TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

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EXECUTIVE SUMMARY

Stocks Rise In All Major Regions In Q1; Bonds Also Rise

In the First Quarter, the domestic S&P 500 Index was up 6.07%, continuing its momentum from 2016 (+11.96%). Noteworthy global regions were Europe (+8.61%) and Emerging Markets (+11.44%). Technology (+12.16%) led Q1 sector performance. Energy (-7.30%) and Telecom (-5.06%) were laggards. The Barclay's bond index rose 0.92% in Q1, following a 2.67% rise in 2016. We remain bullish due to the prospect of tax reform and infrastructure spending in the midst of a healthy economy.

Political Affiliation Drives Investment Bias

People's optimism towards financial markets and the economy is dynamically influenced by their political affiliation. Individuals become more optimistic and perceive the markets to be less risky/more undervalued when their party is in power.

With a Trump victory, there was an historically large economic sentiment gap between Republicans (more optimistic) and Democrats (less optimistic). Republicans became more aggressive regarding investments, while Democrats became less aggressive. Investors often get hurt by basing their investment approach on who is President.

John Barber, CFA
Chief Investment Officer

Dan Laimon, MBA
Managing Member

Michael Harris, CFA
Vice President

www.trivant.com

1-866-4-TRIVANT

toll free

Political Affiliation Drives Investment Bias

Michigan Index of Consumer Sentiment Shows "Unprecedented Partisan Divergence"

The University of Michigan Index of Consumer Sentiment measures attitudes towards topics such as personal finances, inflation, unemployment, government policies, and interest rates. Since the deeply polarizing election of Donald Trump in November, the index has steadily risen from 87.2 (October) to 96.9 (March). On the surface, it appears that Americans have gained confidence to levels not seen in the index since 2004. However, the index readings mask a sharp divide among Americans based on political affiliation.

While the overall February index rose to 96.3, the Republican confidence sentiment was 120.0 (this figure has not topped 112 since 1952) and the Democrat confidence sentiment was 55.5 (a level not seen since the last recession). Richard Curtin, chief economist of the University of Michigan survey, said "the gain represents the net result of an unprecedented partisan divergence". Republicans think this is the best economy in the post-war era and Democrats think it is the worst economy since the financial crisis. How can this happen?

Gallup's U.S. Economic Confidence Index Shifts Abruptly After The November Election

Gallup's Economic Confidence Index is based on the combined responses to two questions:

1. Rate economic conditions in the US today.
2. Are economic conditions as a whole getting better or worse?

Republicans had a dismal view of the economy - especially of its future direction - during Democratic President Barack Obama's two terms. Immediately after the Trump win, Republicans became significantly more optimistic. Conversely, Democrat confidence in the economy plummeted after the election. How can attitudes shift so abruptly by party affiliation within one week?

Gallup Daily Tracking: Perceptions Of Whether Economy Is Getting Worse By Political Party, Before And After The 2016 Presidential Election

Perception of Economy	Republicans Pre-Election (Nov. 1-7)	Republicans Post-Election (Nov. 9-13)	Democrats Pre-Election (Nov. 1-7)	Democrats Post-Election (Nov. 9-13)
Getting Better (%)	16	49	61	46
Getting Worse (%)	81	44	35	47

CNBC Millionaire Survey Reflects Republican Exuberance And Democrat Trepidation

The semi-annual CNBC Millionaire Survey measures the investment attitudes and behaviors of investors with $1 million or more of investable assets. In the survey conducted immediately after the election (November 11 to 17), it was evident that politics is playing a huge role in the outlook of wealthy Americans.

CNBC Millionaire Survey Conducted From November 11 to 17, 2016: Highlights

	Republicans (%)	Democrats (%)
Predict A Stronger Economy	72	15
Believe The S&P 500 Index Will Go Up In 2017	77	38
Plan To Invest More In Equities	28	10
Likely To Increase Short-Term Investments (Bonds, Cash)	12	25

Research Links Investor Optimism And Investment Decisions To Political Affiliation

Published on February 26, 2012, an academic research paper entitled “Political Climate, Optimism, and Investment Decisions” (Yosef Bonaparte, Alok Kumar, Jeremy K. Page) established that the prevailing political climate and political affiliation of individuals jointly influence their optimism towards financial markets and the macro-economy. To the authors’ knowledge, this was the first study to document the dynamic and differential impact of political environment on optimism and investment decisions.

