

Investment Outlook

WINTER 2017

First Quarter 2017 Outlook; 2016 Review

Fiscal Stimulus and Reflation is a Game Changer

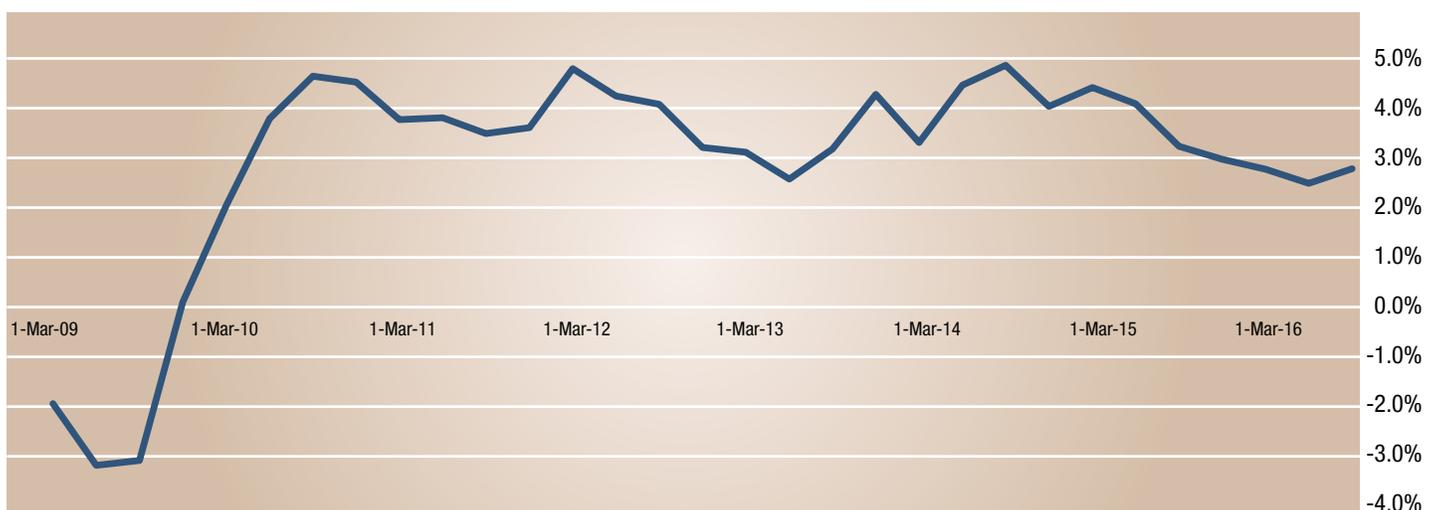
2016 ended with a surge in U.S. equity markets and a commensurate sell-off in higher grade fixed income sectors. Markets reacted swiftly and appropriately to the potential for fiscal stimulus. The next step in the process will be a transition from campaign promises to actual policy implementation. Historically, such transitions have been bumpy as investors begin to contemplate the pace, scope, and probability of policy changes.

While it remains to be seen how much fiscal stimulus is enacted and what form it eventually takes, even moderate acceleration in nominal GDP and inflation significantly alters our outlook for investment markets.

Nominal GDP has been flat-lining in the 2.5% to 4% range for the last six years. That has been the primary culprit for inflation stubbornly remaining below the Federal Reserve Bank's targets.

