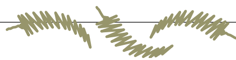
C Y P R E S S

ASSET MANAGEMENT, INC.



MARKET COMMENTARY **April, 2017**

Despite a flat last month, U.S. stocks had their best 1Q in four years (S&P 500 +6%) and outperformed most other asset classes. Gold actually rose 8.5% in the first quarter but remains below its late summer "pre-election" peak, while investment grade corporate bonds and long term U.S. Treasuries both returned about 1.4%. Oil declined 6% in the quarter but has since recovered to the $53 level – the high end of the range since bottoming in early 2016 at roughly $28 per barrel.

In terms of equity market composition, the Technology Sector was clearly the best performer at + 12.5% in the first quarter. It is interesting to note, the 5 largest stocks by market capitalization are now all Nasdaq stocks: Apple, Google, Microsoft, Amazon, and Facebook. The top 10, in order, is then rounded out by Berkshire Hathaway, Exxon Mobil, Johnson & Johnson, JP Morgan Chase, and Wells Fargo.

The top five are all technology companies and three of the next five are financial services behemoths. There is an interesting story here about the ascendency of global technology in the modern world (but as we learned in 2000, valuations in the technology sector are volatile and can be far from enduring), and of the inexorable consolidation of the financial services industry and rise of the super bank despite a post financial crisis policy of preventing "too big to fail".

Market Outlook

The market has struggled over the past six weeks as it digests the reality that the Trump growth agenda will take longer and deliver less than hoped. Tax reform has likely been pushed into early 2018 but remains the most significant component of the agenda for equity markets. In the meantime, however, the Trump administration has moved forward aggressively with regulatory easing and simplification. It is also proving much less of a threat to free trade than feared.

Trump has also recently pivoted on a number of key policy issues that had been areas of investor concern:

1. Trump issues statements that he is broadly supportive of the Fed, easy monetary policy and maintaining low interest rates. A weaker dollar is favored to boost U.S. competitiveness.
2. Amidst the growing discord with North Korea, Trump has declared that China is not a "currency manipulator."
3. Likewise, while relations with Russia vacillate as Syria's regime gets more desperate, Trump has deemed NATO no longer obsolete.
4. Once in power, Trump found that NAFTA needs "tweaking" not replacing.
5. The administration no longer wants to eliminate the Export-Import Bank.
6. Trump's administration now realizes the clunky "border adjustment" as part of tax reform is not a good idea.

On the surface, these developments are reflective of reality, intelligently incremental and positive for growth.

The jury is still out over the ability of the new administration to turn growth policy into legislative success. Perhaps overlooked, however, is that this is arguably the most pro-business administration in three generations. The key to unlocking the puzzle of Washington gridlock remains unsolved, but consumer confidence and business optimism have surged in a big way. We shall have to see whether the rekindling of animal spirits will be followed by measurable improvement in economic growth and activity.

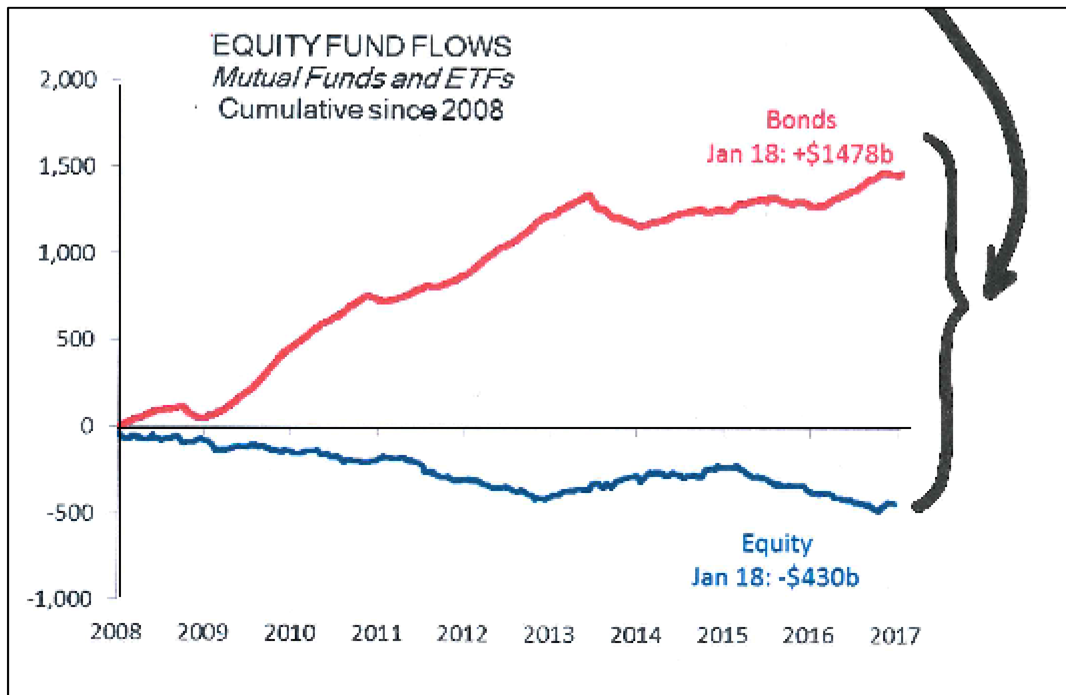
There are also other factors at work that are broadly supportive of equity markets. As we noted in our January letter, the new administration inherited a pretty healthy economy. We see a number of parallel positives in the current economic environment. Concurrently, the U.S. economy is steady and showing signs of improvement while global growth is improving for the first time in many years. Likewise, the outlook for corporate profits is improving, with 2017 growth estimates rising from 6-7% to 9-10% over the past few months. S&P corporate profits are particularly aided by the pickup in global growth and by a more stable dollar.

Geopolitical risks, always lurking, are also rising in the form of the dual threat posed by Syria and North Korea. The uncertainties inherent in these situations are magnified by a new administration.

All in all, the market has shown a great deal of resilience. Thus far it has taken the disappointments of the Trump growth agenda and the heightened international tensions in good stride. A period of consolidation and digestion is to be expected after the strong run and optimism that ended 2016 and began 2017. Caution has returned to the market, money has continued to seek the "safety" of bonds, and investors have regained a good measure of the skepticism towards equities so ingrained in the post 2000 market psyche. The ingredients remain in place for 2017 to be a constructive year for the global economy and for U.S. equities.

Investors Remain Cautious:

Over the past nine years, equity versus bond flows have diverged by almost $2t. Stay tuned.



Evercore ISI – March 2017