Plimoth Investment Advisors®
INVESTMENT MANAGEMENT & TRUST SERVICES SPECIALISTS

THIRD QUARTER – FALL 2016

INVESTMENT SPOTLIGHT

"Learn from yesterday, live for today, look to tomorrow, rest this afternoon."
– Charles M. Schultz

The second quarter of 2016 closed with what will likely be considered a historic referendum vote by the British electorate to withdraw from the European Union. Driven by a "populist" sentiment, anti-EU groups convinced voters that tying the economic fortunes of the U.K. to the EU was not in the best interests of the region. They lobbied the electorate on the notion that the nation's laws and trade policies should not be formed or influenced by an unelected beaurocracy operating out of Brussels. The U.K joined what was then the "European Economic Community" in January of 1973, but lobbied for an opt-out of the Maastrict Treaty, which created the common currency, the Euro. With the pound sterling maintained, the potential to disengage from the EU became more feasible.

In the wake of the vote and the potential uncertainties created across multiple fronts - trade, finance, and political- one would think investors would have been cautious through the summer months. Rather, soon after the initial post-Brexit turmoil, investors' jitters eased and markets settled down accordingly. One measure of investor concern and hence market risk is known as the Volatility Index (VIX), also called the "fear index." While the math is quite complex, the notion is that high levels of the VIX correspond to heightened periods of investor concern, while low levels of the VIX suggest investors are not fearful, which result in quiet markets. Over the past 20 years, the VIX has a high reading of 80.8, a low reading of 9.9 and an average reading of 20.5. After the Brexit fears eased, the VIX settled down and averaged 13.2 during the third quarter.

With uncertainties approaching in the coming months - U.S. elections, the formal exit of Britain from the EU, Federal Reserve rate policy, continued tepid economic activity both here and abroad, and concern over European Banking entities - we certainly do not expect the VIX to remain at these levels.

Any event-driven spike in the VIX will likely be indicative of speculative investors emerging from their restful summer, "looking for tomorrow", and positioning portfolios to protect from market declines that could erode their portfolio values. ■

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Economic Review & Outlook

While the stock market followed its slow upward grind, the U.S. Economy continued its equally slow and laborious sideways slide. Since the end of the last recession in 2009 the economy has averaged 1.78% growth per year, well below historical growth rates which normally see a healthy economy expanding above 3%. During the 28 quarters since the end of the recession the economy registered quarterly annualized growth above 3% only 7 times. Thus far in 2016 we have seen 0.8% GDP growth in Q1 and 1.4% growth in Q2. Data from the third quarter appears to be somewhat stronger, yet not significantly so. At the last FOMC meeting, the Federal Reserve reduced their expectations for 2016 GDP growth from 2% to 1.8%, while also reducing growth estimates for 2017 and 2018 down to 2%.

Personal consumption accounts for roughly 70% of U.S. economic activity, with services representing the lion's share, and it is this component of the economy that continues to provide the bulk of support for an environment of continuing growth, albeit muted. The ISM Non-Manufacturing Index dipped in the month of August, but rebounded strongly in September. The employment situation continued to be supportive of growth, but remains constrained much like the aggregate. While the unemployment rate remains low, which is generally indicative of economic health, the labor force participation rate is historically low, the underemployment rate remains grudgingly high and wage growth remains sub-par.

	Q3-2016	YTD-2016
Consumer Discretionary	2.94%	3.64%
Consumer Staples	-2.63%	7.55%
Energy	2.26%	18.72%
Financial	4.59%	1.40%
Healthcare	0.94%	1.37%
Industrial	4.14%	10.87%
Information Technology	12.86%	12.51%
Materials	3.71%	11.45%
Telecommunications	-5.60%	17.86%
Utilities	-5.91%	16.13%

During the spring and early summer months it appeared as though consumer spending was going to break out of a 12-month stretch of easing activity. March, April, May and June data gave a glimmer of hope that consumers would assume a leadership position in driving economic activity. Those hopes faded with the release of July and August data that eased significantly. Meanwhile, business spending continued to languish in the face of low energy prices and cautious corporations that are refraining from making capital investments in an environment of global economic uncertainty.

Manufacturing activity was similarly muted over the quarter. The strong U.S. Dollar relative to foreign currencies makes exports from the U.S. more expensive for foreign buyers, leading to weaker demand for U.S. products. At the same time, global demand has remained relatively steady, leading to a decline in foreign purchase of U.S. goods. On a positive note, inventory levels have declined, suggesting an eventual need for manufacturers to replenish inventory in the coming months.

Finally, housing activity has remained very stable as New and Existing Home Sales, Building Permits and Housing Starts all held at steady levels throughout the summer months. However, we have seen year-over-year home price appreciation slow during 2016 after posting strong improvement over the past few years. ■

Bond Review & Outlook

At the beginning of the third quarter long-term bond yields troughed in the aftermath of the Brexit vote as investors sought safe havens amid the surprising results. By mid-July, yields bounced back, then traded in a very tight range for the remainder of the quarter. The 10-Year U.S. Treasury closed the quarter at 1.61%, .12% above the level at the beginning of the quarter. On the short end of the yield curve, 2-Year Treasuries traded with a yield of 0.59% at the beginning of the quarter and closed at 0.76%.

