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THE INVESTOR QUARTERLY

MARKET COMMENTARY AND INVESTMENT PERSPECTIVES

The Investor Quarterly is issued in order to communicate the current state of capital markets and provide overview of economic conditions. The information contained in this publication should not be construed as investment advice. You should discuss with your financial advisor the conditions of your unique circumstances. The material prepared by Ashton Thomas Private Wealth, LLC., for use by its approved advisors.

WELCOME

Greetings,

The first calendar quarter of 2017 saw a continuation of the prior quarter's positive performance in most capital markets, with global equity markets delivering further gains, and extending the equity markets' rally that accelerated in the last two months of 2016 (a.k.a. "the Trump Bump"). Domestic *and* developed foreign equity markets around the globe delivered solid, mid-single-digit returns last quarter, with most of those gains gleaned in the first two months of the new calendar year. Momentum in the stock markets cooled in March, as investors' sentiment reached dangerously high levels, leaving few "buyers" holding capital on the sidelines, and with stocks "priced to perfection". Here in the U.S., expectations for increased corporate earnings, accelerating economic growth, and a shift away from monetary stimulus toward (expected) fiscal stimulus, has led to further expansion of the market's multiples. Domestic stocks currently trade at levels that are worrisome to those of us who believe that stock prices should directly relate to their underlying assets, earnings, and sales. At these levels, we see equity risks as having increased, and in recent weeks, we have observed an increasing separation in returns by sector, with "value" stocks, financials, selected health care sectors, dividend growers and shale oil companies finally beginning to overtake the "growth" stocks that have led the market's expansion since 2009.

In foreign developed and emerging market equity markets, valuations are far more reasonable, though investing in those markets requires the management of currency risk, as the U.S. Dollar ("USD") has rallied strongly against all major foreign currencies, all but wiping out the gains seen (in local currency terms) in 2016 in European, Asian, and Latin American equity markets. With the U.S. Federal Reserve Bank's ("Fed") retreat from years of monetary accommodation beginning in late 2015, while unprecedented monetary accommodation continues to be provided by the Bank of Japan ("BoJ"), the European Central Bank ("ECB"), the Bank of China ("BoC") and several other global central banks, the USD skyrocketed in value in 2016. The USD has settled into a narrow trading range during the most recent calendar quarter, and we believe it has limited upside from here. Given a possible reversion to more reasonable valuations for the USD, and the lower, more attractive market multiples currently seen in stocks in European and Japanese equity markets in particular, global equity diversification should be accretive to portfolio earnings in the near term.

That said, in our view, equities are expensive by all fundamental measures, especially here in the U.S., and protecting against the downside risks will be at the forefront of our efforts. While there are reasons for optimism, and we do not expect to see an economic recession here in the U.S. for the foreseeable future (6 – 18 months), we are acutely aware that on the two most recent occasions in which market multiples reached levels seen today (late 1990's, 2007), the bear market declines that immediately followed were massive.

WELCOME

In confirming our outlook, we have seen our money managers reduce their exposures to equities during the quarter.

The debt markets also delivered positive results in the first quarter of 2017, though far more modest gains than their equity counterparts did. Global "reflation" is finally in evidence, especially here in the U.S., where we have seen yields rise along the curve the past three calendar quarters. With an expectation that U.S. economic growth may finally accelerate, bringing with it wage and price inflation, we expect yields to rise further still. For those reasons, in the U.S. we favor credit risk over duration risk, with TIPS, floating rate bank loans and bonds favored over fixed-rate, long-duration bonds that may yield a bit more.

Internationally, yields are lower, and in some cases, negative, though expectations are that they have also likely bottomed out. Headline inflation in the Eurozone has hovered around 0% since late 2014, but has more recently shown some life, and major bond managers we listen to believe economic growth in the region will range between 1% and 1.5%, while the ECB confronts the limits of its extraordinary monetary accommodation. Following decades of deflationary pressures, Japan has seen a resurgence in inflation as well, though at even lower levels than in Europe. We see yields rising globally on improved economic growth expectations, but we prefer U.S. credits to Eurozone and developed Asian credits. Emerging Market debt yields (hedged to the USD) are relatively attractive at current levels, as are agency Mortgage-Backed Securities ("MBS").

That said, generally speaking, we favor equities over fixed income, and selected credit over government bonds. We expect both equity and fixed-income markets to benefit from global growth and "reflation", but we see ***significant*** headwinds to further market advances in extreme valuations (equities) and generally rising interest rates (fixed-income). A broadly diversified, defensively positioned allocation of capital should serve investors well in the current environment

Thank you,

Jay R. Penney, CFP®, CFA®, AIF®,
Chief Investment Strategist
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THE MARKET AT A GLANCE

U.S. EQUITIES:

The S&P 500 Index constituents' "*Operating*" and "*As Reported*" Corporate Earnings peaked at all-time highs in September 2014. Following a five-quarter "Earnings Recession" that saw those numbers decline (-22.09%), and (-31.93%), respectively, they found a cyclical bottom at the end of 2015. During calendar year 2016, those earnings improved +5.78% and +9.27%, respectively, and current consensus analysts' expectations are that earnings in the first quarter of 2017 may have recovered *another* 5% - 10% of the decline[1]. Despite the declines in nominal corporate earnings the past two-plus years, stock prices continued to rise throughout that period, fueling a dramatic expansion in the market's price multiple. The bull market reached eight years in length in March, making it the second longest uninterrupted bull market advance in post-Depression U.S. history, and while earnings are now clearly improving, they would need to grow by (approx.) +30%, while prices remained *flat*, in order for historically average Price/Earnings multiples to be regained. At these elevated prices, we see the downside risks to stocks as outweighing the upside reward potential, so we maintain a tactically defensive allocation to U.S. equities.

