Exencial Wealth Advisors™

Q1 Market Update

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As we reflect on the first quarter of 2017, we find ourselves in a relatively favorable position.

The U.S. remains strong. Recent job numbers came out positive, with the private sector posting 298,000 jobs for the month of February, roughly 100,000 higher than analyst expectations. The stock market has continued to reach highs, with the Dow hitting the 20,000 mark at the end of January and continuing to edge higher.

We are also hearing anecdotal evidence from companies suggesting top-line sales growth ahead, which is very promising. Based on our internal studies, much of the earnings growth the market has experienced in the last few years has come from increased operating efficiencies that have improved profit margins rather than from increased sales.

However, while there are many positives to look forward to on the economic and financial fronts, there are also many uncertainties, especially in terms of government policies. We are still waiting for clarity on both healthcare and tax reform. Though we are slowly getting more information, there is not yet the finality the market is looking for.

We remain optimistic for the rest of 2017, but there are three key trends that we are monitoring closely.

1. **Inflation:** We are finally starting to see inflation move higher. Inflation has moved slowly – and below the Fed's 2 percent target – for the last few years, but expectations have recently jumped.

   The interest rate on the 10-year Treasury also continues to move higher, which is reflective of investors' belief that inflation will rise. Additionally, we expect the increased demands for hiring (as reflected in recent jobs numbers) to support expectations for higher inflation.

   While we believe a moderate increase in inflation is a good sign at this time, if inflation and rates increase, these will likely negatively affect assets that are interest rate-sensitive, such as bonds, some real estate and dividend-yield stocks.

2. **Global growth:** Last quarter, we noted that global growth was slow. It still is, but thankfully, it seems to be improving.

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While the U.S. is showing signs of consistent growth, other developed markets around the world are expected to slightly improve. The World Bank is forecasting 1.8 percent growth for developed countries in 2017, which is an improvement from last year's very low growth.

Growth in emerging markets is beating many expectations. Collectively, emerging market stocks represent some of the best-performing sectors year-to-date.

Overall, while we continue to have varied data across the globe, we are expecting to see at least moderate growth in most regions, which should bode well for investors.

3. **U.S. dollar:** U.S. interest rates are expected to rise in 2017. While we will be monitoring for how much rates rise, we will also be keeping a close eye on international dollars flowing into U.S. bonds, as this could keep rates low despite any increase from the Fed. International bonds are essentially yielding nothing, so U.S. bonds still look attractive, even at low rates. If international flows suppress a rise in rates, we expect the U.S. dollar to strengthen.

   The U.S. dollar is one of the most crowded trades now, especially by active managers who are looking to go long on the currency. The U.S. dollar has had a positive run in the last two years, but we will be closely monitoring to see if it continues.

   The strength of the U.S. dollar can significantly affect many investment factors, especially corporate earnings and international stock returns.

These three areas will be our key focus points over the next quarter. While indicators continue to show an improving economy, we will be watching these areas in particular to determine if adjustments in expectations and portfolio assets are warranted.

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