FARMERS TRUST COMPANY

Market Update and Outlook for Second Quarter 2017

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

- The equity markets need a legislative win to continue higher, ideally in regards to tax reform.
- We expect more volatility if there are any further legislative delays or failures.
- We continue to believe that the growth story has legs and will result in inflation and a higher interest rate environment going forward.
- We are watching the price of oil carefully, as earnings for many of the large integrated oil companies can affect the overall upcoming earnings season.
- A disciplined allocation to foreign equities has begun to add value. However, we continue to believe that current international equity valuations remain attractive.

Market Recap and Outlook Second Quarter 2017

MARKET SCORECARD to 3/31/2017	TOTAL RETURN IN USD	
	Q1	LAST 12 MONTHS
DOW JONES IND AVG	5.18%	19.88%
S&P 500	6.06%	17.15%
NASDAQ	10.13%	14.18%
MSCI EAFE EQUITY	7.39%	12.25%
RUSSEL 2000 INDEX	2.47%	26.22%
MSCI EMERGING MARKET EQUITY	11.49%	17.65%
BARCLAYS INTERM. TREASURY	0.54%	-1.56%
BARCLAYS INTERM. GOV/CREDIT	0.78%	0.42%
BARCLAYS 5 YEAR MUNI INDEX	1.90%	0.35%
BARCLAYS US HIGH YIELD	2.70%	16.39%
S&P GSCI COMMODITY INDEX	-5.05%	8.45%

Note: All returns include re-invested cash flows, expressed in U.S. dollar terms.

Market Recap

Financial markets got off to a solid start in 2017 with all three major U.S. equity markets higher for the first quarter ending March 31st. The technology laden Nasdaq Composite led the way with a +10.13% gain, while the S&P 500 gained +6.06% over the same timeframe. The Dow Jones Industrial Average checked in at a respectable +5.18%. Small cap stocks, as measured by the Russell 2000 Index, lagged the large cap indices with a +2.47% return. The information technology sector was the best performer with a +12.56% return. Foreign equities posted impressive gains in the first quarter with developed international markets up +7.39% as measured by the MSCI EAFE Index, while the MSCI Emerging Markets Index rose a whopping +11.49% during the quarter. Bond yields were modestly lower, with the 10 year U.S. Treasury bond yielding 2.40% at quarter-end vs. 2.45% at the end of 2017.

Investment Outlook

Macroeconomic data has been mixed so far in 2017. "Soft" economic data, such as Consumer Sentiment and the Purchasing Managers Index have shown impressive optimism for the economy. However, there has not been much "hard" data (GDP and industrial production) to back up that optimism. While we are still encouraged by the pro-growth stance of the current administration, we need "hard" economic data to accelerate to justify current elevated equity valuations. The failure to repeal and replace the Affordable Care Act was a setback. If the promise of tax reform is delayed until next year or fails altogether, we would expect the equity markets to give back some of the gains they have experienced since the election last November.

Nominal (market) interest rates have been somewhat stagnant so far in 2017 while inflation has picked up modestly. These recent data points gave the Federal Reserve all the reason they needed to boost the Fed Funds rate another 0.25% at their March meeting. While we can't rule out another rate increase in 2017, the lack of GDP growth will make it harder for the Fed to raise rates aggressively. Earlier in the year consensus projections were for 2.5% growth in GDP; more recently, it looks like GDP growth for the first quarter of 2017 will likely be below that projection (and well below the approximate 3.25% long term trend for the U.S. economy).

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Global Macroeconomic Review and Outlook

Final 4th quarter Gross Domestic Product (GDP) in 2016 was +2.1%. This final GDP number was an upward revision from an estimated 1.9% growth rate in the preliminary report, but still a very disappointing number. We now anticipate that 1st quarter 2017 GDP will struggle to surpass the 4th quarter growth rate, which is a trend that must change to justify current equity valuations. Inflation has shown up in both consumer prices and wages. The Consumer Price Index (CPI) showed a year over year gain in prices of 2.7% as reported for February 2017. The tick up in prices has given the Federal Reserve the ammunition it needs to begin to normalize interest rates. Headline unemployment was reported at 4.5% for the month of March 2017. This is the lowest that measure has been since the early 2000's. While there are many problems with the measurement of the unemployment rate (discouraged workers, the underemployed, seasonal fluctuations), the trend has been decidedly downward for the last 7 years and a very positive sign for the overall economy.

Consumer confidence and consumer sentiment surveys have recently reached optimistic levels not seen since the early 2000's at the height of the internet bubble. While these "soft" data points are often lagging indicators for the economy, they can be coincidental indicators for equity markets. When people feel good about their job prospects, their investment portfolios and their 401k balances, then they are more likely to make purchases (often bigger ticket items like automobiles and houses). We will keep a close watch on any deterioration in the confidence and sentiment numbers. Weakness in the sentiment numbers could eventually show up in disappointing retail, home, and auto sales.

In summary, the financial markets need some of the campaign promises of the current administration to come to fruition. Although only in office for a mere 3 months, the financial markets expect to see meaningful progress on the issues of health care reform, tax reform, deregulation, expansion of infrastructure spending, etc.. We believe that the equity markets can have an extension of the gains over the last several months if a few of these items are enacted.

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