2017 First Quarter Financial & Investment General Commentary

This is the General Commentary for the 1st quarter of 2017. It covers information of general interest on Financial Planning, Financial Services, Market Results, Economic & Market Conditions, Economic & Market Outlooks and current Portfolio Investment Management. The last page provides a list of index returns for each of the market's major categories.

You can access this and other timely articles on a variety of subjects through our website at www.stjohnfinancial.com on the page titled "Reports & Postings". As in the past, our sources of information are diverse and vary from period to period. For this period, sources referred to include the Wall Street Journal, Investment News, Morningstar, Fidelity Investments, Bob Veres, and others. We want to give special recognition to Greenrock Research who provided us their research on the 2017 market outlook for this report.

INFORMATION OF GENERAL INTEREST

- New Website
  You might be interested in knowing that we have engaged Impact Communications, Inc. as consultants to assist us in improving our on-line presence, digital communications and rebuilding our website. Through this improved functionality we will be able to increase the company's visibility, provide links for people to access their information quickly and easily, and provide a cell phone friendly app to access your financial planning information. This project is now underway and is targeted for completion by October 15th.

- Everplans
  A year ago we added a service known as Everplans, a life and legacy planning online tool. As a result of our negotiation and agreement, we can now make this available to all clients. Everplans provides a place for you to organize, store and share your most important documents, health care information, and other personal and private information. Things like wills, insurance policies, account numbers, email passwords, and even recipes. You can designate and authorize within the system the individuals who have access to this information (known as deputies). We will provide you with access to the software and provide information on the use of the program. For more information call Lisa Duncan in our office.

- Your Adult Children
  You may not be aware of the ways we can be of help to your adult children. We offer your adult children the checklist in our Financial Fitness Checkup program. We also offer a free financial consultation when they graduate college or get married. They might also benefit from setting up savings and investment accounts to begin saving for retirement and other life goals. We are also glad to facilitate family meetings to discuss your estate documents with those you have designated as executors, powers of attorney or trustees. If you are interested in any of these services, just let us know and we'll take it from there.

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FINANCIAL PLANNING

Two new programs to help us…help you
For our financial service clients we are initiating two new campaigns to keep up with their ongoing financial planning needs.

We start with the **Financial Fitness Checkup**. We created a checklist that we will be sending out during the course of the first and second quarters of each year. This checklist gives us what we need to complete a financial checkup. This program will help identify some areas of your financial life that might need to be "shaped up." It's a very simple worksheet that should take about 10 minutes to fill out and send back to us in order for us to do your financial checkup. Once we've completed the checkup we will consider the next step. It could be an update to your personal financial plan and an in-person meeting or teleconference call. This checkup covers all the important aspects of your life: family, goals, business or work, health, money, estate, retirement, and your future. You complete the checklist by answering each statement with a simple 'Yes' or 'No.' There's also a space for you to write any notes that affect the issue described. We'll be rolling this out starting in May 2017.

Next we've developed our **Last Chance Financial Planning Checklist**. You can see we like checklists. By the way, checklists are routinely used by surgeons, airline pilots and astronauts so we feel like we're in good company. The Last Chance Financial Planning Checklist is a quick way to determine if you need to take any actions before the end of the year. It's a simple checklist that covers only those areas that need attention at year end – taxes, retirement savings, investments, insurance, and medical. It might take you five minutes to complete, but could save you some aggravation and money. This campaign is targeted to begin in the fall starting around late September-October.

Posted to our website
Checkout our **Monthly Client Letter** that covers topical content on what's happened in the last month. We will at times include our perspective on certain events and hope to cover a range of topics you'll find interesting. The letter and the items below can be found on our Reports and Postings page as well as periodically posted articles and reports you may find of interest.

Financial Fitness Checkup Checklist - We plan to send these out on a schedule, but you can see and download a copy from the Reports and Postings page as well.

Last Chance Financial Planning Checklist – We will post this in the fall of each year.

Quarterly General Commentary – Posted the month following the end of each quarter.

