SAWGRASS Asset Management, L.L.C.

Financial Review & Outlook

March 31, 2017 **Volume 20; Issue 1**

Stock Market: Quarter in Review

- The equity markets continued their post-election rally in the first quarter to post an impressive gain and mark the bull market's eighth anniversary.
- Despite an ongoing lack of concrete details about future catalysts, the markets continued to climb in anticipation of a better earnings and economic growth backdrop.
- Stocks endured very little in the way of pullbacks as the improvement in investor sentiment helped buoy the major indices.
- There were no major themes from a factor standpoint in the quarter but the more selective nature stood in contrast to the broader participation at the beginning of the post-election rally.
- Large outperformed small and growth outpaced value as the sector leaders were information technology, healthcare, and consumer discretionary while the laggards were energy, utilities, and financials.

1st Quarter Scorecard	Table 1	
Index	Quarter	1 Year
S&P 500	6.1%	17.2%
Russell 1000	6.0%	17.4%
Russell 2000	2.5%	26.2%
Russell 3000	5.7%	18.1%
Russell 3000 Growth	8.6%	16.3%
Russell 3000 Value	3.0%	20.0%
Barclays Capital US Aggregate	0.8%	0.4%
3 Month T-Bills	0.1%	0.4%

Source: Bloomberg & Russell Investments

Stock Market: The Quarter Ahead

- As we enter the second quarter, the S&P 500 has risen 13+% from the election day low primarily on the hope of a better environment for earnings growth. From this point, more measurable signs may be needed to move the market meaningfully higher.
- The defeat of the healthcare reform and the waning prospect of immediate tax reform deals a significant blow to those investors looking for positive change.
- Valuations have expanded with the most recent rally from already stretched levels leaving less upside if earnings growth rates fail to accelerate.
- The potential for a higher interest rate environment also makes current valuations even less attractive and increases the risks for valuation multiple contraction if rates rise to more normal levels.
- Much of the cyclically-oriented, higher growth theme that flourished in the earlier portions of the rally has recently dissipated.
- Despite a more challenging fundamental environment, positive investor sentiment and the technical breakout to new highs could see the market drift higher.
- However, the length of the current bull market and recent gains that are well above long-term historical averages should moderate investor expectations for returns to continue at the current pace.
- After an impressive run since the election, increased risks for downside volatility and lower return prospects leave the equity markets with a less favorable risk/reward balance at current levels.

Fixed Income Markets

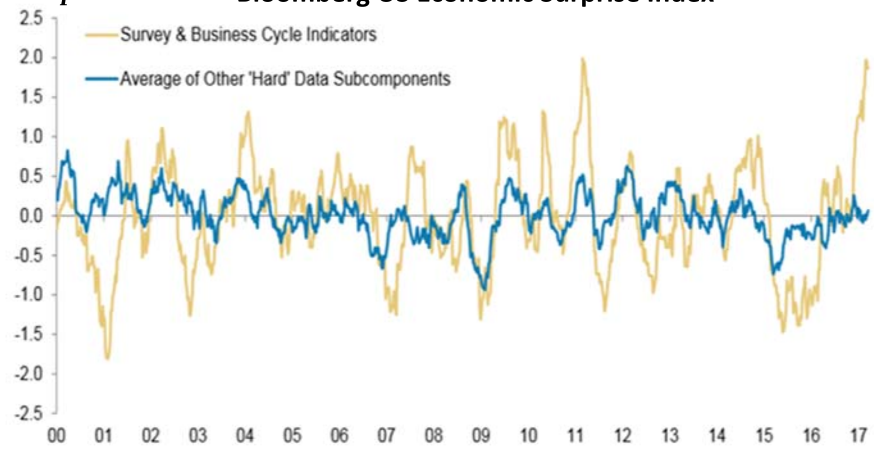
Just Right or Three Bears?

