FLAGSTONE

FINANCIAL ADVISORS, INC.

MARKET REVIEW
FIRST QUARTER 2017

What Happened:
In March 2017, the bull market reached its eighth year without a major meltdown. We had several minor corrections along the way—and one not so minor correction of 19% in 2011—but nothing topping the 20% threshold that would signal the end of the bull and the start of a new bear market. While eight years is not a record, it is certainly longer than average. As we ponder what's ahead for the markets, it is important to sift through the plethora of media reports—often dire—to differentiate between news and circumstances that may be impactful to the markets, and those that will not. Let's take a closer look.

Corporate earnings are the single largest driver of stock prices. First quarter earnings are expected to grow by almost 10% on a year-over-year basis, which is a positive for investors and the markets. What's more, it would mark the third consecutive quarter of growth. You may recall that we had declining earnings for five consecutive quarters leading into the second half of 2016, which contributed to the market's lackluster returns over that period.

The new administration and the Republican majority in Congress have promised a pro-growth platform and a significant overhaul to the tax code. The market has responded favorably since the election in expectation of these changes. However, if this initiative is stalled or diminished significantly, the market will likely be adversely impacted.

The Federal Reserve is expected to gradually increase interest rates in 2017. Stock prices already reflect this expectation. If, however, the Fed's plan changes, stock prices may be affected upward or downward, depending on the change.

Market valuations appear high, or at least fully valued, based on metrics like price/earnings ratios. While high stock prices can contribute to occasional minor corrections in the 5%-10% range, significant declines of 20% or more are usually reserved for economic recessions and there is no recession in sight. Market tops are also accompanied by a euphoric influx of individual investors, but there is no euphoric mood or mass influx of investors presently. What we should expect, however, is more muted returns in light of elevated stock valuations.

First Quarter Performance:

S&P 500 Index (large stocks)	6.07%
Russell 2000 Index (small stocks)	2.47%
MSCI EAFE Index (international stocks)	7.25%
Barclays U.S. Aggregate Bond Index (bonds)	0.82%

Prognosis:
Looking forward, there is nothing to suggest that this bull market will keel over any time soon. As we like to remind our clients, however, small corrections, or occasional pauses should be expected. We will diligently monitor pertinent economic indicators that could have an impact on the markets. For now, the positive indicators are in control.

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