C&N Vantage Point

Quarterly Market Recap & Outlook
Second Quarter, 2017

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This Quarter's Content

- Economic & Financial Indicators
- Quarterly Review
- Quarterly Outlook
- C&N Portfolio Positioning
- Meet Our Experts

Key Interest Rates	2017			
	9/30/16	12/30/16	3/31/17	6//30/17
2-yr Treasury Note	0.77	1.2	1.27	1.38
10-yr Treasury Note	1.6	2.45	2.4	2.31
30-yr Treasury Note	2.32	3.06	3.02	2.84
30-yr Fixed Mortgage	3.66	4.41	4.33	4.13
Corp. Bond Index	2.85	3.38	3.33	3.2
High-Yield Bond Index	6.57	6.46	6.18	6.06

Sources: Northern Trust/JP Morgan

Key Equity Indexes - As of Quarter End	%YTD Return	NTM P/E	P/B	Dividend Yield
S&P 500	9.34	17.46	3.01	2.00
Russell 2000	4.99	24.57	2.06	1.51
Russell 1000 Growth	13.99	20.45	5.92	1.60
Russell 1000 Value	4.66	15.68	2.00	2.65
MSCI EAFE	14.23	14.73	1.62	3.07
MSCI EM	18.60	12.37	1.57	2.43

Sources: Northern Trust/JP Morgan

Economic Indicators Data	2017				2018				Q4 to Q4 Change			Annual Change		
	17:1a	17:2f	17:3f	17:4f	18:1f	18:2f	18:3f	18:4f	2016a	2017f	2018f	2016a	2017f	2018f
Real Gross Domestic Product (% change, SAAR)	1.4	2.8	1.8	2	2	1.9	2	2	2	2	2	1.6	2.2	2
Consumer Price Index (% change, annualized	1.5	0.6	1.6	2	2.1	2	2.1	1.6	1.8	1.5	2	1.9	2	1.8
Civilian Unemployment Rate (% average)	4.9	4.7	4.4	4.4	4.4	4.4	4.4	4.4				4.8*	4.6*	4.4*

a = actual, f = forecast, *= annual average | Source: Northern Trust U.S. Economic & Interest Rate Outlook

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SECOND QUARTER 2017

THE GREATEST SHOW ON EARTH

On May 21, Ringling Bros. and Barnum & Bailey performed its last-ever show to a sold-out audience in Uniondale, New York – marking the end of an impressive 146-year run. Meanwhile, the U.S. economic expansion has just officially turned eight years old; is its long run nearly over as well? Not likely. Helping to extend the tour, fundamentals have impressed in the center ring, with global growth stable and/or accelerating in all major economic regions of the world. This constructive growth environment has averted investor attention from the political sideshow in Washington D.C. (making CSPAN must-watch TV lately) and the tightrope-walking Federal Reserve (which is balancing elevated valuation levels with stubbornly low inflation).

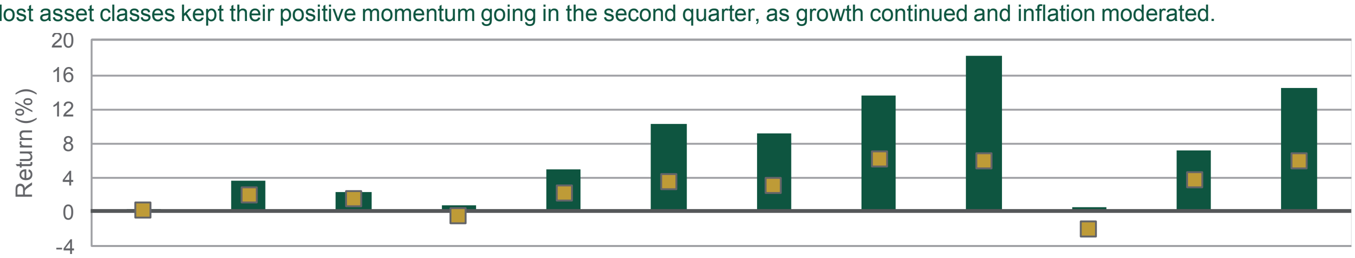
If the political environment can be characterized as a sideshow, then French President Emmanuel Macron could aptly be analogized as the strong man. With his centrist approach, a majority in parliament and a growing rapport with German Chancellor Angela Merkel; France – and Europe more broadly – may have its best shot at economic reform in decades. As we wait to see if Macron can succeed, the European economy is already gaining traction. European purchasing manager indexes – providing a real-time read on the state of the economy – remain healthily above the 50 line (the divider between economic expansion and contraction). Meanwhile, European earnings grew by 23% in the first quarter, outpacing expectations by 14%. Japan impressed by even more in the first quarter (28% growth, 16% surprise); while U.S. companies also beat expectations, though to a lesser extent (14% growth, 5% surprise). These first quarter earnings "beats" – mostly announced throughout April and May – have supported equity markets and raised investor expectations for second quarter results. U.S., European and Japanese second quarter earnings are again expected to grow year-over-year at a double-digit pace.

