First National Bank

2017 OUTLOOK

First National Bank

FIRST NATIONAL BANK WEALTH MANAGEMENT

2017 OUTLOOK – A YEAR OF TRANSITION

How We Manage for the Cause and Effect

Sir Isaac Newton is widely regarded as one of the most influential scientists of all time for his famous "Laws of Motion". We use these laws to help tell a story about where we have been and where we see the world going.

1st Law: "An Object at Rest Stays at Rest"

Objects maintain their natural tendency to remain doing what they have been doing. We have been living in a world of slow and stagnant growth with limited change in U.S. and global economic policy over the past few years.

2nd Law: "Acceleration is Produced When a Force Acts on a Mass"

Acceleration is but a function of force and mass. In order to move a mass as big as the global economy, it will take a huge force. That force appears to be the inclusion of fiscal stimulus, deregulation, and tax cuts to an already accommodative monetary policy.

3rd Law: "Every Action has an Equal and Opposite Reaction"

As new policies begin to make an impact, we see a transition to higher interest rates, inflation, and global economic growth.

What does this mean for you? Our 2017 Outlook will provide guidance on the major topics of this changing investment landscape. We elaborate on many implications of this transition and expand upon how we are positioning portfolios to take advantage of them.

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ECONOMIC OUTLOOK

Will U.S. economic growth accelerate in 2017?

We believe the economic outlook is improving and expect 2.5% growth this year.

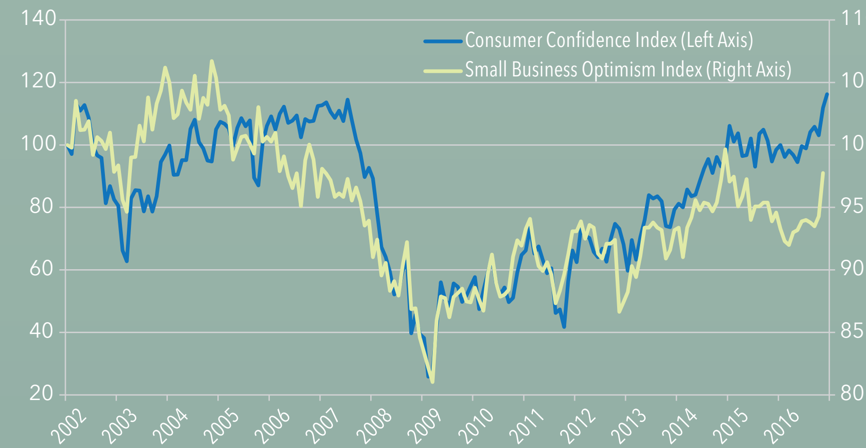
- Personal consumption is the most important element in the U.S. economy and is likely to stay strong. The consumer appears willing and able to continue spending with confidence at its highest level in 15 years.(1) Moreover, the unemployment rate is at a nine year low and wages are rising.(2) In our opinion, personal consumption should continue to lead the U.S. economy.
- As illustrated, small business leaders are growing more optimistic. We anticipate that business spending on new plants, machinery, inventory and equipment is likely to be a mild tailwind in 2017. This spending is an important ingredient for the economy because it expands the economy's capacity for future growth.
- We may see a government stimulus package and believe the transition from monetary stimulus to fiscal stimulus could be a positive influence in 2017.

What is the risk of recession?

Recessions typically occur from excesses building in the economy or from overly restrictive monetary policy. Neither is likely in 2017.

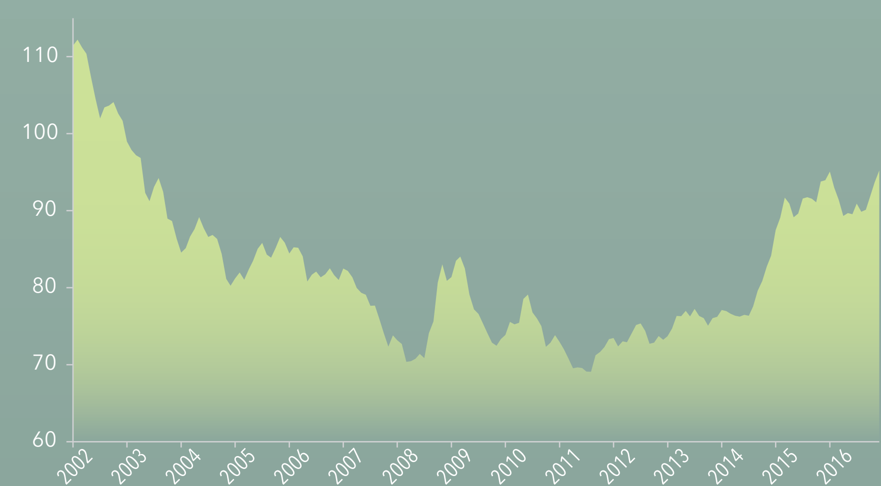
- The current economic expansion is considerably longer than average. As such, some investors feel the U.S. economy is due for a contraction. One of the benefits from the sluggishness of this recovery, however, is that we may end up with the longest expansion in history.
- One risk to economic growth would be a disorderly rise in the U.S. dollar. As shown, the U.S. dollar has strengthened over 10% in the last two years, weighing on the U.S. economy and earnings of multinational companies. It could also create problems in the global economy, especially in emerging markets.
- An additional risk would be a sharp rise in interest rates, which could negatively impact several areas of the economy. Specifically, it could slow the housing market, business investment, and would likely weight on consumer sentiment.

Economic Confidence



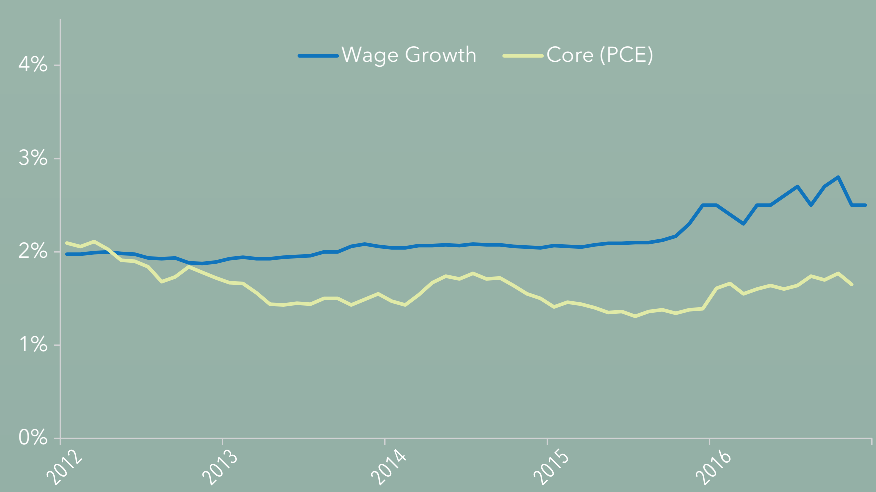
Source: Bloomberg data as of 01/03/2017

U.S. Dollar - Traded Weighted Index



Source: Federal Reserve (Bloomberg) As of 12/31/2016

Inflation and Wage Growth



Source: Bloomberg data as of 01/03/2017

Most Important Small Business Problem

Source: Goldman Sachs November 2016

Are you concerned about inflation?

We anticipate a modest acceleration in inflation, but not to a problematic level.

- Current readings of inflation expectations, while rising, are still within an acceptable range. The Fed appears ready and willing to adjust monetary policy as needed and raised rates last December. They have signaled three more hikes in 2017, which should keep inflation pressures contained.
- Rising wages are the biggest driver of domestic core inflation. As illustrated, wage growth has increased, but remains at fairly low levels. We will continue to monitor wages and the impact of the declining unemployment rate.

What is the economic impact of a Trump administration?

