Quarterly Investment Review and Outlook

People's United Wealth Management

Second Quarter 2017

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Macro Themes

- Growing strength on Main Street, confusion on Pennsylvania Ave
- Fed continues on the path to neutral (normal)
- A rising global economy, yet Populism threatening the European Union
- China's rapid increase in debt

Investment Themes

- Investors savor the eight year equity rally
- Asset Allocation is key at this point in the rally
- Diversification is key at this point in the rally
- Equities to outpace bonds in the year ahead
- Bonds face rising rate headwinds

A Dangerfield Market in a Trump Economy

Last month we celebrated the eighth anniversary of what is now the second longest bull market in U.S. stocks since 1928. If you missed the fireworks and banner headlines across your local newspaper don't feel bad, so did we. The current stock market rally could be named the Rodney Dangerfield, "I get no respect", rally. While investors have seen their equity portfolios rise along with the roughly 315% return generated by the S&P 500 over the last eight years, they have been buffeted by worries over the Treasury debt downgrade in 2011, the Grexit and Brexit votes in Europe, and the seemingly endless turmoil in Washington. Concerns over the lurking demise of this bull market have haunted investors throughout its epic run even as household net worth soared by $38 trillion since the first quarter of 2009. Additionally, the post-election Trump rally of 11% in the S&P 500, as of this writing, has been driven by hopes for improved economic growth but the evidence of an actual economic acceleration is still in the offing.

This lack of respect, or disbelief, in the sustainability of the stock market rally has much to do with the weakness of the economic recovery over the last eight years. Growth of 2.1% since the recession's end in June 2009 marks the slowest expansion since the great depression. The disconnect between stock market strength and economic weakness explains much of the disbelief, but we believe it is the "lack of normalcy" in monetary policy, such as Zero Interest Rates (ZIRP) and the tremendous increase in the Fed balance sheet, that explains much of why many investors believe the stock market is just one step away from a precipitous decline.

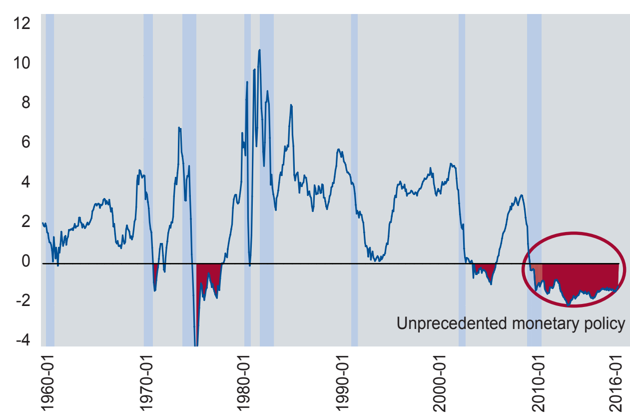
We believe "respect" will return to financial market investors as the Fed continues on its path toward normalcy by raising the Fed funds rate back to a neutral stance and the nascent animal spirits we see bubbling up in corporate confidence lead to greater capital investment. A quick review of Chart 1, which illustrates the real fed funds rate, highlights the unprecedented amount and duration of monetary stimulus provided to the economy over the last eight years. Negative real short term interest rates have punished savers to the benefit of borrowers. The hope was that negative short term rates would spur economic growth to a rate above the aforementioned desultory rate of 2.1%. We commend Fed Chair Yellen as she returns monetary policy back to a more normal stance. As she does this, we believe confidence in the economic expansion will increase along with confidence in the stock market's advance.

Economic Dashboard

Economy	Slow acceleration in U.S. and global growth through 2017. < 25% probability of a U.S. recession within 18 months.
Inflation	Core Inflation rises above 2% for 2017.
Interest Rates	Interest rates subject to domestic and international conditions.
Oil	Stable equilibrium price for oil will depend upon OPEC supply.
Currency	Dollar appreciates along with rising rates.

