Plimoth Investment Advisors®
INVESTMENT MANAGEMENT & TRUST SERVICES SPECIALISTS

FIRST QUARTER – SPRING 2018

INVESTMENT SPOTLIGHT

"If something seems too good to be true, it just may be."
– like mom always said

Investors around the globe were reminded in the first quarter that stock markets do, in fact, decline and not continually march to higher gains as experienced each consecutive month last calendar year. Equity volatility absent throughout 2017 has returned in earnest in 2018 based on investor concerns of higher interest rates, hints of potential inflation and tough talk on trade tariffs. Investors who shook off news headlines regardless of severity in 2017, have taken a far more reactionary approach in a heightened state of risk awareness. With front page headlines ranging from global trade protectionism, Middle East strife to personal privacy on social media, investors took notice, shifting risk sentiment in a way markets have not experienced for quite some time. In hindsight, a steady climb in the S&P 500 in 2017 with some of the lowest levels of volatility in history was too good to be true. The equity benchmark experienced only eight days of a 1% or greater change throughout the entire year. As of this writing, that measure has surpassed 30 times thus far in 2018. Similarly, the Dow Jones Industrial Average had only a single day of a greater than a 400 point move in 2017. A point change in the Dow of that magnitude has happened over 20 times thus far this year.

While the Federal Reserve has continued down the well-forecasted tightening path, raising short-term rates for a sixth time in the current cycle, market participants also stepped in to move longer rates higher. As of this writing, the bellwether 10-year U.S. Treasury yield has moved through the 3% level for the first time in four years. The safety of higher yielding bonds has started to create competition for investors' dollars adding to market volatility. New Fed Chairman Jerome Powell, leading a nearly entirely new cast of the Federal Open Market Committee, has been well received with his first official meeting as Chair under his belt. His transparent post meeting comments will hopefully continue, eliminating the need for "Fed-speak" translations and speculation. ■

Keep up with market activity by visiting www.plimothinvestmentadvisors.com. Our weekly market commentary can be found at the "Market Commentary" button in the lower right hand corner.

Economic Review & Outlook

Economic data has been generally positive thus far this year. With all revisions said and done, the final estimate of Q4 2017 GDP settled at a solid 2.9%. Retail sales reports from the holiday season staged an economist's version of a head fake, initially reported as the strongest in several years, then revised downward with each new updated print to relatively flat levels. This led us to reign in our expectations of Q1 2018 GDP, reported this week at 2.3%. Similar to the retail sales figures, we remind ourselves that this is an initial estimate subject to revisions in the coming weeks.

Business investment has returned, given the clarity provided to companies by the passing of tax reform. Surveys of business confidence have come in at multi-decade highs pointing to a continuation of this trend. While business investment alone will not carry the weight of continuing economic expansion, when combined with robust personal consumption it can be a formidable contributing factor.

Despite a higher than expected wage growth report in the first report of 2018 (2.9%) sparking investor inflation fears, revisions to the January figure and subsequent readings have been more in line with the post-recession average of 2.5%. We maintain the view that a modestly higher level of hourly earnings is a positive for continued economic growth. The markets however, seem to have a lower "Goldilocks" type of tolerance where the temperature cannot be anything but "just right", which apparently is only marginally above average.

U.S. manufacturing reports continued to show expansion, something we will most certainly be monitoring for impacts of any trade policy changes. Employment data was positive as well, with headline unemployment remaining at 4.1%, the lowest since 2000.

	Q1-2018
Consumer Discretionary	3.09%
Consumer Staples	-7.12%
Energy	-5.88%
Financials	-0.95%
Healthcare	-1.22%
Industrials	-1.56%
Information Technology	3.53%
Materials	-5.52%
Telecommunications	-7.48%
Utilities	-3.30%

After digesting some weather-related pullbacks in the month of March marked by multiple Nor'easters, housing stood strong as well. Higher mortgage rates following suit of the bellwether Treasury yield will begin to serve as a headwind for home buyers when rate locks roll off.

Crude oil prices rising to multi-year highs has gone further than we expected, driven by commodity speculators. We expect a rising rig count, enhanced extraction techniques, and U.S. companies desire to grow revenues to push prices down more than production restraint on the part of foreign producers to pull it up. The rise in energy prices will flow through to upcoming inflation data releases. We will focus our attention more on the core (excluding volatile food and energy) readings given our view that energy price spikes flowing into the headline figures are transitory.

It is our assessment that the third longest economic expansion in U.S. history has further room to advance. Given investors' recent panic relating to wage growth (in line with GDP), a distinct overreaction in our opinion, productivity may become more of a factor that we will be monitoring for signs of sustained growth. It has been said that "innovation is the mother of necessity." Productivity advances may prove the adage true as businesses look for innovative ways to compensate for a continued tightening in the labor force. ■

Bond Review & Outlook

Despite new faces in nearly every seat at the Fed, the song remains the same. The short-term Fed Funds Rate was raised at the March meeting of the FOMC to a target of 1.5-1.75%. Although Fed officials are free to publically espouse their own views (not always in line with Committee consensus on some of the pertinent details) on economic growth and the path of interest rate after meetings, the well communicated plan passed from Chair Yellen to Powell appears to remain firmly in place. The Fed is continuing down the path of steady, gradual rate hikes, and unwinding their balance sheet of mortgage-backed and Treasury bonds at a consistent, transparent pace.