President-elect Trump's business background and unconventional economic platform adds uncertainty to the outlook.[3]

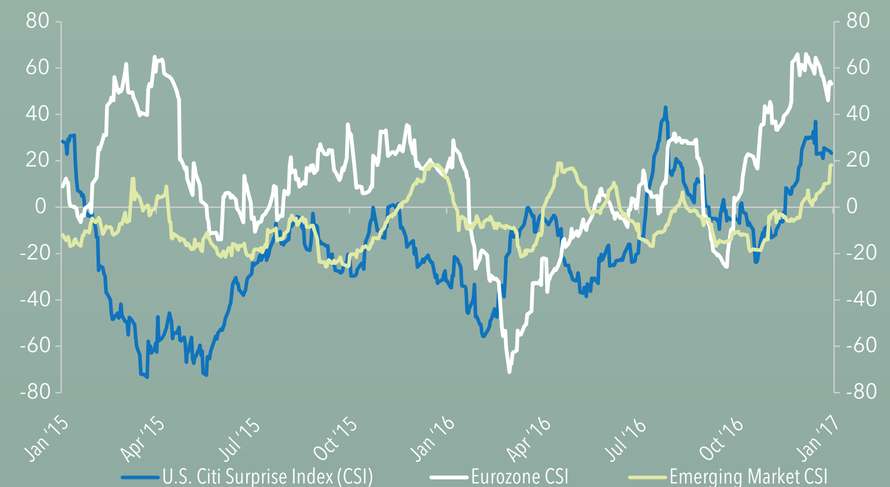
- Business leaders consistently cite excessive regulation and taxes as impediments to growth, as depicted in the chart. The likelihood that tax and regulatory reform will be a priority for the new administration is positive for growth. Moreover, President-elect Trump supports increased infrastructure spending and many of his appointees appear to be business friendly. The combination of these factors could be positive for the U.S. economy.
- In contrast, Trump's immigration and trade ideologies are not a pathway to growth and could hinder economic output. The worst case scenario is new or renegotiated trade deals that could create a trade war, severely inhibiting the global economy.
- The timing of the proposed changes, both positive and negative, is an important consideration as some policies may not be implemented in 2017 and may be more impactful in coming years.

Will the global economy rebound?

After five years of slowing growth, we expect a modest improvement in global economic activity.

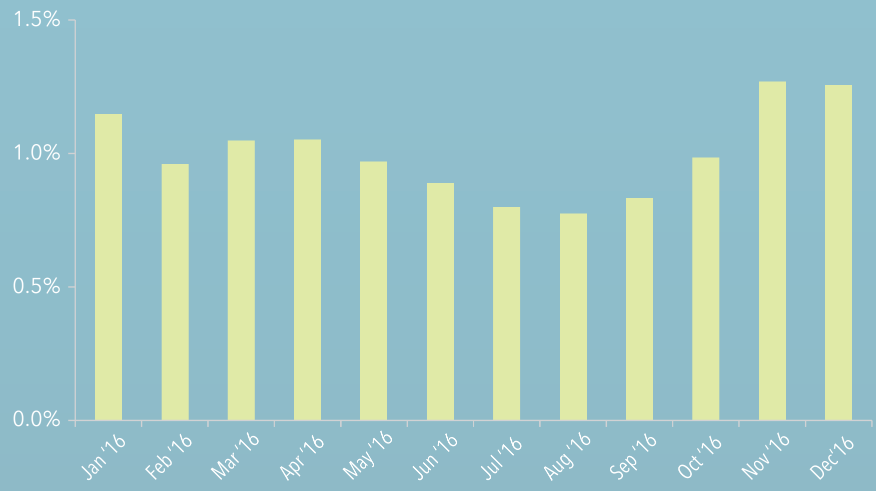
- As noted in the Citi Economic Surprise Index, economic data releases have been stronger than expected over the last year and the rate of positive surprise has made strides over the last two years. A primary source of strength is the improved outlook for growth in the U.S., the world's largest economy. Recent emerging market releases have also been positive with Brazil and Russia expected to rebound from their commodity driven recessions.
- The second largest economy, China, is decelerating as it rebalances toward a consumer-oriented economy. China has $3 trillion in reserves, which should enable them to counterbalance near-term risks and avoid a hard landing.[2]
- As we enter 2017, growth in Europe and Japan looks to be improving. We question the sustainability in Europe due to political uncertainty related to Brexit, the euro and European Union. Meanwhile, demographic headwinds will continue to limit upside potential in Japan.

Citi Economic Surprise Indices



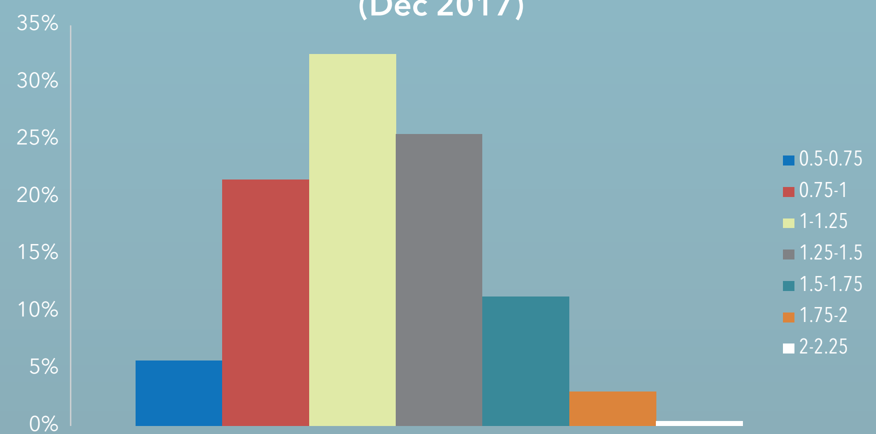
Source: Bloomberg data as of 12/31/2016

Term Premium: 10-Year minus 2-Year Treasury Yield



Source: Bloomberg Indices As of 12/31/2016

Fed Funds Rate Forecast (Dec 2017)



Source: Bloomberg data as of 12/31/2016

What economic implications are signaled by the bond market?

An expectation of higher inflation, interest rates, and growth are reflected in the yield and credit curves.

- In the 4th quarter 2016, the yield curve steepened on a higher inflation outlook. An analysis of the term premium chart shows that 2-year Treasury rates increased just 0.1% during the course of the year, while 10-year rates added 0.3%. The biggest change is that the market is now pricing in 2.0% inflation versus 1.6% a year ago.[1]
- High quality bonds most sensitive to interest rates declined in value during the 4th quarter 2016 as interest rates rose. At the same time, low quality assets gained in value compressing the yield differential.[1] The narrow credit spreads are indicative of projected economic growth.

How many rate hikes will there be in 2017?

We expect 2-3 increases of 0.25% each to the Fed Funds rate.

- The U.S. unemployment rate and core inflation rates are making progress toward the Fed's long-term targets.[4] The positive economic momentum and possible boost from fiscal spending are creating a backdrop for additional rate hikes. The histogram shows the futures market pricing in rate hikes in line with the Federal Reserve forecast.[4]
- The Fed is likely to remain accommodative in monetary policy making more than four rate hikes unlikely. More aggressive moves could result in economic consequences like U.S. dollar strength or a recession.

What is your end of year forecast for 10-Year Treasury Notes?

We could build a case for lower or higher yields and expect 2.5 – 3.0% as a likely outcome.

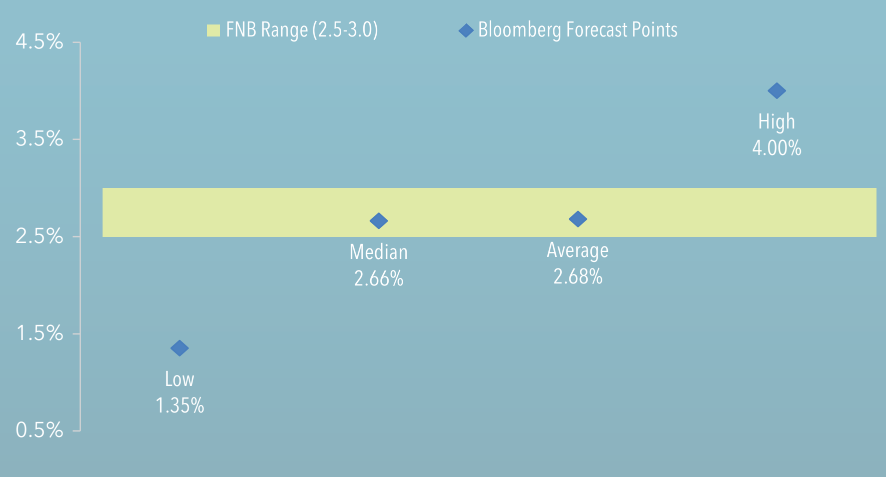
- As illustrated, there is a wide dispersion of rate forecasts which demonstrates the difficulty in predicting yields. Since the last recession, most economists have been wrong in their prediction of higher interest rates. Lower interest rates could result if approximately 2% inflation doesn't materialize or global growth again disappoints.
- Inflation, a basic component of rates, may be higher than anticipated due to an overheated economy or higher import costs from trade restrictions.[8] Excessive inflation or a decrease in foreign demand for U.S. bonds could drive interest rates higher than 3%.

What is the outlook in global fixed income?

We expect limited returns in global bonds due to low yields, especially in developed markets.