Two market observations motivated the authors to initiate the study. First, they noted a huge shift in the optimism levels of Republicans and Democrats when President George W. Bush won the election (November, 2000). Before the election, Democrats were slightly more optimistic than Republicans. Right after the election, the optimism gap between Republicans (more optimistic) and Democrats (less optimistic) widened to 40%. Second, in early 2009 (when Barack Obama won the election) a Gallup poll indicated that 85% of Democrats believed the economy would improve in the next 12 months, while only 50% of Republicans were optimistic.

RESEARCH HYPOTHESIS

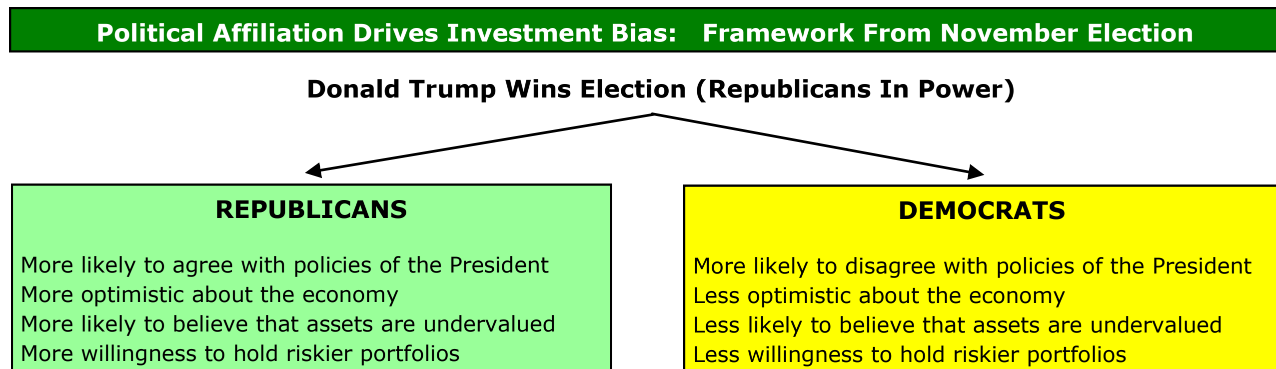
The research hypothesis was as follows:

1. People’s expectations about the behavior of financial markets and the macro-economy vary in a predictable manner and depends on their political affiliation and the existing political climate.
2. People’s optimism about the condition of the U.S. economy has a considerable influence on their investment choices.
3. The hypothesis will be tested using a large sample of UBS/Gallup survey data, the National Longitudinal Survey of Youth (NLSY) data set, and portfolio holdings and trading data from a large U.S. brokerage.

RESEARCH CONCLUSIONS (ABSTRACT FROM PAPER)

“ We show that people’s optimism towards financial markets and the macro-economy is dynamically influenced by their political affiliation and the existing political climate. Individuals become more optimistic and perceive the markets to be less risky and more undervalued when their own party is in power. These shifts in perceptions of risk and reward affect investors’ portfolio decisions. Specifically, when the political climate is aligned with their political identity, investors increase allocations to risky assets and exhibit a stronger preference for high market beta, small-cap, and value stocks. Due to these portfolio reallocations, investors improve their raw portfolio performance when their own party is in power, but the improvement in risk-adjusted performance is economically small. We also find that the excess optimism of Republicans is more pronounced and the excess pessimism of Democrats is more pronounced when the Republican party comes to power.”

The conclusions from the research paper explain the partisan divergence in the University of Michigan Index of Consumer Sentiment, as well as the immediate post-election partisan attitudes towards the economy and investments recorded in the Gallup Economic Confidence Index and CNBC Millionaire Survey (see page 2).

