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Fine Points

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FIRST QUARTER REVIEW & COMMENTARY

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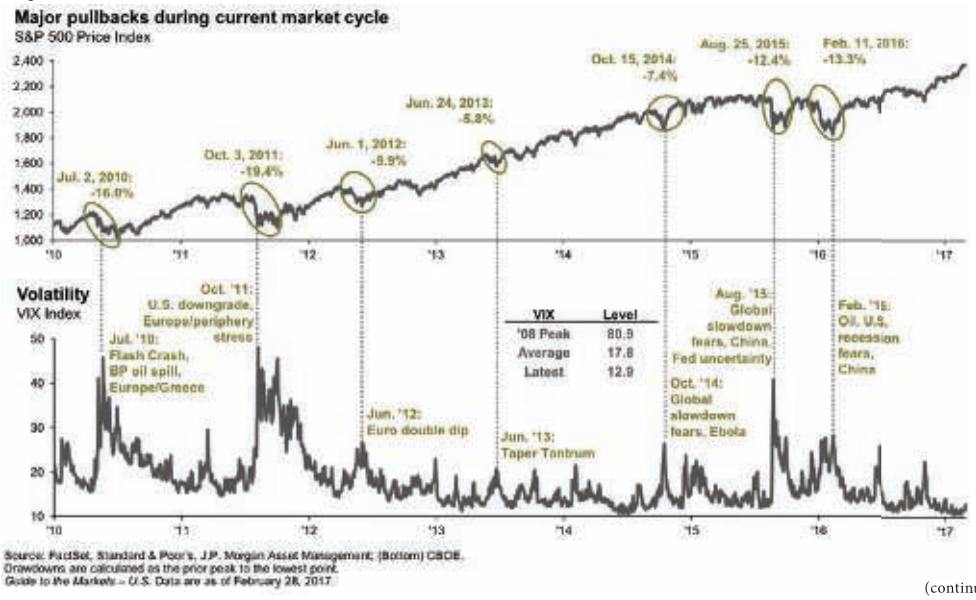
National Markets

The first quarter went largely as projected in our January newsletter however, equities performed stronger than expected. Domestic equities moved up over 9% since the November election, but began to abate somewhat in March due to investor concerns regarding the Trump administration's slow progress enacting economic reform. The S&P 500 suffered its worst day of the year on March 21, closing down more than 1%. This was the first time in 110 trading sessions the market sold off to this degree, ending its longest streak of calm since 1995. The pullback was not surprising; in fact, such a long period of low volatility without a pullback is atypical. According to *The Wall Street Journal*, the first quarter was the calmest quarter in the Dow since 1965. The VIX index, which measures implied volatility for the S&P 500, posted its second-

Figure 1



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Bottom) CBOE.
Drawdowns are calculated as the prior peak to the lowest point.
Guide to the Markets – U.S. Data are as of February 28, 2017.

(continued)

lowest, first quarter measure ever. We expect to see market volatility trend up to normal levels throughout the remainder of the year.

Figure 1 on the previous page depicts a series of pullbacks averaging 12.9% in the market during this latest bull phase. Also, note the low levels on the VIX, which today are at sub 14 levels.

International Markets

In Europe, we heard mildly hawkish rhetoric from European Central Bank (ECB) President, Mario Draghi. He suggested there was no longer the same sense of urgency to boost eurozone inflation as the economy continues to heal. We expect the ECB to communicate further tapering of the quantitative easing program (QE) in the 3rd quarter and finally end QE in Europe sometime in 2018.

Elsewhere in Europe, the Dutch general election took place and far right candidate, Geert Wilders failed to win the majority of seats. Had he won, the notion of further Brexit-style European Union withdrawal may have been brought to the fore in Holland. In the upcoming French election, we expect far right candidate, Marine Le Pen to make it to the second round of voting, but it is uncertain who will win on May 7.

Finally, UK Prime Minister, Theresa May, triggered Article 50 of the Lisbon Treaty on March 29, initiating a two-year countdown to the UK exit from the European Union. Broadly, we believe the deep interdependencies between Europe and the UK will make the divorce process less adversarial than EU officials are suggesting.

