VAN LIEW TRUST COMPANY

as we see it

Spring 2017

THOUGHTS FROM OUR CHAIRMAN

There are business people and investors who feel over long periods of time political efforts from the left or the right have a limited impact on their business decisions. In the shorter term, however, decisions are not only influenced by quarterly earnings reports, but also by the perceived friendly or unfriendly intentions of an administration and/or legislature to current business activity. So far this year, a combination of good first quarter earnings reports and hopes for business success spurred by Washington have cheered business leaders as well as investors.

My associate, Joseph Healy, in this spring issue of As We See It, tackles the challenging subject of the interest rate environment. Spurred by our expanding economy, will there finally be a meaningful increase in long and short term rates? We do not have the answer but as Joe points out, higher rates aren't entirely bad.

Alfred B. Van Liew

Interest Rates Hikes and the Individual Investor

Joseph J. Healy, CFA

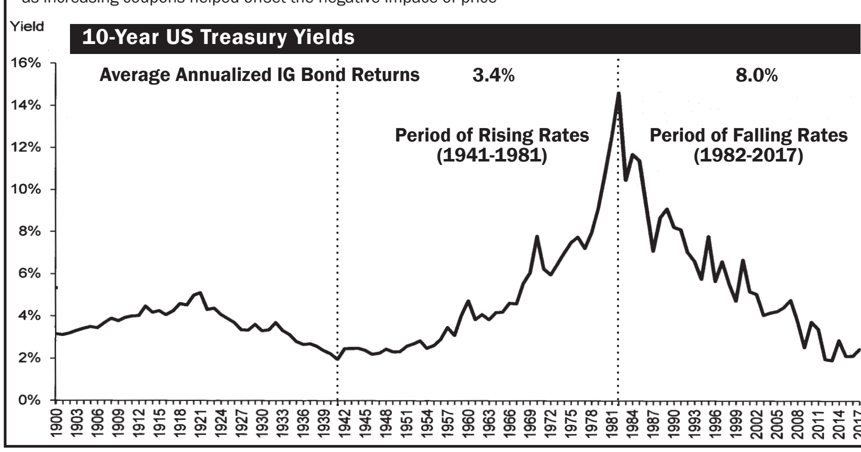
Start discussing interest rates or bond investing and the eyes of most people start to glaze over. Why? Other than sounding boring, perhaps it's the perception that better growth in the economy has made equities more attractive than bonds. Interestingly, three consecutive interest rate increases by the Fed have not led to a significant increase in bond yields and fall in bond prices.

It was not that long ago that rate hike discussions turned investor sentiment negative on equity markets. Remember the 2013 "taper tantrum" when the Fed reduced the amount of money it was pumping into the economy causing interest rates to rise? Stock and bond markets both dipped as investors feared upcoming rate increases and sought safety in cash and shorter maturity investments. More recent investor reactions have been muted and both bond and equity asset classes have experienced low market volatility.

Investment markets are forward looking and markets like predictability. This Fed has been careful to build its case

Even When Rates Rise, Bond Returns Can Be Resilient

The 35-year bull market for U.S. Treasury bonds included outsized returns and brought interest rates to their lowest levels in recent decades, but bond yields are only modestly lower when compared to long-term history. During four decades of rising rates from 1941 to 1981, high-quality investment-grade bonds provided positive nominal returns as increasing coupons helped offset the negative impace of price



Sources: U.S. Treasury, Barclays, Bloomberg Finance, Fidelity Investments for rate hikes by framing the conversation in the most conservative, non-aggressive fashion possible. So far they have done a good job telegraphing their intent to be slow and deliberate. The steady drumbeat of moderation seems to have pacified investors and rate volatility.

To be sure, interest rates are still very low by historic standards, at levels not seen since the 1950's. We've been living in an environment of declining rates for the past 20 years. Some bond pundits state that the easy money has been made in bonds and that it is no longer wise to invest in long maturities and lower rated credits to achieve the highest returns. They say it is time for investors to shorten maturities and improve credit quality. Not so fast.

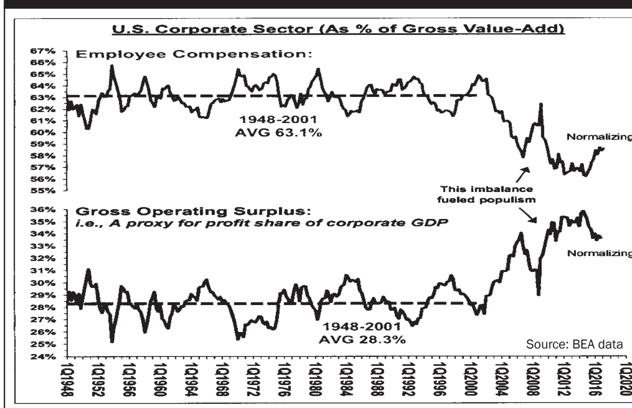
Many investors feel forced to allocate less to fixed income, viewing bond rates too low to merit a greater allocation. But we remind them of the role fixed income typically plays to moderate the higher volatility of the equity component in a diversified portfolio. Could the continuing surge in retiring baby boomers looking for predictable income portend an opportunity for bonds? Perhaps, but not yet while yields are low and investors discount the potential for equity market corrections.

If yields advance, at what point do higher yields start to drain individual investor funds from equity investments? What level of yield – the so-called tipping point - would motivate investors to boost fixed income allocations? That rate may be much higher than where we are today when taking into consideration projected higher real returns of other asset classes and future projected investor needs. We believe that for the individual investor equities remain the best route to long-term growth. Factoring in the steady increase in stock dividend distributions, investors apparently have become more comfortable with higher equity asset allocations. There was a time, not that long ago, when an investor would question why a growth stock would pay any dividend and restrict using its capital for expansion. That's no longer the case.

On the surface, increasing rates can be viewed as a drag on our economy since the common wisdom is that higher rates boost borrowing costs for companies and individuals, thus reducing capital spending and personal consumption. But that ability to reduce rates is a vital tool for the Fed and historically has been its most effective tool to stimulate a faltering economy. We may not need this "ability to reduce rates" tool now but someday we most certainly will.

In summary, we don't anticipate any dramatic rise in interest rates or collapse in bond prices. Despite those who may criticize the Federal Reserve for any rate hikes, we appreciate the Fed's longer term perspective and focus on a monetary policy that is not solely about the short term which, for better or worse, guides so many other policy decisions in government, business, and our own lives.

T R E N D L I N E S



Employee wage growth over the last 17 years has been below the long-term average, while corporate profit margins have risen above long-term averages. As we reach full employment, will this trend reverse? It may have started already. If so, consumer spending seems likely to benefit.