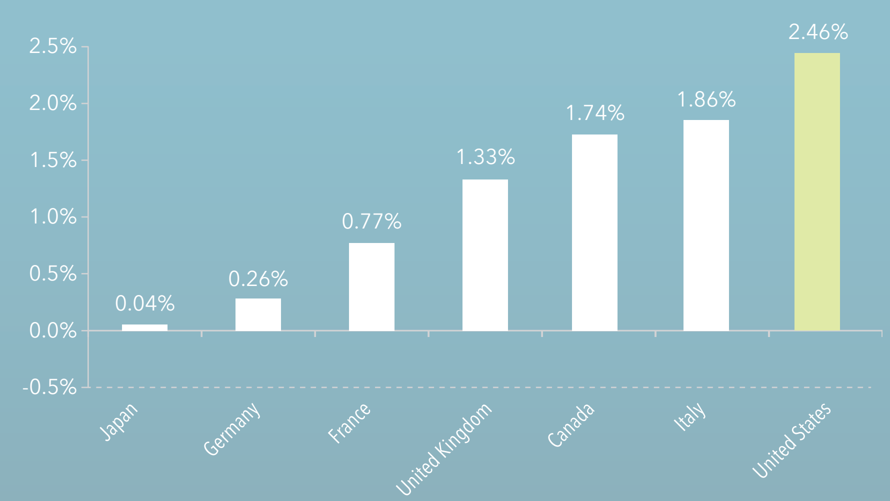
- As shown in the chart, the U.S. has the highest rates of the G-7. The relatively high yield of U.S. Treasuries drew an additional $586 billion of foreign investments to the U.S. bond market from January to September 2016, bringing ownership to over $10 trillion.[5] This has contributed to keeping U.S. interest rates below 3%.
- Negative central bank interest rate policies abroad have sparked debate as to their effectiveness. Most economists agree it has weighed on their respective banking sectors.[6] As a result, global central banks may take measures toward normalizing their rates in 2017.[7] If yields rise in other countries, U.S. interest rates could lift to a similar degree.

10-Year Treasury Projections (Dec 2017)



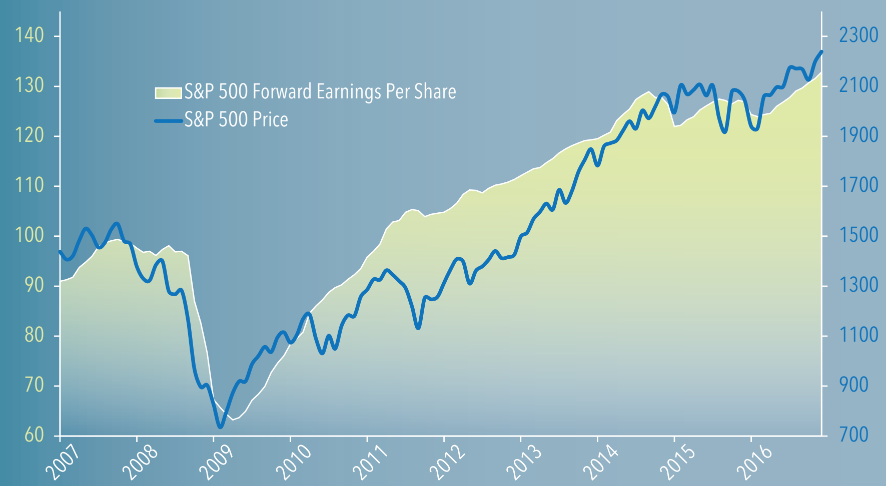
Source: Bloomberg data as of 12/30/2016

Global 10-Year Government Bond Yields



Source: Bloomberg as of 01/03/2017

Stock Price and Earnings Outlook



Source: FactSet Research Systems As of 12/31/2016

Will the bull market continue?

We expect global equities to return 6 – 8%.

- The key to our forecast is a resumption of sales and earnings growth. As illustrated, there is a strong correlation between expected earnings and market returns. We believe U.S. economic growth will modestly accelerate from the 2% level. Over the last 30 years, there has been only one year, 2000, in which U.S. GDP growth exceeded 2% and the stock market declined.(1)
- Our conservative equity return estimate is due to moderately elevated valuations after strong returns last year. Market valuation is historically a poor short-term indicator of performance, but an important factor in forecasting long-term returns. The higher than average market valuation will likely result in below average stock returns over the next 10 years.

How much earnings growth is expected in 2017?

We believe 7–9% earnings growth is realistic.

- Analysts expect positive earnings growth in the 4th quarter 2016 and double-digit growth this year.(9) This seems overly optimistic at this point of the economy cycle, but an acceleration is likely.
- As illustrated in the table, profit growth is being led by the energy, basic materials, financials, and information technology sectors. Limited contributions to earnings growth are coming from utilities and telecommunication services. The strength of the U.S. dollar, if it continues, may also limit profitability growth in multinational companies.

Estimated EPS Growth

Sector	2016	2017
Energy	-77.0%	331.1%
Materials	-2.4%	14.5%
Financials	8.9%	11.3%
Information Technology	5.3%	11.2%
Consumer Discretionary	8.1%	9.2%
Health Care	7.0%	8.5%
Consumer Staples	5.6%	7.0%
Real Estate	NA	5.8%
Industrials	0.9%	4.2%
Telecom	-5.9%	4.0%
Utilities	5.2%	0.4%
S&P 1500	**0.6%**	**12.0%**

Source: FactSet Research Systems as of 12/31/2016

What is the current valuation level of the stock market?

By most measures, the stock market is trading at a premium compared to historical averages.

- Current trading levels reflect equity returns that were driven by higher valuations in 2016. A fair amount of this occurred after the presidential election as market sentiment moved from pessimistic to optimistic.
- One valuation statistic we evaluate is the next twelve months ("NTM") price-to-earnings ("P/E") ratio. As shown, all five areas are trading at a premium to their historical average. On a relative basis, international markets are trading at less of a premium and U.S. small-cap equities are the most expensive.

What scenario would lead to higher returns? What is the downside?

There is potential for positive and negative surprises to our forecast.

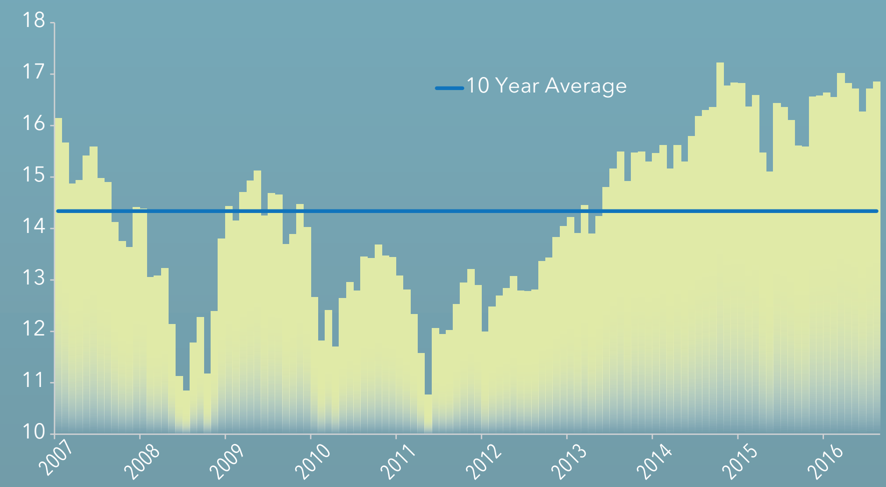
- This economic recovery has been sluggish with global macroeconomic factors holding markets back. The implementation of pro-growth policies from the Trump administration could be a catalyst for a euphoria driven market rally that could easily generate +10% returns. Corporate tax reform alone, for example, could add 4–8% in earnings growth.[8]
- Major concerns domestically include a spike in interest rates and further strengthening of the U.S. dollar. Internationally, we would cite European politics and their populist movement, along with the risk of a China hard landing. Ultimately, the downside risk is a growth scare or U.S. recession, which would potentially lead to a -10% correction.

