PATRIOT
INVESTMENT
MANAGEMENT

Dear Clients & Friends of Patriot Investment Management

Summer has arrived, and the overall economic outlook for 2017 is positive. Global expansion is gaining momentum as the US, developed and many emerging economies are seeing steady, modest growth. The Dow has continued to push higher into new territory and volatility has remained low. The administration's ambitious agenda of deregulation, tax reform and fiscal spending has all but stalled as the legislative battles surrounding healthcare and the steady stream of scandals and negative press threaten to push most agenda items into next year. The primary risk facing the markets are geo-political in nature, with North Korea being the main concern.

US Economy:

Inflation has decreased to 1.6% as oil prices have fallen, but will slowly increase over the medium term, as low unemployment continues to put upward pressure on wages. As planned, the Fed raised the Federal funds rate 0.25% again in June, but may only raise rates one more time in 2017. This is due to the fact that the Fed has laid out a plan for unwinding $400 billion of Treasuries & mortgage-backed securities per year beginning in 2018 through 2020, shedding a portion of assets from the quantitative easing (QE) programs implemented in response to the financial crisis of 2008. We anticipate the Fed will take a cautious approach to prevent a spike in yields as they shrink their holdings, such as slowing the pace of the reduction and spacing out rate hikes should inflation remain low or Europe also begins to reduce their stimulus efforts.

Corporate profits have rebounded from their early 2016 lows, and sales growth is at its highest level in six years. The rise in earnings is gaining momentum, indicating sustained growth in the US economy. Long-term bond yields are expected to gradually rise, but will likely stay below their historical averages as structural factors will keep the economy in a low interest rate environment for some time to come. Because of these factors, while US equities are richly valued, their earnings yields are still more attractive than bond yields.

Overall, US fundamentals are strong, and the likelihood of an economic slowdown in the near-term is remote. Investors can expect modest positive returns going forward, as high valuations and slow productivity growth from an aging workforce will mute returns.

Global Markets:

Global expansion is gaining momentum as fears of deflation fade, particularly in emerging markets and Europe. Emerging markets continued to outperform US markets, boosted by a weaker dollar and an increase in industrial activity that boosted returns. Europe's economy has been helped by the European Central Bank's (ECB's) accommodative policies, but risks remain if the ECB were to reduce stimulus too soon. Fears of rising populism have faded, as France and the Netherlands have elected parties with progressive agendas, and Angela Merkel is likely to win the German election in September.

Optimism is slowly returning for European investments, but systemic issues remain, and it will be up to these new governments to implement labor and tax reforms that will spur growth. The UK will likely face challenges and more volatility as they negotiate the terms of Brexit, as Theresa May's calling of a surprise election in June has backfired. The tactic, which was intended to strengthen the government's Brexit mandate, has instead further weakened the government's position in trade negotiations with the EU.

In Asia, both China and Japan's prospects continue to improve as well, as their central banks have effectively managed their stimulus programs. This stimulus has helped to spur growth in global manufacturing and provided a boost to emerging markets. Japan is moving away from deflationary fears as inflation and corporate earnings are rising, and China has been reigning in some of the excess leverage in their financial system, effectively slowing non-bank lending. However, more work needs to be done in this area, and uncertainty surrounding trade relations with the US remains a risk factor for China's financial stability. Geo-politically, North Korea is the main concern as a potentially destabilizing event in the region.

<u>In Summary:</u>

The US market has continued its rally into the second quarter, but has been more subdued as the new administration has experienced setbacks and challenges in implementing some of the more ambitious parts of their agenda. Global expansion is gaining momentum as markets move into the growth phase of the economic cycle. Going forward, we at Patriot remain guardedly optimistic in our outlook for the year, as global fundamentals strengthen, but political uncertainties remain, and will drive volatility. The US economy is poised for a steady pace of modest growth, and barring a major geo-political event, the likelihood of a major market downturn is remote.

<u>2017 Second YTD Quarter Returns:</u>

S&P 500 + dividends	9.34%
Dow Jones Industrial	8.03%
Russell 2000	4.99%
Emerging Markets	17.22%
EAFE	11.83%
Barclays Aggregate Bond Index	2.27%

Returns are price-only unless otherwise noted

10 year Bond yield as of 6/30/17 2.30%

Inflation	1.6% thru June 2017
Unemployment	4.4% in June 2017

Thank You!

We value the confidence and trust you have placed with us, and we welcome your questions and comments. Our goal is to be our clients' trusted resource for all things financial.

Do you know someone who could benefit from our expertise? We appreciate your introductions and the opportunity to help your family, friends and colleagues meet their financial goals.