



Market Update and Outlook for First Quarter 2017

Company Profile

Farmers Trust Company is licensed by the Ohio Division of Financial Institutions as a bank, authorized to conduct trust business and exercise full fiduciary powers. Our efforts are focused on the administration and management of trust assets. As an independent trust company, Farmers Trust Company offers several investment management options.

We are committed to providing the highest level of service in the areas of investment management, estate settlement, living trusts, testamentary trusts, charitable trusts, charitable endowments and employee benefit plans. Tax and estate planning services are available to our clients as well.

Farmers Trust Company has the unique ability to integrate investment, trust and estate management at a local level. Our clients appreciate the fact that their financial affairs are handled personally and confidentially. They also value our ability to work closely with their attorneys, accountants and insurance professionals to achieve a comprehensive financial strategy.

Key Points

- We can't rule out a short term pullback from the current, elevated, valuation of the equity markets. Near term, we are cautious. Longer term we are comfortable that the pro-growth stance of the incoming administration will bode well for stocks.
- We continue to maintain a cautious view toward global equities in the near term, but depressed valuations may provide opportunities.
- After many years of low interest rates, we now see the potential for rates to continue moving higher.
- A stronger dollar is bad news for commodities, but increasing supply shortages in some areas of the commodity complex should support prices.

Market Recap and Outlook First Quarter 2017

MARKET SCORECARD to 12/31/2016	TOTAL RETURN IN USD	
	Q4	YTD
DOW JONES IND AVG	8.63%	16.39%
S&P 500	3.81%	11.93%
NASDAQ	1.69%	8.95%
MSCI EAFE EQUITY	-0.68%	11.42%
RUSSEL 2000 INDEX	8.83%	21.31%
MSCI EMERGING MARKET EQUITY	-4.08%	11.6%
BARCLAYS INTERM. TREASURY	-2.25%	1.06%
BARCLAYS INTERM. GOV/CREDIT	-2.07%	2.08%
BARCLAYS 5 YEAR MUNI INDEX	-2.63%	-0.39%
BARCLAYS US HIGH YIELD	1.75%	17.13%
S&P GSCI COMMODITY INDEX	5.76%	11.37%

Note: All returns include re-invested cash flows, expressed in U.S. dollar terms.

Market Recap

U.S. equity markets reacted positively to the November election results due to increased optimism for less government regulation, lower taxes and a pro-growth environment going forward. For the 4th quarter of 2017 the S&P 500 gained 3.81% while Small Cap stocks gained 8.83% over the same time frame, as measured by the Russell 2000. Financial stocks led the way with a whopping 21.10% return in the 4th quarter of 2016. Foreign equities, however, were not as enthusiastic with the MSCI EAFE index down -0.68% while Emerging Markets retreated -4.08% during the year-end quarter, as measured by the MSCI EM index. Bond prices went lower during the last quarter of 2016 with the 10 year US Treasury bond yielding 2.43% at year-end (from 1.61% three months previously).

Investment Outlook

The 2016 year-end surge for domestic equities was largely built more on optimism and less on actual data. While we feel encouraged by the pro-growth rhetoric of the incoming administration, we maintain our cautious view toward global equities in the near term until the current stock levels are justified by positive corporate earnings growth and macroeconomic trends. The December Fed Funds rate hike took place without incident and we expect more rate hikes in 2017 barring any significant downturn in economic data. The likelihood of a recession is still low in most major world economies, while global central banks remain very accommodative.

We've seen a move higher in nominal interest rates which confirms our belief that rates would begin to rise from their near record lows in mid-2016 (the 10 year U.S. Treasury bond dipped all the way to 1.36% in July). Given the improved prospects for economic growth going forward (and hence inflationary pressures), the conditions are in place for sustained higher interest rates in the long term. We recently added some Treasury Inflationary Protected Bonds (TIPS) to portfolios to combat the elevated risk of inflation.

A strong U.S. dollar is likely to persist, as elevated domestic interest rates are still attracting foreign investment. The strong dollar presents challenges for both emerging market stocks and commodities, but we continue to believe a position in the latter is justified as a means to hedge against inflation and potential supply shortages.

Global Macroeconomic Review and Outlook

As GDP growth picks up (3rd quarter U.S. GDP was 3.5%), inflation will once again be a topic of discussion in investment circles. While a small amount of anticipated inflation can be a positive sign for a healthy economy (somewhere near the Federal Reserve's target of a 2% annual rate), unanticipated or rampant inflation destroys consumer's purchasing power and can upset an investor's apple cart. While we detect no signs of an unwanted spike in prices, they are moving slightly higher and should continue to do so as the U.S. and world economies accelerate.

The employment situation should continue to improve with the growing economy. Headline unemployment checked in at 4.7% for the month of December, while an alternate measure of unemployment, one which attempts to account for discouraged workers and the under-employed, held at 9.2%. The unmistakable downward trend in unemployment will likely continue in the coming years if we do, in fact, get lower corporate tax rates and a restructuring (or outright repeal) of the Affordable Care Act.

Residential housing and auto sales continue to do well in an environment where interest rates have risen. There may be one final push for home refinancing or a trip to the car dealership in an attempt to get a lower rate while it's still available. Soaring consumer sentiment numbers (the University of Michigan consumer sentiment number was 98.2 – the highest level since 2004) should also contribute to larger purchases by households such as vehicles, housing and other consumer durables.

In summary, we would not rule out some sort of short term pull back in equity markets. In the longer term we are encouraged by the pro-growth stance of the incoming U.S. administration and by the optimism shown by consumers and businesses. We anticipate this optimism equates to a higher interest rate environment, a higher level of inflation, and a continuation of the secular bull market.



Investment Team

Joseph J. Depascale, CPA, CFP®, AIFA®, CMFS - *President*
depascalej@farmerstrustco.com - 330.740.1222

David A. Dastoli, CFA, CFP® - *Senior Vice President*
dastolid@farmerstrustco.com - 330.740.1231

Todd P. Finn, CFA - *Trust Investment Officer*
finnt@farmerstrustco.com - 330.740.1213

John D. Stewart, CFA - *Vice President*
stewartj@farmerstrustco.com - 330.740.1208

John P. Zimomra - *Vice President*
zimomraj@farmerstrustco.com - 330.609.8306

Dale Standley - *Vice President*
standleyd@farmerstrustco.com - 330.740.1207

www.farmerstrustco.com