Valuation by Asset Class

	NTM P/E	10 Yr Average	2016 Premium
S&P 500 Large Cap	16.9x	14.3x	17.7%
S&P 400 Mid Cap	18.6x	15.7x	18.4%
S&P 600 Small Cap	19.9x	16.1x	23.4%
International Developed	14.7x	12.9x	13.8%
International Emerging	11.8x	11.3x	4.0%

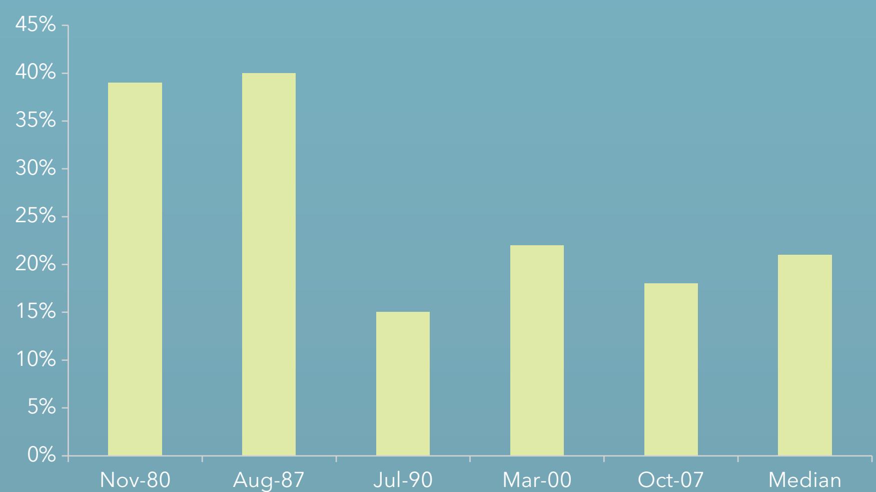
NTM P/E - Next Twelve Months Price-to-Earnings Ratio
Source: Standard & Poors (Large, Mid & Small), MSCI (International, Emerging), FactSet (calculation); as of 12/31/2016

S&P 500 Forward Price/Earnings Ratio



Source: FactSet Research Systems As of 12/31/2016

12 Month Return Preceding Market Peaks



Median 12 month return of S&P 500 prior to 12 market peaks since 1937.
Source: Bank of America, Merrill Lynch November 2016

Why stay invested as we enter the 8th year of the bull market?

The risk/reward potential of equities remains attractive. We believe valuations are reasonable considering the likely acceleration in the economy and low level of interest rates.

- History suggests that unless you can determine the market high within twelve months of the peak, you are better off staying invested. Over the last eighty years, the median return in the final year of the bull market was 21%.[8] The illustration depicts the twelve month return before the last five market peaks. Effectively, the opportunity cost of selling too early is high.

What is your recommended asset allocation?

We remain overweight equities and underweight fixed income and alternative investments ("alts").

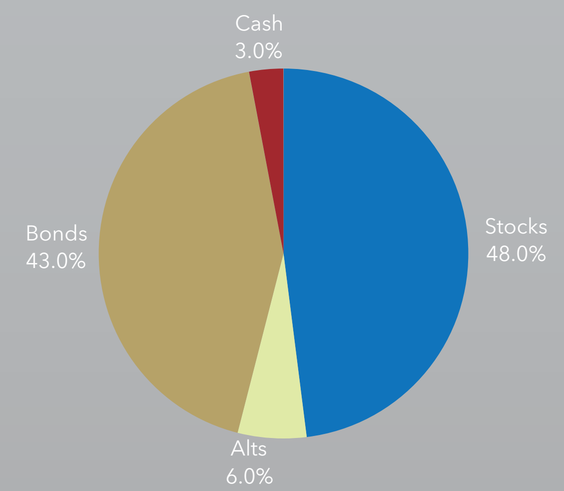
- We invest for clients in a range of investment objectives from all fixed income to all equity. The balanced objective has a midpoint allocation of 45% equities, 45% fixed income, 7% alts and 3% cash.
- We make tactical asset allocation decisions based on our economic and profit outlook, and the relative asset class valuations. The slight acceleration in the U.S. and global economy, and likely resumption of earnings growth favors a higher stock allocation. In addition, the potential for higher interest rates would limit bond returns. Our current allocation for the balanced objective is illustrated.

Why not a higher allocation to equities?

Equities are not as cheap relative to their history and other asset classes.

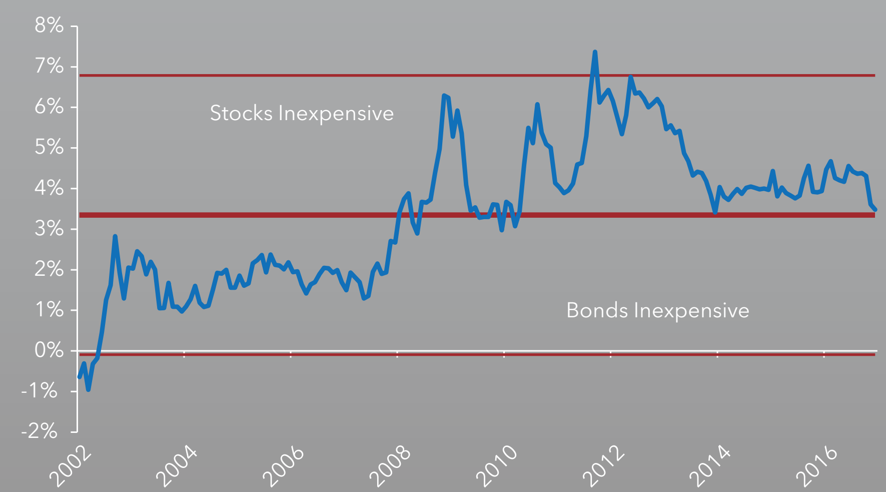
- The reason for not being more optimistic is that relative valuations to fixed income are now at average levels. As illustrated by the equity risk premium, the current 3.5% level is close to the 15-year average of 3.4%.[9] The relative attractiveness of equities has declined since 2011 when stocks were extremely attractive.
- Based on our return expectations, we believe a modest overweight allocation to equities is appropriate.

Balanced Objective Tactical Allocation

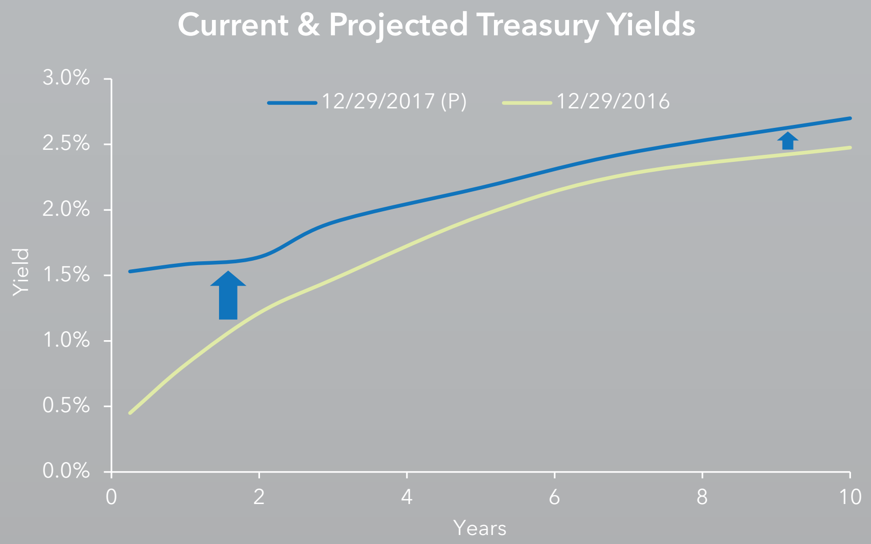


Source: Internal Calculation as of 12/31/2016

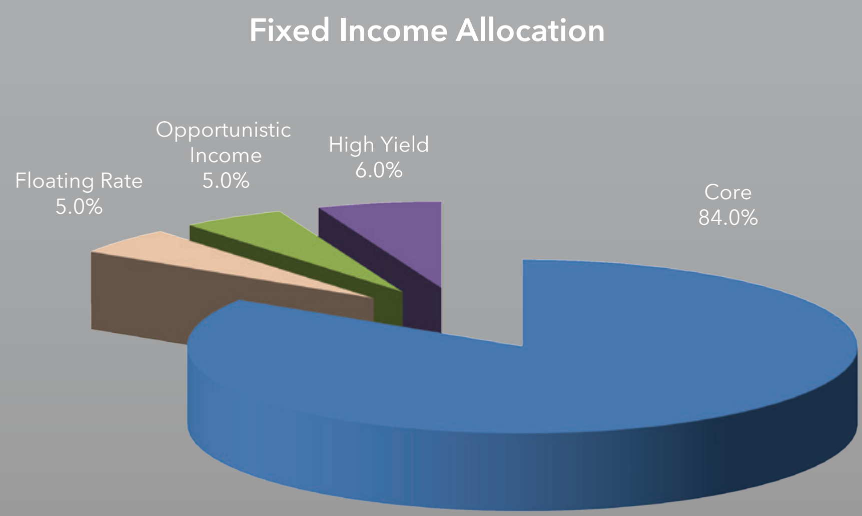
S&P 500 Equity Risk Premium



Source: Factset Research Systems. As of 12/31/2016



Source: Bloomberg as of 12/29/2016



Source: Internal Calculation as of 12/29/2016

If interest rates are expected to rise, is an allocation to bonds still advisable?

