Plimoth Investment Advisors®
INVESTMENT MANAGEMENT & TRUST SERVICES SPECIALISTS

SECOND QUARTER – SUMMER 2017

INVESTMENT SPOTLIGHT

"Sell in May and go away."
– Wall Street adage

The old adage cited above suggests investors sell equity positions in May and take a long vacation through the summer and beyond to avoid a seasonal stock decline, buying back positions in November. While there is some statistical foundation to the concept as stocks have historically performed better in the six month period from November to April than May to October, it is certainly more of a catchy folk saying than an actual investment strategy. It appears that this year in particular, investors have done nothing of the sort.

Investors' exuberance from the first quarter followed into the second as equity markets across the globe provided solid first half gains. Overseas markets in emerging and developed countries were strong, exceeding gains in the U.S. Volatility returned only in short fits and starts as the general trend remained at multi-decade lows. Central banks of developed countries struck a hawkish tone, continuing to plot out less accommodative monetary policy courses following the lead of the United States. ■

Economic Review & Outlook

U.S. GDP growth for the first quarter continued its sluggish grind. The total goods and services produced in the U.S. grew by 1.4%, an estimate twice revised upward from 1.2% and a particularly weak initial estimate of 0.7%. Personal consumption was a key component, albeit at a far slower pace than anticipated based on consumer confidence measures that remain at multi-year highs after only modest pullbacks. Retail Sales continued to vacillate between positive and negative readings with no real momentum, posting negative readings for the last two consecutive months. Weakness in first quarter consumption was not "transitory" (as the Fed had remarked), with the second quarter proving to be even weaker. The release of initial figures for second quarter GDP will be highly anticipated. Economists' estimates are calling for more robust growth, with average initial projections of 3% now lowered closer to 2.5%. In light of continued weakness in consumption data, we view estimates of 2.2-2.4% to be most reasonable.

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Employment remained a bright spot in the U.S. as unemployment fell well into the Fed's range of full employment, a 16 year low of 4.3%, before ticking back up modestly in the June reading to 4.4%. However, wage growth remained weak with nominal year-on-year hourly earnings growth unable to break through the 2.5% level. Inflation also remains stubbornly low as the latest reading of Personal Consumption Expenditures (PCE) for May, the Fed's preferred inflation gauge, came in at 1.4% year-on-year. Since surpassing the Fed's target of 2.0% in February (at 2.1%) for the first time in nearly five years, headline PCE has steadily declined in subsequent months. Further weakness was evident in the Consumer

Price Index (CPI) report for June which capped the weakest four month stretch in the 60 year history of the index.

U.S. manufacturing, as measured by the ISM, remained resilient with the June reading the highest since August, 2014. Durable Goods orders however have been weak, declining in the first two months of the second quarter reported thus far. Housing continued to stand on solid ground as new and existing homes sales sustained a solid pace and the total number of housing starts and building permits kept pace. ■

	Q2-2017	YTD-2017
Consumer Discretionary	2.35%	11.00%
Consumer Staples	1.57%	8.03%
Energy	-6.36%	-12.61%
Financials	4.25%	6.88%
Healthcare	7.10%	16.07%
Industrials	4.73%	9.51%
Information Technology	4.14%	17.23%
Materials	3.17%	9.21%
Telecommunications	-7.05%	-10.74%
Utilities	2.21%	8.75%

Bond Review & Outlook

The Federal Open Market Committee (FOMC) raised the Fed Funds Rate by 0.25% to a 1.00-1.25% target on June 14th as was widely anticipated. Now four rate hikes into the current tightening cycle, declining levels of inflation throughout the second quarter are likely to give the Fed pause on subsequent rate increases for the remainder of the calendar year. For now, the implied probability of an additional hike priced in from the futures market stands at 10% for September and 43% for December.

Equally important is the plan laid out by the Fed for balance sheet reduction, nine years after the Emergency Economic Stabilization Act went into effect which turned the Fed into an active bond market participant. With a current $4.5 trillion portfolio of bonds, maintained by reinvesting the proceeds of maturing bonds since the Fed stopped buying securities in October 2014, the FOMC has laid out a carefully detailed plan to gradually reduce its portfolio consisting of mortgage-backed and U.S. Treasury bonds. While a thoughtful reduction schedule has been well communicated (with initial caps of $10 billion of maturing bonds per month to roll off eventually increasing to $50 billion) an exact time frame for the program to begin has not. Fed officials have indicated that the policy will be coordinated with rate moves when the “normalization of the level of the Federal Funds Rate is well under way.” The plan is an important step to restoring the prevalence of natural market forces in the bond market which we expect to see go into effect toward the end of 2017.

