



PRIVATE CAPITAL MANAGEMENT A Subsidiary of GUARANTY BANK AND TRUST

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First Quarter 2017

"Bull markets don't die of old age."

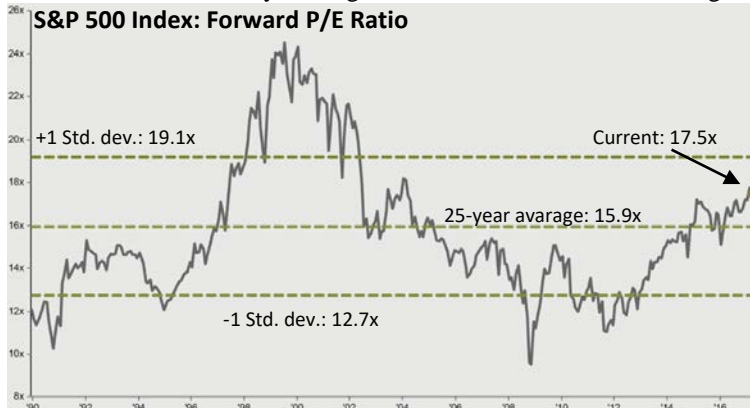
- Leon Cooperman

Following the sharp rise in stocks after the U.S. elections last year, the rally continued through the first three months of 2017 with the S&P 500 gaining 6%. In last quarter's commentary we summarized 10 of the top markets strategists' forecasts for 2017, and the average of their forecasts was a 6% gain for the full year. This begs the question: How much higher can stocks go?

Skeptical Optimism

Investor optimism is elevated right now on hopes that a Republican majority in Washington should be seemingly pro-business and create real potential for key fiscal policy reform. The economy is ripe for pro-growth, fiscal policy reform because the Federal Reserve is starting to slowly tighten monetary policy by raising interest rates. The primary fiscal policies that investors are watching include corporate tax reform, individual tax reform, deregulation, and health care reform. If the recent attempt at healthcare reform is any indication, it may not all be smooth sailing for the Republican controlled House and Senate.

As shown in the chart below from J.P. Morgan Asset Management, the S&P 500 is currently trading at about 17.5x estimated earnings.



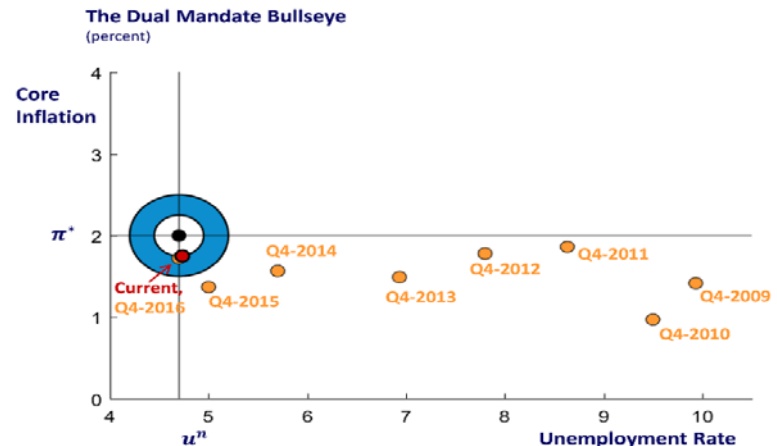
Source: FactSet, FRB, IBES, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management. Price to earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since December 1989, and FactSet for March 31, 2017. Average P/E and standard deviations are calculated using 25 years of FactSet history. Guide to the Markets – U.S. Data are as of March 31, 2017.