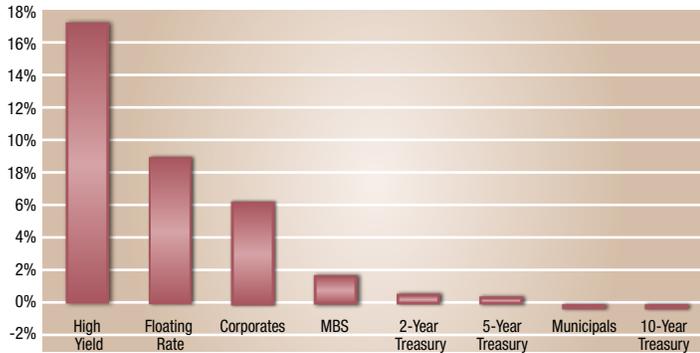
Importantly, the U.S. economy was already firming before the Trump victory. Wages have been moderately rising and the unemployment rate is now at a post-crisis low of just 4.6%. A combination of regulatory relief and cuts in marginal tax rates for corporations and individuals would undoubtedly be expansionary. That may free the Fed from doing all the work of raising nominal GDP and reaching inflation targets.

Nominal GDP Year Over Year Percentage Change



Data: US Bureau of Economic Analysis Chart: Argent Wealth Management, LLC © 2017

U.S. Fixed Income Returns Year to Date



Data: J.P. Morgan, Morningstar; Chart: Argent Wealth Management, LLC © 2017

However, all of this must be put in the context of global growth that, while also firming, remains sluggish. Non-U.S. yields remain anchored at zero for most developed economies. There are structural impediments that will restrain how much inflation can rise.

Post-election market action was completely consistent with the singular theme of reflation. Treasury yields have risen sharply and virtually any asset that has sensitivity to rising interest rates has fared poorly.

Conversely, assets that benefited from the potential for higher inflation and growth have surged. Perhaps the most stunning example of this was a rally of historic proportions in U.S. Financial shares -- up 20% in just eight weeks! Other top-performing areas included Small Cap Equities (particularly Value) and cyclical sectors, such as Energy and Materials. Across all capitalizations, Value styles have dominated Growth as there is a much higher weight within Value indices of inflation friendly and cyclical exposure.

Within fixed income, Floating Rate Loans and High Yield performed exceptionally well as any longer maturity category suffered. We have consistently noted in prior Outlooks a weight in Floating Rate Loans, in addition to exposure to duration, is prudent and improves the risk-reward profile of the overall fixed income allocation. Thankfully, that worked out really well for our clients.

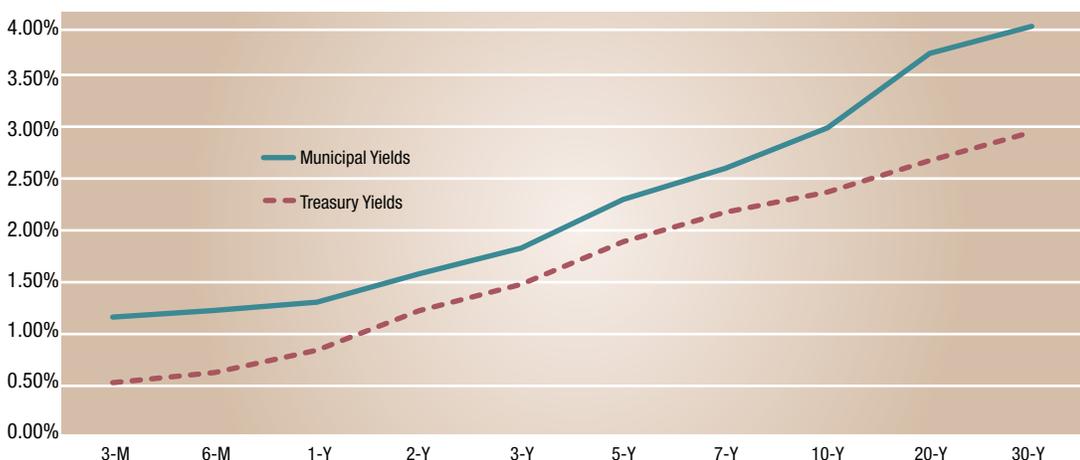
Expect More Pressure on Fixed Income; Looking for Opportunity at a 3% 10-Year Treasury Yield

We expect the trend in rising yields to continue in 2017. Investors appear to have piled into fixed income funds (and ETFs) at what we thought were irrationally low yields post-BREXIT. The yield on a 10-Year Treasury bond touched cycle lows of just 1.34%. That could well mark the cyclical and secular (long-term) yield low.