Chart 1: Real Fed Funds Rate

Nominal Federal Funds Rate - PCE Core Price Index y-o-y Change



Recessions shaded

Source: Federal Reserve

Foundations of a Good Portfolio: Valuation

— **Price is what you pay, value is what you get**

With this quarter's note we initiate our **Foundations** series to expand on those principles and insights that serve as the foundation of the portfolios we build for our clients.

One of the biggest challenges of successful investing is differentiating between what is widely viewed as a great company and what is also a great investment. Great companies are defined by among many things, strong earnings growth, high profit margins and exceptional reputations for innovative products and global brands. Great investments are those that generate high returns, far above the broad market. Those returns are driven by a combination of rising valuation levels, such as the price-earnings ratio (P/E), and rising earnings. Not to diminish the importance of earnings growth in the generation of returns, we believe it is the upward revision of a company's valuation level that determines whether it becomes a truly great investment. Investors must begin their analysis with an understanding of where a company is trading in the normal ebb and flow of valuation levels it has experienced over the last several market cycles. The following illustration compares the trading history of Walmart and the S&P 500 dating back to 1992 and encompasses several valuation cycles for Walmart.

While Walmart has certainly run into a tough competitor in Amazon over the last several years, it can also be argued that Walmart is a great company when compared to its many retail brethren. Chart 2 depicts the P/E history for Walmart and the S&P 500. For almost the entire period, investor perception of the proper valuation level for Walmart varied much more dramatically than for the S&P 500.

Accompanying Chart 3 is a table that notes the price, P/E multiple and earnings change for Wal-Mart and the S&P 500. As can be seen, over the 25 year period, Wal-Mart generated tremendous earnings growth; nearly 34% faster than the rate for the overall market. During the entire time it can easily be argued that Wal-Mart was a great company, but as can be seen by the price chart, the company hasn't always been a great investment. In fact, for an investor who owned Wal-Mart over the entire 25 year period, the three year advance covering 1997 - 2000, captured the entire gain in price. While earnings grew during each period it was the change in valuation level that determined the ultimate return generated for investors.

By combining an understanding of the appropriate valuation level for Wal-Mart along with an analysis of the drivers of earnings growth, an investor could have a tremendous impact on the ultimate results of an investment. We believe this understanding of the importance of valuation to the success of an investment in the stock market can be expanded to every asset class considered for inclusion in a portfolio.

- **During 1992 investors were willing to pay nearly twice as much for a dollar of Walmart earnings as they did the market.**
- **By 1996 their ardor cooled and they saw Walmart's earnings as no more valuable than the market in general.**
- **In 1999, at the height of the dot.com bubble, investors again were willing to pay a significant premium for Walmart earnings.**
- **Over the next seventeen years Walmart continued to grow earnings, at a 7.57% rate compared to the S&P 500 at 4.70%, while its P/E ratio became closely aligned with the overall market.**

Chart 2: Wal-Mart vs. S&P 500 P/E Ratio
(As of 3/17/17)

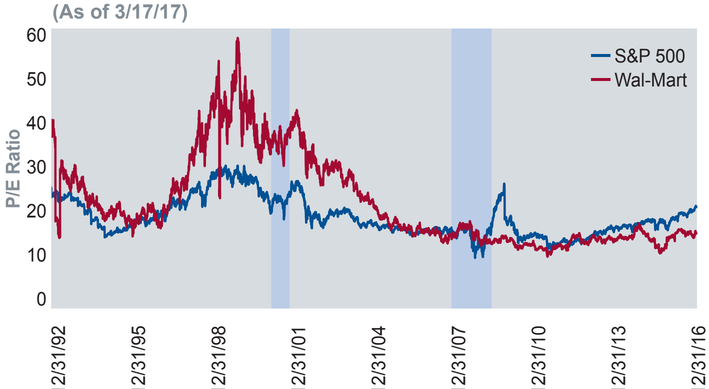
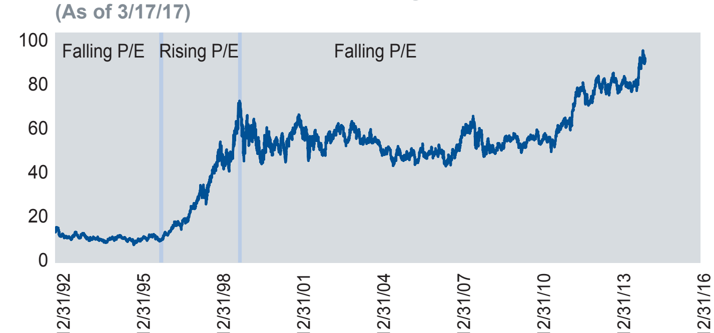


