



April 1, 2017

Taking a T-O!

Dear Clients and Friends,

As March Madness comes to an end, we can't help but feel that the markets, which have been running and gunning since the election, are using the last couple weeks of the quarter to take a time out. Typically, a well-used T-O allows players to catch their breath and for teams to assess which offensive and defensive strategies might be most appropriate going forward.

On the heels of a 5% rise in stocks between November's election and year-end, equities advanced *another* 6% in the first quarter amid increased investor confidence, faster economic growth, and rising corporate earnings.

Over the past five months, investor sentiment has improved in anticipation of several Trump administration priorities including corporate and individual tax cuts, increased infrastructure spending, and reduced regulation. In theory, these priorities should boost earnings, thereby justifying higher stock prices. The Federal Reserve came off the bench, raising interest rates in March for the second time in three months to moderate some of the economic momentum.

Still, as the first quarter comes to an end, investors may be dialing back their pro-growth assumptions. A failed effort to repeal the Affordable Care Act in late March suggests that Trump's other pro-business plans may take longer to materialize. This less bullish view of potential fiscal and regulatory policies brought equities down 1% from their early March peak.

A thoughtful approach to risk assets

FBB took an increasingly cautious approach to risk assets as the post-election mini-bull market played out. We initially proposed that Trump's pro-business plans could boost corporate earnings by ~20% in a best-case scenario, suggesting stocks could rise up to 20% from the election. However, as stocks stretched past the halfway point of that best-case in early March, we pulled back our risk appetite, viewing the current conditions as more equally balanced toward upside and downside. For clients whose portfolios had grown to levels that exceeded their target equity allocations, we encouraged modest shifts into lower risk assets.

Our more guarded outlook in the quarter drove our decision to sell five stocks across many clients' portfolios, while only adding two new positions. We exited Novartis, which is struggling to replace an older 'cash cow' leukemia drug, while buying Newell Brands, a company we believe to be in the early innings of a transformation into a higher quality consumer staples company.

Watching the Fed, volatility, and Europe

As the post-election momentum subsides, we are taking additional time to review potential catalysts and trends that may impact markets for the remainder of the year. We are keeping our eyes on the Fed, market volatility, and international markets.

The Fed continues to move away from the near-zero rates that helped boost employment and wages (but risked sparking inflation). We expect two more interest rate hikes in 2017, although recent declines in energy prices and the slowdown in Trump's pro-business agenda may delay execution.

As bond prices continue to depreciate in the face of a rising (and unusually volatile) interest rate environment, our team is taking advantage of opportunities to buy corporate and municipal bonds with short- to intermediate-term maturities. The Fed theme is garnering less attention these days, as markets factor in the potential impact of fiscal stimulus to the economy. However, any surprises coming from Yellen and Co. could be enough to shift bond and stock market volatility markedly higher.

Historically, equities have experienced a 5% correction every 50 trading days. With the last correction taking place just before the November election, we have been adding high quality companies in software, travel and leisure, and asset management, among others, to our list of Top Draft Picks.

Internationally, we are focusing on European elections, which may determine the future of the European Union (EU) and, ultimately, corporate profits and stock prices of European companies. The global populist wave, which began with the UK voting to leave the EU last summer and continued with Trump's win in November, seems to have stalled out with status-quo elections in Italy and Holland in recent months. French polls also suggest that an anti-EU candidate (Marine Le Pen) may fail to win the top office.

Our sense is European equities could become more attractive if upcoming elections suggest greater stability for the region. We will continue to monitor our weighting to the EU via direct investments and indirect exposure (through multinational companies). In the meantime, our portfolios continue to favor U.S. equities, because we expect relatively faster economic growth at home to drive U.S. profits and stock prices.

As we move from March Madness to baseball's Opening Day, FBB continues to manage your portfolio with a focus on quality, income, and the potential for long-term outperformance, while remaining ever mindful of risk management. We look forward to stepping up to the plate, taking advantage of any volatility to come in the weeks and months ahead, keeping an eye out for fat pitches at attractive prices.

With Warm Wishes for Spring,

FBB Capital Partners