A late month rebound in US stock prices closed out a volatile month, erasing earlier declines and bringing returns to the flat line for March. Failure by the House of Representatives to agree on legislation, supported by President Trump, that would replace the Affordable Care Act (“Obamacare”) triggered doubts about the enactment of future pro-growth policies. The skepticism was perhaps seen best in the bond market. The yield on the 10-Year Treasury peaked at about 2.63% mid-month, only to fall to about 2.40% by month end, as the Trump optimism faded. The yield curve also flattened, further evidence that the bond market was unconvinced of the reflation trade. Broad commodity markets were generally lower on the month. Oil experienced a sharp selloff driven by supply concerns, while in metals, demand from China has ebbed recently.

Stocks in the US finished the month close to where they started, but the path to a flat return for the month was volatile. Early on, stocks continued the rally that began late last year on sustained optimism that pro-growth polices enacted by the Trump administration would revive economic growth. Supporting that narrative was the continued improving economic picture, in the US and abroad. Measures of Consumer Confidence surged to levels last seen in 2000; Small Business Optimism remained at an elevated level; while the Home Builder sentiment indicator finished the month just shy of the peak reached before the Financial Crisis, in spite of the rise in mortgage rates. The labor market added 235,000 jobs in February, while wages rose 2.8% from year ago levels. Manufacturing indicators also suggested improvement in that segment of the economy. This better economic picture prompted the Federal Reserve to raise the Fed Funds Rate by 25 basis points (“bps”) to a range of 0.75% to 1.00%, citing the improving labor market, while several Fed governors announced the potential for faster rate hikes going forward.

Though the positive environment for stocks quickly turned around, it became apparent that the healthcare bill written by House Republicans and supported by President Trump would not receive support from the conservative Freedom Cause and therefore fail to win approval. As a result, stocks tumbled, with the S&P 500...
registering its first 1% move since October of last year. Another factor weighing on stocks was the sharp decline in oil prices. West Texas Intermediate crude breached the $48 per barrel level at approximately the same time that the healthcare bill failed. Increased US production of crude sent prices down, despite the high compliance rate by members of the Organization of Petroleum Exporting Countries (“OPEC”) to meet, and in some cases exceed, the agreed upon cuts in production reached last year.

Then, in reaction to the better Consumer Confidence numbers referenced earlier and a revised GDP report that showed Personal Consumption rose by more than initially reported in the fourth quarter of 2016, stocks rose to close out the month, completely erasing earlier declines. In addition, oil prices rebounded, as comments from Qatar’s oil minister suggested that OPEC could extend the production cuts, should the oil market not achieve the desired balance. Fears that President Trump would be unable to proceed with other promised initiatives also faded.

Meanwhile, stocks outside the US gained handsomely. In Europe, stocks rose after a Euro-skeptic candidate did not win a plurality of seats in the Dutch parliament, dealing a blow to the rising tide of populism spreading across the continent and allaying fears that an anti-Euro candidate could win in France’s April elections. Positive economic data from the Eurozone also helped to push stock prices higher, as the Euro Stoxx 50 Index gained nearly 5% for the month in euros (about 6% in dollars). Interestingly, the United Kingdom officially invoked Article 50 of the Lisbon Treaty, thereby beginning the process of exiting the European Union (“Brexit”), to no significant disruptions in financial markets. Emerging market stocks surged during the month, driven by a declining US dollar and attractive valuations that enticed investors into the asset class, sending the first quarter return up more than 11%, about double the gain of developed market equities.

Bonds, on the other hand, remained skeptical of the Trump trade. Yields rose during the early part of the month, as it became apparent that a Fed rate hike would be a certainty. Shortly thereafter, with the failure of the healthcare bill and the fall in oil prices, bond yields fell, reaching a low of about 2.38% on the 10-Year Treasury. The Treasury yield curve flattened mildly as a result, as yields on shorter dated Treasuries while longer-dated bonds finished roughly unchanged. High Yield spreads rose for much of the month, after touching a near term low below 350 bps at the beginning of March. Consequently, High Yield was the worst performing bond sector for the month until a late rally in the month brought returns for the market down to about -0.2%, followed by a similar performance in investment grade corporates at -0.2%. Both international and emerging market bonds markets rose, as the improving picture abroad gave investors a reason to favor global bonds over Treasuries.

Broad commodity markets posted negative returns for the month. Much of that decline was driven by the steep monthly decline in oil prices. Oil prices have moved lower in recent weeks, hastened by a steady rise in US production that has resulted in larger than anticipated inventory levels in the US. Crude supplies outside the US, however, are declining. OPEC has been successful in enforcing its production cuts upon member and non-member nations, while also suggesting it could extend the cuts if the market failed to reach equilibrium. Natural gas surged during the month, as colder than normal temperatures in the Northeast US reduced supplies. Metals also declined. Copper fell as concerns over demand in China outweighed the tight supply conditions amid disruptions caused by striking miners. Gold, meanwhile, declined as better economic data and the potential for faster Fed rate hikes, made gold less attractive. Agricultural commodities remain mired in oversupply, sending prices down again.

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 March 31, 2017.

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

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