Plimoth Investment Advisors®
INVESTMENT MANAGEMENT & TRUST SERVICES SPECIALISTS

FIRST QUARTER – SPRING 2017

INVESTMENT SPOTLIGHT

"There is nothing riskier than the widespread perception that there is no risk."

– Howard Marks

Slow and steady wins the race? If that is the case, the U.S. economy may very well be on the slow road to victory. U.S. real GDP has grown at the sluggish pace of roughly 2.0% since the post-recession economic recovery began in 2009. Even the current slowest pace of recovery since the Great Depression, however, is a "recovery" none-the-less. While investors in U.S. equities appear to continue their post-election sprint, we see macroeconomic fundamentals more suited for a marathon.

2017 has been marked by a continuation of new highs in U.S. equity markets, albeit with numerous changes in leadership by cap, style, sector and geography. Investors continue to embrace a "risk-on" stance with little hesitation, leaving fixed income investments in the shadows of high flying stock returns. Rising geopolitical concerns and the collapse of efforts to repeal the Affordable Care Act proved to be mere speed-bumps in the post-election stock market rally. ■

Economic Review & Outlook

Since our last quarterly report, Q4-2016 GDP was revised upward from 1.9% to a final estimate of 2.1%. The upward move was encouraging, particularly since it was based primarily on a revision to personal consumption, a key driver responsible for two thirds of U.S. GDP, from 3.0 to 3.5%. With consumer confidence hitting record high levels, we became cautiously optimistic that the soft data provided by these surveys may actually make the leap into hard consumer spending data. While GDP figures reported in the first calendar quarter of most years have been historically low, the Q4 consumption revision left those with a glass-half-full mentality looking for signs of momentum into the first quarter. Q1-2017 estimates for GDP however, have been set at a mere 1.1%. (Shortly before distributing this letter, the preliminary Q1 GDP was reported at a paltry 0.7% driven by a meaningful fall-off in consumer spending.) The lackluster first quarter estimate was in line with headline retail sales reports of -0.3% in February and -0.2% in March, offsetting the 0.5% figure reported in January. While the Conference Board was busy collecting data showing that consumer sentiment had hit a 16 year high, shoppers retrenched, causing particular strain on brick-and-mortar retailers, as those who did spend showed a preference for doing so online from the comfort of their homes.

More than just a haven for online shoppers, homes continued to steadily appreciate in value and sold at a rapid pace during the quarter. Both existing and new home sales were extremely robust. The 5.7 million of existing homes sold in March was the highest year-on-year pace in 10 years. Available inventory declined to 3.8 months of supply for existing and 5.2 months for new homes, well below average levels. As supply declined, the increase in the median price of homes hit a remarkable 60th consecutive month of year-on-year gains.

Employment continued to show signs of strength during the quarter although wages were unable to keep pace with the

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rapid pace of home prices. Headline unemployment declined to 4.5%. While we still see signs of slack in labor markets, underemployment declined modestly. The labor force participation rate as a whole however, remains historically low at 63%.

U.S. manufacturing remains in expansionary territory as the national measures of output caught up with red hot regional figures, with some areas hitting multi-decade highs. Headline durable goods figures held up although rather than autos in the driver's seat as we saw in Q4-2016, airplanes were a key factor last quarter. Auto sales have declined at a precipitous pace in 2017 following a robust 2016 in which dealer incentives drew buyers into showrooms. The auto inventory to sales ratio has ticked up to the highest level since 2009. ■

	Q1-2017	YTD-2017
Consumer Discretionary	8.45%	8.45%
Consumer Staples	6.36%	6.36%
Energy	-6.68%	-6.68%
Financials	2.53%	2.53%
Healthcare	8.37%	8.37%
Industrials	4.56%	4.56%
Information Technology	12.57%	12.57%
Materials	5.86%	5.86%
Telecommunications	-3.97%	-3.97%
Utilities	6.39%	6.39%