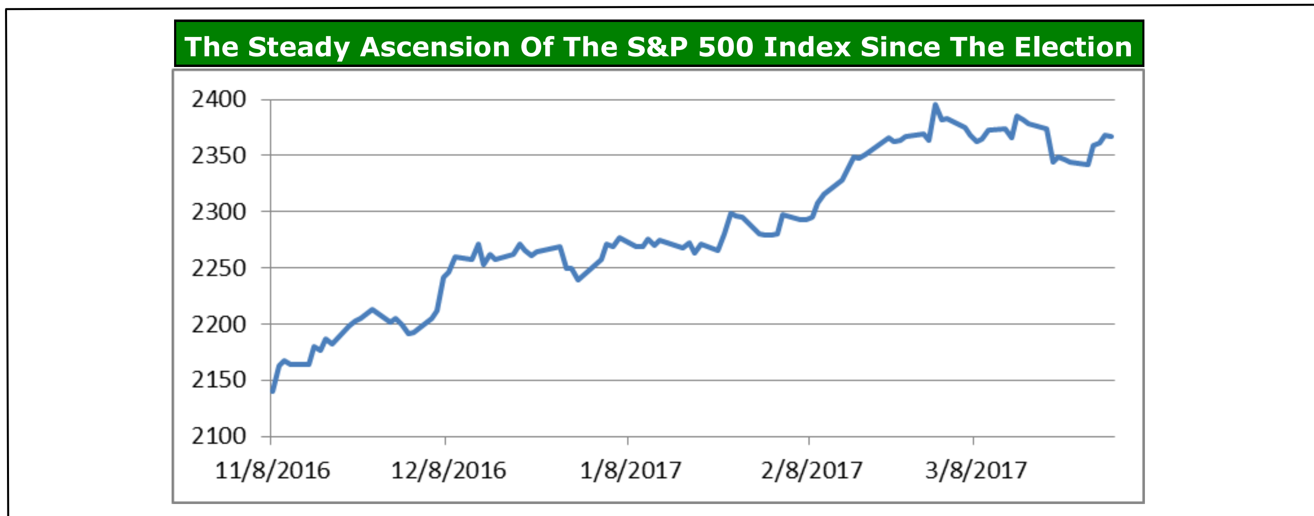


How Should We Deal With Our Inherent Political Bias?

First, it is important to acknowledge your human tendency to feel better when your political party is in power and feel worse when this is not the case. Second, it is critical to resist the urge to be overly aggressive or defensive regarding investments depending on your political affiliation and the presiding President. You can get hurt badly.

The bull market that began in March 2009 is often called "the most hated bull market in history". It was met with initial skepticism and pessimism that has lingered for 8 years. We postulate that many more Republicans than Democrats missed out by staying on the sidelines for all or part of this market run. Why? Republicans were uncomfortable that the Democrats were in power starting in 2009 (Barack Obama) and hence were less enthusiastic about the economy and overly defensive in their investment approach. With large 2008 investment losses and non-participation in the subsequent recovery, many Republicans suffered.

We further postulate that many Republicans who were on the sidelines for many years came back to the market on November 9 (the day following Donald Trump's victory). As evidenced by data from Gallup and CNBC, this sub-group of investors suddenly felt comfortable. Cash and bonds have moved to stocks. The S&P 500 Index, at least partially buoyed by new Republican support, has enjoyed a steady ascension since the election despite hiccups in the White House. Democrats who shifted asset allocation due to politics were hurt.



We Are Apolitical

We are apolitical as your investment manager. As Detective Joe Friday from Dragnet frequently implored female informants to provide "just the facts, ma'am", we also seek "just the facts". Our investment decisions regarding Style Rotation are solely based on prevailing/anticipated market conditions, not political leanings.

In our previous Quarterly Insights report (January, 2017), we stated the following:
"We believe the S&P 500 Index will rise 20% in 2017. With the new Administration, we anticipate significant changes in corporate tax rates, financial market regulations, infrastructure spending, the health care system, and efforts to save US jobs. We concur with the Standard & Poor's forecast of a 20% earnings increase in 2017. The current price earnings (PE) ratio of the S&P 500 Index is 24, in line with its average (25) over the last 25 years. The market will go up with higher earnings and an historical PE."

At no point did our outlook have anything to do with whether we liked or disliked Mr. Trump. We remain bullish.