Asset Allocation Changes

In terms of portfolio positioning, we are becoming more constructive on international equities. Long term, the returns of the S&P 500 and the MSCI EAFE (an index that includes equities from 21 developed markets excluding the US and Canada) are quite similar on an annualized basis. However they tend to go through multi-year cycles of outperforming each other. The US has outperformed international markets the past four years, and six of the past seven. While international outperformance was significant in the 70s, 80s and 00s, the US markets have dominated the 90s and this decade. Figure 2 shows return data for US and international equities beginning in 1970 and running through 2016.

One reason we are becoming more positive on international equities is valuation. US equities, relative to international equities, are trading at a significant premium to where they have historically traded. Figure 3 shows the relative valuation as measured by P/E (price to earnings) ratio of the S&P 500 versus the

Figure 2

MSCI EAFE vs S&P 500

How often has the MSCI EAFE underperformed?

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1970's Decade Average
EAFE	-10.51	31.21	37.6	-14.17	-22.15	37.1	3.74	19.42	34.3	6.18	10.09
S&P	3.89	14.22	18.96	-14.67	-26.31	37.14	23.81	-7.16	6.57	18.61	5.85
Difference	-14.4	16.99	18.64	0.5	4.16	-0.04	-20.07	26.58	27.73	-12.43	4.24
	1980	**1981**	**1982**	**1983**	**1984**	**1985**	**1986**	**1987**	**1988**	**1989**	**1980's Decade Average**
EAFE	24.43	-1.03	-0.86	24.61	7.86	56.72	69.94	24.93	28.59	10.8	22.77
S&P	32.5	-4.92	21.55	22.56	6.27	31.73	18.67	5.25	16.61	31.69	17.55
Difference	-8.07	3.89	-22.41	2.05	1.59	24.99	51.27	19.68	11.98	-20.89	5.22
	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**1990's Decade Average**
EAFE	-23.2	12.5	-11.85	32.94	8.06	11.55	6.36	2.06	20.33	27.3	7.33
S&P	-3.11	30.47	7.62	10.08	1.32	37.58	22.96	33.36	28.58	21.04	18.21
Difference	-20.09	-17.97	-19.47	22.86	6.74	-26.03	-16.6	-31.3	-8.25	6.26	-10.88
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2000's Decade Average**
EAFE	-13.96	-21.21	-15.66	39.17	20.7	14.02	26.86	11.63	-43.06	32.46	1.58
S&P	-9.11	-11.88	-22.10	28.68	10.88	4.91	15.79	5.49	-37	26.46	-0.95
Difference	-4.85	-9.33	6.44	10.49	9.82	9.11	11.07	6.14	-6.06	6.00	2.53
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2010 - 2016**			**Since Inception Average '70-'16**
EAFE	8.21	-11.73	17.9	23.29	-4.48	-0.39	1.51	4.28	-	-	9.28
S&P	15.06	2.11	16.0	32.39	13.69	1.38	11.96	12.83	-	-	10.29
Difference	-6.85	-13.84	1.9	-9.1	-18.17	-1.77	-10.45	-8.55	-	-	-1.01

Source: Morningstar, as of 12/31/2016. All returns are in USD. The data is representative of the MSCI EAFE GR USD and S&P 500 TR USD. The MSCI EAFE Index is an equity index which captures large and mid cap representation across Developed Markets countries around the world, excluding the US and Canada. The S&P 500 Index is a capitalization weighted index of 500 stocks designed to measure the equity market performance of the United States. One cannot invest directly in an index. The MSCI EAFE index inception date is 12/31/1969 and the S&P 500 Index inception date is 4/4/1957. **Past performance is no guarantee of future results. For Financial Intermediary Use Only – Not For Use With The Investing Public**

Figure 3

US vs EAFE equities, relative price performance (USD)

	US	Europe ex-UK	UK	Japan	Emerging Markets
Shiller P/E	24.6	16.9	13.6	23.8	13.5
Long term median	19.8	18.8	14.5	37.7	15.8
Premium / Discount	**24%**	**-10%**	**-6%**	**-37%**	**-15%**

Source: Thomson Datastream, MSCI, Henderson as of 12/31/2016. Shiller (cycle-adjusted) P/E's are inflation-adjusted price-to-earnings ratios that measure the price of a stock (or index) to it's average EPS over the past 10 years. The chart above is illustrating the relative valuation of the European and US equity markets. Currently European markets are trading at a discount to US markets and this discount is significant because its more than one standard deviation outside the mean. Standard deviation measures the dispersion of a set of data from its mean. Long-term median measures the median index value since inception of the index.

