FARMERS TRUST COMPANY

Market Update and Outlook for First Quarter 2018

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 anticipate further upward pressure on interest rates, inflation, and commodity prices in 2018.
- We are likely to see the U.S. economy continue to accelerate this year; however, equity markets may have already priced in a substantial portion of the benefits from tax cuts and other pro-growth policies.
- Tax reform in the U.S. is likely to give an edge to domestic equities over international equities and small cap stocks over large cap stocks in the coming year.

Market Recap and Outlook Fourth Quarter 2017

MARKET SCORECARD to 12/31/2017	TOTAL RETURN IN USD	
	Q4	2017 TR
DOW JONES IND AVG	10.95%	28.07%
S&P 500	6.63%	21.80%
NASDAQ	6.57%	29.71%
MSCI EAFE EQUITY (GROSS)	4.27%	25.62%
RUSSELL 2000 INDEX	3.34%	14.65%
MSCI EMERGING MARKET EQUITY (GROSS)	7.50%	37.75%
BARCLAYS INTERM. TREASURY	-0.41%	1.14%
BARCLAYS INTERM. GOVT/CREDIT	-0.20%	2.14%
BARCLAYS 5 YEAR MUNI INDEX	-0.70%	3.14%
BARCLAYS HIGH YIELD CORP INDEX	0.47%	7.50%
ishares S&P GSCI COMMODITY TR INDEX	9.90%	5.77%

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

Market Recap

Equity markets across the globe had an impressive year in 2017. The S&P 500 finished the year with a 21.80% total return while the NASDAQ Composite Index managed a gain of 29.71%. Large cap growth stocks outperformed value stocks by a wide margin (30.21% vs. 13.66%). Small cap stocks underperformed large cap stocks with the Russell 2000 returning 14.65% for the year. International equites performed well in 2017 with the MSCI EAFE index up 25.62%. Commodities experienced a 5.77% gain for the year, and bonds, as measured by the Barclays Intermediate Govt./Credit Bond Index, produced a 2.14% total return. Municipal bonds posted a 3.14% total return for 2017 as represented by the Barclays 5 Year Municipal Bond Index.

Investment Outlook

The holiday season brought the financial markets an early present in the form of tax relief for many middle-class Americans and businesses (especially small businesses). A pro-growth, pro-business climate seems intact for 2018 and the tax reform package that was passed in December should produce positive tailwinds for the financial markets in the new year. Continued deregulation of certain sectors of the economy, like the financial and energy sectors, will also contribute to further acceleration of the U.S. economy. We would anticipate that corporate earnings will continue to improve on the heels of the recent changes to the tax code, but this has been widely forecasted and is likely fully priced into current equity valuations. Another positive side effect of the new tax law is that corporations will have additional resources to invest in capital stock and to hire additional workers (or retain workers with additional compensation or financial benefits). Wage inflation seems likely in this scenario. In addition to wage inflation, the prices of consumer goods and services are likely to increase in 2018. This is an environment that should also be conducive to upside in commodity prices. To combat inflationary pressures of all kinds, the Federal Reserve is predicted to continue to raise short term interest rates (Fed Funds rate) in 2018, albeit in a gradual manner and dependent on further positive economic data.

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Global Macroeconomic Review and Outlook

U.S. economic growth accelerated in the second half of 2017. Real GDP had two consecutive quarters (2nd and 3rd quarters of 2017) of +3% growth, while the 4th quarter is likely to exceed that rate of growth once official data are reported. The headline unemployment rate finished the year at 4.1% and inflation has been at or near the Federal Reserve target rate of 2% (2.2% versus the previous year as of December, 2017). We have recently seen the highest Consumer Confidence numbers in decades, which reached a 17-year high in the month of November, 2017. We appear to be in a "Goldilocks" scenario regarding the U.S. economy. The Federal Reserve is starting to see the growth and inflation they have been craving, while prices remain relatively calm. This environment allows the Federal Reserve to be flexible with monetary policy, and we forecast a continuation of their "slow and steady" rate hikes in 2018. Worldwide economic growth is likely to accelerate as well, although more modestly than the U.S. economy in our opinion. In summary, 2017 was a banner year for most financial assets. We expect the recent changes to the U.S. tax laws to be a positive catalyst for financial markets in 2018 in the U.S. and around the globe. Smaller companies may benefit proportionally more from tax reform, and we have expanded our participation in that area. While accelerating growth in economies around the world will presumably create inflationary pressures, the issue of rising prices is a positive and healthy sign that true economic growth has returned. As such, we are positioning our clients for higher interest rates, more inflation and continued economic growth in the coming year. One caveat to this strategy is the assumption that countries around the world follow the U.S. lead in a gradual withdrawal of monetary stimulus. Some foreign markets may not be ready for a synchronized global tightening by worldwide central banks; therefore, we prefer domestic large cap stocks over developed international stocks in 2018. Another threat to our positive outlook would be simultaneously experiencing the negative effects of inflation while real GDP growth slows from current levels (stagflation).

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