As previously noted, while we expect rising inflation, there are huge global structural factors that limit the pace and degree that inflation can rise. An adjustment that is too abrupt with U.S. yields would likely cause a surge in the dollar and a rolling over of growth and expected inflation.

Even in a trend toward higher yields, there will be periods whereby the fixed income markets will overshoot and opportunity will be created. Importantly, sectors will not correct in an even or rational manner. We would expect at least several interest rate sectors to significantly overshoot what we believe is fair value.

Tax Equivalent Yield vs Treasury Yield Curve (25% Tax Bracket)



Data: NDR Group. Chart: Argent Wealth Management, LLC © 2017. Taxable Equivalent Yield = Municipal Bond Yield / (1 - Tax Bracket)

Our best current thinking is to maintain a mix of exposure to duration and Floating Rate Loans ... for now. Thinking ahead and subject to change, we like the 3% yield on a 10-Year Treasury bond to begin adding more to higher grade fixed income sectors such as Treasuries, Mortgages, Corporates, and Municipals.

A particular area of potential interest is the Municipal Bond market. This market has been hit particularly hard as investors have reacted to the potential cuts in marginal tax rates. Ratios versus comparable Treasury bonds are already about 100%, making the category compelling even under the scenario of the most aggressive cuts in the maximum marginal tax rate.

Equity Markets; Rebalancing to Targets is Critical

We have consistently maintained in recent years that equity markets have not been excessively valued. While we did not anticipate the added bonus of a cut in corporate taxes and fiscal stimulus, this does push upward our calculation of fair value.

Here too, markets are prone to overshooting. Positive trends can well continue for longer than may seem reasonable or rational. Having said this, the U.S. equity market has already “pulled-forward” some benefit from potential policy actions. We strongly believe that the process of implementing policy will have bouts of uncertainty and worry.

Our strategy is to maintain a rigorous discipline of rebalancing back to appropriate weights within client portfolios on additional periods of rapid appreciation and/or excessive ebullient sentiment readings.

Favoring Value versus Growth; Stay Properly Diversified Internationally

Within U.S. equity markets we favor Value categories and expect recent outperformance to continue. Value tends to outperform during periods of acceleration in earnings and cyclical strength. Despite recent gains, we continue to favor Financials.

Non-U.S. equity markets (both Developed and Emerging) appear cheaper than U.S. markets. Additionally, there seems to be almost universal consensus that dollar strength will continue unabated. We are always wary of such

strong consensus opinions and mindful that extreme sentiment is often wrong.

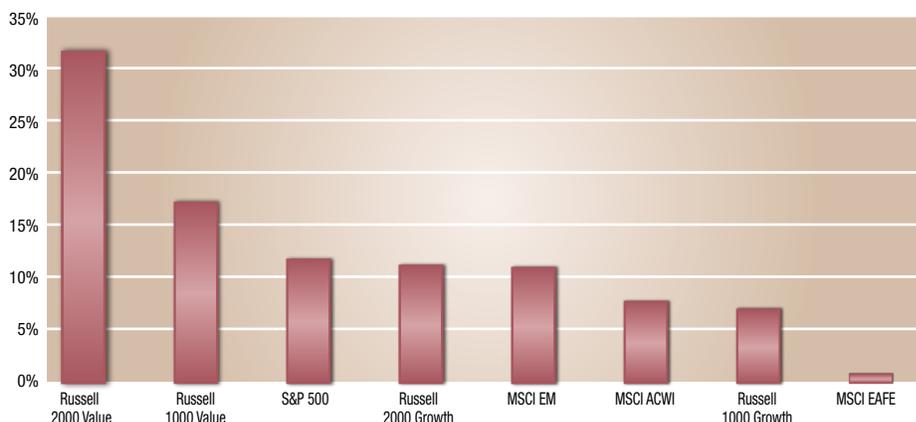
Our strategy is to continue to maintain an appropriate balance between U.S. and International equity exposures. It is too early (in our view) to attempt to overweight International. However, with the valuation gap getting larger and consensus of continued dollar strength (despite already full dollar valuation), the scenario of eventual rotation toward International markets could be powerful and long lasting. We will be watching carefully.