INTERNATIONAL DEVELOPED MARKETS:

After lagging their U.S. counterparts in 2016 (adjusting for currency effect), foreign developed equity markets kept pace with them in the first quarter of 2017. The E.A.F.E. Index (Europe, Australasia, Far-East equities) advanced +6.47%, and the FTSE All-World (ex-U.S.) Index rose +7.85% over the same period[2]. With the exception of a "slowing" Chinese economy that continues to grow at a rate unseen in other major economies, economic growth around the world lags growth seen in the U.S. Offsetting the slower growth and the relative uncertainty (compared to the U.S.) of their continued economic growth rates, foreign equity valuations are *far more reasonable* than those in the U.S., and from a risk perspective, have lower fundamental risks of decline. If global reflation and economic improvement continues, foreign (developed) and emerging market equities are more attractive than their U.S. counterparts at current levels. That said, careful stock selection is required, and active management will likely outperform a "passive" (indexing) approach going forward. Further equity market advances are likely only if economic reforms continue, and political (electoral) outcomes do not hurt global trade.

EMERGING MARKETS:

Emerging market equity prices were in sharp decline from the beginning of 2015, through the middle of 2016, before a resurgence in commodity prices, and by extension, the earnings of commodity producers, sharply rebounded, bringing prices with them. The FTSE Emerging Index rose +10.19% in the first quarter 2017, best among equity markets, developed or otherwise for the quarter[3].

1 *(Source: www.us.spindices.com/indices/equity)*
2 *(Source: https://personal.vanguard.com/us/funds/tools/benchmarkreturns)*
3 *(Source: https://personal.vanguard.com/us/funds/tools/benchmarkreturns).*

THE MARKET AT A GLANCE

Emerging Markets equities are showing signs of life again, and given their dramatic declines in 2014 and 2015, they may be the largest beneficiaries of global reflation and broadening consumer demand across the EM world. Recent recessions in Brazil and Russia, and worries over potential trade protectionist policies remain concerns. On the debt side, selected local-currency EM debt issuance looks attractive, given their higher yields, though exogenous "shocks", such as Trump's election victory, still bring higher volatility to these stocks than seen among their developed counterparts.

COMMODITIES:

Global commodity prices were a mixed bag in the first quarter of 2017, with Metals and Minerals leading the way with gains of +5% - + 10%, respectively, followed by solid gains (+2% to +4%) in Energy, Agricultural Products, Foods, Grains, and Fats and Oils. In the Metals sector, the largest gains were seen in Iron Ore prices, followed by Copper, Zinc, Aluminum, and Lead prices. Offsetting those gains somewhat were modest declines in Raw Material prices such as Timber, Plywood, and Wood pulp products[4]. Like any capital market, commodity prices respond to changes in demand, and to global growth, both of which are improving. There were somewhat mixed results in the Energy complex, with the dramatic declines in Coal prices continuing throughout the first quarter of 2017, while Crude Oil and Natural Gas prices, which had bottomed out in mid-2016, have stabilized at levels at which producers can continue to do so profitably. Precious Metal prices peaked in the third quarter of 2016, and declined toward year's end, before also stabilizing in the first quarter of 2017. Should the "reflation trade" referenced in prior market commentaries continue, commodities in general should benefit, especially those used in construction and industrial production.

REAL ESTATE:

The publicly-traded U.S. REIT market, like its domestic equity counterparts in other sectors experienced some late-quarter volatility, with the S&P United States REIT Index declining (-2.71%) in March, but still managed to finish the calendar quarter with a positive +0.58% total return. The Index contains 158 constituent REIT's in *all* sub-sectors of the U.S. Real Estate markets[5]. The best performing sub-sectors in the first calendar quarter were Specialty REIT's, + 13.23%, Single Family Home REIT's, up +12.98%, Timber REIT's, up +12.85%, Infrastructure REIT's, up 12.25%, and Data Center REIT's, up 11.45% for the period. Laggards in the quarter were in the Retail REIT sub-sectors, including Shopping Center REIT's, down (-7.86%), and Regional Mall REIT's, down (-4.79%) for the quarter ending March 31st.

