ECONOMIC & FINANCIAL MARKET UPDATE – First Half, 2017

"Goldilocks"

Global Markets!

During the past twenty years, only four first-half rallies have been as far reaching or as strong as the first six months of 2017. All but a handful of the 30 major global stock indexes have risen this year. The likely catalyst? Improving economies, growing corporate profits, and still, accommodating support from central banks that has kept interest rates at or near historic lows.

Despite surging equity markets and some shocks in the UK (election results & terrorism), Brazil (government fraud), and the US (initial challenges to Trump initiatives) not only have investors benefited from attractive returns, but those returns have occurred with little volatility. Measures of volatility during the first six months of 2017 were at or near multiyear lows in the U.S., Europe, and Asia.

U.S. Markets

Source: Thomson Reuters Datastream

Expectations by many Wall Street strategists at the beginning of this year were for a modest (+5.5%) upward appreciation in the S&P 500 by year-end, as well as for rising interest rates (the benchmark 10 year U.S. Treasury note) during the same time period. However, the reality ***thus far*** in 2017 is quite different. Stocks have had their best first half of the year since 2013 with the S&P 500 up 8.2% and closing at record highs 24 times during the first 180 days of the year.

Bonds too have performed well (bonds increase in value as interest rates decline) as the rate on the 10-year U.S benchmark bond declined from 2.45% at year-end to 2.29% at the end of the

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second quarter. Outlooks were that higher oil prices, a more aggressive (?) Fed and the passage of President Trump's fiscal agenda would likely stimulate growth, produce an increase in inflation and simultaneously lead to higher interest rates. That hasn't happened.

In fact, the opposite has occurred. After expanding at a slightly higher than 2.0% annual rate in February, for the first time in the past five years, consumer prices are now rising at their lowest rate (+1.4%) in six months. Perhaps this should not be a surprise since U.S. wireless-service prices have *declined* more than 10%; U.S. used car prices by 6% and crude oil by 20%. The cost of education, medical care, and housing are rising at more modest rates than usual.

Stock Market Returns

As mentioned earlier, each of the primary U.S. equity markets posted strong positive returns during the first half of 2017. The S&P 500, Dow Jones Industrial Average and the (technology heavy) NASDAQ achieved returns of +8.2%, +8.0% and +14.4% respectively. As an indication of just how broad based the market advances were, it should be noted that 9 of the 11 S&P 500 Economic Sectors advanced; only the Telecom and Energy sectors declined during the past six months. As in the past, diversification and a bias toward larger, high quality growth companies has proved rewarding during this period.

Best Performing Sectors*		Lagging Sectors*	
Technology	*+16.4%*	Materials	+ 8.1%
Health Care	*+15.1%*	Consumer Staples	+ 6.6%
Utilities	+13.0%	*Financials*	*+6.0%*
Cons. Discretion	*+10.2%*	Real Estate	+4.6%
Industrials	*+8.3%*	Telecom	-12.8%
		Energy	-13.8%

Sectors displayed in ***italics*** above are those that are generally weighted more heavily in client accounts.

Mid and small capitalization stocks, asset classes that historically have added value to the performance of equity portfolios, also achieved positive returns in the first half of this year, but were definitely overshadowed by the performance of their larger brethren. The S&P Mid Cap 400 and Small Cap 600 indexes had returns of +5.2% and +2.1% respectively.

Bond Market Returns

Like stocks, bonds too rewarded investors in the first half of 2017 by providing positive returns. Positive, but still moderate economic growth, coupled with cascading energy prices, low inflation and a delay in the enactment of any of the new administration's major fiscal policies led to declines in most interest rates during the first half.

Using the Bloomberg Barclay's Indexes as proxies for various types of fixed-income (bond) returns high yield, corporate, and intermediate-maturity (7-10 yr.) provided returns of +4.9%, +4.2% and +2.4% respectively.