Major central banks are hoping this economic momentum allows them to slowly move out of the spotlight. Both the Federal Reserve (the Fed) and the European Central Bank (ECB) have taken a less-accommodative tone in recent public statements. The Fed is looking to reduce the size of its $4.5 trillion balance sheet soon (possibly as early as September) while the ECB may look to slow its asset purchases from the current €60 billion-per-month rate (possibly in early 2018). Both want higher policy rates as well. The pace at which they raise them will be dictated by the mix of economic growth, inflation and financial market stability. Steady growth and low inflation argues for a gradual approach, but elevated financial asset valuations have some policy makers pushing for policy to be tightened more quickly. Valuations are, of course, a concern for investors as well; no one wants to be one of the "suckers born every minute" referenced in the phrase commonly (but likely erroneously[1]) attributed to P.T. Barnum. Investors have been safe so far, but would be at risk if inflation picks up and/or central bankers decide to get more aggressive.

[1]No records exist to prove that Barnum ever uttered the famous quote. As Barnum's biographer, Arthur H. Saxon, pointed out, "Barnum was just not the type to disparage his patrons."

SECOND QUARTER AND YEAR-TO-DATE 2017 TOTAL RETURNS

Most asset classes kept their positive momentum going in the second quarter, as growth continued and inflation moderated.



	FIXED INCOME						EQUITIES			REAL ASSETS		
	Cash	Muni	Inv. Grade	TIPS	High Yield	Emerg. Markets	U.S.	Dev. Ex-U.S.	Emerg. Markets	NR	GRE	GLI
■ YTD	0.3	3.6	2.3	0.9	4.9	10.4	9.0	13.6	18.3	0.6	7.2	14.4
■ 2Q17	0.2	2.0	1.4	-0.4	2.2	3.6	3.0	6.1	5.9	-2.0	3.7	6.0

Source: Northern Trust Investment Strategy, Bloomberg. NR = Natural Resources; GRE = Global Real Estate; GLI = Global Listed Infrastructure.
Indexes are gross of fees and disclosed on last page.

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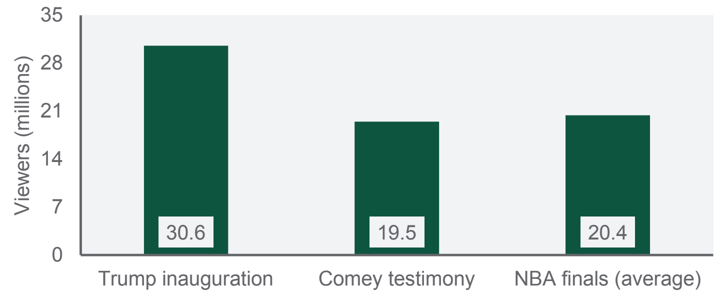
KEY THEMES

Drama in Washington

D.C. politics have provided a lot of flash but little substance. The healthcare bill now sits in the Senate, where a handful of vulnerable Republican senators up for re-election in 2018 are doing political calculus on whether they should support the bill. Increasingly, investors just want a vote – pass or fail – and a move to tax reform, more important to the markets. Meanwhile, the investigation into Trump administration-Russian ties took an interesting turn when FBI director James Comey was fired by President Trump, introducing new obstruction of justice allegations. Republicans claim all the drama is not distracting from legislative efforts, with House Speaker Paul Ryan promising to “walk and chew gum at the same time.”