While this is nowhere near the valuations reached before the 'Dot-Com' bubble in 2000, the stock market is above its 25 year average of 15.9x earnings. Any time valuations are elevated on investor optimism, we believe there is heightened potential for disappointment. This could be in the form of weaker than expected GDP growth, earnings growth, or fiscal policy reform. If fiscal policy reform takes longer than expected, or is not of the magnitude that investors desire, we could see the stock market reprice itself to

reflect lower expectations. Likewise, if policy reform, economic data, or corporate earnings are better than expected, stocks could continue to do well. Only time will tell if the politicians in Washington can successfully pass the baton from monetary policy to fiscal policy and help keep the economy growing. We believe this uncertainty makes the case that investors should always own a diversified portfolio that is appropriate for their risk tolerance and goals. Last year's elections and the recent failed attempt at healthcare reform serve as important reminders that predicting these types of events is not an appropriate way to manage investment risk.

Dual Mandate

The Federal Reserve is the primary monetary policy setting body in the United States. In 1977, Congress established two primary objectives for the Fed: foster economic conditions that achieve both stable prices and maximum sustainable employment. This has more recently been translated to mean 2% inflation and 4.7% unemployment. By raising and lowering overnight interest rates, and more recently by expanding its balance sheet, the Fed adjusts monetary policy to try and manage economic conditions. The Federal Reserve Bank of Chicago published the following Dual Mandate Bullseye on March 31st, which shows just how close current conditions (red dot) of inflation (left axis) and unemployment rate (bottom axis) are to its stated target (bullseye) since the great recession. The Fed may feel pressure to slowly tighten monetary policy (raise interest rates) as inflation and the unemployment rate creep closer to its stated mandate. As the Fed reduces monetary stimulus, fiscal stimulus may be increasingly important to keep the economy expanding in the years ahead.

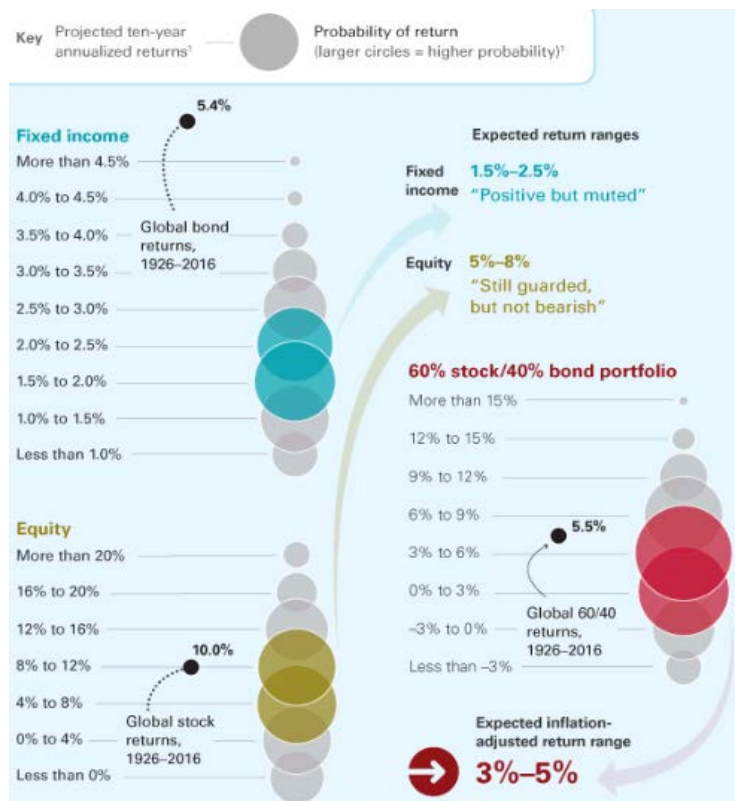


Notes: The dot for the current situation indicates the three-month average of both the unemployment rate and the year-over-year percent change in inflation as measured by the core PCE price index; uⁿ is the median FOMC participants' estimate of the longer-run normal level of unemployment as reported in the most recent Summary of Economic Projections. Source: Federal Open Market Committee, U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Advisors from Haver Analytics.

