FIRST CITIZENS
INVESTMENT & TRUST SERVICES

Investment and Trust Services
731-287-4247
www.FirstCNB.com

OUTLOOKS

March 2018

ECONOMIC OUTLOOK

Summary

On the last day of February, the Bureau of Economic Analysis released their first revision to the fourth quarter 2017 GDP report. Any hopes that it would be revised upward and add to the second and third quarters' streak of a 3%+ growth rate were dashed by a small revision downward. Despite strong measures of personal consumption, fueled by modest income gains and the extension of credit, there were enough detractors in industrial production, capital investment and international trade to temper the overall measure of economic health.

Nearing the mid-point of this year's first quarter, we continue to see mixed economic data and reductions in the overall estimates for growth. One of the overwhelming signs of strength is the labor market. New filings for unemployment claims continue to hover near levels last seen in the early 1970s, when the U.S. population was only about 60% of today's size. Payrolls are expected to have expanded by about 200,000 jobs in February which would match the strength seen in January. The unemployment rate has been at 4.1% for months and may actually drop below 4% for the first time since December of 2000. Still, productivity gains have been low, industrial production flat and sales in key sectors such as autos and new homes have plateaued. The Atlanta Fed's GDP forecasting model was expecting growth about 4% for the current quarter, but that estimate has now dropped below 3%.

While still digesting the positive economic impacts from tax reform, regulatory relief and the possibility of a federal infrastructure program, the Trump administration threw a curve ball to economists, forecasters and business owners alike with the announcement of tariffs on imported steel (25%) and aluminum (10%). Trade protectionism is negative for economic growth. It introduces unpredictable retaliatory actions by both friendly and hostile trading partners. This uncertainty rightly leads to increasing volatility for the financial markets. We should all expect more of this as even Canada, Mexico, the European Union and other Western-leaning trading partners announce targeted tariffs on U.S.-made products imported into their countries. An escalation of a trade war would likely make any outlook for the economy clear as mud.

Positives

- Labor market continues to exhibit robust strength
- ISM non-manufacturing index beats expectations
- Small business optimism near historic highs
- Personal income increases to about 4% year-over-year for the past few months

Negatives

- New home sales drop to 593K versus 643K expected with a shortage of supply
- Auto and truck sales decrease to 16.96 million versus 17.2 million expected

Unknowns

- Tariffs and the possibility of trade wars could derail business optimism
- Design and implementation of an infrastructure program
- Fed's reaction if inflationary pressures pick up

Copyright 2018 by FCI Advisors. This material has been prepared for information purposes only. Factual materials obtained from sources believed to be reliable but cannot be guaranteed.

FIRST CITIZENS
INVESTMENT & TRUST SERVICES

Investment and Trust Services
731-287-4247
www.FirstCNB.com

OUTLOOKS

March 2018

EQUITY OUTLOOK

Summary

The impressive streak of 15 consecutive monthly gains for the S&P 500 ended after posting a 3.7% decline in February. The index soared 5.7% the previous month as investors expressed exuberance over the impact from recently passed tax cuts. In the first week of February, attention quickly turned to the fact that the surging U.S. economy may soon become overheated. Comments from the Federal Reserve about pending inflation fueled concern that the Fed may be forced to hike interest rates more aggressively than previously forecasted. The reaction sparked a spike in volatility. Global stock markets stabilized and recovered somewhat in the latter half of the month, but investors were reminded that the benefits of owning equities over the long-term also come with potential for significant volatility at times.

Growth stocks held up better in last month's decline with the Russell 1000 Growth falling just 2.6% versus a 4.8% loss in the Russell 1000 Value. In fact, the growth-laden technology sector was the only of the 11 economic sectors to end January in positive territory (+0.1%). Middle and small sized U.S. companies were slightly weaker than their large cap peers. The Russell Mid Cap Index fell 4.1% and the Russell 2000 Index dipped 3.9%. Developed international and emerging markets stocks offered no refuge during the downturn. The MSCI EAFE index and MSCI Emerging Markets Index declined 4.5% and 4.6%, respectively.

We believe that volatility is likely to remain elevated or at least elevated relative to recent history. We have experienced several quarters of low volatility, a moderate increase in volatility would be considered a return to normal. In spite of increasing volatility, solid and in many cases improving economic fundamentals create a fertile environment for corporate America. We see a gradual increase in interest rates as generally healthy for the economy and don't currently forecast an overtightening by the Fed. Our outlook for the equity markets for the long-term remains constructive.

Domestic and foreign equity markets often show high positive correlations over shorter periods of time as illustrated during the recent market pullback. However, we still believe the growth prospects, valuation levels and currency momentum provide a favorable backdrop for international equity outperformance in the intermediate term.

Positives

- Synchronized global expansion
- Corporate earnings growth

Negatives

- Rising volatility
- Potential for accelerated Fed rate hikes
- Rising interest rates

Copyright 2018 by FCI Advisors. This material has been prepared for information purposes only. Factual materials obtained from sources believed to be reliable but cannot be guaranteed.

FIRST CITIZENS
INVESTMENT & TRUST SERVICES

Investment and Trust Services
731-287-4247
www.FirstCNB.com

OUTLOOKS

March 2018

FIXED INCOME OUTLOOK

Summary

For much of the past year and a half, U.S. Treasury bond yields have been positively correlated with equity prices. As stock prices generally increased, yields have generally increased. The backdrop of better economic data, business optimism, tax reform and some modest inflationary pressures has been good for equity markets and bond yields alike. Bond prices, on the other hand, have been negatively correlated as they have been declining as equity prices increased. This trade-off is one of the great benefits of diversification as not all asset classes perform well at the same time. It works well, until it doesn't.

At some point rising interest rates become competition to other investment classes and then the environment that causes interest rates to rise becomes bad for other asset classes. That tipping point might have been reached in February as the 2-year Treasury yield marched from 2.14% to 2.27% before ending the month at 2.25%. The 10-year increased 25 basis points (bps) to hit 2.95% before ending the month at 2.86%. Overall bonds delivered negative returns across the entire yield curve and across all sectors. Corporate bonds were the stalwart of the fixed income market with spreads declining for most of the past two years, but even that trend ended in February. This happened at the same time as the streak of positive monthly equity market returns came to an end.

The good news is that the bulk of the increase in the term structure for interest rates is likely behind us. Interest rates will likely grind only modestly higher as the Fed continues on their path to normalize monetary policy by increasing the overnight rate and slowly reducing balance sheet purchases. Considering that the 10-year Treasury note yield has more than doubled since the summer of 2016, we believe another 25 bps or so will be digested easily by fixed income investors. Additionally, the incremental yield on corporate bonds seems fairly priced at 90-100 bps for the investment-grade universe in aggregate. It has been a rough six months in particular, but the future looks much brighter with yields higher and spreads wider.

Positives

U.S. rates still look attractive compared to other countries around the world

Higher yields are already compensating longer-term investors for anticipated overnight rate hikes

Credit spreads are attractive given solid credit fundamentals, tax reform and cash repatriation

Negatives

Tax cuts and an infrastructure bill will increase Treasury borrowing

More bonds need to be absorbed by the market as the Fed shrinks balance sheet

Inflationary pressures could reemerge,
especially if trade wars flare

Unknowns

The Federal Reserve's Open Market Committee (FOMC) is likely to remain on a steady path under Chairman Powell

Appetite of foreign owners of Treasury debt to increase purchases

Copyright 2018 by FCI Advisors. This material has been prepared for information purposes only. Factual materials obtained from sources believed to be reliable but cannot be guaranteed.