Yes, bonds offer diversification benefits and help stabilize portfolios. We believe our taxable bond strategy will return around 2% this year.

- A primary benefit is the positive performance of bonds during stock market downturns. Our taxable bond strategy produced a +3.5% return in 2008, for example.[10]
- Bonds also produce a steady source of income, buffering price declines when rates rise. Our portfolios are tactically positioned for rising rates. In 2013, the 10-year Treasury increased by over 1% and our taxable bond strategy produced positive returns.

What measures are in place to protect client bond portfolios from rising interest rates?

We implement a short to intermediate-term strategy, and make tactical maturity and sector decisions.

- We utilize a 1-10 year bond ladder to control interest rate risk. The core portion of our strategy has a 3.8 duration and weighted average maturity of 4.1 years.[11]
- The projected Treasury rate curve shows short-term rates rising more than long-term rates this year. This outlook leads us to emphasize the short and long ends of the maturity range. Investing in short-term bonds creates an opportunity for reinvesting at higher rates sooner. The longer duration bonds have higher yields due to the steep curve and may have less price movement if the yield curve flattens.
- Our 16% allocation to diversifying bond mutual funds is expected to positively contribute to returns in a rising rate environment. These sectors are more dependent on the strength of the economy and company fundamentals. In municipal bond portfolios, we hold a lower allocation to these funds, but are increasing it in light of our interest rate outlook.

What sectors of the bond market are the most opportunistic?

We believe floating rate and high income are attractive.

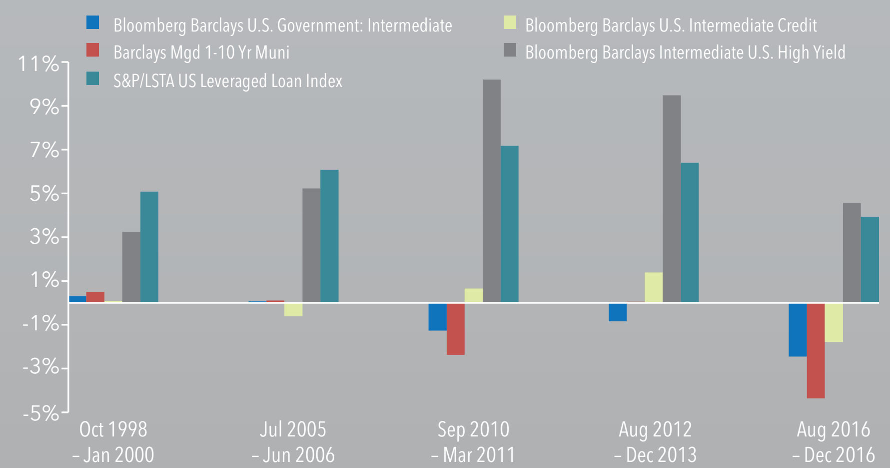
- As shown, intermediate-term bonds have some downside risk to rising rates. In contrast, other sectors perform better in this environment.(10) The increased likelihood of short-term rates rising creates a positive outlook for investing in bank loans that reset to market rates. With a 4.4% SEC yield as an added benefit, we have initiated a position to the Lord Abbett Floating Rate Fund.(12)
- The Palmer Square Income Plus Fund focuses on relative value opportunities in the fixed income universe. The fund has a 4.2% dividend yield while taking minimal interest rate risk. Its holdings include collateralized loan obligations, mortgage backed securities, asset-backed securities, bank loans and corporate bonds.(12) We are maintaining an allocation to the Palmer Square fund.

What are your thoughts on municipal bonds?

For clients interested in tax-exempt income, we believe municipal bonds are attractive.

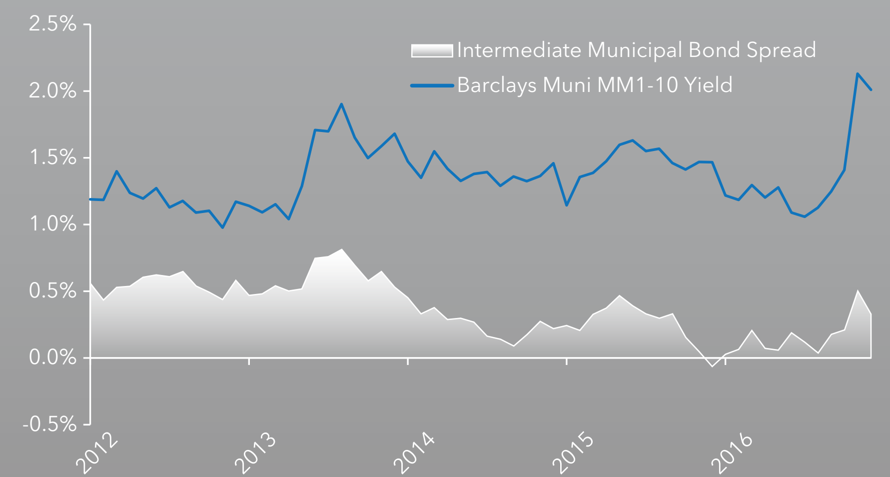
- Municipal bond yields have now improved relative to three year norms and are in line with the five year average, as illustrated. Their yields are currently higher than U.S. Treasuries.
- There is, however, uncertainty regarding potential changes to the tax code and higher levels of issuance to finance the proposed fiscal package.(8) High quality taxable municipal bonds are not exposed to the same degree of risk from the new administration and are also being issued at attractive yields. This is creating an opportunity for our taxable strategies.

Sector Returns In Rising Rate Environments



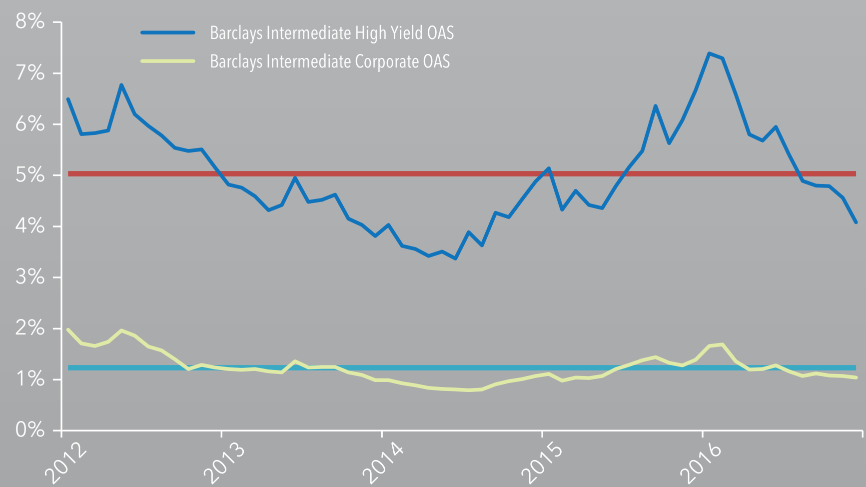
Source: Bloomberg Data as of 12/31/2016

Municipal Bond vs Treasury Yield



Source: Barclays Capital (Bloomberg), Bloomberg Indices As of 12/31/2016

High Yield & Investment Grade Spreads vs 5-Year Average



Source: Bloomberg as of 12/31/2016

What bond sectors have a neutral to positive outlook?

We see opportunities in investment grade corporate bonds and high yield. Their attractiveness however, is somewhat limited by valuations.

- Spreads for investment grade corporate bonds have dropped considerably over the last year as depicted in the graph. There is still approximately a 1% yield pickup relative to Treasury bonds. We continue to have an overweight allocation to high quality core bond issuers, where we have identified positive valuations and fundamentals.
- High yield was the top performing sector in 2016 bringing spreads below the historic average as shown. With commodities stabilizing and resilience in the economy, we believe the default rate will decline in 2017. We are maintaining our Federated High Yield Fund allocation, but may trim it if fundamentals deteriorate or the sector becomes even more expensive.

Where are you cautious in fixed income?

We have a low allocation to U.S. Treasuries and zero allocation to global bonds.