The yield on the 10-Year U.S. Treasury has traded within a range of 2.45% to 3.0% thus far in the calendar year. The yield curve flattened considerably during the quarter with the spread between the 2-Year and 10-Year Treasuries narrowing from a high of

0.77% to a low of 0.44%, not seen since 2007. Following the rise in the 10-Year yields, the spread now stands at a more palatable level above 0.50%. A very narrow spread leads market participants to fear a yield curve "inversion" in which short rates become higher than long rates. While one could argue cause and effect of recessions from many different perspectives, an inverted yield curve has preceded each recessionary period since the 1980s.

The probability priced in by the futures market of a further 25 basis point Fed Funds increase in the June FOMC meeting stands at 90%. While we remain in the camp that three rate hikes (including the increase in March) in 2018 is the most likely path of continued monetary policy tightening, there is a growing view that four hikes may be in the cards. ■

	Q1-2018
Cash:	
Citi 3 Mo. T-Bill Index	0.35%
Taxable Fixed Income:	
Barclays US Agg. Bond	-1.46%
Barclays Govt./Credit Int.	-0.98%
Barclays Govt./Credit Long	-3.58%
BofAML High Yield Index	-0.91%
Tax Exempt Fixed Income:	
Barclays Muni. 5 Yr.	-0.57%
Barclays Muni. 7 Yr.	-1.20%
Barclays Muni. TR	-1.11%

Stock Market Review & Outlook

The "too good to be true" streak of positive monthly total returns for the S&P 500 ended at 15, with a negative return posted in the month of February, followed by an additional decline in March. The pullback erased gains from earlier in the year and equity indices closed the quarter in the red. The more domestically oriented small cap companies fared marginally better than large cap stocks. Levels of stock market volatility increased meaningfully during the quarter. The key measure of volatility of the S&P 500 (the VIX Index) has been, on average, 60% higher in 2018 than last year.

The Information Technology and Consumer Discretionary sectors were the only components of the S&P 500 to post positive returns during the quarter, despite being some of the hardest hit stocks in the final month of the quarter and beyond. Stocks in the Consumer Staples and Telecommunications sectors fared the worst.

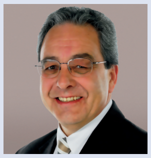
	Q1-2018
DJIA Index	-1.96%
S&P 500 Index	-0.76%
Russell 2000 Index	-0.08%
MSCI EAFE Index	-1.53%

Despite the shift in overall risk sentiment, corporate earnings are poised to post another rock solid quarter of growth, expected to be in the double digits yet again. The newfound certainty of tax reform affords companies the flexibility to deploy capital to invest in growth areas of their businesses, buy back shares or payout higher dividends to shareholders.

Equity valuations, while stable based on current earnings at 21.5x, are becoming more attractive on a forward basis. The S&P 500 now trades with a forward P/E multiple of 17x, roughly in line with the 25 year average. Many of the companies in the index are, in our mind, being "priced to perfection"; meaning companies that meet or exceed expectations across a variety of metrics (e.g. revenues, earnings, margins) are being sold off for the slightest perceived infraction or CEO comment reigning in forward expectations.

With a continued strong fundamental backdrop for equities, we view the latest round of (historically quite normal) volatility as an opportunity. We continually sharpen our pencils aiming to add great companies to our portfolios at attractive prices, taking a longer-term horizon than market speculators creating near-term volatility. ■

Meet the Plimoth Investment Advisors Executive Leadership Team



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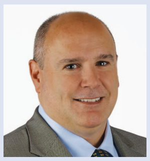

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Closing Thoughts

Long-term investors in the U.S. stock market have been handsomely rewarded with a 290% cumulative total return from the lows of the post-financial crisis period, including the latest declines. With outsized returns of that nature, periodic pullbacks like we have been experiencing are quite normal and arguably overdue.

With the benefit of hindsight, it is quite easy to cherry pick the date of an extreme market low to provide such an eye-popping statistic, but of course no one's timing will ever be that "right" on a consistent basis and trying to time market entry and exit points has historically proven to be counterproductive. Prudent long-term investors maintain exposure to equities to capitalize on the long-term return potential and compounding that has occurred over time. While past performance is not predictive of future results, patient long-term investors in U.S. stocks have also been handsomely rewarded. Over the past 30 years, the S&P 500 has provided a compounded annualized return of 10.4%. By staying the course, taking advantage of opportunities created by short-term volatility, it is our goal to continue to compound your capital in a prudent, time-tested manner.

In the current environment, that strategy will entail allocating capital to a diverse mix of assets, taking advantage of higher bond yields to continue to add high quality corporate bonds, attractive yields on preferred stocks and REITs, as well as select equities in the U.S. and an allocation to non-U.S. stocks.

We maintain our base case assumption that we will be writing to you about the longest bull market in U.S. history later this year, albeit with more historically normal peaks and valleys along the way.

If we can be of assistance to you along the way, 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.