Chart 3: Wal-Mart Price Change
(As of 3/17/17)



	7/24/92 - 12/31/96		12/31/96 - 12/31/99		12/31/99 - 3/17/17	
	WMT	S&P 500	WMT	S&P 500	WMT	S&P 500
Price Change	(-17%)	(+80%)	(+507.6%)	(+98.3%)	(+1.1%)	(+61.9%)
P/E Change	(-52.2%)	(+35.8%)	(+222%)	(+54.2%)	(-71.9%)	(-25.9%)
EPS Change	(+91.4%)	(+142%)	(+86.5%)	(+29%)	(+252%)	(+118.3%)

Source: Bloomberg

Gregg S. Fisher, CFA
Head of Quantitative Research
and Portfolio Strategy

Pro-Globalization for Portfolios

Global tensions continue to be high – but no one seems to have given the news to global investments.

Across the primary asset classes, global investments outperformed domestic in the first quarter. Developed-country stocks outperformed U.S. stocks, while emerging market equities outstripped all developed markets by a wide margin. U.S. real estate investment trusts (REITs) declined slightly, while global REITs enjoyed a healthy surge. Even global bonds earned a solid positive return, while U.S. bonds fell slightly.

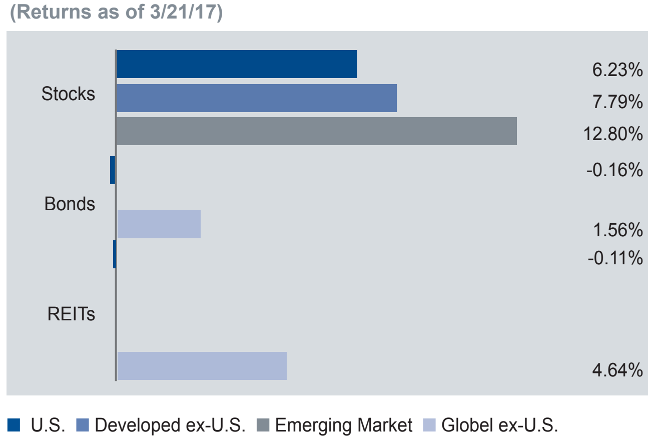
This moment may or may not be the "perfect" time to jump into international investments – we strongly caution against trying to time the market. But the gap between U.S. and non-U.S. performance this quarter calls attention to one of the most powerful reasons to go global: diversification of returns. Economies outside the U.S. offer diversified monetary policy, fiscal policy, currency, skilled labor stock, local supply and demand trends, resource inputs, etc. Investing in international stocks and bonds is a means of gaining exposure to those diversifying trends.

Now, if you own stock of any company in the S&P 500, there's a strong likelihood that your portfolio already has some exposure to international economies, through non-U.S. sales and suppliers. Likewise, many of the large-cap companies based outside the U.S. earn revenues from American customers and offer diversified global exposure. Some research suggests that the strongest diversification benefits come from exposure to smaller countries and the domestically-focused companies based there.

Nearly 50% of global market cap is outside the U.S., yet most American investors have only a small portion of their portfolios allocated to non-U.S. investments. Academics and industry reports regularly expose the "home bias" present in portfolios. The point: most of us could stand to be more global, and there are a range of options to do that in portfolios. Incidentally, non-U.S. stock valuations are lower than U.S. valuations today, on metrics like price-to-earnings. We don't see this as a short-term opportunity, but it does suggest the window is open to add global investments for a good price.

If the world is indeed trending away from globalization, we'd offer this idea to investors: perhaps it's time for portfolios to trend toward it.

