POLARIS WEALTH ADVISORY GROUP

The Polaris Perspective

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First Quarter 2017 Update

Strong corporate earnings and robust economic data more than offset the political and legislative missteps by Trump's administration during the first quarter of the year. Even the first fed funds hike of the year, one of three expected moves during 2017, barely made the markets pause to take notice. While the S&P 500 finished the first quarter of 2017 with a fizzle, losing 0.04% in March, it still gained 5.53% in value for the quarter (as seen below). This is the best start to the year since 2013 and the third best start to the year since 2000.

Source: TD Ameritrade

Highlights for the Quarter

- The S&P 500 had a 109-day streak without a 1% decline, its longest stretch in almost 22 years with 55 straight days without a 1% move in either direction (first time since 2014).
- Most commodities lost value, with the S&P GSCI commodity index losing 2.51%. Gold bucked that trend, ending the quarter up 8.53%.
- Top performing sectors were information technology, consumer discretionary, and health care, up 12.16%, 8.09%, and 7.89% respectively.
- The worst performing sectors were energy, telecommunication services, and financials, with respective performance of -7.30%, -5.06%, and 2.08%.
- FANG stocks (Facebook, Amazon, Netflix, and Google) had an equal-weighted return of 16.9%. Amazon (a PW AG Global Growth strategy holding) was up 18.2% for the quarter, masking the weakness in companies like Macy's, Kohl's, and Target which were all down more than 17% for the quarter. Because Amazon is nine times greater in size than these retails combined, it pushed the consumer discretionary index up significantly.
- Long-term bonds were up 1.40%, the Bloomberg Barclays US Aggregate Bond index was up 0.82% and T-Bills were up 0.15%, despite the Fed raising rates.
- The U.S. dollar lost 1.79% of its value in the quarter.
- Six of the seven regions of the MSCI All-Country World Index (ACWI) were up, sending the index up 5.18% for the quarter. Only Japan was down for the quarter, losing 0.95%. The best performing market was emerging markets, up 7.47%, and the best performing region was Pacific Rim, ex-Japan, up 6.93% (in their local currencies).

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The Fed Makes Its Third Move

In 2014, the Federal Open Market Committee (FOMC) announced their plans to "normalize" fed fund rates. At the time, they stated their intention to slowly and systematically move rates from zero percent up to three percent, so long as the economy was able to absorb these moves without negative consequences. Mixed economic data forced them to delay until December 2015, when they abandoned their seven year Zero Interest Rate Policy (ZIRP). The FOMC did not make another move until December 2016, and now their third move in March 2017. As you can see from the chart below, with fed fund rates in a 75 basis points to 100 basis points (.75% - 1%) range, they are still at historically low rates as compared to the 30-year average of 3.45% or 50-year average of 5.39%.

Historical Fed Fund Rates (1954 to 2017)

20.00%
18.00%
16.00%
14.00%
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%

1954 1955 1956 1957 1958 1959 1960 1961 1962 1963 1964 1965 1966 1967 1968 1969 1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016

Source: Federal Open Market Committee (FOMC), Macrotrends.