***Source: FactSet**

2017's Second Half – Our View

The U.S. economic expansion remains on track and, in fact, recent revisions have indicated that the economy (GDP) was actually stronger (+1.4%) than initially reported (+0.7%) in 2017's first quarter. Estimates for the second quarter, which ended last Friday, call for a doublying of the first quarter's rate to approximately +2.9%. Good news!

This environment of continued economic growth, when coupled with historically low interest rates, less than 2.0% inflation (the effects of technology, globalization, and intense competition), the best quarterly S&P 500 earnings in more than five years, an unemployment rate below 5% and much-improved consumer balance sheet and confidence, enabled stocks to again set records in the first half of the year.

The positive returns from other global indexes is likely an expression of confidence that there is the likelihood of a synchronized global expansion in its infancy.

While current stock ***and*** bond values are at a premium when compared to historic averages they are not near historic highs particularly when viewed in the context of current interest rate and inflation levels. As we have mentioned previously, we are quite aware that equity valuations have changed markedly during the past eight plus years, however, we maintain our optimistic posture based upon the positive factors mentioned above and the fact that we do not see the likelihood of meaningful deterioration in those factors or a recession in the near future.

Although tax-efficiency, when managing financial assets, is an important element of our management style, realizing some of the meaningful capital gains that have been accrued during the past nine years may be warranted.

Although largely optimistic, we are not unmindful of what could be meaningful domestic and geopolitical issues that may possibly affect financial market sentiment and thus volatility (which has almost been none existent for the past six months). North Korea, terrorism in general, Russia, China, "Brexit", oil, European elections, the ability/inability to implement the current administration's policies, or the proverbial "Black Swan" are all issues that we discuss and investigate regularly.

What would cause a meaningful change in our current posture besides the above? A change in direction (decline) of S&P earnings; an inversion of the yield curve (normally short maturity interest rates are lower than longer maturity interest rates – when the yield curve inverts, short rates exceed longer rates); a decline in consumer sentiment; a further plunge in oil prices and/or indications of a decline in economic activity in the Eurozone or China. We monitor these indicators in real time.

Portfolio Strategy

We continue to prefer equities over fixed-income due to the fact that interest rates remain near historic lows and in many cases the dividend (which can grow) yield on high quality stock investments exceeds the yield on ten-year government bonds. Also, if we are correct in our expectations that the economy