Stock Market Spotlight

Stocks Positive In All Major Regions In Q1

In the First Quarter, the domestic S&P 500 Index was up 6.07%, continuing its momentum from 2016 (+11.96%). Noteworthy global regions were Europe and Emerging Markets. European stocks (+8.61%) rebounded from a tough 2016 (+1.34%), perhaps due to stronger than expected economic data - factory output and orders rose in February at the fastest rate since April 2011. Emerging Markets led global markets in Q1 (+11.44%), pushed by China (+12.93%) and India (+17.12%). This may be tied to higher investor enthusiasm to move funds outside the US - after years of dismal performance, Emerging Markets was +11.19% in 2016.

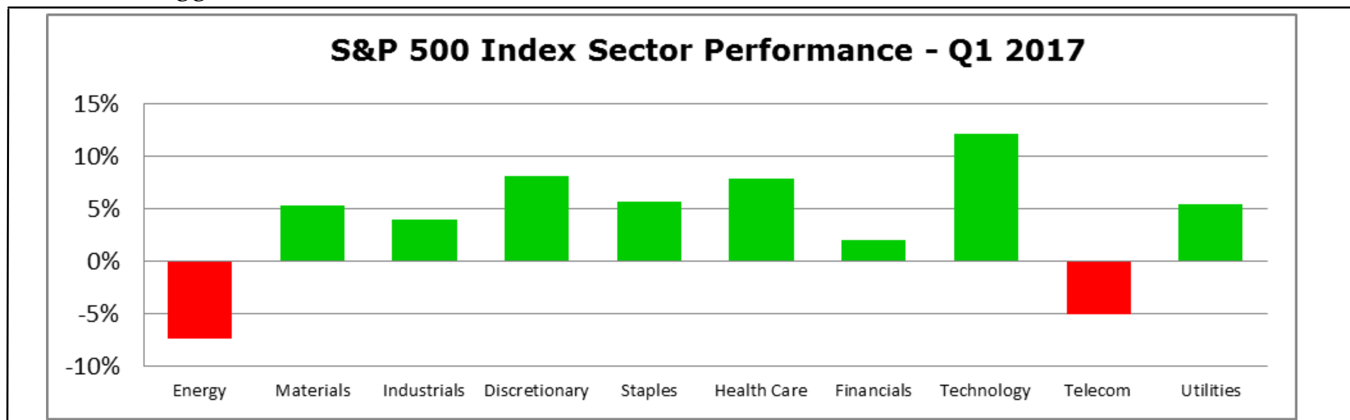
Equity Index Performance

Index	Q1 2017
S&P 500 (Domestic)	**6.07%**
MSCI EAFE (Foreign) *	**7.25%**
MSCI Emerging Markets	**11.44%**
MSCI EMU (European Monetary Union)	**8.61%**
MSCI Japan	**4.49%**

* Europe, Australia and the Far East

Technology Drives Sector Performance In Q1

Technology (+12.16%) dramatically led Q1 sector performance. Energy (-7.30%) and Telecom (-5.06%) were considerable laggards.



We Remain Bullish

Tax reform and infrastructure spending are the two main drivers for our bullish stance. With the Executive Branch and Congress controlled by Republicans, there is a much better chance that plans will be carried out. We anticipate positive legislative changes regarding tax reform and infrastructure spending and believe this will help the stock market.

We are also encouraged that the US economy is healthy by many measures. GDP growth is 1.9% (source: Bureau of Economic Analysis), unemployment is 4.7% (source: Bureau of Labor Statistics), inflation is 2.7% (source: Bureau of Labor Statistics), and the Leading Economic Indicators index has risen six consecutive months to 126.2 (its highest level in over a decade). The Fed has endorsed the health of the US economy through its second rate hike in three months (the Fed raised its target rate by 0.25% on March 15).

Bond Market Spotlight

Bonds Rise In Q1

The Barclay's Capital US Aggregate Bond Index, a broad-based representation of bond performance, rose 0.92% in the First Quarter, following a 2.67% rise in 2016. The yield curve hardly shifted in Q1. On March 15, the Fed raised its target rate from 0.50% to 0.75%. This was the second rate hike in three months (the Fed raised its target rate from 0.25% to 0.50% on December 14, 2016).

