BlackDiamond Financial

1st Quarter 2017 Update

Market Commentary

The U.S. stock market was strong again this quarter as stocks extended their post-election gains. Investors continue to expect lower corporate tax rates, increased infrastructure spending, and a more favorable regulatory environment that will boost corporate profits. In addition, the market experienced its lowest quarterly volatility since 1965 with the only real instability occurring more recently when Republicans failed to replace the current healthcare system. Many investors were concerned this could be a harbinger of difficulties to come for the Trump administration's agenda, especially tax reform, since Republican tax reform is predicated on reduced healthcare spending. Although challenges remain, tax reform is a high priority for Republicans. The market continues to expect that corporate tax rates will decline by the end of 2018 and that economic growth will improve, thereby boosting earnings for stocks.

After a 12.0% gain in 2016, the S&P 500 continued to show strength and rose 6.1% during the quarter. Foreign stocks outperformed as developed foreign and emerging market stocks climbed 7.9% and 12.4%, respectively. Investors increased their emerging markets holdings including $10.5 billion flowing into emerging markets ETFs, due to lower relative valuations and strengthening emerging currencies. Small company stocks, the strongest performing stock segment of 2016, cooled somewhat and gained 2.5%. Bonds and real estate had more muted performances this quarter and were up 0.9% and 1.0%, respectively.

Economic Strength Provides Increasing Clarity on Federal Reserve Plans

In March, the Federal Reserve raised its target for the federal funds rate by a quarter of a percent to a range of 0.75% to 1.0%. The federal funds rate is the interest banks charge each other for overnight loans, which usually creates a floor for interest on short-term Treasury bonds. The rate increase was largely anticipated by financial markets due to strengthening economic data, rising inflation, and overt communication by the Fed leading up to the announcement. The Fed has a dual mandate to support full employment (4.5% to 5.0% unemployment) and maintain stable prices (2.0% inflation based on the Personal Consumption Expenditures price index). With these targets generally achieved (eight years from the end of the last recession), Fed policy will likely follow a more traditional post-recession trajectory and move to normalize short-term rates in a predictable and measured way. Expectations are for consistent future rate increases through the end of 2019 with rates stabilizing at around 3.0%.

Politics Should Not Impact Long-term Investing Decisions

The volatile political environment has caused some investors to ascribe an exorbitant amount of relevance to politics. Studies have shown that when an investor's political candidate is victorious, the investor is apt to be more optimistic and take more investing risks. The inverse is also true; when an investor's candidate loses, they are more pessimistic and take fewer risks. In reality, long-term investment portfolio decisions should not be made based on short-term shifts in the political environment. Emotions are often an investor's biggest enemy and should be minimized when contemplating investment choices. Instead, investors should create a thoughtful plan based on risk tolerance, return expectations, and future cash needs, while ignoring political noise.

Comparative Returns

	Q1 2017 Returns	Annualized Performance			
		1 Year	3 Years	5 Years	10 Years
Large Cap U.S. Stocks(1)	6.1%	17.2%	10.4%	13.3%	7.4%
Small Cap U.S. Stocks(2)	2.5%	26.2%	7.3%	12.4%	7.2%
International Stocks(3)	7.9%	13.1%	0.6%	4.4%	1.4%
Real Estate(4)	1.0%	3.1%	10.0%	9.7%	5.0%
U.S. Bonds(5)	0.9%	0.5%	2.6%	2.3%	4.3%

1. *Measured by the S&P 500 index, which includes 500 of the largest U.S. companies in all sectors of the economy*
2. *Measured by the Russell 2000*
3. *Measured by the MSCI ACWI ex-U.S. index, which includes large and mid-capitalization stocks from developed and emerging international markets*
4. *Measured by the MSCI U.S. REIT index, which includes domestic publicly traded real estate stocks*
5. *Measured by the Barclays Aggregate Bond index, which includes a representation of the performance of the entire U.S. investment grade bond market*

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