



SPINNAKER

SPINNAKER TRUST QUARTERLY NEWSLETTER

APRIL, 2017

FIRST QUARTER 2017 MARKET REVIEW & OUTLOOK

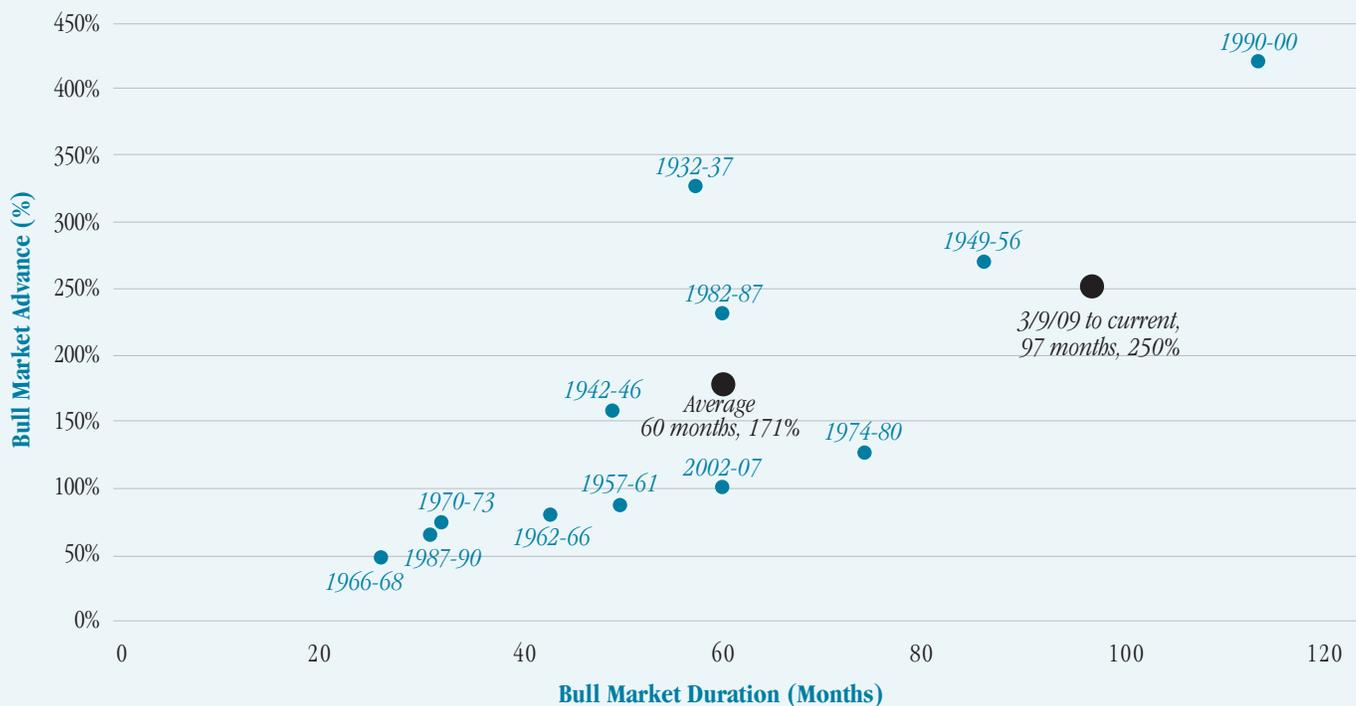
So far, financial market performance in 2017 seems to have been a continuation of what we observed at the end of 2016. The U.S. large-cap and developed international markets are up by approximately 6% and 9%, and we are only a quarter into the year! However, under the surface, there have been some notable changes. The “value” style is no longer outperforming the “growth” style as it did in the months after the election. Small and mid-cap stocks are no longer outperforming large-cap stocks. The “defensive

& safe” equity sectors have started to gain versus more cyclical sectors. International markets are outperforming U.S. markets. The U.S. Treasury bond yield and the U.S. dollar have both fallen a bit.

