Review & Outlook

First Quarter 2018

April 11, 2018

Executive Summary

John Augustine, CFA, Chief Investment Officer

First Quarter Market Returns:

S&P 500	-1.22%
S&P 400	-1.15%
S&P 600	+0.23%
MSCI EAFE	-2.37%
MSCI EM	+0.93%

Barclays Intermediate Bond Index	-1.00%
Barclays High Yield Bond Index	-0.86%
Barclays TIPS Bond Index	-0.79%
Barclays Municipal Bond Index	-1.11%
Gold	+1.37%

The Return of Volatility

Markets started the year with a powerful January. Investors were consistently buying stocks and selling bonds during the month. The return for the S&P 500 in January exceeded 5% for only the 13th time since WWII, and the yield on the 10-year Treasury note rose from 2.41% to 2.71%.

That all changed in February and March as the headlines focused on inflation, central banks, trade, politics and a slow start in the economy for the year. George Mokrzan, Randy Hare and Kirk Mentzer will have summaries of that activity in their reports later in this publication.

The passage of the tax bill in late December confirmed the optimism for the US economy that had been building consistently throughout 2017. Regardless of the current headlines around trade and technology companies, we suspect optimism will turn into action during 2018 with increased corporate investment and slowly building consumer spending as the year progresses.

What will get more interesting in markets as the year progresses will be the pace of the economy, the inflation it produces, and how the Federal Reserve will react to all of this.

Our goal in the Huntington Private Bank is to have the proper diversification for investor outcome intentions (growth, income or principal preservation) with respect to the accounts we manage. We are currently investing into the thesis of a growing US (and global) economy, with corporate profits improving noticeably and inflation slowly moving higher to levels more desired by the Federal Reserve.

Managing through the current volatility has been our focus this quarter, with our Strategy Team making several adjustments to portfolios where we have full authority and follow a stated direction of investment. We suspect the volatility could calm in the second quarter at some point, but we will remain diligent of the headlines and new fundamental information as it develops.

The Economy

George Mokrzan, Ph.D., Senior Vice President, Director of Economics

GDP in Q1 is likely to slow from the strong pace of the previous 3 quarters, but this ease in total spending is expected to be temporary. The economy continued to perform well overall in the first quarter of 2018:

- According to the Institute for Supply Management Composite Index for Manufacturing and Non-Manufacturing, economic activity grew at its fastest quarterly average pace since records began in Q3 1997. Economic growth was broad-based across industries and sectors.
- Labor markets continued to strengthen. New employment grew by 605,000 jobs in the first quarter, with broad-based gains across all major private sectors. Labor force participation rose 0.2% to 62.9% during the quarter, holding the unemployment rate at 4.1% -- its lowest rate since 2000. At 8.0%, the underemployment rate (U-6) reached its lowest since March 2007. First time unemployment claims reached multi-decade lows. The one soft area of labor markets was private average hourly earnings, which rose 2.7% annually in the first quarter, compared to an estimated rise of 2.2% in the CPI-U.
- Consumers moderated spending after opening their wallets wide and often in 2017. However, the business equipment recovery that began in late 2016 continued to build momentum. Export and import growth reflected strong overall international economic growth. Housing markets exhibited only modest growth, but average home price appreciation remained upwards.
- The Federal Reserve's preferred measure of Inflation, (Personal Consumption Expenditures excluding Food and Energy,) remained stable at 1.5% in the 12 months through February. However, producer prices continued on a broad-based accelerating trend in the first quarter, and are expected to rise consistently in the 2.0% to 3.0% range in the coming months. The Federal Reserve raised its Fed Funds rate target by a quarter point into the 1.5% to 1.75% range in March. The forecast is for at least 2 more quarter point increases in 2018.

Our real GDP outlook is 2.8% in 2018, and could realize the strongest economic growth since 2005. High and sustained fiscal stimulus will likely bolster consumers and businesses, and help maintain the economic expansion into 2019. Interest rates and inflation will likely rise, as well. Conflicts over International trade could pose a potential risk to the forecast. However, if new improved trade terms result for the U.S., then U.S. export growth could benefit in the long-term.

For more information on the Economy, please request the Huntington Private Bank "*Economy in Focus*" publication from your local Huntington Team members.

Fixed Income Markets

Kirk Mentzer, Senior Vice President, Director of Fixed Income

In the first quarter of 2018, the 10-year Treasury yield overall rose 0.33% to 2.73%. However, it was a tail of two directions. In the first 45 days of the quarter, the yield rose all the way up to 2.95% on inflation concerns. Then, in the last 45 days, the yield reversed back lower to 2.73% on trade concerns.

- Overall, bond investors saw slightly negative total returns for most of the major domestic averages in the first quarter.
- Interestingly, short-term treasury yields (2 year) rose consistently during the quarter as the overall US economic growth thesis remained intact, and the Federal Reserve delivered on rate hike, with two to three more being currently expected.
- As the trade concerns rose in the quarter, we did see a slight increase in spread between treasury yields and corporate yields. Investment Grade Corporate spreads widened 16 bps for the quarter to 109 bps.
- For new issuance, what caught our attention in the quarter was that Investment Grade Credit supply for the quarter has slowed compared to the same period in 2017 with Q1 gross supply down 11% and net supply down 26%. This is something we had started thinking about late last year.

