Northport Investment Management, LLC
A Registered Investment Adviser

Market Commentary – 4th Quarter 2017

It was a banner year for stocks, the strength of which virtually no one predicted at the end of 2016. U.S. stocks continue to be helped by the positive combination of record earnings, a global economic expansion, historically low interest rates and low inflation. The Dow rose 10.3% in Q4 2017, its best quarter since Q1 2013, its ninth straight quarterly advance, and its longest streak since 1997. For the year, the Dow added 25.1%. Additionally, the S&P 500 advanced 6.1% in the fourth quarter, for its ninth consecutive positive quarter, and its longest streak since one ending in Q1 2013. For the year, the S&P 500 was up 19.4% (21.8% with dividends). The tech-heavy NASDAQ Composite climbed 6.3% for the quarter and jumped 28.3% for the year. All three of these stock indices had their best year, since 2013.

Mid-Cap stocks (S&P 400 Mid-Cap Index, +14.5%) and Small-Cap stocks (Russell 2000 Index, +13.1) lagged in 2017. Developed international (MSCI EAFE Index, +21.8%) and emerging markets (MSCI BRIC Index, +38.7%) outperformed domestic markets in 2017. This was mostly a "catch up" event after years of underperformance, a trend that should continue. Nine of the eleven S&P 500 Sectors had positive returns for 2017 (eight in double-digits), led by Technology (+36.9%) and Materials (+21.4%). The Telecom (-6.0%) and Energy (-3.8%) sectors were the worst. In the Dow 30, Boeing (BA) was the best 2017 performer (+89.4%) and General Electric (GE) was the worst (-44.8%).

Bonds had a flat Q4 2017, with the Bloomberg Barclay's Aggregate Float Adjusted Bond Index returning .41%, and the Bloomberg Barclay's 1-15 Year Municipal Bond Index returning .15%, for the quarter (2017 returns were a relatively modest +3.6% and 4.3% respectively). The yield on the benchmark ten-year Treasury note closed 2017 at 2.409%, just below its 2.446% yield at the end of 2016 (higher prices, lower yields). For most of 2017, longer-term Treasury yields fluctuated within a narrow band. They remain stubbornly low, suggesting that the bond market remains skeptical that our current long span of tepid economic growth and slim wage gains will change anytime soon.

We aren't overly worried about this disconnect between the bond and stock markets. Current low rates don't necessarily foretell ongoing weakness. Foreign demand for our bonds will continue to keep our interest rates low until overseas central banks take further action to raise rates. We won't see our yield curve steepening until then. We won't see inflation jump until growth accelerates further.

Global accommodative monetary policy has supported growth and has inflated stock prices. As central banks reduce their monetary stimulus, can the transition to fiscal stimulus foster enough economic growth to support, or increase, these values going forward? We see economic growth

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coming from the recent tax law changes. We hold out hope for infrastructure initiatives and regulatory reform. As these fiscal initiatives play out, we remain confident that the Fed will continue its slow and steady hand to make sure that the economy remains on solid footing. They may even let inflation heat up a bit until we see more wage gains for average workers. We don't fear the Fed. We still see interest rates rising gradually. Despite the disparity in stock returns over bonds, we still view bonds as a valuable asset to balance out more conservative portfolios.

For stronger economic growth to occur, we will need the transition from monetary to fiscal policy to deliver better earnings growth and increased spending by businesses and consumers, without igniting significantly higher inflation. If this happens, stocks will continue to outperform. We are bullish on the U.S. economy. We don't envision a recession until at least 2020. There are many positives. The passage of significant tax relief for U.S. corporations bodes well for corporate profits. We are near full employment. Inflation is low. Consumers are healthy and are willing to spend money. We haven't had a business capital spending cycle for years, but tax reform should encourage it. Investor and consumer confidence are high, but not yet overly euphoric (although the investor "wall of worry" is starting to fade).

2017 was one of the least volatile years that the stock market has experienced. We haven't had a normal 5% to 15% correction in a couple of years. We are overdue. Despite our economic bullishness, we will be watching for stretched valuations. Higher valuations serve to make anticipated economic greatness more and more of a necessity. Our dividend emphasis, and economic conditions that should favor our more value-oriented equities (which lagged growth in 2017) going forward, should temper expected future volatility. In addition, having some cash on hand is also prudent. Now would be a good time to analyze your situation to determine if you can weather an inevitable, albeit temporary, dip in equity value.

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