The Federal Reserve raised the Fed Funds Rate from 0.50-0.75% to 0.75-1.00% at its March 15th meeting, but longer term interest rates have since fallen. The 10 year U.S. Treasury Yield has fallen from 2.51% to 2.36% by April 5th. It's important to understand that the movement in longer-term interest rates is not directly controlled by the Federal Reserve.

Guarded Expectations

While we don't rely on other firm's market forecasts, below is Vanguard's recently released outlook for global stock and bond returns, which they note is guarded.



Source: The Vanguard Group, Inc. 3/29/17. All investing is subject to risk, including possible loss of principal. The figures display the projected range of potential returns for portfolios of 70% U.S. bonds/30% ex-U.S. bonds, and portfolios of 60% U.S. stocks/40% ex-U.S. stocks, rebalanced quarterly, from 10,000 VCMM simulations, as of September 2016. IMPORTANT: The projections or other information generated by the Vanguard Capital Markets Model® (VCMM) regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes from the VCMM are derived from 10,000 simulations for each modeled asset class. Simulations are as of September 30, 2016. Results from the model may vary with each use and over time. For more information: https://advisors.vanguard.com/VGApp/iip/site/advisorsec/research/article/ArticleTemplate.xhtm?iigbundle=IWE_InfographBreakdown2017&sub=1357220247&st=R&oeat=grDnAjvrLq

Economic Update

On March 30th, the U.S. Department of Commerce reported the U.S. economy continued to expand at a moderate pace with fourth quarter GDP growth of 2.1%. Full-year 2016 GDP growth was only 1.6%, marking its worst performance since 2011. This is down from 2.6% GDP growth in 2015. It will be interesting to see if the economy gets a boost in 2017 from President Trump's proposed stimulus spending, sweeping tax cuts, and less regulation. On April 7th, the U.S. Department of Labor reported that non-farm payrolls increased by 98,000 in March, an unusually low number. This followed payroll gains of 219,000 in February and 216,000 in January. But, the unemployment rate declined another 0.2% to 4.5%, which is the lowest level in nearly a decade, and is starting to dip below the Federal Reserve's target of 4.7%. Additionally,

average hourly earnings increased 2.7% year-over-year. The smaller than expected gain in payrolls combined with the strong increase in hourly earnings could be signs of a tightening labor market. Deutsche Bank reported that it now takes 27 days to fill a vacant job, up from 23 days in 2006, before the financial crisis started.¹

In summary, there doesn't appear to be a recession on the horizon, but investor uncertainty around policy will likely remain elevated.

PCM welcomes Nicki Kadel back to the firm.

We are thrilled to announce that Nicki Kadel has rejoined Private Capital Management as our Client Service and Operations Manager. Nicki has 10 years of experience and worked at PCM from 2008-2011. She took some time off after having her second child and rejoined the investment industry in 2013. We are pleased to have her back with PCM to oversee the firm's operations and Client Service team. Welcome home Nicki!

Cherry Hills Investment Advisors is now integrated with Private Capital Management.

We are also pleased to announce that the legal integration of Cherry Hills Investment Advisors and Private Capital Management is now complete. We are delighted to be able to combine our exceptional teams and expanded resources together to help you reach your financial goals. If you have questions or ideas to explore, we are here to listen and respond. Thank you for your continued support.

By the numbers...

Index	Close	1 st Quarter	Year-to-Date
S&P 500	2362	+6.1%	+6.1%
Dow Jones Industrial Average	20,663	+5.2%	+5.2%
Russell 2000	3444	+2.5%	+2.5%
MSCI EAFE	1792	+7.3%	+7.3%
MSCI Emerging Markets	958	+11.5%	+11.5%
Barclay's US Aggregate Bond	-	+0.8%	+0.8%
Bloomberg Commodity	85	-2.3%	-2.3%

Data provided by Morningstar as of 3/31/2017

¹ Hooper, Peter, Matthew Luzzetti, Torsten Slok. US labor market: Job growth slowing in March, it is probably just weather and residual seasonality. Rep. April 2017. New York: Deutsche Bank, 2017. Email.

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