Moving into the second quarter and beyond, what we are monitoring are several areas for portfolio management:

1. Concerns over a rising level of Treasury issuance to finance increased fiscal deficits related to the tax and spending bills enacted in Congress.
2. Fed Chair Jerome Powell commented in his first post-Fed meeting press conference in March that, “There is no sense in the data that we are on the cusp of an inflation surge”.

Looking ahead, our economic outlook suggests the balance of evidence to weigh towards higher yields as the year progresses. As mentioned in the Economic Section and above, we anticipate stronger economic growth, rising inflation, and an active Federal Reserve intent on raising interest rates along with reducing the size of their balance sheet. Thus, we expect the 10-year Treasury yield to gravitate towards 3% over the course of 2018. If expectations start to increase for 2% or higher inflation, markets may push 10-year Treasury notes yields towards 3.25%.

In terms of our sector allocation for investment grade corporate bonds, we remain cautiously optimistic. After nine years of narrowing credit spreads, we find credit spreads positioned near the narrowest levels of the cycle and will remain highly selective. We favor higher-quality credit issuers with strong or improving metrics, while shying away from the lower-rated credits.

Our favored sectors include late cycle beneficiaries such as materials along with less economically sensitive areas such as REITs and Utility issuers. Upgrading portfolio quality requires little yield sacrifice and produces a more stable portfolio, a point exemplified last quarter.

Investors may need to become satisfied with simply collecting the incremental income afforded by corporate bonds, should credit spreads remain near present levels.

Equity Markets

Randall Hare, Senior Vice President, Director of Equity Research

The Equity Markets in Q1:

The first quarter was also a tale of two markets (similar to our Fixed Income market summary). The quarter started with enthusiasm for the recently enacted tax cuts driving stocks higher. The quarter ended with a focus on headlines around trade and technology privacy (with the Technology sector being nearly 25% of the overall S&P 500).

During the first quarter, despite earnings estimates moving higher, stocks finished lower for the quarter.

- Small cap US stocks (S&P 600) and Emerging Market stocks produced a slight positive total return in the quarter.
- Large cap US stocks and the main international developed market index (MSCI EAFE) saw losses in the 2-3% range.
- The Consumer Discretionary and Information Technology sectors of the S&P 500 were the only of 11 to see positive gains in the quarter.
- Perhaps the biggest story of Q4-2017 earnings (reported in Q1) was the upward revision to 2018 earnings estimates. We started the quarter with 2018 EPS growth expectations of 14.8% for the S&P 500, and ended with EPS growth estimates of 20.6%.

Looking ahead to the second quarter of 2018 and the remainder of the year, some of the factors that we are keeping our focus on at Huntington include:

- U.S. economic growth, as noted above, has been revised upward from 2.5% to 2.8% for 2018. We forecast an acceleration in inflation, with a continual rise in Fed Funds rate.

- S&P 500 EPS growth is expected to accelerate each consecutive quarter during the year.
- Headline risks to domestic equity markets have shifted from inflation concerns to trade & technology for the time being – and day-to-day volatility of stocks is expected to remain heightened as a result.
- When, or will, the shift from growth sectors (technology, healthcare and consumer discretionary) to value sectors (financials, energy, industrials) take place?

Weighing the headwinds and tailwinds, we see a continuation of double-digit earnings growth, which should be beneficial for stocks in a volatile headline environment. However, this will call for U.S. investors to be patient, let the economic and earnings growth gel and yet maintain a positive environment for U.S. equity investors.

Volatility in a time of fundamental economic strength is a time to upgrade stock portfolios, not sell on emotion.

This publication contains general information. The views and strategies described may not be suitable for all investors. Any forecasts presented are for illustrative purposes only and are not to be relied upon as advice or interpreted as a recommendation. Individuals should consult with their investment adviser regarding their particular circumstances. This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, accounting, legal or tax advice. Contents herein have been compiled or derived in part from sources believed reliable and contain information and opinions that are accurate and complete. However, Huntington is not responsible for those sources and makes no representation or warranty, express or implied, in respect thereof, and takes no responsibility for any errors and omissions. The opinions, estimates and projections contained herein are as of the date of this publication and are subject to change without notice. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Investing in securities involves risk, including possible loss of principal amount invested. Past performance is no guarantee of future results.

International investing involves special risks including currency risk, increased volatility of foreign securities, political risks, and differences in auditing and other financial standards. Prices of emerging markets securities can be significantly more volatile than the prices of securities in developed countries and currency risk and political risks are accentuated in emerging markets.

Bonds are affected by a number of risks, including fluctuations in interest rates, credit risks, and prepayment risk. In general, as prevailing interest rates rise, fixed income securities prices will fall. Bonds face credit risk if a decline in an issuer's credit rating or credit worthiness, causes a bond's price to decline.