Global Investments Outperform in First Quarter
(Returns as of 3/21/17)



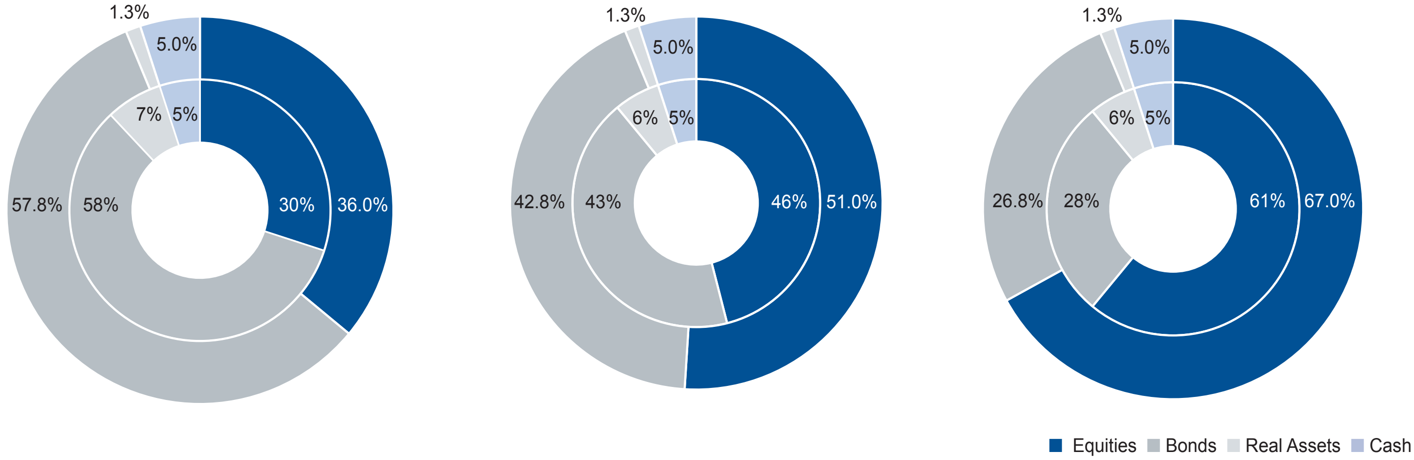
Source: Bloomberg

Income with Moderate Growth Objective

Balanced Objective

Growth with Moderate Income Objective

Strategic allocations inside ring, Tactical allocations outside ring.



Portfolio Notes & Insights

The three portfolios depicted here reflect our most common investor objectives. The inside circle in each chart represents our long-term strategic allocation for the objective. The outside circle represents the current tactical adjustments we've made within the allowable allocation ranges to take advantage of current and prospective market and economic conditions.

It is important to note that the allocations shown are frequently tailored for client specific circumstances and preferences.

Equities are overweight in each portfolio. We expect equities will have higher returns than bonds, real assets, or cash in 2017. Equities are not likely to match 2016's returns.

Bonds are modestly underweight. Equity volatility has been exceptionally low over the past 12 months and will increase. Bonds will dampen volatility and keep portfolio returns within the risk limits of each investor objective. Though bond returns may be low, bonds still play a critical role in all but the most aggressive portfolios.

Bond returns will be very modest in 2017, but should remain positive even in a rising rate environment, provided rates do not move rapidly higher, which we do not expect.

Cash allocations are neutral – neither overweight nor underweight. The days of a near-zero rate of return on cash are over. Returns will still be low, but a neutral cash position makes sense with bonds and stocks fully priced.

Real assets are underweight in each portfolio. Stocks should outperform real estate, commodities, and precious metals in 2017. We prefer bonds over real assets for risk mitigation.

As a final note, we are currently cautioning investors to be wary of stretching for returns in this market. An investor should always maintain an allocation best suited to his or her long-term risk tolerance. With markets fully priced, moving outside one's risk tolerance has the potential to result in larger losses than can be tolerated.

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TRUST CORNER

Trusting in a trust.

Establishing a trust is a powerful and practical step toward aligning your financial affairs with your goals and priorities. A trust enables you to determine when and how your heirs receive their inheritance, and can help assure that children with special needs are provided for. A trust can orient your finances toward philanthropic causes that reflect your priorities, as well.