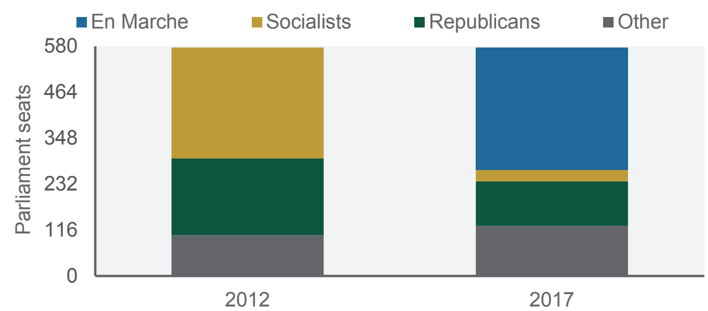
U.S. TELEVISION VIEWERSHIP



Hope for Change in Europe

A new political star is born. Emmanuel Macron, the 39-year-old former investment banker turned politician, went from founder of an entirely new political party to president of France – with majority control in parliament – in just 14 months. Optimism abounds on Macron’s chances to reform France’s rigid labor markets and influence broader European Union policies, but it is far from guaranteed. France has resisted reform for decades and opposition parties quickly argued that low voter turnout restricted Macron’s mandate. At the very least, however, France has avoided a worst case outcome by rejecting Marine Le Pen and her populist and anti-euro National Front party, which only won eight seats in parliament.

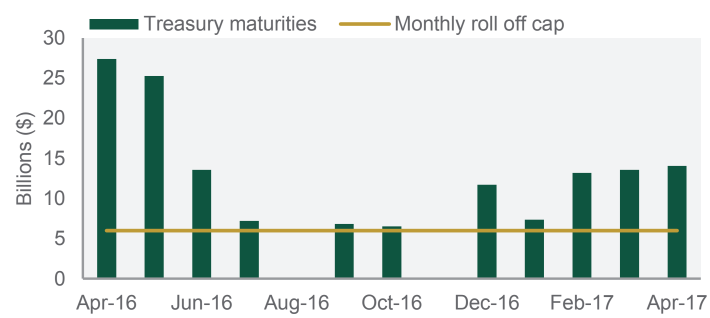
CHANGES IN FRENCH PARLIAMENT COMPOSITION



The Fed Presses Forward

Softening inflation did not stop the Fed from raising interest rates to a range of 1-1.25% in its June meeting. Fed Chair Janet Yellen asserted that raising rates gradually now would save the Fed from more aggressive monetary policy later. The Fed also announced its plan for reducing the size of its $4.5 trillion balance sheet. Thus far, the Fed has been reinvesting all maturing assets. It continues to do so, but sometime soon (likely later this year) it will – at first – allow $6 billion in Treasury – and $4 billion in mortgage-backed security – maturities to roll off each month, reinvesting any amount above that. For perspective, the chart shows monthly Treasury maturities over the past year; there will still be a lot of reinvestment going on.

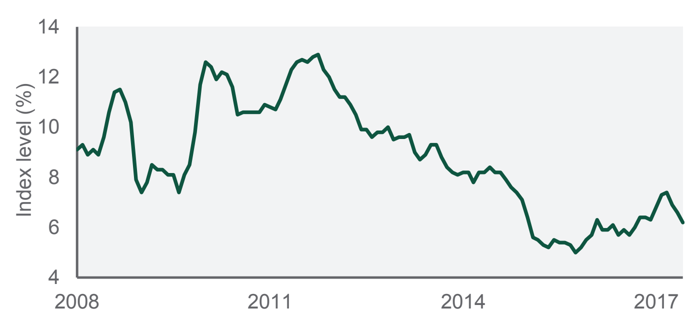
FED BALANCE SHEET MONTHLY MATURITIES



Constructive Economic Fundamentals

The combination of steady economic growth and subdued inflation has provided investors with a “goldilocks” environment (not too hot, not too cold, just right), despite the political drama and geopolitical pressures. In the United States, the “misery index” – a simple summation of the unemployment rate and year-over-year inflation level – has resumed its trend downwards and sits below levels seen prior to the financial crisis. Low unemployment helps consumption while low inflation caps interest rates. The two combined should help to extend the 8-year-old U.S. economic expansion. But this isn’t just a U.S. story. All other major global economies – including Europe, Japan and China – are currently healthy as well.