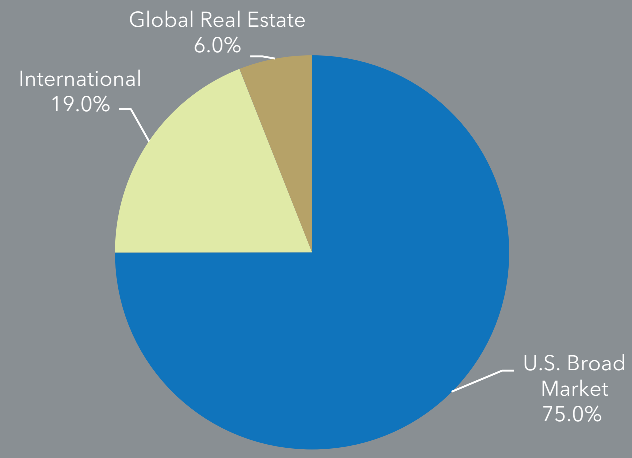
- While U.S. Treasuries provide the most protection against stock market declines, the sector is also the most sensitive to interest rate movements. We maintain a low allocation to Treasuries relative to the benchmark.
- Interest rates in developed international markets are lower than U.S. rates so we are avoiding this sector.[1] Emerging markets have more appealing spreads, but are vulnerable to U.S. dollar strength. We would consider an allocation to emerging debt when there are fewer economic uncertainties.

Switching to equities, how should investors diversify their stock portfolio?

We believe the long-term equity allocation should be 75% U.S. broad market, 19% international and 6% global real estate.

- The optimal allocation is based on extensive research, emphasizing a portfolio with the highest risk-adjusted returns. The analysis period covered returns and volatility since 1970. We created the diversified equity benchmark, which is used as the basis of our tactical decisions and to compare performance.
- The U.S equity index has large, mid and small-cap exposure and the international allocation includes developed and emerging markets. Relative to our peers, we advocate a higher exposure to U.S. equities and lower allocation to international equities.

Diversified Equity Benchmark



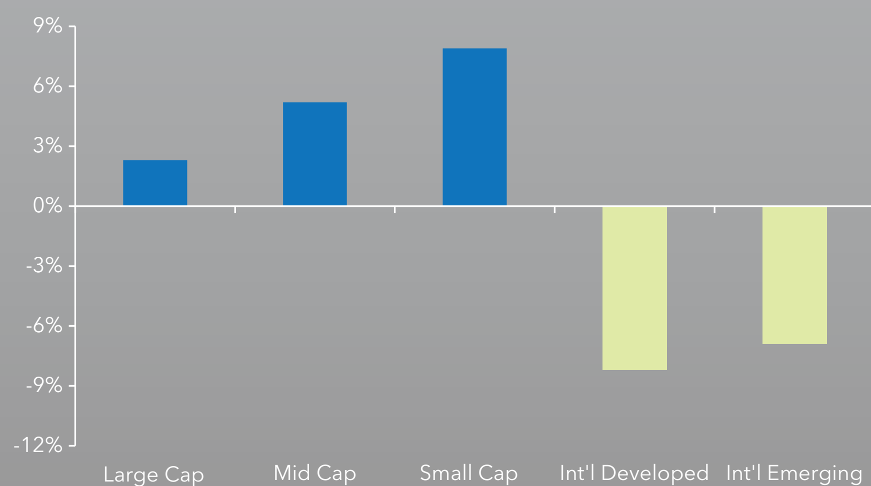
Source: Internal Calculation as of 12/31/2016

What areas of the stock market are the most opportunistic?

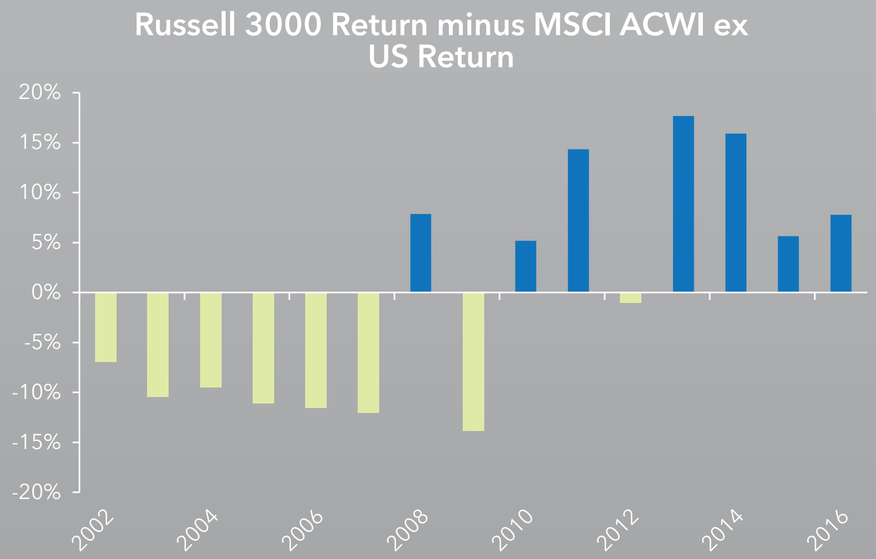
We continue to find U.S. small and mid-cap ("SMID") stocks attractive.

- We moved to an overweight position when SMID-cap stocks had a rising profit outlook and a relative valuation discount. With its recent outperformance, U.S. small-cap no longer trades at a discount to large-cap. We continue to like this area due to its higher revenues from the growing U.S. economy and less exposure to dollar strength. SMID-cap equities are also more insulated from the potential downside of global trade disputes.
- We continue to believe company fundamentals are attractive, especially the consistency of earnings growth. The chart shows that earnings growth over the last five years has been highest in small-cap followed by mid-cap. With continued U.S. economic growth, we anticipate solid earnings growth for SMID-cap stocks.

Average Earnings Growth - Last 5 Years



Source: FactSet Research Systems: 11/30/2016



Source: Bloomberg: 12/31/2016

Where are you cautious in equities?

We are underweight international equities and global real estate.

- Over the last five years, earnings have contracted by -8% on average in developed markets and -7% per year in emerging markets. Both international asset classes have not recovered from peak earnings in 2008.[9] As a result, international equities have significantly lagged the U.S. market over the last seven years, as illustrated.
- International equities typically outperform when the global economy accelerates and the U.S. dollar is weak. Analysts are expecting a resumption of earnings growth in 2017 based on an improving global economy.[9] We believe developed markets may be held back by European political risk, high debt, and poor demographics. We are more likely to add emerging markets if growth accelerates relative to developed countries.
- We continue to advocate a low exposure to global real estate based on high valuations and the negative impact higher interest rates can exert on the asset class.

What asset classes have a neutral to positive outlook?

We have a neutral allocation to U.S. large-caps.

- On the positive side, U.S. large-caps have a higher exposure to financials and energy than their smaller counterparts. An earnings rebound in these two sectors should help relative performance.
- The higher exposure to slower growing international developed countries and the strengthening U.S. dollar is a negative, along with the potential risk from trade wars.

Is there an opportunity in value or growth styles?

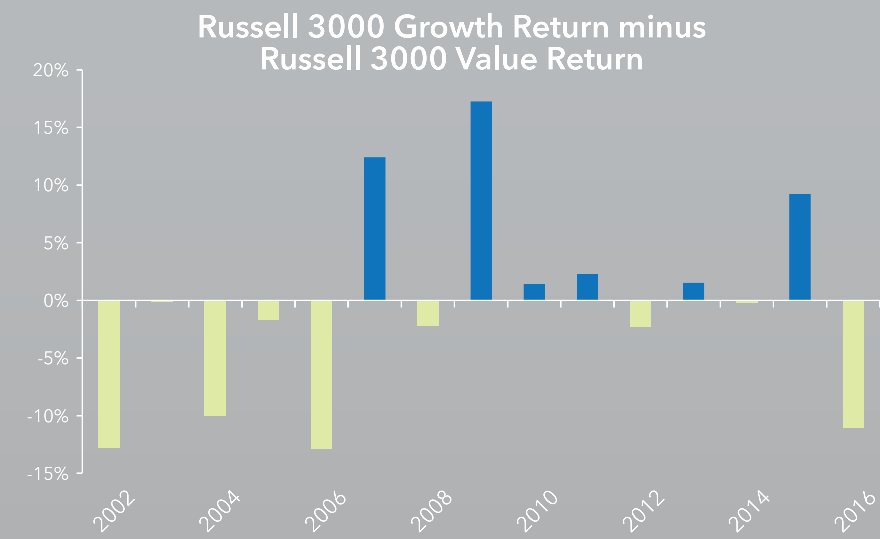
We have recently increased exposure to value and lowered our growth allocation.

- For nine cumulative years ending in 2015, growth investing outperformed value investing. This typically occurs in a sluggish economic environment where earnings growth is scarce. As illustrated, value indices reversed this trend in 2016.
- Improving global economic growth, Federal Reserve rate hikes, and modestly higher interest rates are likely to drive continued value leadership. The macro benefits are offset by attractive valuations in certain growth oriented sectors.

Are you finding opportunities at the sector and stock level?

Our equity team is taking advantage of market movements and implementing portfolio changes.

