DANN ASSET ADVISORS, LLC

Second Quarter 2017 Update

July 17, 2017

2Q17 Highlights

- Stock market rises with volatility increasing moderately in June
- Longer term interest rates fall as inflation remains low; short term rates rise
- Prospects for near term fiscal stimulus fading in a distracted, fractured Washington
- Fed raises rates in June and signals at least one more increase likely in 2017

The table below summarizes the performance of some key indices during the second quarter and year to date:

Market Performance		
Index	% Ch. 2Q17	% Ch. YTD
S&P 500	3.1	9.3
MSCI Developed Markets (excl US)	6.1	13.8
MSCI Emerging Markets	6.3	18.4
MSCI All Country World	4.3	11.5
US Aggregate Bond (1)	1.5	2.3
Liquid High Yield (1)	2.1	4.5
US Dollar Emerging Markets Bond (1)	2.3	6.3

(1) Barclays indices

Equities. Coming on top of the first quarter's 6.1% advance, U.S stocks (as measured by the large company S&P 500 index) rose an additional 3.1% in the second quarter, making for the strongest first half of a year since 2013. Beneath the impressive headline gains, markets were more mixed. For example, during the first half, growth sectors beat value, with the S&P 500 Growth index up 13.3% vs. the Value index up only 4.9%. And large company stocks (those in the S&P 500) outperformed small company stocks, with the Russell 2000 small cap stock index returning a more modest 5.0% over the first half. With U.S. economic growth anemic thus far in 2017, investors have been willing to pay premiums for established companies generating strong, reliable growth.

Similar to the first quarter, international markets on the whole rose more than the U.S. Developed market economies outside the U.S. have been stronger than expected and, at least for now, investors believe China is less likely to have significant economic problems. The weaker dollar also enhanced U.S. investors' returns on international stocks. Despite the stronger first half international markets remain less expensive than the U.S. However, recent declines in commodity prices may make for a more challenging second half in developing markets.

Fixed income. Ten year Treasury yields declined from 2.40% during the quarter, reaching a low of 2.14% on June 26. Over the next several days, yields moved back up, ending the quarter at 2.30%. The quarter-end increase stemmed from European Central Bank statements implying a less accommodative monetary policy – this caused an even larger jump in certain European markets yields. As indicated above, the Barclays Aggregate Bond index returned 1.5% for the quarter. More speculative, higher yielding sectors of the bond market fared slightly better as investors continue to search for yield in what remains a historically low rate environment.

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General comments. Given that U.S. economic growth remains at about the same level as under the Obama administration, we're surprised how strong the markets have been since the November election (up about 16%). In our opinion some of the strength is due to a temporary pick up in earnings growth, partly the result of easy comparisons against the worst of the energy/industrial downturn in the first half of 2016. But we also believe that much of the market's gain reflects expectations that the economy will have a sustainable acceleration and/or that Washington soon will enact legislation to reduce corporate income taxes and fund infrastructure projects.

Unfortunately, we don't see these potentially positive developments for the economy and corporate earnings happening soon. And with the S&P 500 trading at a relatively expensive 17.8x next year's earnings, we're nervous about the near term for the market. Having said that, we appreciate that markets can remain expensive for long periods of time and that timing the market (knowing when to buy and sell) is impossible. Accordingly for most clients we remain invested relatively conservatively and in line with client-specific asset allocation guidelines.

Market sectors. The best performing broad market sectors during the second quarter were healthcare, technology and industrial companies. The strong performance of healthcare and technology we believe reflected investors' search for what is perceived as consistent and safe growth in a slowly advancing economy. We judge that healthcare also was helped by less talk of government imposed price constraints. Industrials had the benefit of easy comparisons against depressed earnings in 2016 and probably also were aided by hopes for increased infrastructure spending. Through the first half, healthcare, technology and consumer cyclical (led by Amazon) stocks were the leading groups.

The second quarter's worst performing sectors were energy, telecommunications and consumer staples stocks. Energy stocks declined more than 5% as oil prices fell roughly 20% from their April high as U.S. shale producers ramped up production. The telecommunications sector continues to be hurt by tough competitive conditions and, we believe, questions about Verizon's strategy for recent acquisitions. Consumer staples stocks had the benefit of a weaker U.S dollar (helps earnings) but were hurt, in our opinion, by Amazon's pending acquisition of Whole Foods and the prospect of increased pricing pressure/reduced margins. Energy, telecommunications and REITs were the worst performers over the first half.

Portfolio Positioning

We added modestly to intermediate term (five to six years), investment grade fixed income for some accounts during the quarter, but most portfolios' fixed income allocations still are 60%-80% in short duration (under three years) investment grade bond funds. While we have some lower credit quality exposure, this remains small across most accounts and is divided between short and intermediate term maturities. We'd like to get more aggressive with credit sensitive investments but continue to believe the risks outweigh the modestly higher income streams.

We had a relatively quiet quarter with respect to equities. Our only significant transaction was a modest reduction in the size of one of our larger U.S. mutual fund holdings, with proceeds being allocated to other already owned equity positions. The primary reason for the switch was to reduce exposure to U.S. stocks and add to international stocks, which we believe are more attractively valued.

Economy

U.S. GDP grew 1.4% in the first quarter, down from 2.1% in the fourth quarter and less than we had expected. Economists continue to feel that seasonal adjustments understate first quarter growth numbers, and often the following quarters are stronger. 2017 seems set to follow that pattern, with current expectations for second quarter growth (to be reported later this month) in the 2.5%-3.0% range. During the first quarter consumer spending slowed significantly to 1.1% from more than 3% the three prior quarters. Lower inventory accumulation also restrained the quarter while strong business investment helped.

Consistent with the consensus we anticipate better economic growth in the second and third quarters. We believe consumer spending will at least temporarily reaccelerate with unemployment at current low levels. And we expect a continued cyclical pick up in the industrial side of the economy due to lapping the weakest periods for energy, manufacturing and export-driven businesses in 2016. On the whole, international economies have been stronger than expected in 2017 and this should continue to provide support for the U.S.

Despite the foregoing, we don't see anything that's going to lead to a lasting secular reacceleration in growth as targeted by the Trump administration. And with all the turmoil surrounding the administration it seems to us less and less likely that significant economic stimulus – tax reform, infrastructure spending – is going to occur over the near term. Finally, if investigations and hearings become the norm, it's likely that business and consumer sentiment will deteriorate and potentially negatively impact the economy. Even though it recently raised rates, we believe the Fed will continue moving slowly in removing support for the economy.

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