F.L.PUTNAM
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R. THOMAS MANNING, CFA
Chief Executive Officer and President
tmanning@flputnam.com

ELLEN FLAHERTY
Sr. Vice President, Chief Operating Officer
eflaherty@flputnam.com

ROBERTSON P. BREED, CFA
Sr. Vice President, Portfolio Manager
rbreed@flputnam.com

ELLEN K. HAZEN, CFA
Sr. Vice President, Portfolio Manager
ehazen@flputnam.com

D.J. SHAUGHNESSY, CFA
Sr. Vice President, Portfolio Manager
dshaughnessy@flputnam.com

STEVEN N. VIOLIN, CFA
Sr. Vice President, Portfolio manager
sviolin@flputnam.com

ANDREW B. WETZEL, CFA
Sr. Vice President, Portfolio Manager
awetzel@flputnam.com

ABIGAIL PSYHOGEOS
Sr. Vice President, Private Client Advisor
apsyhogeos@flputnam.com

GLEN P. MARTIN, CFP
Private Client Advisor
gmartin@flputnam.com

SCOTT MAZUZAN, CFP
Private Client Advisor
Smazuzan@flputnam.com

CHRISTIAN D. MCVEY
Sr. Vice President, Marketing
cmcvey@flputnam.com

WENDY M. BUSH
Vice President, Development
wbush@flputnam.com

PIVOT POINT

R. THOMAS MANNING, CFA, CHIEF EXECUTIVE OFFICER AND PRESIDENT

In many ways the first quarter of 2017 represented a pivot point for investors, serving to significantly alter the way they need to think about and approach investing.

Most obvious for U.S.-centric investors has been the political regime change, one that has rapidly shifted the discussion away from easy monetary policy to the potential economic and market impact of fiscal policy that has long been dormant. Ironically, this shift, which has heightened political uncertainty in our country, had been met by one of the most stable market environments that we have ever witnessed – at least this was the case up to and directly preceding the unsuccessful first attempt to repeal and replace the *Affordable Care Act*. Only once did the markets move more than 1% above or below their close during the first quarter.

Monetary policy has also changed course. The Federal Open Market Committee (FOMC) has now increased interest rates twice since the election with 2 to 3 more hikes likely by year end. The market has absorbed the recent rate hikes with minimal disruption as there appears to be growing confidence in the economy and resiliency in corporate earnings. This is in stark contrast to the reaction in the first quarter of 2016 following the Fed's initial rate hike, which was met with fear and skepticism, sparking more than a 10% decline in the stock market.

The third pivot that may also be underway – and potentially underappreciated by many investors – is the improvement in the economic environment outside the U.S. Economic growth overseas seems to be gaining traction despite the uncertainty created by populist movements in the U.K., France and elsewhere. U.S.-based investors might be well served to look overseas as they think to allocate their next dollar. Improving economic fundamentals will likely lead to rising earnings for foreign companies. Combined with attractive valuations relative to U.S. counterparts, foreign stocks may have greater upside potential and investors considering a foray overseas may be presented with an interesting entry point into both the international and emerging-market asset classes.

While policy rhetoric regarding tax cuts and deregulation may continue to boost the markets here in the U.S., the failed effort to "repeal and replace" Obamacare should serve as a warning to the Trump administration that Republican support for other legislation is not a given. The warning for investors is not to get too far ahead of themselves if trying to forecast the impact of policy changes on market returns.

The most important pivot from our perspective was the fundamental change in investor expectations that began during the 4th quarter of last year. While linked to both fiscal and monetary policy, its roots seem to be embedded deeply in the perception of an improving economic backdrop. Throughout 2015 and a good part of 2016, the U.S. and many global economies appeared to be headed toward recession. Leading economic indicators were falling, growth rates were anemic at best and declining corporate profits seemed to confirm a reality that an economic downturn was on the horizon. As a result, equity investors plowed into defensive sectors, such as consumer staples, utilities, and telecom, as well as companies that maintained higher than average dividend yields. The valuations of these stocks skyrocketed to levels that could only be justified if we were indeed heading into a recession. Additionally, on the other side of the spectrum, investors were also willing to pay a significant premium for companies with a demonstrated track record of sales growth in a slow-growth environment. This bifurcated market proved frustrating for investment managers, like F.L.Putnam, that focus their research efforts on fundamental factors and refuse to chase stock prices at either end of this spectrum. We have long believed that the combination of paying reasonable and sustainable multiples for earnings with better than market growth rates will lead to higher returns over an investment cycle than those offered by richly valued or slowly growing companies. Whether the result of the election, the shift in monetary policy, the prospect of fiscal policy, or simply improving economic fundamentals, we have started to witness the unwinding of the "defensive trade" and a growing conviction that earnings are improving across different market segments. We believe a shift away from the extremes is underway, and, if affirmed, we would expect our investment philosophy and discipline to result in beneficial outcomes for our clients.

As the title 'Pivot Point' suggests, we believe the underlying market dynamics are now evolving. Change in any context is naturally disruptive, and as active investment managers, we believe disruption can create opportunity. The end of unprecedented monetary stimulus, sweeping economic policy changes, and a volatile political environment across the globe are challenges that we believe demand a heightened focus on risk control and tactical positioning. As the persistent tail-wind of zero interest rates that propelled markets higher subsides, and the economic cycle matures, we are confident that our emphasis on fundamental research and risk management is well suited to navigate this shifting landscape.

2017 MARKET DIARY

		Last 3 Months *	Last 12 Months *
U.S. Equities			
	S&P 500	6.07%	17.16%
	Dow Jones Industrials	5.19%	19.91%
	Russell 2000	2.46%	26.19%
	Russell 3000	5.74%	18.06%
International Equities			
	MSCI World Index ex-US	6.95%	12.52%
	MSCI Emerging Markets	11.49%	17.65%
Fixed Income			
	Barclay's U.S. Int. Gov't/Corporate	0.78%	0.42%
	Barclay's U.S. High Yield	2.70%	16.39%

Source: *Bloomberg Capital Markets*

* Total return for all indices