Northport Investment Management, LLC
A Registered Investment Adviser

Market Commentary – 2nd Quarter 2017

U.S. stocks continued upward in the second quarter, with the Dow gaining 3.3%, the S&P 500 advancing 2.6%, and the NASDAQ Composite posting a gain of 3.9% for 2Q 2017. For the first half of 2017, the Dow is ahead 8.0% and the S&P 500 stock index is up 8.2% (+9.4% with dividends), their best first half performance since 2013. The tech-heavy NASDAQ Composite surged 14.2%, setting 38 closing records along the way, for its best first-six-months since 2009. Positive fundamentals (better earnings) and a world-wide recovery continue to support global equities, in what can be described as synchronized global growth. While still significantly lagging since the Great Recession of 2008-09, international stocks beat the S&P 500 benchmark for a second consecutive quarter (developed markets MSCI EAFE Index +5.0% in 2Q 2017, +11.8% year-to-date; emerging markets MSCI BRIC Index +3.8% in 2Q 2017, +15.6% year-to-date). Nine of the eleven S&P 500 sectors were positive year-to-date. Technology (+16.4%) and Healthcare (+15.1%) were the best performers. Energy (-13.8%) and Telecom Services (-12.8%) were the worst.

Bonds logged another positive quarter in 2Q 2017. The taxable Barclay's U.S. Aggregate Float Adjusted Index returned +1.5% for the quarter and the tax-exempt Barclay's 1-15 year Muni Bond Index returned +1.6%. The yield on the benchmark ten-year Treasury note fell from 2.396% to 2.298% (yields down, prices up) during the quarter. We have been unenthusiastic about bonds (especially versus stocks) for a while because bonds generally do poorly in a rising interest rate environment. Comments from Central Bankers, worldwide, in 2Q 2017 have indicated that the era of easy money may finally be coming to an end globally. That being said, one cannot underestimate the importance of diversification. Despite their relative unattractiveness, we would never totally abandon bonds in our diversified portfolios. Interest rates are on the rise, but we don't see data supporting a big rise in bond yields. Growth is up, but subdued. Inflation is muted. The upside for bond yields is limited. Bonds are a steadying influence. We will maintain prudent bond exposure in portfolios.

After nicely outperforming in 2016, Value investing is now out of favor, causing our value-oriented Northport equites to lag the benchmark. It is interesting however, that despite Growth investing leaving Value in the dust this year, Growth and Value investing are running roughly neck-and-neck the past two years. Our more consistent, less volatile, lower P/E approach can lag in the short-term, but it outperforms in the long-term.

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We are comfortable being more defensive after observing some disconcerting aspects of the recent market. Market volatility increased in 2Q 2017, with vicious Sector rotations not uncommon. Entire equity categories were indiscriminately decimated in a quick, broad brush, reaction to the "Amazon effect". An outsize portion of market gains this year has been produced by just a handful of mega-cap tech companies. The prevalence of ETF's and passive indexing may also be exacerbating volatility. Market valuations are on the high side historically. We are overdue for a normal, healthy, 5% - 10% temporary market correction. We are close to where the S&P 500 will probably end this year, around 2500.

We approach the current stock market with cautious optimism. Equities have advanced on fundamentals, and fundamentals should improve. Second quarter earnings will be positive, and although likely to be of slightly lesser magnitude than Q1, they should be enough to sustain current market levels. Some see signs that economic growth may be slowing, but, at the same time, consumer and business confidence is high, company balance sheets are solid, housing market fundamentals are strong, wages are rising, and there are many positive signs from the industrial economy and from overseas. Earnings are becoming much more consistent. The economy has continued to grow at 2% or better for a long time. We are still in a "Goldilocks" situation, with a strong economy, good job growth and low inflation. Future earnings drive markets. Unemployment, at a ten-year low, will drive earnings. Alternative investment options still remain relatively unattractive. Slow growth is not optimal, but is adequate. Equities are still feeding off of a high liquidity, slow growth story. It's slow and steady growth with a diversifying economic growth picture, broadening across the globe. The bull run will end when the economy overheats, inflation quickly picks up, and optimism becomes too widespread. We don't see these negative conditions in the near future. We will stay on our long-term, slow and steady, more value-oriented, equity path, collecting our dividends as we go, maximizing portfolio cash flow as a significant part of the long-term growth plan.

John M. Grib, CFA, CFP®

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