Private Equity and Private Real Estate; Being Highly Selective is the Key to Success

Private asset markets have continued to be a significant contribution to our returns. It is well understood by institutional investors such as endowments, that these areas can consistently produce returns well above that of public markets (i.e. S&P 500). However, long holding periods, complexity, and illiquidity make them appropriate only for clients that can accept these constraints.

Within Private Equity markets we strongly favor Middle Market, Direct strategies. We still are finding some value in Middle Market Private Equity space, but on a more selective basis. Entry purchase multiples are high by historical standards. It is critical to work with the very best General Partners (GPs) that can find promising companies that can be purchased at reasonable prices compared to their growth potential. Fortunately, the Middle Market is

Global Equity Returns Year to Date



Data: Morningstar, Inc.; Chart: Argent Wealth Management, LLC © 2017 Performance data through 12/31/2016

inefficient and has thousands of companies. By contrast, we are not allocating any assets to the Large or Mega Market until the cycle corrects.

Private Real Estate has also been characterized by robust exit activity. There is demand for quality assets that our GPs are exploiting.

Private Real Estate is a large and complex category with many different property types and strategies. While some areas such as Multi-Family, and Core look expensive and risky, other areas such as Value-Added Suburban-Office still look attractive.

A critical issue that we believe creates opportunities for skilled GPs is that a large amount of distressed commercial mortgages (CMBS) will be coming due over the next several years. Many of these mortgages will not be able to be refinanced. Poorly structured deals done prior to the peak of the last cycle will be distressed sellers. As a result, skilled GPs can buy at attractive prices and add value to these assets.

True Diversification Requires Being Sensitive to Correlation

Major market inflection points, such as the recent market rotation away from core bonds to stocks, exposed some flaws in perceived diversification. In addition, we saw a rotation away from certain “bond proxy” stock sectors like Consumer Staples. For the first half of the year, this sector, along with other bond proxy sectors like Utilities, was one of the best performing areas of the market. Unfortunately, those that had large exposure to both core bonds and bond

proxy stocks did not do as well as those that understood the potential for correlation between these areas and actively moved away from them (as we did).

To those paying close attention, it was somewhat clear that bond proxy sectors looked expensive, and were likely getting a bid due to their perceived safety and dividend yield. In a world where interest rates stay under 2% on the 10-Year Treasury, this thesis made sense. Not surprisingly, as yields rose, bond proxy sectors performed poorly relative to the market.

NAME	QTD
S & P 500	+4.01%
Consumer Staples	-2.10%
AGG Bond	-3.12%

Data: Morningstar; Chart: Argent Wealth Management, LLC © 2017 ETF Proxies used: S&P 500 (IVV) Consumer Staples (XLP) Agg Bond (AGG)

That is why we spend extensive energy and effort understanding how assets correlate with each other and under what scenarios those correlations may change. Proper

and true diversification means that your equity and bond portfolios don't always move in the same direction. Core bonds should protect in risk-off scenarios, and stocks should do well in risk-on scenarios. Long-term correlations between general asset classes give us guidance, but a deep dive into sub-asset classes, and trying to understand how they may move in the future, is something the Investment Committee at Argent spends a lot of time discussing. This is one important input, of many, we discuss when making decisions. Our goal from this, and other analyses, is to ensure our clients have a properly diversified portfolio that helps them achieve their goals.



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All of us at Argent thank you for your continued support and confidence. If you know of anyone that might benefit from Argent's services, we would welcome the opportunity to discuss their particular situation with them.

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