2017 Weekly Portfolio Manager Commentary — *July 14 , 2017*

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ECONOMIC HIGHLIGHTS

Final Demand Producer Prices in the U.S. were up 0.1% for June and up 2.0% for the 12 months ended June 30th. Consumer Prices were flat for June and up 1.6% for the year ended June 30th. Janet Yellen's testimony to Congress this week was somewhat focused on inflation. According to Ms. Yellen, the jury was still out as to whether or not the recent inflation pause was permanent or temporary. On a separate note, Industrial Production was up 0.4% for June, with Capacity Utilization at 76.6%. Finally, Retail Sales were down 0.2% for June, slightly worse than expected.

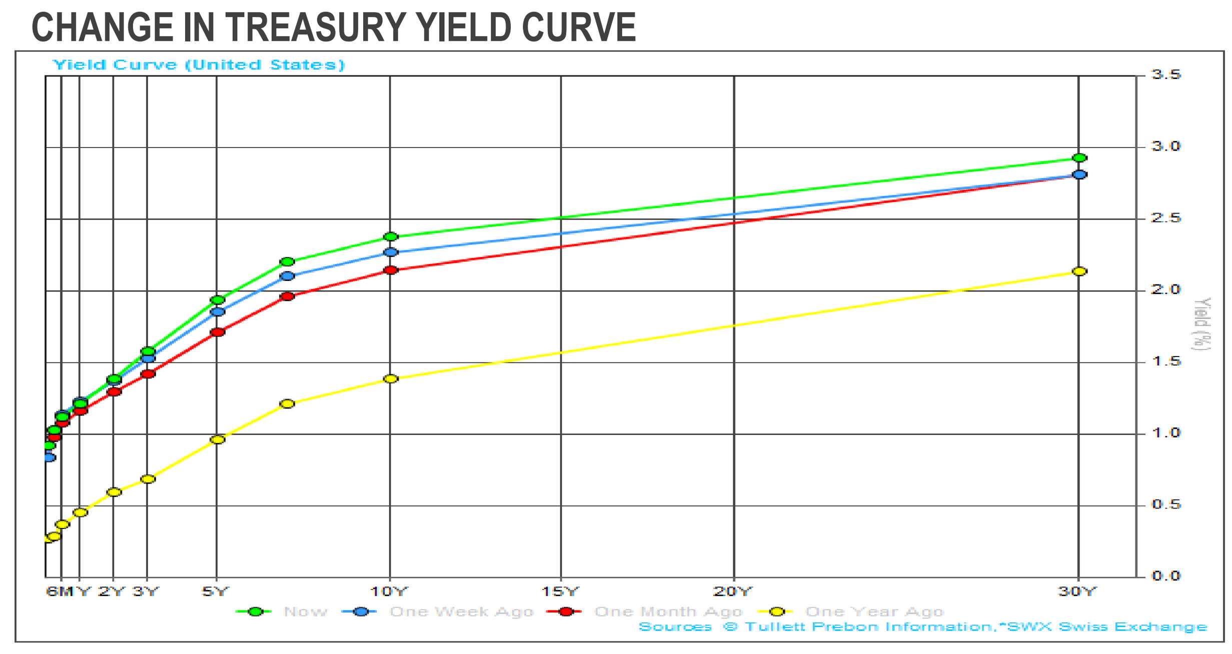
FIXED INCOME

Federal Reserve plans for gradual interest-rate increases hinge on inflation rising to its 2% target, but it's not showing up and they don't know why. That's undermining Chair Janet Yellen's case for further policy tightening. Over two days of congressional testimony last week, Yellen stuck to the Fed's outlook for gradually rising inflation that would support additional hikes in the fed funds rate. That was before Friday's consumer price index report that showed continued weak pricing power in June across a range of goods and services for the fourth consecutive month. At the Fed's June policy meeting, and in her testimony before Congress, Yellen stuck with the FOMC's baseline forecast, which predicts increasing resource constraints gradually lifting inflation and supporting another rate increase this year with three more in 2018. She told the Senate Banking Committee Thursday that inflation risks were "two-sided," dismissing some of the weakness in recent reports to "transitory" moves in some categories of the data series. The FOMC's outlook and Yellen's comments reflect forecasters' bedrock understanding of how inflation works. They look at public expectations of prices, near-term inflation performance or "inertia," and resource-use benchmarks such as estimates on what rate of unemployment begins to trigger higher compensation that fuels demand in the economy. Expectations have been low but stable, while inflation inertia has shown little upward traction. Right now, central bankers are making a big bet that low rates of unemployment will boost prices eventually. Investors see a less than 50% chance of another hike this year, according to pricing in fed funds futures contracts.