- In 2016, we experienced a violent sector rotation with the market rewarding companies with a high dividend yield in the first half of the year, and companies benefitting from a focus on cyclical industries in the second half. This volatility has created opportunities for active management.
- On a valuation basis, telecom, information technology and health care are trading at significant discounts to their 10-year history. The 88% energy P/E premium is misleading due to the negligible earnings with the sector trading at a discount on other measures.

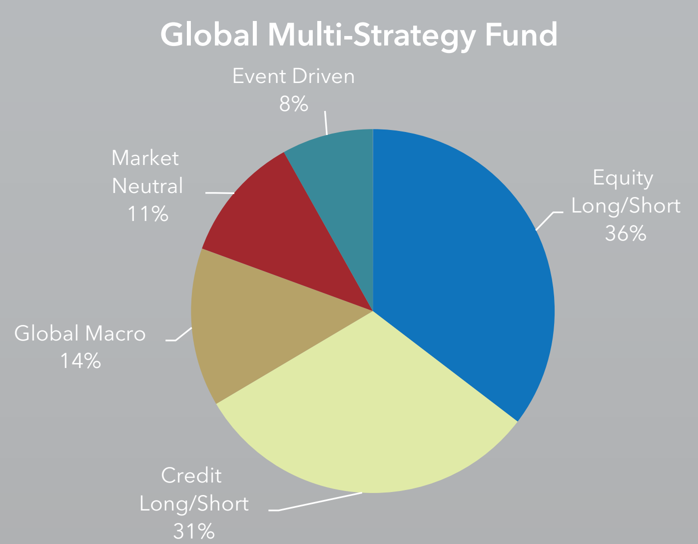


Source: Bloomberg: 12/31/2016

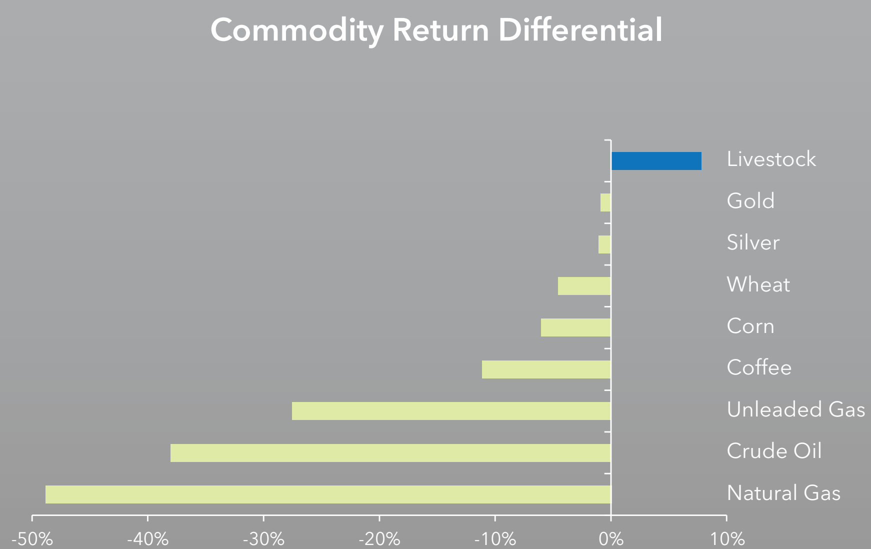
Sector Valuations

	NTM P/E	Premium/ Discount
Telecom	14.2	-18.8%
Information Technology	16.5	-17.7%
Health Care	14.7	-17.2%
Consumer Staples	19.3	-4.1%
Consumer Discretionary	17.9	-2.5%
Basic Materials	17.4	-1.2%
Industrials	18.1	0.5%
Real Estate	16.5	1.2%
Financials	14.3	1.2%
Utilities	17.4	3.3%
Energy	36.3	88.4%
S&P 1500	**17.1**	

Source: FactSet Research Systems as of 12/31/2016



Source: Principal Global Multi-Strategy and AQR Fact Sheets as of 09/30/2016



Source: Internal Calculation (Bloomberg). As of 12/31/2016

What do you recommend as an appropriate allocation to alternative investments (alts)?

We currently recommend 6% exposure to liquid alts.

- We implemented this allocation to strategically manage risk, while also striving to meet client return goals. This asset class has helped reduce portfolio risk, but returns have modestly disappointed. We expect higher returns in alts if the Federal Reserve increases rates.
- We hold the Principal Global Multi-Strategy Fund as our exposure in this area. This diversified strategy seeks to provide positive returns while reducing exposure to equity and fixed income risk. The asset class holdings of the fund are depicted.

With a higher inflation outlook, do you advocate any commodity exposure?

No, we advise a zero allocation to commodities as this asset class adds risk with limited expected returns.

- As the world leader in manufacturing, China imports commodities like steel, oil, iron and copper. The deceleration in the Chinese economy negatively impacts commodity demand and prices. The potential for a strong U.S. dollar could also put downward pressure on commodity prices.
- In addition, we are in a period where the spot price is lower than the futures price, so total returns on investments aren't tracking price movements well. The total return for commodity funds, for example, was up about half the amount of the spot price last year.(13) As shown, aside from livestock which suffered a supply imbalance, the performance gap is wide. This lowers the attractiveness of commodity investments.

THANK YOU

Our 2017 Outlook began with Isaac Newton's renowned Laws of Motion to help illustrate the transition to higher economic growth, inflation, and interest rates. This in-depth analysis of the economy, bonds, and stocks supports this perspective. We will continue to position your portfolios to take advantage of these changes, as well as protect against the unknown.

Your wealth team is never "at rest" when working to achieve your goals.

Thank you for your interest in this year's Outlook and for the trust you place in the Wealth Management Group at First National Bank.

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Unless otherwise stated, all data are as of December 31, 2016 or most recently available.

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PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS. Periods greater than one year are annualized except where indicated. Returns of the indexes also do not typically reflect the deduction of investment management fees, trading costs or other expenses. It is not possible to invest directly in an index. Indexes are the property of their respective owners, all rights reserved.

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Research reports often contain terminology and acronyms that are specific to the industry. The following definitions are provided to help navigate the terminology used in this report.

ALTERNATIVE INVESTMENTS: Alternative investments, or specifically liquid alternative investments (or liquid alts) are mutual funds or exchange-traded funds (ETFs) that aim to provide investors with diversification and downside protection through exposure to alternative investment strategies. These products' selling point is that they are liquid, meaning that they can be bought and sold daily, unlike traditional alternatives which offer monthly or quarterly liquidity. They come with lower minimum investments than the typical hedge fund and investors don't have to pass net worth or income requirements in order to invest.

ASSET ALLOCATION: An investment strategy that aims to balance risk and reward by apportioning a portfolio's assets according to an individual's goals, risk tolerance and investment horizon.

COLLATERALIZED LOAN OBLIGATIONS (CLO): A type of security backed by a pool of debt similar to mortgage backed securities. CLOs are backed by generally low-rated corporate loans.

COMMODITIES: Any good exchanged during commerce, which includes goods traded on a commodity exchange. Examples of commodities include corn, oil, gold, live cattle, and coffee.

CONSUMER AND BUSINESS CONFIDENCE (SENTIMENT): Consumer confidence is a measure of the level of optimism consumers have about the performance of the economy. Generally consumer confidence is high when the unemployment rate is low and GDP growth is strong.

Business confidence is a measure of the level of optimism businesses have about the performance of the economy. Generally business confidence is high when GDP growth is strong and business leaders feel good about the prospects of their companies.

CORPORATE BONDS: A debt security issued by a company. The backing for the bond is usually the payment ability of the company's earnings from future operations. In some cases, the company's physical assets may be used as collateral for bonds. Corporate bonds are considered higher risk than government bonds, thus interest rates are almost always higher.

CREDIT RISK: The risk of loss of principal stemming from a borrower's failure to repay a loan or otherwise meet a contractual obligation. Credit risk arises whenever a borrower is expecting to use future cash flows to pay a current debt. Investors are compensated for assuming credit risk by way of interest payments from the borrower or issuer of a debt obligation. Credit risk is closely tied to the potential return of an investment, the most notable being that the yields on bonds correlate strongly to their perceived credit risk.

DEVELOPED MARKETS: Nations that have met all of the following criteria: They are a high-income economy as defined by the World Bank having a Gross National Income per capita of $12,736; they have a formal market and regulatory environment, a stable & transparent financial system; and a broad depth to their markets.

DIVIDEND YIELD: A financial ratio that shows how much a company pays out in dividends each year relative to its share price. In the absence of any capital gains, the dividend yield is the return on investment for a stock. Dividend yield is calculated as follows: Annual Dividends Per Share divided by Price Per Share.