Bond Review & Outlook

The Federal Open Market Committee raised short-term rates in March for a third time in the current tightening cycle. The three increases in as many calendar years look and feel nothing like the last tightening cycle in which 17 rate hikes took place over the course of two years from mid-2004 to 2006. The Fed is operating at a slow and measured pace with an eye perhaps beyond their mandate of managing to a designated inflation target and an elusive "full employment" level, which to their credit seems to have been achieved. The PCE (Personal Consumption Expenditures) reached the Fed's 2% target in February with a headline year-on-year figure of 2.1% while the core measure (ex-food and energy) was 1.8%. The 4.5% unemployment level noted above also hits the Fed's target of "full employment." After a tenuous recovery from the "black swan" (i.e. statistically significant, unexpected and highly impactful) market correction of 2008, rife with quantitative easing monetary policy tools never before used, the Fed clearly has an eye on markets with each action, not wanting to be accused of taking the punch bowl away. More hawkish Fed Governors have expressed comfort with overshooting these targets balanced by their dovish counterparts.

	Q1-2017	YTD-2017
Cash:		
Citi 3 Mo. T-Bill Index	0.12%	0.12%
Taxable Fixed Income:		
Barclays US Agg. Bond	0.82%	0.82%
Barclays Govt./Credit Int.	0.78%	0.78%
Barclays Govt./Credit Long	1.58%	1.58%
BofAML High Yield Index	2.71%	2.71%
Tax Exempt Fixed Income:		
Barclays Muni. 5 Yr.	1.90%	1.90%
Barclays Muni. 7 Yr.	1.95%	1.95%
Barclays Muni. TR	1.58%	1.58%

While the 10-Year U.S. Treasury yield ended the quarter at 2.39%, only modestly below where it started at 2.45%, the yield curve undertook meaningful gyrations. When all was said and done, the general curve shape flattened in a noticeable manner. As expected, the short-end of the curve rose in lock step with the Fed hike, but pivoted at the 3 to 5 year part of the curve and decreased further out. At the time of this writing, the 2-10 year spread is at a historically low level of approximately 1%.

While the Fed has made progress on achieving their key goals, they've done so in quite an unprecedented manner by figuratively driving with one foot on the gas and the other on the brake. While raising short-term rates and taking every opportunity to publicly announce their intentions to continue to do so, they have yet to abandon the quantitative easing practices of creating artificial demand in the longer end of the curve. The Fed has accumulated a whopping $4+ trillion in bonds ($1.5 trillion of mortgage-backed securities along with longer dated Treasuries) through the bond purchase program implemented during more dovish financial crisis recovery times. We, along with the majority of investors, remained skeptical of the hawkish comments the Fed continued to make through 2016, while not only staying on the side lines with rate moves, but also providing no plan for how they would proceed when bonds on their own balance sheet matured. Word was eventually released of a plan to let some, not all, of the maturing bonds roll off without being replaced. For now the FOMC continues to tap the proverbial brakes through periodic rate hikes impacting the short-end of the yield curve, but has yet to commit to backing entirely off the accelerator impacting the longer end. We expect this dynamic to continue to cause flattening pressure until more normal market forces are allowed to prevail. ■

Stock Market Review & Outlook

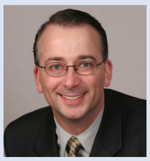
The post-election rally which began toward the end of 2016 picked up steam and continued through the first quarter of 2017 nearly unabated. The S&P 500 Index posted an impressive 6.1% return in the calendar year through March 31, 2017. Sector leadership however, rotated away from the initially roaring cyclical sectors early in the reflation-trade rally (financials and industrials in particular). Investors turned their attention to the growth prospects in the Information Technology sector in 2017. Stocks within the IT sector posted strong double digit returns during the period, followed by solid gains in the Consumer Discretionary sector. More defensive areas like Healthcare, Consumer Staples and Utilities also provided strong returns, while the struggling Energy sector and Telecommunications were laggards. As of this writing, equity valuations continue to soar to new highs. With the S&P 500 Index trading at a 21.5x multiple (relative to 17.1x 10-year and 19.6x 20-year averages), investors' appetites for riskier assets continue to expand with stock multiples. Ironically, the VIX Index - which provides a gauge of the market's expectation of forward volatility based on trading in S&P500 index options and known as the "Fear Index" - continues to muddle along at an anemic pace. This lack of "fear" suggests investors are perhaps excessively optimistic.