Toward the end of the quarter rates were driven by expectations over what the Federal Reserve would announce at the end of their September policy meeting. The Fed decided to hold interest rates steady, but left room to hike rates in December, as they did in December of 2015. After projecting four rate hikes at the start of 2016, it appears as though the Fed will likely try to sneak in only one prior to year-end.

We believe the Federal Reserve has a "behavioral bias" toward slowly normalizing interest rate policy. However, during every policy announcement they reference the fact that any future policy decisions remain "data dependent." The fact is that the economy continues to struggle in several ways, unable to achieve an acceptable sustainable level of growth. Indeed at the last meeting the Fed announced a downward revision to growth expectations. Combined with very low inflation and wage growth, the fundamentals simply do not support hiking short-term interest rates. That is not to say the Fed will not hike rates in December; they certainly may. We simply do not believe a hike is warranted given the underlying strength of the economy.

Credit spreads tightened over the course of the quarter and the year, leading to strong performance across the corporate bond credit sector, including high-yield bonds which were battered in 2015. With low yields and tight credit spreads, fixed income investors will be hard pressed to continue such strong gains for the remainder of this year and into 2017, particularly so if rates migrate even modestly higher amid Fed tightening. Municipal bonds did not fare quite as well as spreads widened modestly, leaving only the coupon yield to drive the bulk of the performance. ■

	Q3-2016	YTD-2016
Cash:		
T-Bill Index	0.07%	0.19%
Taxable Fixed Income:		
Barclays US Agg. Bond	0.46%	5.80%
Barclays Govt./Credit Int.	0.16%	4.24%
Barclays Govt./Credit Long	1.24%	15.74%
BofAML High Yield Index	5.49%	15.32%
Tax Exempt Fixed Income:		
Barclays Muni. 5 yr.	-0.02%	2.30%
Barclays Muni. 7 yr.	0.07%	3.29%
Barclays Muni. TR	-0.30%	4.01%

Stock Market Review & Outlook

As mentioned previously, equity markets climbed steadily higher over the course of the quarter, with the S&P 500 posting a solid quarterly gain of 3.85%. We did witness some sector rotation during the quarter. Stocks in the Utility, Telecom and Consumer Staples sectors posted losses for the quarter after leading the way during the first 6 months of the year. Information Technology stocks led the charge over the summer months with Financials posting solid performance amid expectations of rising interest rates in advance of the FOMC meeting.

On a market capitalization basis, small and mid-cap stocks led the market higher over the course of the quarter and the year, with small-cap stocks performing particularly well over the course of the third quarter. Value stocks also strongly outperformed their growth counterparts. International markets turned in a solid quarter after posting modest losses over the first six months of the year. Emerging markets were particularly strong after suffering large losses in 2015.

	Q3-2016	YTD-2016
DJIA Index	2.78%	7.21%
S&P 500 Index	3.85%	7.84%
Russell 2000 Index	9.05%	11.46%
EAFE Index	6.50%	2.20%

At the beginning of 2016 we expected that U.S. stock growth would be roughly in line with earnings growth, somewhere in the low to mid-single digits. With the run in the third quarter, we believe markets are trading at a level consistent with our 2016 expectations at the beginning of the year. However, earnings growth has been stagnant, while earnings multiples have expanded. We believe the earnings data will improve in the coming quarters, justifying the current level of the market. However, given our outlook for tepid economic growth, we do not see a fundamental basis for anticipating a strong move higher in equity markets in the coming months. Rather we anticipate range-bound trading in the S&P 500 amid an environment of economic and political uncertainty both here and abroad. ■

Meet the Plimoth Investment Advisors Executive Leadership Team

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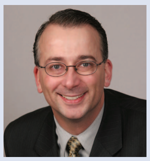

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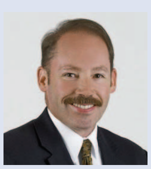

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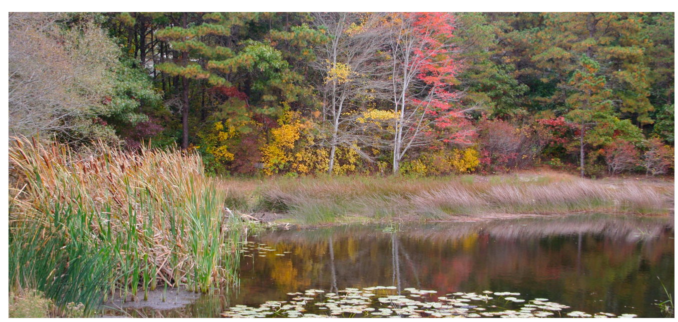
Closing Thoughts

The extremely divisive political environment here in the U.S. has similarities to the Brexit vote in the U.K. where a populist movement was determined to overrule a political establishment that many believed was out of touch with the wants and needs of the people. Much like that election where polls moved back and forth between "remain and leave" our polls have had similar swings, though most have remained suggestive of a Hillary Clinton victory.

We have been asked many times whether or not we think the election will have a big impact on the markets. Answering this question in terms of market history during an election year, investors appear more comfortable in the short-term with a continuation of leadership in the White House, whether that is Democrat to Democrat or Republican to Republican. Given the nature of this election, perhaps that is even more likely than ever. Again, we can look at the reaction to the Brexit results for some perspective. Markets had a short-term sell-off based on heightened uncertainty surrounding the political and policy implications of the vote.

However, the real implication of the results will not be known for some time as the long-term importance of policy changes and direction will ultimately drive the economic path our country takes, which in turn drives business development and stock market direction.

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. ■



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