We have positioned our U.S. equity portfolios in a “barbell” style – overweighting certain defensive, yield-seeking industries as well as attractive cyclical industries. Cyclical, “value” sectors like Financials and Energy unequivocally offered more long-term value six months ago; however, much of that attractive valuation spread has been erased

as prices have risen. On the other hand, the “defensive” sectors (utilities, REITs, consumer staples) remain expensive and over-owned. We believe that the quest for yield has no reason to end anytime soon and, despite the Trump agenda, slow-growth pressures remain in the developed world thanks to the disinflationary megatrends of demographics, technology and debt. But price matters. Currently, we are underweight to the “safety” sectors and overweight to Health Care, Technology and Financials. We believe that bond yields will slowly rise, peaking out at lower levels than

S&P 500 Historical Bull Markets 1928 to Present



Source: Strategas Research

have been typically observed in previous cycles.

As it stands today, the market run since the depths of March 2009 is the second-longest bull market on record and the fourth greatest in magnitude since 1928. While we see a great deal of fundamental improvement both in the U.S. and around the world, we believe that a healthy proportion of the market's most recent run assumes the (at least partial) success of the Trump agenda. While it is prudent to start thinking about when this cycle may end, there is a reasonable chance that markets will continue to rise for another year or two. We had a global "earnings recession" in 2015 and early 2016, but that ground has now been recaptured and higher levels established. Corporate fundamentals are strong, consumer confidence is close to all-time highs, and demand and inflation are rising at a "goldilocks" pace.

Fixed Income: We believe that the

Federal Reserve is finally embarking upon a normal interest-rate cycle (discounting an errant and unpopular rate hike in December of 2015), albeit a slow one by historical standards. Following that lone hike, the fear of deflation spread and interest rates hit multi-year lows, putting the Fed on hold for a year. Having held a short duration position across our bond portfolio for years, we felt that the probability of rates going even lower was minimal, and that the risk/reward trade-off favored our positioning. We were finally vindicated following the U.S. election as rates soared higher, fueled by optimism around tax reform and infrastructure spending. While many investors mention the "Trump Trade" as the catalyst, we believe that the election was coincident with a legitimate turn in global growth.

However, just a few months into what is supposed to be a reflationary year, we have observed investors balking despite a Fed that is confident enough in the economic data to

increase interest rates multiple times in 2017. Just last month the Fed, as expected, raised short term rates; however, financial markets were not pleased to see expectations for future hikes remain the same and have since reacted as though the Fed had cut rates. This is not surprising as inflation has been almost non-existent for years as the U.S. economy has been dogged by low productivity, worsening demographics and decreased demand worldwide. A certain amount of skepticism may be healthy and prolong this cycle.

Nevertheless, we feel rates will trend higher this year. Currently, the Fed is planning to raise short rates two more times. We think that a third hike may be possible with pressure on wages building. Longer rates are less likely to rise as much as they tend to be influenced more by global growth expectations, which remain muted. Furthermore, the yields on U.S. long duration bonds continue to be attractive versus the rest of the developed world, bolstering demand. We feel this will continue to be

FOSSIL FUEL FREE INVESTING

When looking at any specific window of time it is difficult to discern whether or not fossil fuel free investors are being rewarded for choosing not to invest in energy companies. Oil and gas prices, which are the most important factors in determining industry profitability, are volatile and will remain that way for some time as companies stabilize their operations following the crisis last year. Furthermore, we are now in the midst of an extreme change in the mindset of our political leadership. The Obama administration made progress steering the United States away from fossil fuels, but much of that will now be rolled back under the new administration as almost all of it was done by executive action. Where does this leave fossil fuel free investors? We believe not investing in fossil fuel companies will decrease portfolio volatility over time and provide opportunities to invest in companies that are driving a transition away from a worldwide reliance on oil and gas. The majority of clean energy companies are in their infancy, easily disturbed by regulatory shifts and economic cycles, which makes it challenging to find long-term winners. Nevertheless, we will continue to evaluate the merits for investing in this industry and target those companies and regions of the world that are encouraging its progress.

the case for the foreseeable future as the rest of the developed world remains reluctant to raise rates in light of slow growth. As a result, these are difficult times for investors in fixed income markets. Yields across the majority of sectors indicate very low go-forward return expectations. With this in mind, we have increased our allocation to alternative investments as we feel they offer investors a vehicle for capturing some upside while also protecting against a large drawdown in the portfolio.