Uncertainty is now, and has always been, perhaps the most trusted companion in the financial world.

Markets are fickle. Prices confound. Political regimes come and go and with them the regulatory superstructures that guide and determine how we manage our assets and plan for the future.

Emerging into the uncertain landscape of the new administration, we can point to the certainty that President Trump is determined to keep his campaign promises. And among those oaths, we would highlight his promise to repeal Estate, Gift and Generation-Skipping taxes. The likelihood of achieving this goal in Congress is being debated at present. Many feel that a repeal of the Estate tax will be coupled with a change in the income tax cost basis rules and due to Senate rules the repeal may not be permanent. Others feel that even if the Estate tax is repealed, it is more likely that the Gift tax will remain with the possibility of a lower exemption to avoid income tax shifting techniques.

Setting aside specific regulatory changes, we can point to a roster of nontax related benefits to incorporating a trust in your estate plan.

— **Incapacity:** Using a trust to provide protection in the event of your (or your spouse's) incapacity can be beneficial. A successor trustee can step in and protect and manage your assets. If the trust is not yet funded, there should be a Power of Attorney ready to be exercised to fund the trust.
— **Asset protection:** Your trust can contain provisions to protect assets passing to your children from creditors or claims in divorce proceedings.
— **Distribution:** Provisions can be drafted to guide the trustee in exercising discretion in distributing assets to avoid removing the disincentive to a child to be gainfully employed or to complete his or her education.
— **Special needs:** Your trust can ensure that help can be provided without disqualifying the child from receiving governmental benefits.
— **Philanthropy:** Charitable Lead Trusts and Charitable Remainder Trusts can give you an effective vehicle to accomplish your philanthropic goals.
— **Maintenance:** Your trust can articulate how the family residence should be maintained [and possibly sold] to accommodate the needs of the surviving spouse.
— **Re-attachments:** Your trust can address issues that may arise if the surviving spouse remarries.

Working with a team of advisors that can include your attorney, accountant and Wealth Management professionals, can create the means to grow and protect wealth across generations.

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March 2017 Investment Strategy

By **Albert J. Brenner, CFA**
with **John Conlon, CFA**
and **Karissa McDonough, CFA**

How do current and prospective conditions affect our asset class strategy? Following is our analysis of conditions by asset class and the tactics to suit.

Of course, each investor is unique. Investors should review the tactics discussed here with their portfolio manager to see if they are appropriate to their portfolios.

Equity

U.S. Analysis

Economic growth will continue through 2017 and 2018. Growth will be between 2% and 2.5% per year and sustained by the considerable forward momentum of the overall economy. Policies of the Trump administration may boost growth modestly in 2018, but growth is not dependent on the new administration. The risk of a recession is low.

Sustained economic growth will support higher corporate earnings. We look for $125 per share for the S&P 500 in 2017.

Stocks are in the 8th year of a bull market rally and not cheap. But current valuations are fair in light of bond yields, inflation, and a recovery in earnings. Investor enthusiasm in response to an improving economy, higher earnings, and a business friendly administration in Washington has led to an increase in valuations.

International Analysis

Global economic growth will pick up in 2017 and 2018 driven primarily by growth in emerging markets. Growth in Europe and Japan will be slower than in 2016 and slower than in the U.S. Growth in emerging markets will accelerate, particularly in China.

The euro zone and Japan are still in the early stages of economic recovery. Both are supported by extraordinary measures from their central banks including negative interest rates and bond buying programs. Political uncertainties continue to threaten the cohesion of the European Union.

European and Japanese stocks are less expensive on an absolute valuation basis than U.S. equities – they trade at lower multiples of forward earnings than U.S. stocks. U.S. stocks, however have historically traded at a premium thanks to higher profitability and lower volatility.

Emerging market stocks are trading at a discount to historic levels, and earnings have started to recover after a five year decline, but equity returns remain linked to commodity prices. A stronger dollar and higher interest rates remain a challenge for emerging market economies with dollar debt.