4 Source: http://www.worldbank.org/commodities)
5 Source: https://us.spindices.com/indices/equity/sp-united-states-reit-us-dollar

THE MARKET AT A GLANCE

Lodging and Resort REIT's declined (-1.90%) during the quarter, Self-Storage REIT's were down (-1.42%), and Industrial REIT's were down (-0.71%) for the period[6]. (Sources: FTSE; NAREIT). With dividend yields averaging 3.85%, publicly-traded REIT's have enjoyed solid returns since the equity markets' collapse in 2008, and now trade at a lofty (trailing) Price/Earnings Ratio of 29.3 X, so caution is warranted at these price levels.

FIXED INCOME:

Unlike the equity markets, fixed income markets have been facing headwinds in the form of rising rates. The "bell weather" 10-year Treasury Bond yield has risen by 75 basis points (0.75%) over the twelve months ending March 31st. That modest increase in rates took the one-year total return on that Bond *negative*, to (-1.4%), for the year ending March 31st. High-Yield Corporate Bonds continued their fixed-income market leadership, rising +2.7% for the quarter. Their (High-Yield) Municipal counterparts fared even better over that period, rising +4.1%. International Bonds rose +2.5%, and Emerging Market Bonds rose +3.3%. Investment Grade Corporate Bonds rose +1.3%, and Investment Grade Municipal Bonds (Insureds, State and Local GO's and Revenue) returned between +1.5% and +1.7% to investors for the quarter[7]. As economic "global reflation" continues, it will be challenging for fixed-rate, longer-dated bonds of any type to avoid price deflation. We favor "floating-rate" bonds, and believe that active management of an investor's fixed income portfolio will outperform a passive ("indexed") approach in the near term.

6 Sources: FTSE; NAREIT
7 Source: Baird Q1 2017 Market ChartBook)

THE WORLD ECONOMY AT A GLANCE

Forecasts for growth in global GDP for all economies of the world in 2017 average +2.9%, an acceleration from the +2.6% global growth rate seen last year. As one would expect, the fastest growing economies are Emerging or Developing Economies, which are expecting to average +3.5% growth this year. The fastest growing among them, India, is expecting to see +6.2% growth in their GDP this year, followed by other developing Asian economies (i.e. Viet Nam, Indonesia, etc.) which are expecting to see +5.1% GDP growth collectively. China's GDP growth rate has "cooled" to an expected +3.8% growth in 2017, following years of GDP growth of +4% to +8%. More developed, or "mature" economies are expecting a slight acceleration in GDP growth in 2017 to +2.1%, from the +2.0% they averaged in 2016. The largest of those "mature" economies, the U.S., is expecting a healthy increase in GDP growth of +2.5% this year, while the Eurozone and Japan will expect growth in their GDP of +1.6% and 1.5%, respectively[8].

Here in the U.S., the likelihood of achieving those GDP gains will be dictated largely by the success, or lack thereof, of the Trump Administration, and the Republican-led Congress to enact Tax Reforms, as well as Health-Care Reforms, while avoiding sparking a costly trade war with China and/or Mexico. The Eurozone economies are "behind" the U.S. in their economic cycle, and as such, are more vulnerable to economic "shocks" than the U.S economy is. The European economies are focused on tapering their Central Banks' monetary accommodation programs, and on avoiding further "defections" from the Eurozone members following the "Brexit" vote, which is now official. Japan is hoping for a continuation of its economic expansion, however modest in momentum, following decades of deflation and economic contraction. China has been running large fiscal deficits and struggles under the weight of a real estate bubble they have yet to address. China's economic growth will be severely tested in the coming years, as they deal with the Trump Administration's attempts to reduce our trade deficit with them. They are also showing signs of struggle with (1), systemic challenges in their country's accelerating "urbanization", (2), their infrastructure needs and costs, (3), a growing, and more demanding middle class, and (4), the costs of building their military, an increasingly large portion of their domestic spending.

8 Source: https://www.conference-board.org/data/globaloutlook/index.cfm)

THE U.S. ECONOMY IN FOCUS

GROWTH

Estimated to be +2.5% in 2017. Moderate, and stabilizing[9].

JOB CREATION

Q1 - 533,000 new jobs - Unemployment Rate (March) 4.5%. Solid Growth[11].

CORPORATE PROFITS

Estimated to be +20% in 2017. Moderate, and rising[10].

INFLATION

Core CPI up +2.7%; (Ex-Food & Energy, up +2.2%) for year ending 02/28/2017. Low, but Rising[12].

INTEREST RATES

The Federal Open Markets Committee (FOMC) announced that it would raise its target for the federal funds rate by 0.25% to a range of 0.75% to 1.00% at its March meeting. Rates are still low from historical terms. Yield curve is "Positively Sloped", but Flattening.

RISK TO CONTINUED U.S. ECONOMIC GROWTH

Potential Trade – Wars, Fiscal Reforms, Government Debt and Deficits, Geopolitical Tensions.

9 Source: https://www.bea.gov
10 Source: https://www.us.spindices.com/indices/equity/sp-500
11 Source: https://data/bls.gov/timeseries/LNS14000000
12 Source: https://www.bls.gov/bls/inflation.htm

ASHTON THOMAS
PRIVATE WEALTH

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