IdahoTrust

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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

Interest rates have been increasing since this past summer as domestic economic activity has moved along at a healthy albeit modest pace. The U.S. dollar has risen along with interest rates and an increase in the "greenback" is sure to have an impact on Emerging Market debt. Volatility levels are now at exceptionally low levels by historical standards; however, this may change given the high level of political uncertainties both in the U.S. and overseas.

The U.S. Economy

In March, the Federal Open Market Committee (FOMC) announced that it raised the target range for the Federal Funds Rate by 25 basis points to 0.75% - 1.0%. The change was widely expected by financial markets and was already reflected in prevailing interest rates. Fed members expect two more rate increases this year.

Since Election Day, the U.S. stock market has experienced a healthy advance. The Dow Jones Industrial Average rose above the 21,000 level. Remember, less than eight years ago, the index was below 6,500. The volatility levels have declined and sit near historically low levels. The S&P 500 had gone 109 trading days without closing down by more than 1% in a single day with that streak just recently ending. Compare that to last summer, when there were six straight days of moves greater than 1%. The current level of low volatility is very unusual.

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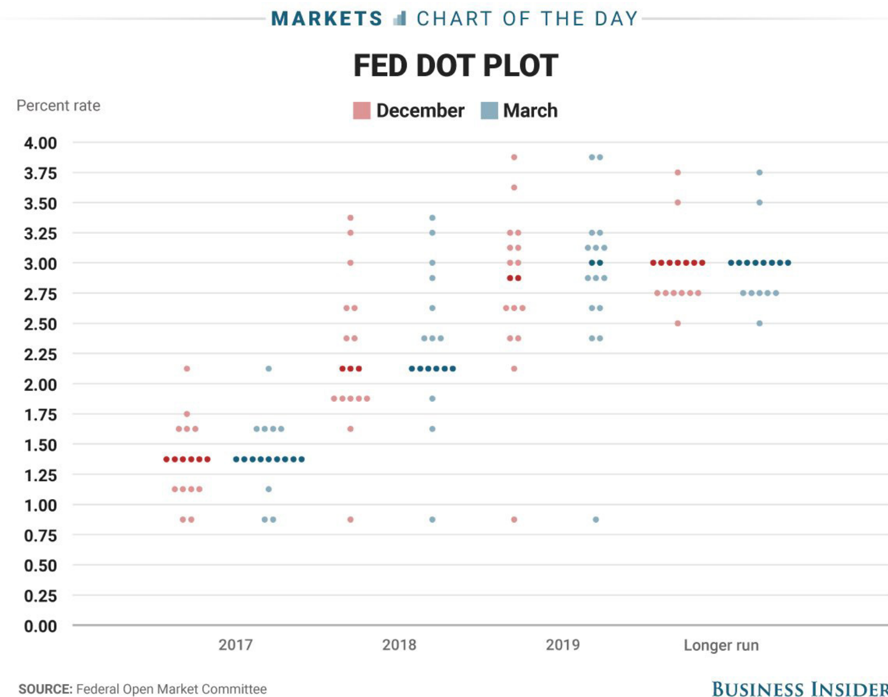
LifeNeeds™ wealth management accounts feature optimized asset allocations, robust security screening and Idaho Trust's unique TacticLogic™ investment process. All of which are tailored to our clients' unique financial needs.

Many Federal Reserve Bank (Fed) members have clearly telegraphed their intension to raise interest rates in the future, assuming the economic data continues to warrant such actions. The FOMC released its "dot plot," which is a graphical depiction of the policy rate predictions from each of the FOMC



participants. This "dot plot" provides insight into the thinking of each of the committee members looking ahead to future policy decisions. The "dot plot" chart (see above) shows that the median view (nine of 17 members) is that the target range will be 1.25-1.5% at the end of 2017. This means that the majority of the Committee expects to raise rates two more times this year, anticipating a 25 basis point increase each time. The chart also shows how these expectations have changed from the December 2016 meeting to the most recent meeting.

Looking ahead to the end of 2018, the "dot plot" indicates that the Fed Funds Rate will be 2.0-2.25%. The longer term federal funds rate expectation is 3.0%. The committee noted that "monetary policy remains accommodative" and they will continue to monitor economic conditions pursuant to their dual mandate of price stability and maximum sustainable employment.