In other reversals of leadership, large cap stocks outpaced small and mid during the quarter, while growth stocks outperformed value. Non-U.S. stocks, as measured by the MSCI EAFE Index, also staged a strong recovery. The concerns over Britain's exit from the European Union proved to be short-lived. Article 50 was formally enacted at the end of March allowing complex separation and trade pact renegotiations to begin. More recent results from the French election were a further catalyst to European stock gains as investors wager that the polls showing centrist candidate Emmanuel Macron, who favors France remaining in the EU, with a lead over far right EU-exit advocate candidate Marine Le Pen, will hold up in the upcoming run-off election in May. ■

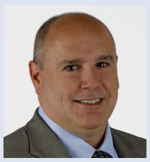
	Q1-2017	YTD-2017
DJIA Index	5.19%	5.19%
S&P 500 Index	6.07%	6.07%
Russell 2000 Index	2.47%	2.47%
MSCI EAFE Index	11.49%	11.49%

Meet the Plimoth Investment Advisors Executive Leadership Team

George Oliveira, CFP®, CTFA
Chairman of the Board
508-675-4310
goliveira@pliadv.com



Steven A. Russo, CFA
President & CEO
508-591-6202
srusso@pliadv.com



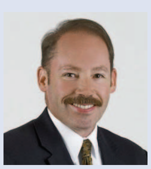
Louis E. Sousa, CFA
Senior Vice President & Chief Investment Officer
508-675-4313
lsousa@pliadv.com

Susan Sartini, CTFA
Senior Vice President & Senior Trust Officer
Department Head - Trust Administration
508-591-6203
ssartini@pliadv.com

Joseph R. King
First Vice President & Trust Counsel
774-319-3695
jking@pliadv.com

Edward J. Misiolek
First Vice President & Operations Officer
508-675-4316
emisiolek@pliadv.com

Meet Our Business Development Team



Thom Miller
Vice President / Relationship Officer
Individual & Institutional Accounts
781-320-4865
tmiller@pliadv.com

Lucia Rebelo
Retirement Plan Officer
508-742-4714
lrebelo@pliadv.com

Closing Thoughts

As stock prices continue to rise, along with valuations and earnings multiples, we continue to employ our disciplined process of identifying companies with above average earnings growth potential and waiting for opportunities to own them at attractive valuations. We are encouraged by the turnaround in corporate earnings which began in Q4 and which seems to be continuing into Q1 as releases begin, but the overall sluggish pace of U.S. economic growth continues to merit caution. While investors' perceptions currently appear overly optimistic, we remain perfectly comfortable patiently waiting for one-off attractive valuation opportunities in the high quality companies on our buy list.

From a macroeconomic perspective, we will continue to watch for the signposts of consumers' perceived confidence turning into spending reality. We will also be closely following business investment. As details of proposed tax reforms take shape, how businesses respond with respect to hard dollar investment versus soft data surveys will guide our thinking. With respect to the myriad of ongoing geopolitical uncertainties, only time will tell how the developing realities of these situations will impact investor perceptions and potential event-driven market activities.

As always, we will continue to monitor economic and market conditions to ensure timely and appropriate investment action. If we can be of assistance, please do not hesitate to call us at the numbers provided. ■

If you are interested in receiving this quarterly newsletter electronically, please contact Thom Miller at tmiller@pliadv.com. We will be happy to take you off the mailing list and add you to the e-mail list.