The stock market continued its celebratory mood, advancing on the prospects of President Trump's political agenda. Expectations are high as the S&P 500 added over 6% this quarter. The bond market meanwhile marked time fearing a stronger economy would allow the Federal Reserve to raise interest rates for the third time this cycle. Mid-March brought us both the Federal Open Market Committee's rate hike and the Republican's stumble during their first attempt to enact policy. The failure to bring the American Health Care Act to the floor of Congress gave the market pause. While the Fed raised rates on the Ides of March, the prospects for two or three more increases in 2017 remain. Short-term rates moved higher, while long-term rates drifted stubbornly lower (see Table 2), driven by still slow economic growth. Concern is mounting over the administration's ability to pass the rest of the economic agenda, tax cuts and infrastructure spending. The Bloomberg Barclay's Aggregate added 0.82% for the quarter, barely over its yield. In addition to the challenge of assessing growth prospects, the Fed is also eyeing what may be a changing inflation picture. In fact, on a year over year basis, the Consumer Price Index is currently registering a 2.7% increase for the 12 months ending February versus 1.0% for the prior 12 month period. In the category of 'be careful for what you ask for,' by the end of March, the United Kingdom's Prime Minister, Theresa May invoked Article 50, starting the clock on Brexit reality. The celebratory mood changed to disappointment. Who knew health-care was so hard? The Fed stopped being so soft.

Too Hard or Too Soft?

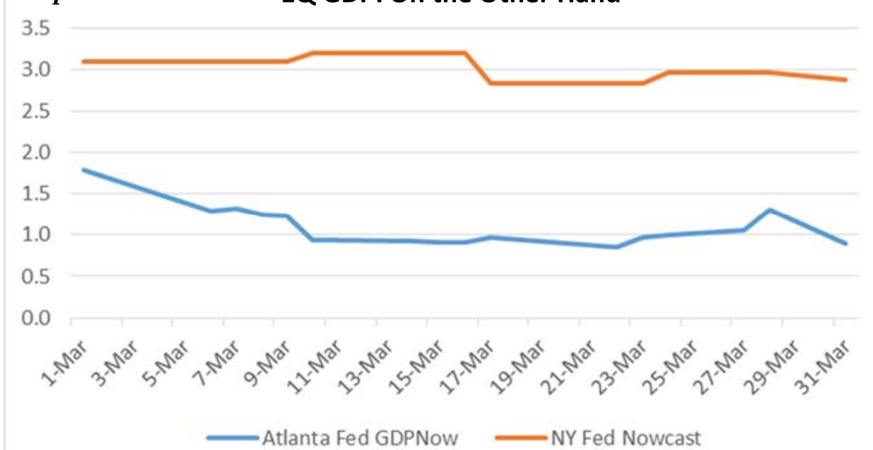
Considering the recent economic data, hard, quantifiable indicators continue their sluggish path. Soft data, from surveys or sentiment, show robust growth. The economists from Morgan Stanley highlighted this divergence as seen in Graph 1. The Federal Reserve Bank of Atlanta forecasts GDP utilizing hard data. Their current forecast for the quarter just ended is 0.9%, down from the prior quarter's 2.1% pace. In contrast, the Federal Reserve Bank of New York includes some soft data in their model of GDP growth leading to their estimate of 2.9% (see Graph 2). While the quarter is over, we must wait until the end of April to get the initial measurement of first quarter GDP. Will expectations lead actual growth, as the equity markets suggest, or will low growth bring expectations down?

Graph 1 **Bloomberg US Economic Surprise Index**



Source: Morgan Stanley, Bloomberg

Graph 2 **1Q GDP: On the Other Hand**



Source: Bloomberg

Interest Rate Summary — **Table 2**

	3/31/16	12/31/16	3/31/17	Qtr Change	12-Month Change
3 Month T-Bills	0.2	0.5	0.8	0.3	0.6
5 Year Treasury	1.2	1.9	1.9	0.0	0.7
10 Year Treasury	1.8	2.4	2.4	-0.1	0.6
30 Year Treasury	2.6	3.1	3.0	-0.1	0.4
5 Year Corporate ('A')	2.1	2.6	2.6	0.0	0.5
10 Year Corporate ('A')	2.9	3.4	3.4	0.0	0.4
30 Year Fixed Rate Mortgage	3.7	4.1	4.0	-0.1	0.3

Source: Bloomberg