FINANCIAL PLANNING IDEAS, FACTS OR OBSERVATIONS FROM OUR RESEARCH

Best and Worst States for Retirement
The classic retirement destination is Florida. How does it rank against the other 49? Bankrate recently evaluated the 50 states for quality of retirement lifestyle based on these seven criteria: (1) health care quality, (2) crime, (3) cultural vitality, (4) weather, (5) taxes, (6) senior citizens' overall well-being, and (7) the prevalence of other seniors. New Hampshire came out on top, and Alaska fell to last place. See the full 50 state ranking here.

2nd Quarter Key Planning and Investment Deadlines (plus a few others of note)
May 15 - 2016 non-profit tax returns due
May 29 - Memorial Day (markets closed)
May 2 - Teacher Appreciation Day
May 6 - Kentucky Derby
May 14 - Mother's Day
May 28 - Indianapolis 500
June 15 - 2nd quarter 2017 estimated taxes due
June 15 - Last day for US citizens living abroad to file tax returns
June 30 - Free Application for Federal Student Aid (FAFSA) 2016-2017 closes
June 2 - Donut Day
June 12th thru June 18th - U.S. Open Golf Championship
June 18 - Father's Day
June 18 - Go Fishing Day

How Much Should I Be Saving?
When constructing personal financial plans for clients, we are sometimes faced with low levels of savings, particularly outside their 401(k) accounts. David Hultstrom, a financial planner in Woodstock, GA, listed the following guide which we find interesting:

> ***Savings Rate.*** *The traditional rule of thumb is that annual retirement savings should be 10% of your income. In my opinion this is correct for people with modest incomes, but I think the rule can be improved.*
>
> *My rule of thumb would be 10% of income plus 1% for every $10,000 of income over $50,000 but not more than 25%. For example, if an individual's income is $70,000 per year, the savings rate should be 10 + (7 - 5) = 12%. If the income level is $200,000 the savings rate should be 10 + (20 - 5) = 25%. Households with incomes over $200,000 could remain at 25%.*

Many financial plan outcomes would benefit greatly from following this guideline. We can't control market returns, nor political, economic, interest rate or inflationary risks…but we encourage clients to mind their spending, which can be controlled and will provide for higher levels of saving.

FINANCIAL SERVICES

We have been actively pursuing a means to keep our client's personal financial plan updated and useful. The best way to accomplish that is to make the plan readily available. A client should be able to view the status of their plan in real-time and determine "Am I on track?" whenever they want to.

One way to do this is a **client dashboard**. What exactly is that? A dashboard is an information management tool (it's a webpage you'll land on when you follow the link we'll provide you) that is used to track various metrics, and other key data points relevant to your financial plan. Through the use of data visualizations, dashboards simplify complex data sets to provide users with at-a-glance awareness of current performance. Think of it as a one-stop destination to see all of your financial plan's details in a simplified visually represented location. Like the elements of an automobile's dashboard, you can see everything you need to see simply and easily in one place. We hope to have this fully operational soon.

Stock Options
Reminder: We have a very sophisticated resource for managing our client's stock options, restricted stock, restricted stock units, performance shares, stock appreciation rights, and employee stock purchase plans. Some of the services available to you include grant tracking and modeling capabilities. We also recently added a client portal where our clients have special access to a confidential, highly secure site to see their grants online. We can provide you grant alerts reminding you of important dates and target values for each of your options.

If you have stock options, this is one of the best available means for keeping up with how best to exercise, manage an exercise strategy and any tax implications.

What other services do you provide?
We find the following services in high demand from our Full Service clients:

Tax Reviews * Social Security Planning * Late-Stage College Funding *
Estate Planning * Comprehensive Financial Planning
Debt Management (Mortgage Refinancing/Home Equity Lines of Credit)
Insurance Reviews and Recommendations
Life – Health - Long Term Care - Property & Casualty Insurance reviews

If you feel you may benefit you may want to consider becoming a Full Service client. Here is a much more complete listing of the many financial services we provide. Click HERE.

We also have Professional Affiliations with CPA's, Lawyers (estate/business/litigation), mortgage brokers, as well as insurance brokers for various types of insurance, eldercare professionals, career councilors and others. If you have a need, we likely have a professional affiliation you can benefit from. Let's talk.