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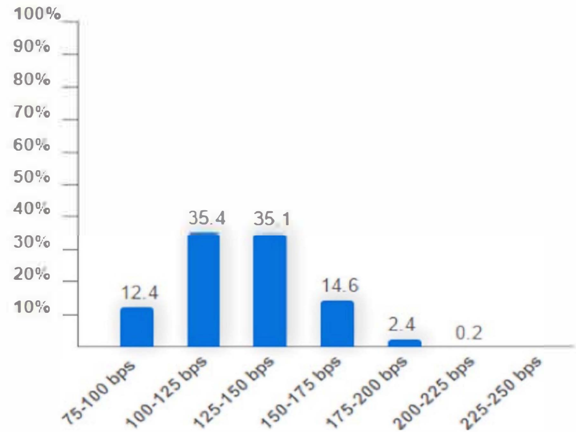
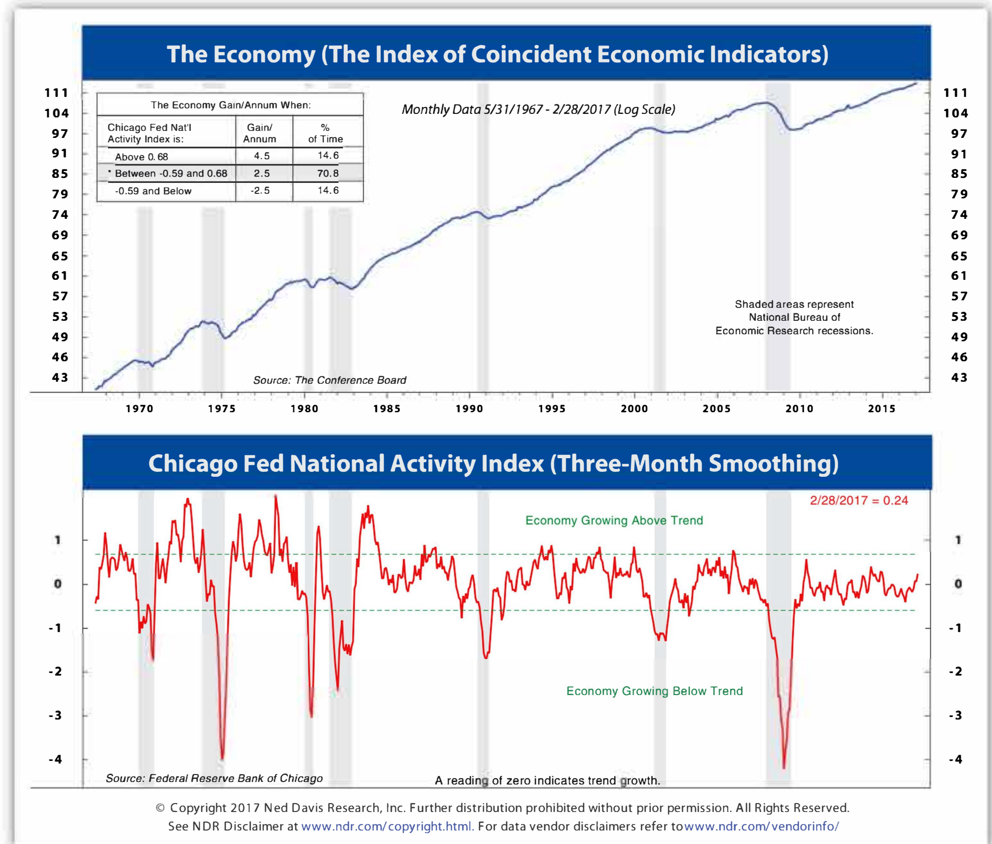
Fed futures rate probabilities (right) indicate that we will see at least one move, if not two more moves, this year. As I write, according to CME Group, there is only a 12.4% chance that the FOMC will leave rates where they are this year. There is a 35.4% chance that rates will rise to between 100 and 125 basis points (1% -1.25%) and over a 50% chance that rates will be 1.25% or greater at year's end.



Source: CME Group

The Economy

The U.S. economy is improving and Leading Economic Indicators point towards further strength in near future. As you can see from the lower half of the chart to the right, the Chicago Fed National Activity Index is now growing at an above average rate. This gives more evidence that the FOMC will continue to raise rates in an attempt to normalize rates.



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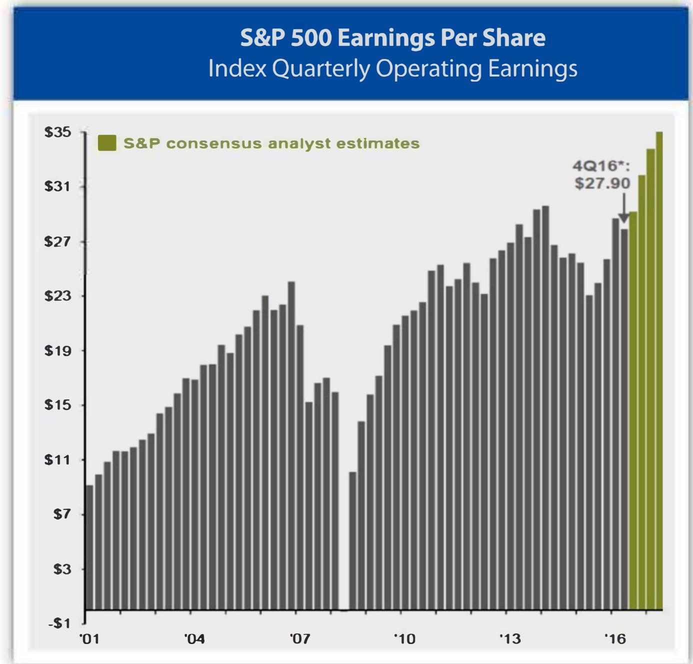
S&P 500 Corporate Earnings

As mentioned earlier in this piece, we have seen a resurgence of earnings per share from S&P 500 companies, and estimates for earnings in 2017 are for record results for these firms' earnings.