Tactics

— Stocks will outperform bonds in 2017. Overweight equities.

— A market pullback would not be surprising, but don’t wait for it to occur before investing. Should a correction occur, it will be an opportunity to rebalance and to add to equities.

— We are modestly overweight U.S. equities, neutral on developed market equities, and underweight emerging market equities.

— Within U.S. equities, sector performance remains critical to the relative performance between growth and value and among large-cap, mid-cap and small-cap stocks

— Don’t chase last quarter’s small cap performance. We are maintaining a neutral allocation across large-, mid- and small-cap as we do not expect relative returns for 2017 to warrant an overweight or underweight allocation to any size sector.

— We are also maintaining a balanced allocation between growth and value in view of the prospects for traditional value sectors such as financials and utilities and growth sectors such as health care and technology.

— Overweight economically and interest rate sensitive sectors such as industrials, materials, financials and technology. Underweight utilities and telecom.

— Dollar appreciation will be a drag on international equity returns. We continue to hedge the currency risk of a portion of the developed market allocation.

Fixed Income

Bond Market Analysis

With unemployment below 5% and inflation near 2%, the Federal Reserve is reducing the stimulus it has provided since the financial crisis. Unless the economy hits a soft spot – which we do not anticipate – the Fed will raise rates another half or three-quarters of a percent this year.

Higher oil prices will drive inflation as measured by CPI well above 2.0% in 2017. Core inflation will remain moderate. Inflation expectations remain well anchored. A major stimulus program out of Washington could drive inflation higher.

The bond market's reaction to the March rate hike was measured. Long term rates actually declined. As we noted last quarter, the biggest moves in interest rates will be in short-term rates. We expect the two-year yield to move above 2% by 2018 and the ten-year yield to approach 3%.

Corporate finances remain solid. With the economy continuing to grow, bond defaults will remain low throughout 2017 and 2018.

Tactics

— Underweight bonds. But why hold any in a rising rate environment?

1. Bonds still play a crucial and necessary role in mitigating risk. Without them, investors will suffer larger portfolio losses than they can tolerate.

2. Even though bond returns will be lower than stock returns in 2017, bonds can generate positive returns as rates rise.

— Managing maturities (or duration) in a rising rate environment continues to be a trade-off between harvesting coupon returns and managing price depreciation induced by higher rates. Maintain a moderately short to neutral duration strategy.

— Overweight corporate bonds relative to Treasuries for the interest rate protection provided by the higher coupons.

— High-yield bonds continue to provide return premiums, but watch for the sector getting overbought.

— Underweight mortgage-backed securities. Rising rates will extend their maturities and result in larger market value declines.

Real and Alternative Assets

Analysis

Returns on real estate investment trusts (REITs) are highly correlated to bond returns, and valuations remain well above historic norms. Investors need to keep in mind that REIT dividends are taxed as ordinary income unlike long-term dividends on other equities.

Commodity indexes stabilized in 2016 as prices of several commodities rose off of early and mid-year lows. Although global economic growth should support demand for commodities, conservation in energy consumption in the developed world, a shift away from infrastructure spending in China, and a stronger dollar will temper demand. Rising interest rates will support traditional total return commodity strategies.

The opportunity cost of owning gold – an asset that pays no interest, dividends, or rent – has increased and will continue to increase with rising interest rates.

Tactics

— REITs will be less attractive as interest rates increase. We are maintaining an underweight allocation to REITs in asset allocation models.

— Underweight commodities.

— Gold can be a currency, a hedge against inflation, and a safe-haven asset in times of economic or political uncertainty. With a stronger dollar, rising interest rates and inflation remaining modest, we continue to maintain a zero allocation to the precious metal.

— We believe select hedge fund strategies implemented through liquid, tradeable mutual funds can be useful for risk management in select situations.

People's United Wealth Management helps institutions, employers, individuals and their families navigate investment, trust, retirement, banking and planning challenges. Our experienced professionals work as a team bringing specialized knowledge and solutions to the conversation.

For more information on our investment offerings please contact us at: wealthmanagement@peoples.com or (203) 338-5510

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