ECONOMIC & MARKET OUTLOOK

Following a wild 2016 with the most unpredictable events, the first quarter of 2017 began the year for what looks like the ninth year of the bull market for US Equities. Driven by expectation of changes in regulation and tax reform, the quarter began strong, but with the lack of measurable results by the new administration resulting from the government system of checks and balances, towards the end of the quarter, returns leveled off. It became evident that President Trump's administration would face the media and investor focus on the President's election commitments. Speculation on progress or roadblocks has added to the market's volatility, but overall it has continued a positive movement. While this may be keeping the short term market direction positive, the overall movement over the next 4 years will inevitably be driven by job growth, earnings growth and overall economic growth. So far the market appears to remain focused on the potential positive impacts President Trump may have on taxes, corporate profits and healthcare.

On the corporate front, earnings growth reported from the fourth quarter were more than enough to support the rally. S&P 500 earnings grew 5% year-over-year and are expected higher for the first quarter. If it meets the prediction it would be the highest quarterly growth rate since 2011. If earning growth continues it may be the true driver for the market, over the talked about political or legislative action. Unemployment is at 4.7%, a nine-year low. Increasing housing prices are again setting all-time highs.

Interest rates are slowly rising, but remain low and conducive to growth. All of this is positive and supports a new path of higher equity prices. Unfortunately, there is never a way to know if the path is without bumps or detours. As we saw in 2007, stock prices often start falling six-to-twelve months before cracks in the economy become apparent.

While there are always potential risks in investing, giving in to fear of possible losses can cause significantly more damage to retirement plans than riding out a bear market or short term correction in a properly diversified portfolio. There are two primary risks associated with guessing about market volatility from your full long-term allocation to equities. First is that regardless of the length of a bull market or valuation, stocks more often go up than they go down. The second, and more timely, the Fed and other major central banks have printed trillions of dollars, pounds, euros, and yen over the last several years. Some of this money has already found its way into equity and real estate prices and is responsible for a good portion of the current bull market. It’s hard to know how much this will affect the market. For the level of stimulation over the past nine years, the market returns were relatively low and therefore is getting resistance from other forces. If inflation starts to creep higher, it is entirely possible we’ve only seen the beginning of this powerful force.

The Personal Consumer Expenditure, PCE, the Fed’s favored measure of annualized inflation, hit 2.1% at quarter end, marking the first time in years that inflation has reached the desired 2% range. While this has been a stated goal, inflation trends generally have strong momentum and often overshoot targets. This is always a concern.

The Fed is now faced with the tricky task of keeping the inflation genie in the bottle while also finding a way to begin liquidating its swollen balance sheet. The likely approach is to let existing bonds mature while attempting to let interest rates rise slowly. This has implications for stock prices because there is a tradeoff between what investors are willing to pay for stocks and what they can earn on bonds based on prevailing interest rates. Still, it is important to keep perspective. Assuming constant prices, an increase in company earnings can completely offset any negative impact from rising rates, and help stocks maintain their attractiveness relative to bonds.

In the real world, the market already expects rates to go up by about 0.5% over the remainder of the year and for earnings to climb by about 10%. What matters will be results relative to those expectations as well as evolving expectations for the future. If the labor and housing market remain strong, and credit remains relatively loose, valuations can easily go higher, even if rates rise and earnings stagnate. As always, there are many variables.

Overall investor sentiment can often be a useful indicator, or one that tends to be contrarian. Long bull markets usually don’t end until it feels like there is universal greed and little fear. At that point, most everyone has already bought in and valuations are likely excessive.

Most of this bull market seemed to feel joyless for many, and we viewed that as bullish. That has changed over the past year or so. While we began to notice some signs of greed and waning fear during the rally last spring, strong election-related hesitation remained. With President Trump winning the election and the market rallying, it caught bears off-guard. Many threw up their hands and gave up. Interestingly, we don't see excessive greed, but we don't see much fear either. Comfort seems to be the dominant emotion. To us, this means sentiment is now at neutral. There are pockets such as large cap technology where investors feel a little too smug, in our view.

