IdahoTrustBank

January 2018

WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

The global financial markets performed exceptionally well last year. Moreover, volatility levels remained at very low levels. This seems at odds with a global political landscape that appears to be filled with uncertainties around the world. Most central banks are maintaining an accommodative policy outlook. The U.S. central bank increased interest rates three times last year as the domestic economy continued to experience healthy activity levels.

Interest Rates

At the mid-December meeting, the Federal Reserve Bank (Fed) raised interest rates for the third time in 2017 (marking the 5th increase in the past 10 years). Despite all of the attention surrounding this increase, interest rates remain at very low levels. The target range of the Fed funds is now 1.25% – 1.50%. The domestic economy has experienced a notable improvement over the past six months and the Fed members currently project that they will increase rates three additional times this year. Presently, inflation appears very low, although it has ticked up a bit in the past six months.

The Fed appears to want to act before there are actual signs of inflation. The central bank has made an effort to convey the idea that economic activity levels will determine the path and timing of future interest rate increases. During the last

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tightening cycle of the Federal Reserve, it raised interest rates by 0.25% at 17 straight meetings. This time, the Fed has made it clear that there will be no predetermined path.

On February 3, 2018, Jerome Powell will become the next Chairman of the Federal Reserve Bank (Fed). Powell does not have a formal economics background, which would make him the first Chairman of the Fed without an economics degree since the late 1970s. Many market observers are hopeful that without formal economics training, Powell will be able to address monetary issues in ways that fall outside of traditional academic thinking. Overall, Powell is expected to continue to follow the gradual rate increase approach of Fed Chairwoman Janet Yellen but have a somewhat different view on financial regulations. Another interesting development to watch is that the Vice-Chair of the Fed, Stanley Fisher will step down in October. President Trump will nominate a replacement at some point this spring.

First Half Recap

Of the major U.S. indices, the Nasdaq Composite, which contains a large portion of technology companies, surged almost 30% in 2017. The S&P 500, which contains a broader composition of companies, registered a lower but still very respectable gain of 21.8%. International stock indices experienced exceptionally strong gains, especially compared to the past few years, when overseas markets have lagged behind the domestic stock indices.

A strengthening of the corporate earnings outlook is likely the primary reason for the broad based rally in global equities. Other contributing factors, in our opinion, are improving economic pictures as well as continued support from most major central banks. Europe in particular has been the beneficiary of surprisingly stronger-than-expected economic conditions. Many sentiment indicators from Eurozone businesses and consumers have moved to some of their highest levels since before the financial crisis. While the U.S. has raised short-term interest rates five times since the end of 2015, the European Central Bank and Bank of Japan have mostly remained accommodative, helping boost asset prices and likely contributing to low volatility levels.

In the U.S., strong earnings growth has been a crucial underpinning of the market's performance. And a resilient Tech sector, led by U.S. and Chinese giants, has had an increasing influence on markets domestically and in Asia. The stock market was unusually steady last year. Measures of volatility for 2017 were at or near multiyear lows not only in the U.S., but also in Europe and Asia.

During 2017, the U.S Technology sector rose 38.8%, making it the strongest performing domestic industry. The Telecommunication Services and Energy sectors were the two biggest losers, each declining slightly more than 1% for the year (including dividends). A sharp decline in oil prices was a major factor in that group's weak performance even though energy prices rebounded in the final months of the year.

Small cap stocks lagged behind larger stocks for most of the year. However, hopes that U.S. tax reform would provide a bigger benefit to more domestically oriented small cap companies, helped boost these indices in the second half of the year. For the year, small cap equities, as measured by the Russell 2000, rose 14.6%, following an exceptionally strong showing in 2016.

Generally speaking, fixed income investments produced modest gains as the Fed raised interest rates throughout the year. Another interesting development was Commodities, which despite strong global economic growth experienced only modestly higher performance in 2017; as a group prices rose almost 1.7%.

2017 Market Returns

Broad Market Returns	
S&P 500	21.82%
Dow Jones Industrial Average	28.11%
Nasdaq	29.73%
Russell 2000 - small cap	14.63%
MSCI EAFE	25.03%
MSCI Emerging Markets	37.51%
US Bond Index	3.54%
Treasuries	2.31%
Corporate Bonds	6.42%
Municipal Bonds	5.45%
Foreign Bond Index	11.33%
Commodities	1.70%
Domestic Stock Sectors	
Information Technology	38.83%
Financials	22.14%
Health Care	22.08%
Energy	-1.01%
Consumer Discretionary	22.98%
Consumer Staples	13.49%
Industrials	21.01%
Utilities	12.11%
Materials	23.84%
Telecommunication Services	-1.25%
Real Estate (REITs)	10.85%

Conclusion

The total return for the S&P 500 in 2017 was up sharply from the gains experienced in 2016. Given the relatively healthy state of the domestic economy, the pace of Fed interest rate increases will certainly have an impact on the financial markets. We also think another important variable will be inflation expectations. If inflation rates begin to accelerate, the Fed will become more aggressive in tightening monetary policy. Uncertainty surrounding this issue could create volatility in 2018, but the underlying foundation of economic health remains strong.

S&P 500 Index

3 Month	6.23%
Year-to-Date	21.82%
1 Year	21.82%
3 Year	11.44%
5 Year	15.22%

MSCI EAFE Net Index

3 Month	4.36%
Year-to-Date	25.03%
1 Year	25.03%
3 Year	8.07%
5 Year	7.54%

Barclays Aggregate Bond Index

3 Month	0.39%
Year-to-Date	3.54%
1 Year	3.54%
3 Year	2.17%
5 Year	2.15%

As of 12.29.2017

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