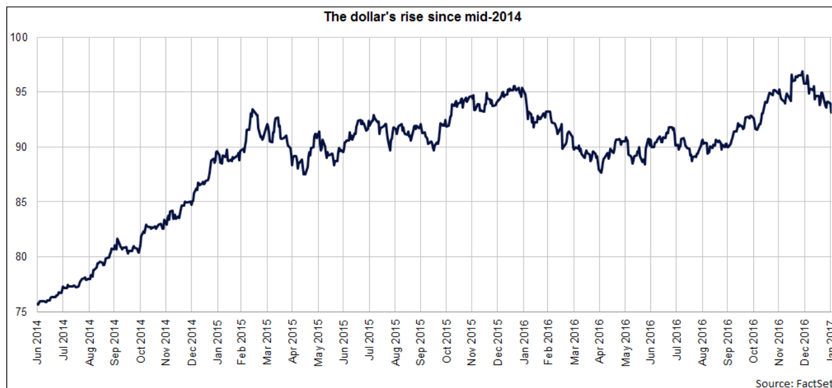
Earnings for banks and other financial companies are particularly sensitive to changes in interest rates. This increase marked the second rate hike in the past three months. As a result, analysts have been increasing their earnings estimates for companies in this sector.

The Impact of a Rising U.S. Dollar

The U.S. dollar is well above the levels reached in mid 2014 (see graph). The increase reflects better domestic economic conditions. The strong dollar, expectations of future interest rate increases, and a fall in value of

the Euro and British pound, has widespread global economic implications. As a result, there have been big shifts in trade balances and fluctuations in the value of countries' foreign exchange reserves. The soaring dollar also affects emerging market companies as they are exposed to fluctuations in the exchange rate between the dollar and their local currencies.

The International Monetary Fund projects that Emerging Market (EM) economies will be responsible for most of the world's economic growth in 2017 and 2018, continuing a trend that has been firmly established over the past few years. Debt is often utilized to finance that growth, and oftentimes companies in emerging markets issue bonds denominated in U.S. dollars to attract foreign investors that do not want exposure to these EM currency risks. The companies issuing the U.S. dollar dominated debt are exposed to the foreign exchange risk. When the value of their domestic currencies falls against the U.S dollar, the cost of servicing their debt increases.



A strengthening dollar can help emerging market economies in other ways. Companies that export goods to the United States see benefits when their products are cheaper from the perspective of American companies and consumers. A stronger dollar encourages U.S. travelers to go overseas to areas with weaker currencies as their money goes further. Finally, countries with a high level of U.S. dollars in foreign exchange reserves will experience an increase in value of these reserves

Conclusion

Interest rates remain low by historical standards. Currently, the Fed expects that it will increase interest rates two additional times this year, although Chairperson Yellen has stated that future increases will be dependent on future economic data. The Fed has raised rates only three times in the past decade and we do not expect that future increases will be enough to hurt economic activity, given the relatively healthy state of the domestic economy. Another important variable will be the changing political and fiscal policy environment, which has created many uncertainties; from infrastructure spending to the impact from changes in trade deals by the new Administration. Uncertainty surrounding these issues could create volatility this year, but the underlying foundation of economic health remains strong.

S&P 500 Index

3 Month	6.07%
Year-to-Date	6.07%
1 Year	17.16%
3 Year	10.35%
5 Year	13.28%

MSCI EAFE Net Index

3 Month	7.25%
Year-to-Date	7.25%
1 Year	11.67%
3 Year	0.50%
5 Year	5.82%

Barclays Aggregate Bond Index

3 Month	0.82%
Year-to-Date	0.82%
1 Year	0.44%
3 Year	2.68%
5 Year	2.33%

As of 3.31.2017

Boise Branch
888 W. Broad St.
Boise, Idaho
208.373.6500

Coeur d'Alene Branch
622 E. Sherman Ave.
Coeur d'Alene, Idaho
208.664.6448

Las Vegas Trust Office
2850 W. Horizon Ridge PKWY, Ste 200
Henderson, Nevada
702.430.4747

Info@IdahoTrust.com
www.IdahoTrust.com

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