On a positive note, we believe globally diversified investors have a brighter outlook and have less risk. U.S. stocks have dominated this bull market, outgaining international by a factor of nearly three. Two of the main drivers have been somewhat transparent: currency and valuation.

Although later than we predicted, the broader global economy is likely to be the bigger driver for stocks in the coming years. Despite the doom-and-gloom tone of the election and pockets of geographic weakness, the overall economy is robust and stocks reflect it.

Following events like Brexit and the US election, the populist trend represents a threat to the EU, and is likely one reason U.S. stocks have outperformed over the past few years. Foreign investing is a risk, but also an opportunity. Although we predicted a boost to the European markets, future populist events like elections in France and Italy, depending on the outcomes, may limit gains. Still the first quarter European market finally rallied ahead of these events.

International stocks are now cheaper by most valuation metrics. The S&P 500 has a forward-looking price-to-earnings ratio of 18, the MSCI EAFE (a proxy for developed international stocks) is 15 and the MSCI Emerging Markets Index is 12. In terms of currency, on a purchasing power parity basis, the dollar now looks expensive - many things are cheaper overseas than in the U.S. and it is a great time to vacation in most other continents. Short-term currency moves are impossible to predict, but we don't see much more room for the dollar to run higher.

The Fed so far has stayed on course as it related to interest rates and expectations. They raised short-term interest rates 0.25% late in Q1 and reiterated an expectation of two more hikes over the remainder of the year. Bonds still managed modest gains in this environment.

PORTFOLIO INVESTMENT MANAGEMENT

As predicted, there was a notable sector rotation this quarter. Two of the best performing sectors last year were energy and communications, and this quarter they are two of the worst. This also led to the change over from index funds outperforming to managed funds outperforming. The biggest companies have led the way so far this year, most of which are mega-cap technology and healthcare stocks. This market is reminiscent of 2015 when the "FANG" stocks drove the market outperforming all others and were the largest contributors to most of the major indexes. FANG is an acronym for Facebook, Amazon, Netflix and Google.

The difficulty for the market is to resist the temptations of chasing short term trends. It can be easy for investors to jump on rising tech companies. Sector leadership, however, is always cyclical. One year's biggest winners are frequently the next year's biggest losers. While the technology sector isn't nearly as overvalued as it was in 1999, and traditional value sectors are not as overlooked, there are similarities.

Perhaps more so than at any time in this bull market, we think it is important to stay diversified at the sector level, capitalization level and domestic versus international level.

As a turnaround from last year where value stocks were the big winners, growth stocks are leading the market in 2017. With higher valuations, value has become harder to find. Growth was driven from the economic expectations of changes in regulation, healthcare and taxes. While the S&P 500 was up 6.1% over the quarter, the S&P 500 Growth portion of the index was up 8.5% led by the tech stocks. Large-caps also outperformed mid-cap and small-cap stocks. Over the last 12 months, however, small and mid-cap stocks still outperformed large caps, pointing out again that diversification still matters.

International stocks outperformed the U.S. for the quarter as seen by the MSCI EAFE returning 7.3% and the MSCI World ex US was up 6.8%. Much of this was currency related. The post-election dollar rally reversed as it became clear the new administration’s spending plans will be facing opposition. The euro got a boost in March with the defeat of far-right candidate Geert Wilders in the Netherlands. Still, emerging markets were the big winner with the MSCI Emerging Markets index up 11.5% for the quarter.

Amid talk of rising interest rates, fear surrounding bonds remains elevated. Yet much of this fear is misguided. Bonds were relatively flat in this environment. The U.S. Aggregate bond market returned 0.8% in the period, demonstrating that bonds can hold their value while providing diversification and income even in a rising short-term interest rate environment. High yield corporate bonds and TIPS (Treasury Inflation Protected Securities) outperformed the broad bond market, once again highlighting the value of a diversified approach to fixed income.

Understand, however, that while bonds may be remaining positive, bond returns are primarily providing stability. As inflation rises, bond returns will not be keeping up with inflation. This is a major concern as we look at the last rising rate environment in the 1950’s to see annual rates of returns at 0.8%.

