Week of March 20, 2017

Investors Cautiously Optimistic as Fed Raises Rates Again

Based on evidence of continued economic growth, the Federal Reserve Board raised its benchmark interest rate by 0.25% last week in an effort to ensure the economy and inflation don't expand too rapidly. It was the second time in four months that the Fed tightened its monetary policy. The Fed also forecasted two more interest rate hikes in 2017.

The broad stock and bond markets reacted positively to the rate increase.

- Equity investors saw the move as yet another sign that the economy is healthy.
- That said, U.S. banks struggled as investors balanced their views on the positive effect of higher interest rates with the headwind of a flattening yield curve. Also, the healthcare sector took a break from its strong year-to-date performance due to political rhetoric and the potential for budget cuts in medical research.
- Fixed-income investors were heartened by the Fed's forward guidance suggesting two more rate hikes this year, which was less aggressive than many investors expected.

European markets also performed well, as European financial services firms continued to strengthen their balance sheets. Investors also were reassured by the incumbents winning the Dutch elections, which could improve the overall political climate in Europe.

Emerging markets were last week's best performers, as Fed Chairman Janet Yellen said the Federal Reserve will keep its policy accommodative for "some time"--a positive development for fund flows into developing market assets.

Meanwhile, Saudi Arabia roiled oil markets by announcing that it pumped more than its quota of oil in February. The move by Saudi Arabia, a member of OPEC, could jeopardize an agreement among OPEC nations last year to restrict oil output in an effort to raise the price of oil.

GAIN: Active Asset Allocation

Most asset classes were up last week, with the notable exception being the U.S. dollar. In particular, emerging market stocks led a strong international rally following the Fed's rate hike

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and comments. Year-to-date, emerging markets as a group are up more than 12%.

In contrast, oil has fallen more than 10% so far this year. The decline has put pressure on value-style investments, which have underperformed growth-oriented investments by approximately 4% year-to-date. The Gain portfolios' overweight to growth stocks has been beneficial in this environment, and we expect to continue to emphasize growth investments as we enter earnings season.

Bonds were also up last week, with high yield bonds rising nearly 1%. So far in 2017, however, the overall bond market is flat (as measured by the Bloomberg Barclays U.S. Aggregate Bond index). We continue to overweight corporate bonds, as we believe equity risk is preferable in a rising-rate environment.

PROTECT: Risk Assist

Global equity markets were positive last week, and the Risk Assist portfolios remained positioned to participate in the gains. Risk Assist is designed to be able to capture most of the gains in an "up" market. We sought opportunities to lock in recent gains to help safeguard investors' assets. We do this through a process we call ratcheting. When portfolio values rise to meet certain targets, the protection level (or "floor") is reset to reflect that higher amount.

SPEND: Real Spend

Last week, another sign of rising inflation emerged. U.S producer prices (as measured by the Producer Price Index) rose more than expected in February, and posted their largest year-over-year advance (2.2%) since March 2012.

The Fed's press conference last week following the decision to raise interest rates had some interesting observations about key risks in retirement portfolios:

- Inflation risk is under control and the Fed would step in if inflation gets out of control.
- Interest rate risk is high, as small rate changes could have large impacts.
- Equity market stimulus doesn't appear to be at risk, but fixed-income markets may remain under pressure.

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