, involve substantial risks, and generally should be part of the diversified portfolio of sophisticated investors.

Long/short equity funds are subject to normal alternative investment risks, including potentially higher fees; while there is additional management risk, as the manager is attempting to accurately anticipate the likely movement of both their long and short holdings. There is also the risk of "beta-mismatch," in which long positions could lose more than short positions during falling markets.

Distressed Debt is an investment in companies in or near bankruptcy. The investment is often made to gain control of the company with the goal of either improving the operations of the company or disposing of assets. The risks associated with distressed investing arise from several factors including: limited diversification, the use of leverage, limited liquidity, and the possibility that investors may be required to accept cash or securities with a value less than their original investment and/or may be required to accept payment over an extended period of time.

Definitions

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

Index Definitions

The Bloomberg Barclays U.S. Corporate High Yield Index measures the market of USD-denominated, noninvestment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below, excluding emerging markets debt.

The Bloomberg Barclays U.S. High Yield Loan Index tracks the market for dollar-denominated floating-rate leveraged loans. Instead of individual securities, the U.S. High-Yield Loan Index is composed of loan tranches that may contain multiple contracts at the borrower level.

The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and non-agency).

The Bloomberg Barclays U.S. Corporate Index is a broad-based benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate, taxable corporate bond market.

The Bloomberg Barclays U.S. Treasury Index is an unmanaged index of public debt obligations of the U.S. Treasury with a remaining maturity of one year or more. The index does not include T-bills (due to the maturity constraint), zero coupon bonds (strips), or Treasury Inflation-Protected Securities (TIPS).

The Bloomberg Barclays U.S. Mortgage Backed Securities (MBS) Index tracks agency mortgage backed pass-through securities (both fixed rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

The Bloomberg Barclays U.S. Treasury TIPS Index is a rules-based, market value-weighted index that tracks inflation-protected securities issued by the U.S. Treasury.

The BofA Merrill Lynch Preferred Stock Hybrid Securities Index is an unmanaged index consisting of a set of investment-grade, exchange-traded preferred stocks with outstanding market values of at least $50 million that are covered by Merrill Lynch Fixed Income Research.

The Bloomberg Commodity Index is calculated on an excess return basis and composed of futures contracts on 22 physical commodities. It reflects the return of underlying commodity futures price movements.

The HFRX Equity Hedge Index, also known as long/short equity, combines core long holdings of equities with short sales of stock or stock index options. Equity hedge portfolios may be anywhere from net long to net short, depending on market conditions. Equity hedge managers generally increase net long exposure in bull markets and decrease net long exposure (or even are net short) in a bear market. Generally, the short exposure is intended t generate an ongoing positive return in addition to acting as a hedge against a general stock market decline. Stock index put options are also often used as a hedge against market risk. Profits are made when long positions appreciate and stocks sold short depreciate. Conversely, losses are incurred when long positions depreciate or the value of stocks sold short appreciates. Equity hedge managers' source of return is similar to that of traditional stock pickers on the upside, but they use short selling and hedging to attempt to outperform the market on the downside.

The HFRX Macro: Systematic Diversified CTA Index strategies have investment processes typically as function of mathematical, algorithmic and technical models, with little or no influence of individuals over the portfolio positioning. Strategies which employ an investment process designed to identify opportunities in markets exhibiting trending or momentum characteristics across individual instruments or asset classes. Strategies typically employ quantitative process which focus on statistically robust or technical patterns in the return series of the asset, and typically focus on highly liquid instruments and maintain shorter holding periods than either discretionary or mean reverting strategies. Although some strategies seek to employ counter trend models, strategies benefit most from an environment characterized by persistent, discernible trending behavior. Systematic Diversified strategies typically would expect to have no greater than 35% of portfolio in either dedicated currency or commodity exposures over a given market cycle.

The JP Morgan Emerging Markets Bond Index is a benchmark index for measuring the total return performance of international government bonds issued by emerging markets countries that are considered sovereign (issued in something other than local currency) and that meet specific liquidity and structural requirements.

The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000 Index and includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 represents approximately 92% of the U.S. market.

The Russell Midcap Index offers investors access to the mid cap segment of the U.S. equity universe. The Russell Midcap Index is constructed to provide a comprehensive and unbiased barometer for the mid cap segment and is completely reconstituted annually to ensure that larger stocks do not distort the performance and characteristics of the true mid cap opportunity set. The Russell Midcap Index includes the smallest 800 securities in the Russell 1000.

The Russell 2000 Index measures the performance of the small cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index.

The Russell 3000 Growth Index measures the performance of the broad growth segment of the U.S. equity universe. It includes those Russell 3000 companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 3000 Value Index measures the performance of the broad value segment of U.S. equity value universe. It includes those Russell 3000 companies with lower price-to-book ratios and lower forecasted growth values.

The MSCI EAFE Index is recognized as the pre-eminent benchmark in the United States to measure international equity performance. It comprises the MSCI country indexes that represent developed markets outside of North America: Europe, Australasia, and the Far East.

The MSCI Emerging Markets Index captures large and mid cap representation across 23 emerging markets (EM) countries. With 822 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Bloomberg Barclays U.S. Municipal Index covers the USD-denominated, long-term, tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds.

The Bloomberg Barclays Municipal High Yield Bond Index is comprised of bonds with maturities greater than one-year, having a par value of at least $3 million issued as part of a transaction size greater than $20 million, and rated no higher than 'BB+' or equivalent by any of the three principal rating agencies.

The Citigroup Non-U.S. World Government Bond Hedged Index measures the performance of fixed-rate, local currency, investment grade sovereign bonds. This index is a widely used benchmark that currently comprises sovereign debt from over 20 countries, denominated in a variety of currencies, and has more than 25 years of history available. It provides a broad benchmark for the global sovereign fixed income market, excluding the U.S., with currencies hedged against the U.S. dollar.

The USD Index measures the performance of the U.S. dollar against a basket of foreign currencies: EUR, JPY, GBP, CAD, CHF and SEK. The U.S. Dollar Index goes up when the dollar gains "strength" compared to other currencies.

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