CURRENT GENERIC BONDS YIELDS

TREAURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	1.03%	3 mo	1.06%	3 mo	1.25%	3 mo	0.75%
6 mo	1.12%	6 mo	1.15%	6 mo	1.34%	6 mo	0.80%
1 yr	1.19%	1 yr	1.19%	1 yr	1.42%	1 yr	0.88%
2 yr	1.36%	2 yr	1.37%	2 yr	1.68%	2 yr	1.04%
5 yr	1.87%	5 yr	1.77%	5 yr	2.32%	5 yr	1.49%
10 yr	2.33%	10 yr	2.73%	10 yr	3.09%	10 yr	2.23%
30 yr	2.92%	30 yr		30 yr	3.92%	30 yr	3.42%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	1.04%	10.91%
S&P 500 (Large Cap)	1.42%	11.05%
S&P 400 (Mid Cap)	1.05%	7.15%
Russell 2000 (Small Cap)	0.93%	6.01%
NASDAQ Composite	2.59%	18.01%
MSCI EAFE (International)	2.28%	16.75%
iShares Real Estate	1.45%	5.70%

Stocks spent last week rallying – with the S&P 500, Dow Jones Industrials, and the Russell 2000 closing the week at new all-time highs. Also viewed as a bullish indicator was the Dow Jones Transportation Average making new all-time highs confirming the new high in the Industrial Average.

For the week, Technology, Materials, and Energy were the clear winners of the eleven major sector groups. Financials ended the week flat, the only sector not to post a gain. Financials remained flat as interest rates fell sharply after comments from Fed Chair Yellen in her testimony before Congress hinted the Fed might be getting close to their target fed funds rate. Energy got a boost as crude oil prices rose nearly 5% last week, closing at $46 a barrel.

Shares of Best Buy fell over -6% on Monday after Amazon announced plans to build its own version of the Geek Squad – Best Buy's online and in person tech support unit.

Bespoke issued a report last week that put this year's first half performance in historical perspective. They noted that as of June 30, the S&P 500 booked a total return over the prior 12 months of nearly 18% - well above the average return of 11.7% for all 12 month periods. However, over the longer-term the S&P 500 has actually underperformed its average 10 and 20 year average return. Over the past 10 years, the S&P 500 had an annualized return of 7.2% versus its average of 10.4% for all rolling 10 year periods. The index has also lagged its 20-year annualized average of 11.1%, ending June 30 with a 20 year annualized return of 7.2%.

For the week ahead – earnings season begins to heat up with some of the more high profile releases being: Netflix, Bank of America, Goldman Sachs, UnitedHealth, IBM, Microsoft, eBay, and General Electric.

The move to new all-time highs changed some of the support levels for the S&P 500. Moving forward one should watch in the short-term the prior high of 2450. Below that level 2400, 2365, 2325, and 2310 would be the next few important levels – the index closed last week at 2459.

ASSET ALLOCATION

CURRENT SENTIMENT	
Cash	Neutral
Short Fixed Income	Neutral
Intermediate Fixed Income	Neutral
Inflation-Adjusted Fixed Income	Unfavorable
High Yield Fixed Income	Neutral
International Fixed Income	Neutral
Equity Income	Favorable
Large Cap Equity	Favorable
Mid Cap Equity	Favorable
Small Cap Equity	Neutral
International Equity	Neutral
Emerging Markets Equity	Favorable
Real Estate	Favorable
Commodities	Unfavorable

Below is a summery of our current stance on most asset classes:

Cash - Holding as little as possible given the miniscule yields in money market instruments. Any exposure is for defensive positioning.
Short Term Bonds - Relative to Intermediate Bonds, the reduced duration is preferable given the outlook for higher interest rates.
Intermediate Term Bonds - The current trading range of intermediate bonds warrants a neutral position with limited upside potential. Some opportunities still remain present in spread products.
Inflation-Adjusted Bonds - Low inflation expected in near-term providing zero real return.
High Yield Bonds - Spreads have tightened; however, still remain attractive versus Treasuries.
International Bonds - Emerging market bonds offer good diversification qualities while providing higher yield opportunities relative to domestic fixed income.
Equity Income - High quality and higher-dividend-paying companies remain attractive for long-term investors given their favorable risk-adjusted profile and current yield curves.
Large Cap Stocks - A favorable weighting is recommended. Growth has reemerged as a more favorable style and should be overweighed versus Value.
Mid Cap Stocks - Mid cap exposure along with a value tilt is preferred. Mid cap stocks continue to provide the "sweet spot" of market capitalization - large enough to provide stability, but small enough to be more nimble.
Small Cap Stocks - In broad market corrections, small cap stocks will suffer most with increased volatility. However, a recent divergence of relative strength between small caps and large caps warrants a neutral exposure.
International Stocks - Given most foreign investment is in developed markets and European countries, until sovereign debt concerns are alleviated, an underweight to neutral weight is recommended.
Emerging Market Stocks - Stronger balance sheets, less debt, and better growth potential make emerging markets more fundamentally attractive than developed countries longer-term. Recent relative performance versus developed markets support the stronger fundamental backdrop and positions have been added.
Real Estate - Pricing has stabilized and long-term valuations appear attractive. Real Estate has performed well of late and should continue to be a strong alternative to other asset classes.
Commodities - Global demand should support higher prices if the global recovery remains on track. Although, volatility will be higher and commodities will be susceptible to short-term price shocks, if used in conjunction with other asset classes, risk can be reduced substantially to a diversified portfolio. However, used alone is not recommended as the short-term outlook is not favorable.