The days of consistent big returns from bonds are probably gone for several years, but we see no reason why a properly constructed bond portfolio should not continue to generate better returns than cash while providing diversification from stocks. However, there could be some modest negative years that impact parts of the bond market more than others, such as long-term Treasuries.

Inflation expectations are higher than a year ago, which means some of the upside has already been captured in TIPS, but we continue to believe these securities provide important inflation insurance and should be utilized for a portion of most bond allocations.

CONCLUSION

The portfolios have done well being highly diversified in such a changing market. 2016 had value stocks on the rise only to see the market change in 2017 to favor growth stocks. A rising interest rate environment and higher inflation has put pressure on bonds. The political environment has held back the growth in equities in Europe and slow recoveries of developed economies have delayed the recovery of emerging economies. Unexpected global and domestic events have added an extra wrinkle in an already changing market.

We are at a bit of a turning point in the market as we wait to see if economic growth is spurred on by this new administration and what will happen to interest rates and inflation. Although weak, we have been in a period of growth for over a decade while at the same time interest rates have fallen and inflation has hovered around zero. We have to make a decision if our current models which were set up for this in a different environment will continue to work with what is expected in the future.

During the past 12 months we have been involved in researching a possible major change in the Company's portfolio design and asset allocation for our clients. These portfolios would significantly reduce the number of actively managed mutual funds for lower cost ETFs (exchange traded funds) and individual securities and would be designed to outperform our current range of portfolios over the long term without increasing volatility (range of risk). They would continue to be globally diversified and strive to achieve superior income generation.

The portfolios would be constructed to include global fixed income, global high and growing dividend equities and tactical non-correlated alternatives at an appropriate mix for each client. This is important as we expect the equity market over the next decade to flatten and for bonds to underperform inflation. The difficulty we have is finding a better alternative to bonds that will not raise the overall risk level of the portfolio.

We expect to have completed our research and if appropriate be ready to introduce this new portfolio management program to you and begin the changeover by the end of the 2nd quarter. We will advise you of the final decision and, as appropriate, send more detailed information in separate reports.

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Below are the returns for mutual fund categories making up our clients' portfolios and the major stock market averages. Morningstar sourced these mutual fund returns. Returns beyond one year are annualized.

	1st Qtr 2017	1 Year Average	5 Year Average	10 Year Average
Large-Cap Growth	8.63	14.85	11.55	7.71
Large-Cap Value	3.70	17.44	11.47	5.59
Mid-Cap Growth	7.30	15.58	10.30	7.12
Mid-Cap Value	3.50	18.86	12.02	6.68
Small-Cap Growth	5.56	22.41	10.73	7.31
Small-Cap Value	0.29	23.43	11.38	6.43
DJIA	5.19	19.91	12.15	8.10
S&P 500	6.07	17.17	13.30	7.51
S&P Mid-Cap 400	3.94	20.92	13.32	8.96
Russell 2000	2.47	26.22	12.35	7.12
Russell 3000	5.74	18.07	13.18	7.54
Health	10.82	14.39	16.30	11.22
Commodities	-2.02	9.06	-9.86	-6.54
Real Estate	0.99	3.08	8.82	4.04
Technology	12.40	27.15	13.34	9.68
Emerging Markets	11.59	16.40	1.20	2.22
International Large	9.16	8.60	5.49	1.90
International Large	7.00	12.41	4.68	0.10
Intl Small/Mid Growth	9.01	7.76	7.77	3.61
Intl Small/Mid Value	8.07	12.14	6.68	1.07
MSCI EAFE	7.25	11.67	5.83	1.05
MSCI Emerging Mkt	11.45	17.22	0.81	2.72
MSCI World	6.38	14.77	9.37	4.21
Inflation Protected	1.19	2.13	0.40	3.30
Intermediate Term	1.07	1.74	2.52	4.06
Short Term Bonds	0.62	1.66	1.29	2.41
Multi Sector Bonds	2.08	7.40	4.07	5.39
Barclays Aggregate	0.82	0.44	2.34	4.27
High Yield Bonds	2.31	13.52	5.56	5.86
High Yield Muni	2.43	1.30	4.70	3.39
World Bonds	2.30	1.84	1.37	3.73
Fidelity Money Market	0.05	0.09	0.03	0.63