EAFE index. It shows US equities trading well over one standard deviation above their developed market peers, at nearly the highest valuation disparity in 46 years. Such valuation disparities are historically rare. The further data moves away from this historical norm, the greater the tendency to revert to the median. Additionally, the bottom of the chart shows US equites trading at a premium to developed market peers.

The US equity market has outperformed its international peers (UK, Japan and Europe) since the global financial crisis for several reasons. Chiefly, the US economy has recovered more significantly than its peers since the great recession. This is evidenced through a more substantial drop in unemployment, greater economic activity as measured by Gross Domestic Product (GDP) and superior labor force demographics. The US remains the best jurisdiction for business management as measured by return on equity versus its developed market peers. The US has also been fertile ground for technology and still remains a land of opportunity for immigrants seeking a better life.

We see further evidence of the US recovery through the Federal Reserve's tightening of monetary policy by ending QE in 2014, followed by a series of fed funds rate hikes. Comparatively, the Bank of Japan, the Bank of England and the European Central Bank remain more accommodative.

While we are not abandoning our view on the US, we believe it's time to start directing capital toward international markets. As the rest of the world recovers, their equity markets should emulate the performance trends of the US market during the US Recovery.

Interest Rates & Equity Prices

We are frequently asked our view on interest rates and our expectation for monetary policy. For many of our clients this question is not prompted so much by concerns over the cost of debt, but rather how monetary policy will effect their investment portfolio.

Generally, investors believe rising rates are the death knell for equities. This can be the case where rate hikes are used as a tool to curb excess inflation. However, there are two very distinct environments where rising rates can have very different effects on equities: when rates are above 5% on the 10 year Treasury and below 5%. When interest rates are above 5%, rate hikes have resulted in lower future equity prices; whereas, in a sub 5% rate environment, rate hikes have positively correlated with higher equity prices.

Despite our expectation for higher rates, we remain constructive on equities especially in international markets. Additionally, we expect higher rates to put downward pressure on fixed income returns. Notwithstanding, we are not expecting rate hikes to be significant enough to negatively impact equity markets.

At FineMark, we are always here to serve you with your investment needs or any other questions that might arise. Whether you are heading north for the summer or staying closer to home, feel free to reach out to your investment professional at any time.

ALPHABET SOUP IS NOT JUST FOR LUNCH

By Read Sawczyn
Vice President & Private Wealth Advisor

Have you ever encountered an estate planning acronym that you did not recognize? You are not alone. Here are a few of the most common acronyms used in trust and estate planning:

ALPHABET SOUP IN THE TRUST WORLD			
CLAT	Charitable Lead Annuity Trust	IRA	Individual Retirement Account
CLT	Charitable Lead Trust	JTWROS	Joint Tenancy with Right of Survivorship
CLUT	Charitable Lead Unitrust	LLC	Limited Liability Company
CRAT	Charitable Remainder Annuity Trust	POD	Payable-on-Death Account
CRT	Charitable Remainder Trust	QDOT	Qualified Domestic Trust
CRUT	Charitable Remainder Unitrust	QDRO	Qualified Domestic Relations Order
DPOA	Durable Power of Attorney	QFOB	Qualified Family-Owned Business
DNRO	Do Not Resuscitate Order	QPRT	Qualified Personal Residence Trust
FLP	Family Limited Partnership	QSST	Qualified S Corporation Trust
GRAT	Grantor Retained Annuity Trust	QTIP	Qualified Terminable Interest Property
GRIT	Grantor Retained Income Trust	SEP IRA	Simplified Employee Pension IRA
GRUT	Grantor Retained Unitrust	TIC	Tenants in Common
GST	Generation Skipping Tax	TBE	Tenants by the Entirety
IDGT	Intentionally Defective Grantor Trust	UGMA	Uniform Gifts to Minors Act
ILIT	Irrevocable Life Insurance Trust	UTMA	Uniform Transfer to Minors Act

2007-2017 10 YEARS

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