Source: Compustat, FactSet, Standard & Poors, JP Morgan Asset Management

And the markets look like they are properly valued, or slightly over valued, but not so overvalued to be concerned.

Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-valued
P/E	Forward P/E	17.5x	15.9x	0.5
CAPE	Shiller's P/E	29.0	26.1	0.5
Div. Yield	Dividend yield	2.1%	2.0%	-0.2
P/B	Price to book	2.9	2.9	-0.1
P/CF	Price to cash flow	12.2	10.6	0.8
EY Spread	EY minus Baa yield	1.0%	-0.3%	-0.7

Source: FactSet, FRB, IBES, Robert Shiller, Standard & Poors, JP Morgan Asset Management

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What Does This All Mean?

- We believe that any pull back in the stock market will be short lived and should be viewed as a potential buying opportunity rather than fearing a recession or bear market. We feel that there are certain areas of the stock market that are undervalued and have the potential for strong future earnings.
- Europe's stabilizing economy could present a potential opportunity for investors but it also has negative implications for domestic bond investors. Europe's current economic environment is complicated. Many European investors have flocked to the U.S. bond market over the past few years, while they were experiencing negative interest rates for their sovereign debt and while the dollar was showing strength to the euro. A stabilizing European economy might uncover a good place to invest, especially in their stock market. But their stabilizing economy could mean less foreign investors in the U.S. bond market, which could potentially lead to lower U.S. Treasury bond prices.
- The FOMC's stance to increase interest rates will most likely mean weakness in the U.S. bond market. At the least, continued interest rate hikes will certainly be a headwind to investors in every part of the yield curve, exposing retirees with significant bond allocations to lower than expected returns.
- There could be geopolitical flare ups that might cause the markets to fluctuate more than our current low volatility environment. In general, most of the current geopolitical issues would most likely be nothing more than a blip on the radar screen and should be treated accordingly. Unless the United States were dragged into a full-fledged war, places like North Korea and Syria seem nothing more than saber rattling rather than a major concern.

In conclusion, we feel that while the U.S. markets might be slightly over-valued, there are significant reasons to be bullish about our stock markets. We are less optimistic about the U.S. bond market. There are also significant improvements to many international markets that could drive these markets higher, too. While there have been many missteps in domestic politics, there are far more potential positive outcomes than negative, and thus we are fully invested in equities in our portfolios.

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Polaris Wealth Updates

In order to focus our clients on their long-term financial goals, this will be the last quarter that we will be providing benchmark information in the quarterly statements. Starting next quarter, benchmark information will only be available during your quarterly review with your Polaris Wealth advisor. Your wealth advisor will also be sharing more investment strategy detail during these meetings.

There is a term in the financial industry called "performance persistence." This is an evaluation of investment managers being able to outperform their benchmarks. According to the Financial Times, only 19% of U.S. large-cap managers were able to outperform their benchmark in 2016. According to a 2013 S&P Dow Jones persistency study, no large-cap or mid-cap manager was able to remain in the top quartile of all managers for five straight years, with only 3.35% of large-cap and 0% staying at this lofty level for even three straight years.

Short sighted investors either switch managers at exactly the wrong time or try to do it themselves. Dalbar's 2015 study showed that the average individual equity mutual fund investor produced only a 3.55% return, while the S&P 500 yielded a 10.35% return, from 1986 through 2015.

If you were to evaluate Polaris Greystone's strategies performance on an absolute (total return) and relative basis (risk adjusted return) we have consistently shown significant value to our clients. While we may not do it every month, or even every quarter or year, our strategies remain strong and sound.

We encourage you to speak with your wealth advisor to make sure that your long-term goals are properly aligned with our investment strategies and the current market environment.

As always, I welcome your feedback, questions, and comments.

Sincerely,

Jeffrey J. Powell
Managing Partner

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