Policy & the Trump Agenda: As we closed the quarter, Trump's first major policy initiative was rejected by the President's own party. This will certainly make it more difficult to get the fiscal year 2018 budget and debt ceiling passed in the coming months. It goes without saying that a Republican Congress that would not support the Trump/Ryan healthcare plan will almost certainly not stand behind the Boarder Adjustment Tax proposal. In the words of our research partner Strategas, "the AHCA (Affordable Healthcare Act) would have been a \$900

billion tax cut that served as a down payment on more comprehensive tax reform." However, we do not believe that the defeat of the healthcare plan necessarily dooms tax reform. Rather we think that the tax reform that is eventually passed will be moderate. Strategas believes that the most likely outcome is a 23% corporate tax rate (from the 15%/20% rate proposed by Ryan and Trump, respectfully) that includes repatriation of overseas corporate profits.

Outlook & Conclusion: The global economy has entered a reflationary window where deflation risks are receding, but fears of excess inflation have yet to surface. For the first time in recent memory, growth in Europe and Japan is faster than it is in the U.S. The Emerging Markets have largely cleaned up their balance sheets and are benefitting from the environment. We would note that chronically low productivity and the full labor force will likely make it difficult for the Federal Reserve to contain inflation once it does begin

to accelerate. Global bond yields should rise only modestly this year.

The evolution of our current business cycle has been odd. Investors and consumers were rightly traumatized by the Global Financial Crisis in 2008 and 2009. As a result, this bull market has been a reluctant one that has certainly been climbing the "wall of worry." As Strategas has written, "... this has been the most hated bull market in history." Despite widespread asset overpricing, there are few signs of an equity bubble; indeed some indicators are rather bearish. All great market declines of modern times were preceded by universal optimism and high prices. We have recently refreshed our economic indicators and tracking process so that we can be ready to position portfolios for the end of the cycle. However, we do not believe that a recession is imminent or probable this year or next. The market can certainly hit us with an ordinary pull-back of 5-10%, but a serious decline seems unlikely.

WELCOME

Laura Kate Greenstein joined us as an Assistant Portfolio Manager in January from Merrill Lynch. We are thrilled to have Laura with us and hope that you are able to meet her soon.

MARKET DATA

<i>Index</i>		<i>Q1 2017</i>	<i>2016</i>	<i>2015</i>	<i>2014</i>
S&P 500	<i>U.S. Large-Capitalization Stocks</i>	6.07%	11.95%	1.37%	13.68%
S&P 400	<i>U.S. Mid-Cap Stocks</i>	3.94%	20.73%	-2.18%	9.74%
S&P 600	<i>U.S. Small-Cap Stocks</i>	1.06%	26.46%	-2.01%	5.74%
Russell 1000	<i>U.S. Large- and Mid-Cap</i>	6.03%	12.04%	0.91%	13.24%
Russell 1000 Growth	<i>Growth Stocks broken out</i>	8.91%	7.07%	5.67%	13.05%
Russell 1000 Value	<i>Value Stocks broken out</i>	3.27%	17.33%	-3.84%	13.45%
MSCI EAFE Index	<i>Established International Markets</i>	7.39%	1.59%	-0.28%	-4.32%
MSCI Emerging Markets	<i>Developing International Markets</i>	11.49%	11.27%	-14.61%	-1.97%
		<i>3/31/17</i>	<i>12/30/16</i>	<i>12/31/15</i>	<i>12/31/14</i>
90 day T-Bill	<i>Short-Term Interest Rate</i>	0.76%	0.51%	0.17%	0.02%
10 Year US Treasury Rate	<i>Longer-Term Interest Rate</i>	2.39%	2.45%	2.28%	2.17%
VIX Index	<i>Risk Measurement</i>	12.4	14.0	18.2	18.1
Corporate Bond Spread	<i>Risk Measurement</i>	118 bps	120 bps	165 bps	131 bps
TIPS Spread	<i>Inflation expectations</i>	160 bps	197 bps	171 bps	170 bps

SUMMER OF 2017 UPGRADE COMING YOUR WAY....

We are working hard to make sure your client experience is the best possible.

- New and improved statements
 - Easier to read
 - Option to receive online or in the mail
- Better access to account information
 - New client portal with easy navigation and more information
- State-of-the-art portal security

We will be keeping you updated as we get closer to our July 2017 launch.