	Q2-2017	YTD-2017
Cash:		
Citi 3 Mo. T-Bill Index	0.18%	0.30%
Taxable Fixed Income:		
Barclays US Agg. Bond	1.45%	2.27%
Barclays Govt./Credit Int.	0.94%	1.73%
Barclays Govt./Credit Long	4.39%	6.03%
BofAML High Yield Index	2.14%	4.91%
Tax Exempt Fixed Income:		
Barclays Muni. 5 Yr.	1.25%	3.17%
Barclays Muni. 7 Yr.	1.93%	3.92%
Barclays Muni. TR	1.96%	3.57%

The yield on the 10-Year U.S. Treasury declined during the second quarter before a spike in the last week of June (from 2.14% to 2.30%) brought the benchmark Treasury nearly back to where it started. The move reduced some of the flattening in the shape of the yield curve as the spread between the 2-Year and 10-Year Treasuries widened from a low of 0.80% during the month of June to 0.92% by month's end.

Talk of less central bank accommodation from many developed countries around the world, which some pundits have termed "hawkish herding", has led to some degree of rising rates in developed markets. Modest upticks in government bond rates occurred in Germany, France, Italy, UK and Canada at the mid-year mark. The yield on the stubbornly low bench-mark Japanese government bond found its way out of negative territory to edge back above zero as well. ■

Stock Market Review & Outlook

The strength of global equity markets carried straight through the second quarter generating a profitable first half of the year for investors around the world. Twenty-six of the world's top 30 stock markets by value generated positive returns, the first such occurrence since the first half of 2009. In the U.S., the technology-centric NASDAQ Composite Index also had the strongest first half return since the post-crisis recovery of 2009. The Dow Jones Industrial Average and S&P 500 Index continued to post new all-time highs through the midyear mark and beyond. The S&P reached a new closing high water mark a remarkable 24 times in the first half of the year.

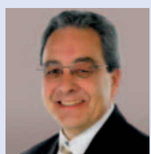
The S&P 500 Index advanced by a solid 9% through the first half of the year. Technology stocks were the strongest of all sectors during this period followed closely by Healthcare. Consumer Discretionary stocks also posted strong double digit returns. Energy and Telecom stocks continued to slide as the only sectors producing negative returns. Despite meaningful stock price declines and positive earnings growth (from dramatically low comparable hurdles from a year ago), we remain quite bearish on the prospects for oil and gas-related stocks in the near-term based on supply concerns. Rig counts have continued to rise and exploration and production (E&P) companies stand ready to drill, pump and ship at the slightest sign of oil price appreciation keeping the commodity price range bound. Valuations of Telecom stocks combined with attractive dividend yields however, have become more interesting to us at current levels.

U.S. Large-cap stocks continued to outperform small and mid-cap. Stocks exhibiting higher growth characteristics (led by IT) also continued to outperform value stocks. Although large technology-related companies such as Amazon, Apple and Facebook have been big winners for investors, a rotation in sector leadership and a broad rally (70% of companies in the S&P 500 posting gains) the U.S. equity market has been rewarding to both passive and active investors. With few short-periods of exception, equity volatility as measured by the VIX Index remained in multi-decade low territory during a period when the largest peak to trough drawdown of the S&P 500 was a paltry 3%.

Equity valuations have become further stretched with the S&P 500 trading at 21.8x current earnings and 18.9x forward. Despite three quarters of positive earnings growth, the current P/E is well ahead of historical averages of 17x over the past 10 years and 19.6x for 20 years. The forward P/E has climbed to the highest level in 13 years. We are comforted to some degree by corporate earnings growth reported for the first quarter edging into the double digits (intentionally excluding the lofty growth figures within the Energy sector from rock bottom levels). Some combination of continued earnings growth and price decline is necessary to bring valuations for the overall market to a level we are more comfortable with. ■

	Q2-2017	YTD-2017
DJIA Index	3.95%	9.35%
S&P 500 Index	3.09%	9.34%
Russell 2000 Index	2.49%	4.99%
MSCI EAFE Index	6.37%	14.23%

Meet the Plimoth Investment Advisors Executive Leadership Team



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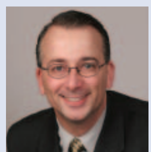

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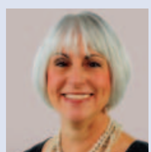

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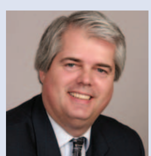

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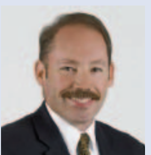

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Closing Thoughts

As long-term investors with a buy and hold (while actively monitoring) mentality, we don't plan on "going away" from the U.S. equity market anytime soon. With that said, we remain acutely aware of the potential for a pullback with stretched valuations, a looming debt ceiling deadline in Washington and a myriad of geopolitical risks to consider despite sanguine levels of equity volatility. We stand ready to capitalize should such a pullback occur with an interesting pipeline of investment ideas waiting for attractive entry points.

As U.S. bond yields rise further past the yield on the S&P 500, the asset class becomes a more viable alternative for investors who have been seeking yield in dividend paying stocks. We expect investors to gradually once again embrace the stability of bonds as equity valuations continue to extend and test limits.

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.