



## Market Update and Outlook for Second 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

- Interest rates and inflation should continue to trend higher, but short-term upside may be limited
- We favor U.S. equities versus international, value over growth stocks, and small cap over large
- Second order benefits from tax reform are yet to be realized and will continue to be a tailwind to economic growth
- Geopolitics, trade tensions, and slowing growth abroad present risks; however, these should provide opportunities for tactical investing

### Market Recap

The headline story for the first quarter of 2018 is that volatility returned to the financial markets in dramatic fashion. The S&P 500 set a new all-time high in late January (2,872.87 on 1/26/2018) followed quickly by a sharp selloff in February, dropping down to a low for the year at 2,581.00 on 2/8/18. This correction in the U.S. equity market came swiftly and without warning, reminding investors that the relative calm they experienced in 2017 could not be expected to last forever. The irony of the recent onslaught of market volatility is that it came at a time when corporate earnings are the strongest they have been in years, and was coupled with the fact that the U.S. economy continues to accelerate. Rising corporate profits and higher economic growth expectations are not normally reasons to sell equities. However, other factors such as rising interest rates, rising inflation estimates, fears of a “trade war” and the looming mid-term elections have investors on edge. After a rapid rise in January, and despite the recent selloffs, the S&P 500 is down only 0.76% year-to-date, while small cap stocks (as measured by the Russell 2000 Index) are only down 0.08% over the same time frame. After the end of the first quarter of 2018, growth stocks (both small and large) have outperformed value stocks. International equities have fared worse in 2018, with the MSCI EAFE index posting a decline of 1.41% in the first quarter. Both U.S. corporate bonds and municipal bonds have fallen with the rise in interest rates. The U.S. Aggregate Bond Index is down 1.46% so far this year, and the Municipal 10 Year Index is down 1.61%. The 10-year U.S. Treasury bond has traded in a range of 2.4% to 2.9% in 2018 and currently sits at approximately 2.75%. Oil has traded higher in 2018, rising from \$60.46 for a barrel of West Texas Intermediate (WTI) grade crude to \$64.91 at the end of March.

### Market Recap and Outlook First Quarter 2018

### Investment Outlook

The tax reform legislation that was passed in late 2017 should benefit the U.S. economy (and corporate profits) in 2018 and beyond. Many companies have already announced wage increases (and one-time bonuses) for their employees, larger than planned capital expenditures, share buybacks and increased dividends as a direct result of the tax savings resulting from the new tax law. We anticipate that corporate earnings will accelerate well into 2018, justifying the more modest valuations in the wake of the recent equity market selloff. The Federal Reserve Bank announced a much-anticipated 0.25% increase in the Fed Funds Rate in March to a range of 1.50% to 1.75%, and should be on pace for two more quarter-point rate hikes in 2018. Although higher

MARKET SCORECARD to 3/31/2018	TOTAL RETURN IN USD	
	Q1	Last 12 Months
DOW JONES IND AVG	-2.29%	18.96%
S&P 500	-0.76%	13.97%
NASDAQ	2.59%	20.83%
MSCI EAFE EQUITY (GROSS)	-1.41%	15.32%
RUSSELL 2000 INDEX	-0.08%	11.79%
MSCI EMERGING MARKET EQUITY (GROSS)	1.47%	25.37%
BARCLAYS INTERM. TREASURY	-0.75%	-0.16%
BARCLAYS INTERM. GOVT/CREDIT	-0.98%	0.35%
BARCLAYS 5 YEAR MUNI INDEX	-0.57%	0.65%
BARCLAYS HIGH YIELD CORP INDEX	-0.86%	3.78%
ishares S&P GSCI COMMODITY TR INDEX	2.19%	13.83%

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

## Investment Outlook (cont.)

rates can eventually be a headwind for equity markets, we believe a gradual “normalization” of interest rates (from an extended period of historically low rates) is actually a healthy sign for both the economy and financial markets moving forward. An accelerating economy and improved corporate earnings are tailwinds for the equity market while the geopolitical climate is wrought with short-term pitfalls. Strong language from Washington D.C. regarding trade (re)negotiations has added to the recent market volatility. As financial markets get used to the negotiating tactics of the current administration, the positive news of rising corporate profits and a growing economy should regain the focus of investors. Internationally, the economic picture has given investors less clarity regarding a continuation of the recent growth acceleration. More recent data has been cause for concern that the pace of growth may be slowing along with inflation expectations. Therefore, we continue to keep our bias toward domestic equities versus international equities.

## Global Macroeconomic Review and Outlook

U.S. economic growth has been accelerating since the second quarter of 2017; narrowly missing three consecutive quarters of annualized Gross Domestic Product (GDP) growth in excess of 3% (Final Q4 reading for 2017 was 2.9%). The U3 unemployment rate held steady at 4.1%, and the February Non-Farm payroll report showed an impressive 313,000 jobs gain for the month (the largest monthly gain since December 2014). The Producer Price Index (PPI), which is the Fed’s preferred inflation measure, showed a 2.8% increase year-over-year in the February release. Although slightly above the Fed’s target inflation level of an annual 2% increase, this represents a decrease from a 3.1% year-over-year level in late 2017. While investor confidence has been shaken by the recent bout of volatility, consumer confidence continues to be near multi-year highs. Increases in take-home pay as a result of reductions in marginal tax rates would have found their way into consumers’ paychecks beginning in February. Those additional discretionary dollars will likely lead to increased consumer spending, and should be a tailwind for GDP growth in 2018. Fiscal spending is also set to increase in 2018 (both for infrastructure and defense), which will provide additional support to the economy.



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