DURATION (MATURITY) RISK: A measure of the sensitivity of the price (the value of principal) of a fixed-income investment to an inverse change in interest rates. The longer period of time to maturity of a security, the more sensitive it is. Duration risk is associated with Interest Rate Risk and Reinvestment Risk.

EARNINGS (EPS) GROWTH: Percentage change in earnings per share (EPS) over an annualized period. EPS is the portion of a company's profit allocated to each outstanding share of common stock calculated as (Net Income – Dividends on Preferred) divided by average number of outstanding shares.

EMERGING MARKETS: Nations with social or business activity in the process of rapid growth and industrialization. Emerging markets generally do not have the level of market efficiency and strict standards in accounting and securities regulation to be on par with advanced economies (such as the United States, Europe and Japan), but emerging markets will typically have a physical financial infrastructure including banks, a stock exchange and a unified currency.

EQUITY: A stock or any other security representing an ownership interest. In terms of investment strategies, equity (stocks) is one of the principal asset classes. The other two are fixed-income (bonds) and cash/cash-equivalents. These are used in asset allocation planning to structure a desired risk and return profile for an investor's portfolio.

EQUITY RISK PREMIUM: The excess return that an asset or the overall market provides over a risk-free rate. This excess return compensates investors for taking on the relatively higher risk of the asset. The size of the premium will vary as the risk in a particular asset, or in the market as a whole, changes; higher-risk investments are compensated with a higher premium.

EUROZONE: A geographic and economic region that consists of all the European Union (EU) countries that have fully incorporated the Euro as their national currency. Participating in the Eurozone are: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain (19 of the 28 EU States). Other member states of the EU are: Bulgaria, Croatia, Czech Republic, Denmark, Hungary, Poland, Romania, Sweden, and the United Kingdom. (as of 1/1/2017)

FIXED INCOME: Any investment paying a fixed interest rate such as a money market account, a certificate of deposit, a bond, a note, or a preferred stock. A fixed investment is the opposite of a variable investment.

GROSS DOMESTIC PRODUCT (GDP): The total of goods and services produced by a nation over a given period, usually one year. Gross Domestic Product measures the total output from all the resources located in a country, wherever the owners of the resources live.

HIGH YIELD: A subset of corporate bonds characterized by having a rating below Investment Grade (below BBB- or Baa3) or no rating at all. High yield bonds typically have a significantly higher interest rate because of their historically higher default rates.

INFLATION: Increase in the overall level of prices over an extended period of time. Core inflation is most often calculated using the personal consumption expenditures (PCE), which eliminates products in the highly volatile energy and food sectors, and is preferred by the Fed.

INVESTMENT/CAPITAL SPENDING: Money spent on capital goods, or goods used in the production of capital, goods, or services. Investment spending may include purchases such as machinery, land, production inputs, or infrastructure. Investment spending should not be confused with investment, which refers to the purchase of financial instruments such as stocks, bonds, and derivatives.

LIQUIDITY: The degree of how easily an asset or security can be bought or sold in the market without significantly changing the price. Cash is the most liquid asset.

MARKET CAPITALIZATION (LARGE CAP, MID CAP SMALL CAP): Market capitalization is the total value of the tradable shares of a publicly traded company; it is equal to the share price times the number of shares outstanding. As outstanding stock is bought and sold in public markets, capitalization could be used as a proxy for the public opinion of a company's net worth and is a determining factor in some forms of stock valuation.

Large Cap > $17.4 billion
Mid Cap $3.5 - $17.4 billion
Small Cap < $3.5 billion

MONETARY POLICY: The actions of a central bank, currency board or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates. Monetary policy is maintained through actions such as increasing the interest rate, or changing the amount of money banks need to keep in the vault (bank reserves).

Related Fiscal Policy refers to the actions of a government in regards to the budget, spending, taxation, and borrowing.

MORTGAGE BACKED SECURITIES (MBS): A type of asset-backed security that is secured by a mortgage, or more commonly a collection ("pool") of hundreds of mortgages. The structure of the MBS is known as "pass-through", where the interest and principal payments from the borrower or homebuyer pass through it to the MBS holder. Other types of MBS include commercial mortgages (CMBS), collateralized mortgage obligations (CMOs, often structured as real estate mortgage investment conduits) and collateralized debt obligations (CDOs).

MUNICIPAL BONDS: A debt security issued by a state, county, or municipality to finance its capital expenditures. Municipal bonds can be exempt from federal, state, and local taxes, especially if you live in the state in which the bond is issued.

OPTION ADJUSTED SPREAD (OAS) OR SPREAD: Mainly used for fixed-income products, OAS measures the yield spread that is not directly attributable to the security's characteristics. This is a measurement tool for evaluating price differences between similar products with different embedded options (call/put, etc). A larger OAS implies a greater return for credit risk taken.

PERSONAL CONSUMPTION: Measure of data pertaining to spending on goods and services targeted toward individuals and consumed by individuals.

PRICE TO EARNINGS (P/E): Price-to-earnings is a ratio calculated by taking the current stock price and dividing it by the earnings per share.

- Historical P/E uses actual earnings data for the past 12 months.
- Forward P/E uses earnings estimates (forward earnings per share [EPS]) for the next four quarters.

RECESSION: A significant decline in activity across the economy, lasting longer than a few months. It is visible in industrial production, employment, real income and wholesale-retail trade. The technical indicator of a recession is two consecutive quarters of negative economic growth as measured by a country's gross domestic product (GDP).

REAL ECONOMIC GROWTH: A measure of economic growth from one period to another expressed as a percentage and adjusted for inflation (sc. expressed in "real terms").

REAL ESTATE INVESTMENT TRUST (REIT): A security that sells like a stock on the major exchanges and invests in real estate directly, either through properties or mortgages. REITs receive special tax considerations and typically offer investors high yields, as well as a highly liquid method of investing in real estate.

SEC YIELD: The SEC yield is a standard yield calculation developed by the U.S. Securities and Exchange Commission (SEC) that allows for fairer comparisons of bond funds. It is based on the most recent 30-day period covered by the fund's filings with the SEC. The yield figure reflects the dividends and interest earned during the period after the deduction of the fund's expenses. It is also referred to as the "standardized yield."

SPOT PRICE: A spot price is the current price in the marketplace at which a given asset such as a security, commodity or currency can be bought or sold for immediate delivery. In contrast to spot price, a security, commodity or currency's futures price is its expected value at a specified future time and place.

STANDARD & POOR'S 500 INDEX: An index of 500 stocks chosen for market size, liquidity, and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe. Companies included in the index are selected by the S&P Index Committee, a team of analysts and economists at Standard & Poor's. The S&P 500 is a market value weighted index where each stock's weight is proportionate to its market value.

SURPRISE INDEX: The Citi Economic Surprise Index is a data series that measures how data releases have generally compared to economists' prior expectations. When data is coming in weaker than expected, it declines; when data is coming in stronger than expected, it rises.

TRADE WEIGHTED DOLLAR INDEX: Trade-weighted dollar index is a measurement of the foreign exchange value of the U.S. dollar compared against certain foreign currencies. Trade-weighted dollars give importance - or weight - to currencies most widely used in international trade, over comparing the value of the U.S. dollar to all foreign currencies. Since the currencies are weighted differently, changes in each currency will have a unique effect on the trade-weighted dollar and corresponding indexes.

UNEMPLOYMENT RATE: The percentage of the total labor force that is not working but actively seeking employment and willing to work.

VALUATION: The process of determining the current worth of an asset or company. There are many techniques that can be used to determine value, some are subjective and others are objective. Many types of valuation methods are used, involving several sets of metrics. For equities, the most common valuation metric to use is the P/E ratio, although other valuation metrics include: Price/Earnings, Price/Book Value, Price/Sales, Enterprise Value/EBIDTA, Economic Value Added and Discounted Cash Flow.

YIELD CURVE: A curve that plots interest rates of bonds with equal credit quality but differing maturity dates. These curves are commonly used as predictors for economic output and growth.

ZERO INTEREST RATE POLICY: A method of stimulating economic growth by keeping interest rates close to zero. This policy is primarily used to combat deflation and promote economic recovery. The United States Federal Reserve recently moved away from a zero interest rate policy after several years of economic stimulus.

Definition Sources: Investopedia; About.com; Wikipedia, Federal Reserve Bank of Cleveland

RESEARCH SOURCES:

1. Bloomberg.
2. Wall Street Journal.
3. Reuters.
4. The Federal Reserve.
5. U.S. Department of the Treasury.
6. CIO Reports.
7. J.P. Morgan Asset Management.
8. Bank of America Merrill Lynch.
9. Factset Research Systems.
10. Zephyr StyleADVISOR.
11. Advent.
12. Morningstar.
13. Bloomberg Commodity Index.

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