The stock market rally that began just days before the November election continued into 2017 with the S&P 500 finishing the first quarter with a 6.07% total return. The S&P 500 posted its largest gain since the fourth quarter of 2013 as optimism surrounding the new administration's pro-growth agenda remained a tailwind for stocks. Improving global economic data and recovering corporate profits, both of which predate the election, also lifted stocks over the quarter. Following a sharp rise higher in November, fixed income yields were relatively range bound during the first quarter with the 10Yr Treasury trading inside a tight 31basis point range. With the slight recovery in yields, the Barclays Managed Money Municipal Short/Intermediate Index gained 1.68% for the quarter. Taxable bonds, as measured by the Merrill Lynch US Corp/Gov't 1-10 Year A or Better Index, returned 0.64% over the quarter.

Policy expectations dominated the headlines throughout the first quarter of 2017 with much of the attention going to health care and tax reform. Stocks rallied as President Trump used adjectives such as "huge," "massive," and "big-league" to describe his upcoming tax plan, although offering little in the way of detail. While the idea of corporate tax reform seemingly has bipartisan support, the scope and timing are far from certain. Look no further than the failed American Health Care Act vote towards the end of the quarter, which highlighted the difficulty of getting comprehensive policy changes through Congress. We believe that the future of the administration's pro-growth initiatives hinges on how quickly Republicans can pivot away from the health care debate and towards tax reform. Deregulation and infrastructure spending remain as potential boons, but corporate tax reform will be crucial to sustaining the upward momentum in the stock market.

Away from politics, there are reasons to be positive on the stock market as we look ahead in 2017. The global macroeconomic backdrop continues to improve as a number of data points, particularly overseas, have come in above expectation. However, there has been a focus on the relative outperformance of the upside surprises in "soft" data points versus "hard" data points. Soft data typically refers to survey figures including optimism and confidence readings, whereas hard data refers to actual actions by businesses and consumers, such as vehicle sales. The team at Appleton believes that this divergence illustrates how far ahead policy expectations have gotten from reality. For stocks to continue to trend higher in the coming quarter, we believe that the hard data must begin to close the gap on soft data in terms of beating expectations. Another positive for the stock market is the recovery we've seen in corporate profits. After several consecutive quarters of year-over-year declines last year, S&P 500 earnings are expected to grow roughly 9% in the first quarter of 2017, according to data from FactSet Research. That would mark the highest year-over-year quarterly growth rate since the fourth quarter of 2011. We should note, however, that over 40% of the growth in earnings can be attributed to the Energy sector given the recovery in oil prices over the past year. If earnings come through close to what Wall Street is expecting, we think the stock market should continue to support above-average valuation levels.

For the fixed income market, the first quarter was relatively calm as monetary policy was largely on the backburner. The Fed left rates unchanged in February, as expected, but the meeting minutes showed that participants were split on the appropriate timing for further tightening. Given some signs of firming inflation, largely tied to the comeback in oil, and improving growth trends, the Fed ultimately decided to raise rates by 25 basis points in March. While rates rose in anticipation of the March hike, the dovish tone struck by Chairwoman Yellen during the subsequent press conference sparked a reversal in yields, which quickly retraced over the last two weeks of the quarter. Also compressing yields was the Fed's median projection for three rate hikes in 2017 and three in 2018, a dovish signal in that the forecast was unchanged from the December meeting. Looking further into 2017, the lack of meaningful wage inflation, in addition to the elevated level of discounting we are seeing at retailers and auto dealerships, likely keeps a lid on overall inflation. With that, Appleton's bias would be that the Fed hikes only twice this year, barring a sweeping success of tax reform, deregulation and infrastructure stimulus, and rates remain range bound near current levels.

Stock markets were able to remain calm during a particularly tumultuous period in American politics. The VIX, a widely followed volatility measure, traded below 13, a historically low number, for much of the quarter. The S&P 500 enjoyed a 64-tradingday streak without an intraday move of 1% or more, the longest such streak in the past three decades. It has been somewhat surprising just how readily investors have shrugged off concerns.

As we look ahead, the team at Appleton believes one of the largest risks to the tranquility is political policy implementation risk. Much of the positive momentum in stocks seems to be attributed to investors' confidence in the President's ability to jumpstart the economy. Should those growth initiatives stall, or fail to come to fruition, the market could easily sputter in the short term. However, the fundamental outlook mentioned above should be enough to buoy markets in the longer run as the economy continues to gradually improve and corporate profits continue to recover. We will be diligent in monitoring events out of Washington and how they might impact your portfolio as we navigate these turbulent political times.

As always, we welcome your comments and questions. Please contact us if there are any changes to your financial situation or investment objectives. Appleton is also now active on Twitter: follow us on Twitter at @AppletonPtnrs.

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