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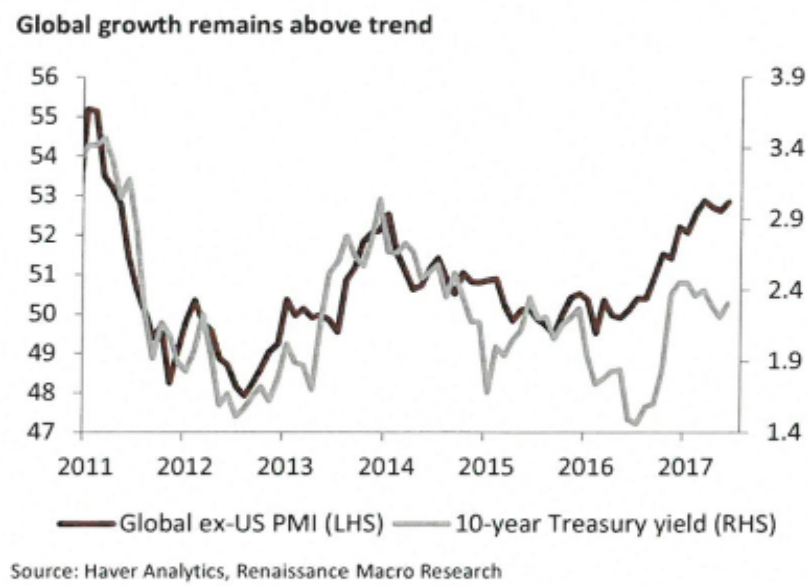
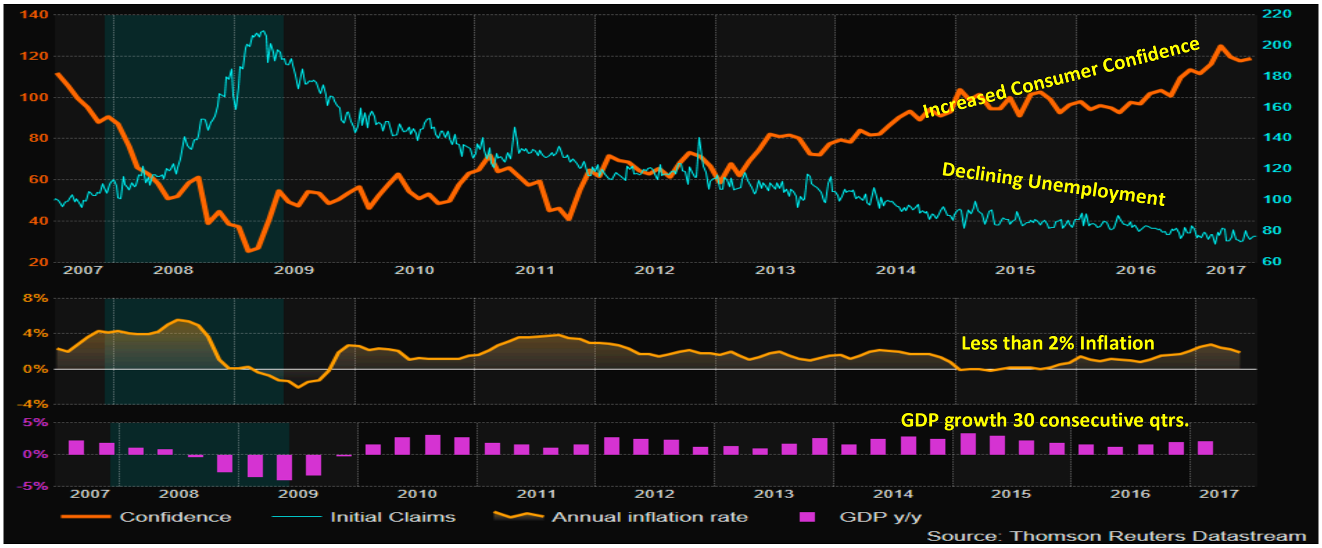
will continue to expand, more Fed hikes are likely.



Where fixed-income is required and/or held, as it is in most of our client portfolios, we focus on the ownership of bonds with shorter rather than longer maturities. This strategy maintains flexibility and reduces risk.

Within the equity portfolio, we are continuing to maintain, or even advance the degree of portfolio diversification and the "over-weighting" of positions in companies/market sectors that are operationally leveraged to the improving economy. Those types of companies are better able to increase their earnings and share dividends with investors. These companies can be described generally as either Industrial, Technology, Financial or Consumer Discretionary companies.

Lastly, we would again like to share with you a chart (a picture is worth 1,000 words) that helps us maintain (or alter) our perspective on major factors e.g. Employment, GDP growth, Inflation, and Consumer Confidence that effect the financial markets. Our evaluation? Positive.



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Our current strategy has a positive bias for what we believe are strong fundamental reasons, however, we remain sensitive to risks that are apparent.

We appreciate the opportunity to serve you. If you have any questions, or if we may be of assistance in any way, please do not hesitate to contact us. We look forward to meeting with you in the near future.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. All performance referenced is historical and is no guarantee of future results. The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful. All indices are unmanaged and may not be invested into directly.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk.

The prices of small and mid-cap stocks are generally more volatile than large cap stocks.

Stock investing involves risk including loss of principal.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

High yield/junk bonds (grade BB or below) are not investment grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets.

Investment advice offered through Stratos Wealth Partners, Ltd., a registered investment advisor.

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