## Quarter in Review

The buoyant mood that pushed stocks higher through year-end 2016 continued into the first quarter as signs of an improving global economy continued to mount. Stock indexes were up across the board. Emerging-market stocks were the star performers. Their double-digit gains eclipsed returns for developed international stocks (up 8%), and both outperformed larger-cap U.S. stocks (up 6%).

The investing environment also proved favorable for bonds. Treasurys moved higher after the Federal Reserve's widely anticipated mid-March decision to raise interest rates. Only the dollar bucked markets' upward trend, ending the quarter 2.8% lower against a basket of currencies.

| ***Asset Class*** | ***1Q*** | ***1 Year*** | ***5 Years*** |
|---|---|---|---|
| U.S. Large-Cap | *6.03%* | *17.02%* | *13.14%* |
| U.S. Large Growth | *8.80%* | *15.65%* | *13.13%* |
| U.S. Large Value | *3.12%* | *19.02%* | *12.94%* |
| U.S. Small Blend | *2.24%* | *26.18%* | *12.38%* |
| Developed Int'l Stocks | *7.96%* | *12.94%* | *6.18%* |
| Emerging-Markets Stocks | *11.21%* | *17.83%* | *0.90%* |
| REITs | *0.95%* | *2.95%* | *9.59%* |
| Investment-Grade Bonds | *0.88%* | *0.33%* | *2.16%* |
| Municipal Bonds | *1.58%* | *0.15%* | *3.04%* |
| High-Yield Bonds | *2.71%* | *16.88%* | *6.85%* |
| Global Bonds | *1.55%* | *-3.65%* | *-0.58%* |

### Portfolio Positioning and Outlook:

We continue to believe that over the next several years the most likely direction for U.S. interest rates is higher, although the path will likely be *bumpy*. That would be consistent with the evidence of global economic reflation. In that scenario, core bonds' annualized returns would likely be extremely low, but that does not impact the rationale for holding fixed income in client portfolios.

For the first time in a while, global economic growth is in sync and improving. Corporate earnings estimates are being revised higher in both European and emerging-market countries and, particularly in Europe, sentiment seems to be turning positive. To date, global recession risk appears low. Taken together, the data we are seeing suggests the investment environment should remain supportive of stocks and other risky assets, at least in the near term. Given this macroeconomic backdrop, we see reasons for optimism that the trends that benefited our portfolios in recent quarters can continue.

In terms of our overall equity positioning, our foreign stock positions (including emerging-market and developed international markets) were positive contributors to portfolio performance in the quarter. We estimate that over the next several years, European companies will likely grow earnings at a much faster rate than their U.S. counterparts, which could lead to outperformance by European stocks. We believe European earnings are cyclically depressed, while U.S. earnings are near cyclical highs. We do not believe this condition is adequately reflected in their respective valuations. We don't know the precise timing or exactly what catalyst will lead investors to close the gap, especially now, when political uncertainty in Europe is high. Yet, there are reasons for optimism that foreign stocks may finally provide attractive returns relative to domestic equities.

Across several metrics, U.S. stocks are the most expensive they have been in 50 years, with the exception of the stock market bubble period of the late 1990s. We don't believe this time is different. We do believe valuation matters. When stock market valuations are high, the odds are your future market returns will be lower. While we will never attempt to predict major market swings, this is the primary reason we preach the importance of maintaining a well-diversified and global portfolio. Given a current investment environment that features high uncertainty, and one that we view as offering lower than historical returns, we believe the diversified portfolios we've assembled for clients are both resilient and well-positioned for long-term outperformance on a risk-adjusted basis.

## Putting It All Together

Across a wide range of measures, the global economy is in its best shape in many years. Economic growth in most countries and industries is in sync and has been accelerating, albeit modestly. Leading economic indicators suggest this trend can continue, and many of the respected economic research firms we follow agree. Global Manufacturing Purchasing Managers Indexes, which have been correlated with global equity returns over time, recently made new multiyear highs in the United States, the eurozone, and China. While unexpected macro shocks can occur at any time, causing at least a short-term flight from risk assets, the likelihood of an incipient U.S. or global economic recession appears low. Without a recession, history suggests a bear market in stocks is unlikely.

Despite a high level of volatility emanating from U.S. politics in recent months, U.S. stock market volatility has remained very low. That is unlikely to last. Our portfolios are prepared for more oscillations, particularly downside risk to U.S. stocks. We remain confident in our positioning and in our investment process, both of which allow us to look past periods of uncertainty and keep our focus where it should be: on prudently managing our diversified portfolios to achieve long-term, risk-adjusted returns.

Contrasting last year's rough start with this quarter's stock market performance, we are certainly more sanguine than we were then. With global growth accelerating, there are reasons for the confidence being displayed in financial markets. Yet we remain cognizant of how quickly things can change and still see a high degree of uncertainty present. We are keenly aware that successful investing requires patience and discipline, as well as an ability to live with both noise and uncertainty.

As we move into the second quarter, we are alert to emerging political risks in the United States, whether related to domestic policy or stemming from geopolitical developments. We are also clear-eyed on the potential for upcoming elections in Europe to generate shocks to financial markets. Particularly now, when market gauges of expected volatility suggest many investors are disregarding downside risks, we remain cautious, seeking to balance returns with appropriate levels of risk and bracing for more stock market volatility. All that said, we continue to stick to our discipline of basing our positioning on a long-term time frame, regularly revisiting our analysis, and keeping our focus on managing downside risks. We believe this is the best approach not only to investing, but also to building and maintaining wealth over time.

*-We thank you for your continued support!*