Continued optimism that a Trump administration will bolster already growing economies around the world, combined with a healthy rebound in corporate earnings in the US, helped propel global stocks higher in February. US stocks indexes reached record highs, and at one point during the month, the Dow Jones Industrial Average closed higher for 12 consecutive trading days, tying a record that dates back 100 years. Non-US stock indexes also largely rose, benefiting from growing confidence that economic growth was gaining momentum outside the US, especially in the Eurozone. Fixed income markets rose as well. Bond investors were somewhat more skeptical than stock investors as to the timing and effects any Trump stimulus may have on the US economy. Broad commodity indexes eked out a small gain, in spite of the steep decline in natural gas prices. Nevertheless, crude oil finished the month higher, as the Organization of Petroleum Exporting Countries ("OPEC") announced that its production cut, inclusive of Non-OPEC commitments, had reached nearly 90% of the quota agreed to in November.

Boosted by continued optimism in the Trump administration’s ability to accelerate economic growth and a solid quarterly earnings reporting period for S&P 500 companies, US stocks posted their strongest monthly gain since March of last year. Equity investors seemingly shrugged off concerns about the new administration’s ability to implement its agenda, which includes lowering taxes, reducing corporate regulatory burdens and spending huge sums on infrastructure projects, and instead forecast an accelerating economy driven by these policies. Economic data released during the month also added to the positive sentiment in equity markets, as surveys of manufacturing and non-manufacturing activity were strong, the labor market added more jobs than expected in January and core Retail Sales rose more than forecast.

Earnings reports were also supportive of stock gains. With approximately 94% of companies having announced fourth quarter 2016 results, profits for S&P 500 companies rose by 4.7% during that quarter, while sales grew by 4.6%. This represents the best quarterly performance for earnings and sales in nearly two years, a period in which earnings were declining for much of that time. From a
sector perspective, Energy and Industrials remain the worst performers, though well off the steep declines registered in 2015. Encouragingly, sales did grow in both of those sectors. In addition, consumer related sectors held up well, suggesting the large increases seen in consumer confidence surveys in recent months materialized in better spending trends. Not all retailers benefited, of course, though the home improvement companies, apparel and drug retailers did well. Also somewhat surprising was the relative strength in the large department store chains, though the better results were overshadowed by lower expectations.

Looking overseas, stocks rallied on improving expectations for better economic growth, primarily from the Eurozone. Like the US, manufacturing surveys showed improvement in the currency bloc, led by France, a country not long ago expected to slow down. Valuations likely played a role as well, with Eurozone equities trading at more attractive levels relative to the US.

Concerns remain in the Eurozone, however, over upcoming elections in France, the Netherlands and possibly Italy, later in the year, where populism appears to be growing in several countries. The leading candidates in France and the Netherlands, according to the latest polls, are Euroskeptics, though in France, at least, it appears unlikely at this time that the leading candidate would win in the second round elections. Emerging market stocks also rose for the month, despite the political rhetoric around trade, tariffs and a rising dollar. Chinese economic activity held steady for the month, while rising commodity prices no doubt helped to stabilize markets.

Bond markets in the US rose, as bond investors questioned the speed of implementation of the Trump administration’s policies and the timing of the Fed’s next move. The yield on the 10-Year Treasury declined nearly 6 basis points (“bps”) during the month, and would have declined more if not for a late month increase. The yield curve did flatten, with the 2-Year Treasury yield virtually unchanged and the 10-Year yield moving lower, a sign bond investors were cautious. This cautiousness is likely the result of uncertainty as to how well the promised policies from the Trump administration would add to economic growth, combined with the market’s skepticism over the Fed’s next rate hike. The Fed has suggested it expects to raise interest rates three time in 2017. Further, credit outperformed sovereigns in the US, with High Yield gaining the most.

Interestingly, spreads between German and French 2-Year yields widened during the month, reflecting nervousness over the upcoming elections in France and the safe-haven status of German bunds. Le Spread, as the French call the difference between the two country’s yields, climbed to 35 bps by month end, having started the month at below 20 bps.

Broad commodity markets rose slightly, even after the steep declines experienced in Natural Gas, which fell by over 13% during the month, pushing the year to date decline down nearly 30%. Much warmer than normal temperatures during large portions of the month led to the steep declines in Natural Gas futures. Other major Energy commodities, however, gained, led by West Texas Intermediate crude oil, despite the increase in oil rigs and the corresponding increase in production from shale producers. The aforementioned cuts by OPEC and non-OPEC members appeared to be having a larger effect on the market than the rig count. Metals markets posted varied returns, as Precious Metals all rose but Industrial Metals were mixed. Industrial Metals were still up for the year, as Chinese demand and economic activity was steady. Agricultural commodities declined during the month, though prices were mostly up through mid-month. Prices declined later in the month as supply concerns re-emerged.

Finally, this month’s moves in financial markets is a good reminder of how markets can sometimes be confounding. Both stocks and bonds rose during the month, however, for what appears to be opposing reasons. Bonds rose for the most part due to investors questioning the viability of the Trump administration’s policies, while equities rose for that very reason. One market will likely be proven correct, however, only time will tell which one. Please stay tuned to these pages to see which one.

Should you have any questions about this update or your portfolio, please do not hesitate to contact your Portfolio Manager or Trust Officer.
Unless otherwise noted, performance and return data sourced from Bloomberg, LP as of February 28, 2017.

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This is only an opinion and not a prediction or promise of events to come.

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