Key US Interest Rates	Dec. 31, 2016	March 31, 2017	Change
Federal Reserve Board Funds Target Rate	0.50%	0.75%	+ 25 basis points
5-Year Treasury (Constant Maturity)	1.93%	1.92%	- 1 basis points
10-Year Treasury (Constant Maturity)	2.45%	2.38%	- 7 basis points
30-Year Treasury (Constant Maturity)	3.06%	3.01%	- 5 basis points

Note: 100 basis points (bp) = 1.00% Source: Telemet

We Bought A Mortgage-Backed Security (MBS) In January

A mortgage-backed security (MBS) is an asset backed security that is secured by a collection (a "pool") of mortgages. The mortgages are sold to a group (such as a government agency or investment bank) that securitizes ("packages") the loans together into a security that investors can buy. The MBS pays periodic payments that are similar to bond coupon payments.

For many people, the mere mention of an MBS brings back nightmares of the 2008 financial crisis. You may recall the problem at that time. The credit rating agencies had placed an AAA rating on high-yield (junk) mortgage-backed securities, claiming they were as safe as US Treasurys - they weren't!

Today's mortgage-backed securities are much safer than in 2008 and are now accurately rated given the scrutiny of the credit agencies as a result of the 2008 debacle. National housing indicators from the US Department of Housing and Urban Development (HUD) show continued strength in the housing market.

US Department of Housing and Urban Development: Positive Indicators As Of March 31, 2017
Purchases of new homes rose to a seven-month high in February.
Sales of existing homes reached the strongest pace in a decade in January.
Year over year foreclosures declined 11 of the last 12 months. Prior to that, foreclosures declined for 27 months.
Home prices were up again in January with annual house price changes stable in the +5%-6% range.

We bought FlexShares Disciplined Duration MBS Index Fund (symbol: MBSD), a low-fee (0.20%) mortgage-backed-security (MBS) exchanged traded fund (ETF) that features a weighted average yield to maturity of 2.89% and a weighted average effective duration of 4.23 years. MBSD is a high quality holding with a rating of AA+ from Standard & Poor's.

An MBS does best in a stable/rising interest rate environment, which is the market condition we see right now. The reason is that there is little mortgage refinancing risk (mortage holders like to refinance when interest rates are falling). We believe MBSD offers a good risk/return tradeoff in terms of duration/yield.

Your Portfolio

We made several portfolio adjustments in Q1. The rationale for these moves included a desire to increase Financials exposure in a new environment of financial deregulation, add a hedge against inflation, and regarding bond exposure, enhance the risk/return tradeoff in terms of duration/ yield.

We bought Moelis & Company (symbol: MC), a small cap ($1 billion) leading global independent investment bank. The company has over 600 employees in 17 offices spanning North and South America, Europe, the Middle East, Asia, and Australia. In a new environment of financial deregulation, we believe that MC can thrive with increased mergers and acquisitions (M&A) and initial public offerings (IPOs).

We also bought Goldcorp Inc. (symbol: GG), a leading gold producer with operations in North and South America. Gold is a good hedge against inflation, and indeed we have seen increased inflation. Also, we view gold as a "defensive component" of our portfolio - if we are surprised by stalled economic growth and/or roadblocks to federal legislation, investors may turn to gold.

Finally, we bought FlexShares Disciplined Duration MBS Index Fund (symbol: MBSD), a low-fee (0.20%) mortgage-backed security (MBS) exchange traded fund (ETF) that features a weighted average yield to maturity of 2.89% and a weighted average effective duration of 4.23 years (see detailed discussion on page 6).

We will continue to closely monitor the market and adjust your portfolio as needed. Please feel free to contact us anytime to discuss questions or comments you may have. We will keep you informed of portfolio progress.

Respectfully submitted,

TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

John Barber, CFA
Chief Investment Officer

Dan Laimon, MBA
Managing Member

Michael C. Harris, CFA
Vice President

Disclaimer

The information presented herein is intended for informational purposes only. All views are subject to change based on updated indicators. The recommendations made in this publication are made without regard to individual suitability. Investors should consider their own needs and objectives before making any investment decision.

Commentary in this review reflects our portfolio strategy. Many of our clients have different objectives and circumstances which are reflected in unique portfolio considerations. Please note that accounts may not contain all elements of the strategy discussed here. Additionally, individual client customizations and start dates may preclude certain elements of this strategy from being implemented.

Past performance is no guarantee of future results. A risk of loss is involved with investments in stock markets.