ICR® 1st Quarter Newsletter – April 2017

Stocks advanced again in the first quarter, with the S&P 500 gaining 5.5% against a backdrop of optimism about tax reform, deregulation, and infrastructure spending. The rise in stock prices occurred in a steady manner as volatility was extraordinarily low. The average VIX (a measure of stock volatility) for the first quarter of 2017 was the second-lowest for any calendar quarter since 1990.

Discrepancy among sectors proved to be an interesting story as technology led the way with a 12.6% gain, while energy stocks lost 6.6% as oil prices retreated. With the prospects for a major health care system overhaul decreasing, the health care sector rallied 8.4% after losing 4% in the fourth quarter of 2016.

Foreign stocks also performed well as the MSCI EAFE added 6.5% and emerging markets gained 11.1% in the first three months. Part of those gains came in the form of currency fluctuations as the dollar declined modestly during the first quarter. The year is filled with upcoming events that could move international markets, including significant elections in France and Germany. The outcome of those elections could determine the fate of the European Union and will certainly affect markets worldwide.

Interest rates stayed in a fairly narrow range throughout the quarter and finished just slightly lower than where they started. As was widely expected, the Federal Reserve raised the Fed Funds Rate by 0.25% in March and indicated that it is poised to raise twice more this year if current conditions hold.

Political Challenges

The markets seem to be watching and reacting to the political landscape more than usual, and with good reason. We touched on the rise of populism (Brexit, Trump's election) in previous newsletters and it continues to be a story worth watching. In March, the far-right populist candidate was defeated in the Dutch election, but Marine Le Pen, the nationalist candidate for president in France, just advanced to the final run-off against more centrist candidate Emmanuel Macron. After Macron's strong showing in the first round of voting, world markets rallied strongly. There is fear that a Le Pen victory could lead to France following Great Britain's lead in exiting the European Union and that a French exit would open the floodgates for others to do the same. Whether the dissolution of the EU would be beneficial or not in the long run is debatable, but the markets clearly predict turmoil in the short run should France decide to exit. Following the French election, the German federal election this September and the Italian general election a year from now will provide a clearer picture of the fate of the EU. In the meantime, markets will continue to try to anticipate the direction of world politics.

In the U.S., enthusiasm for the Trump agenda faced a bit of a setback when the White House and the Republican-controlled Congress couldn't come to an agreement on the best path for health care reform. This level of discord within the party should underscore the challenges that likely face other policy proposals, including tax reform. While there is substantial optimism in the markets regarding tax reform, it is important to remember that even within one political party, there are competing interests and the bill that eventually passes will likely look very different from the original proposal. There is also significant disagreement about the best way to approach global trade. While Trump has pushed a protectionist agenda, some Republicans still favor free trade. The extent to which tariffs or border-adjustment taxes are imposed could impact global economic growth, currencies, and inflation.

Emerging Opportunities

With political uncertainty, lofty stock prices, and low interest rates providing plenty of investment challenges, there are also opportunities to be had. Emerging market stocks, for example, currently have a cyclically-adjusted P/E (CAPE) ratio of around 15, representing an attractive valuation relative to developed markets where the CAPE is currently 23. Recent U.S. stock market gains have driven its CAPE above 29. There are currency and geopolitical risks, to be sure, when investing in emerging markets, but they are displaying one of the more attractive risk/return profiles at the moment.

Investors have flooded into exchange-traded funds which, on the surface provide great liquidity, but in the event of a major sell-off, could become illiquid as market-makers struggle to meet redemptions while sell orders pour in. For that reason, we remain concerned about potential liquidity issues in certain asset classes, and we want to maintain the flexibility necessary to step in and purchase securities at discounts when others are frantically selling, should such opportunities occur.

Finally, given the scarcity of attractively-valued assets and the uncertainty of policy outcomes, we believe investing in some "non-directional" strategies could be beneficial in the current environment. Investments whose returns do not depend on the stock market going up, for example, have the potential to decrease the volatility of a portfolio by providing returns that are uncorrelated to the broader market.

While always focused on the downside risks, ICR will continue to pursue these potential opportunities and search for others in these increasingly uncertain times. Should you have concerns or questions about your portfolio or anything regarding your financial situation, please call us so we can work together to help you meet your financial goals. As always, thank you for entrusting us with the important responsibility of managing your wealth.

Sincerely,

James A. Heine

James L. Cobb

Market Report (as of 3/31/17)

Index	**2017 YTD (%)**	**3-Year Annualized (%)**	**5-Year Annualized (%)**
S&P 500	5.53	8.05	10.89
Dow Jones Industrial Average	4.56	7.88	9.35
U.S. Aggregate Bond Index	0.82	2.68	2.33
MSCI EAFE (Foreign Index)	6.47	-2.18%	2.91

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