MISERY INDEX



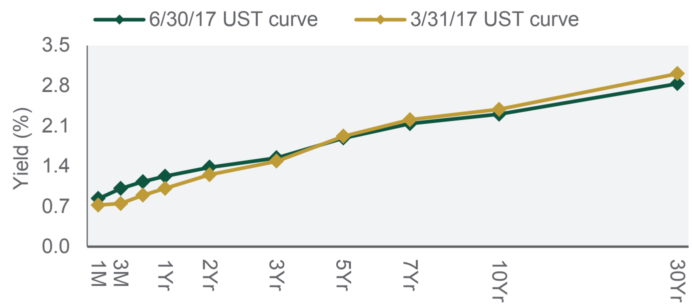
Source: Northern Trust Investment Strategy, Bloomberg, Ministry of the Interior, Federal Reserve.

MARKET REVIEW

Interest Rates

The U.S. yield curve moved little from point-to-point over the quarter, masking underlying interest rate volatility. The 10-year UST reached as low as 2.12% in the quarter as inflation rolled over and the "Trump bump" was put on hold. However, the last week of the quarter brought a nearly 0.2% jump in the 10-year as the Fed signaled its intent to remain committed to accommodation unwind despite "transitory" softness in recent inflation data. As important, ECB President Mario Draghi struck a more optimistic tone on the ECB's ability to remove ultra-accommodative policies; the 10-year German bund jumped to 0.47% from 0.24% in response. Japanese rates remain concentrated around 0% across the yield curve.

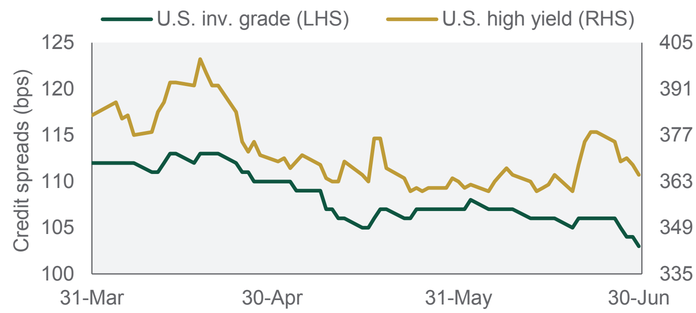
YIELD CURVE



Credit Markets

Credit spreads drifted lower during the quarter; investment grade spreads were tighter by 9 basis points (bps) to 1.03% while high yield spreads were tighter by 19 bps to 3.64%. Quarterly returns equaled 1.4% and 2.2%, respectively, pushing year-to-date returns further into positive territory. Market liquidity remains healthy and investor demand remains high, combining with the constructive fundamental backdrop. High yield credit spreads jumped a bit in mid-June, responding to oil price weakness, but moved lower towards quarter-end. While both high yield and investment grade yields remain near all-time lows, credit spreads are still wider than the levels reached pre-financial crisis.

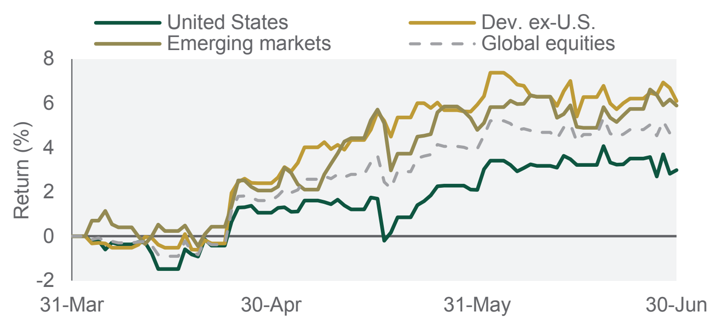
CREDIT SPREADS



Equities

The post-election jump in U.S. stocks has continued to broaden into a global equity rally. Second quarter returns from developed ex-U.S. equities (6.1%) and emerging market equities (5.9%) were roughly double that of U.S. equities (3.0%). For the year, global equities are up 11.8%, led by emerging markets – up an impressive 18.3%. The emerging market story is a good lesson in not getting too caught up in political rhetoric. Instead, investors should focus on actual government policy and its impact on fundamentals. Immediately after the U.S. election, emerging market equities were down as much as 7% over political concerns that have not come to fruition. Since that sell-off, emerging market equities have rallied over 22%.

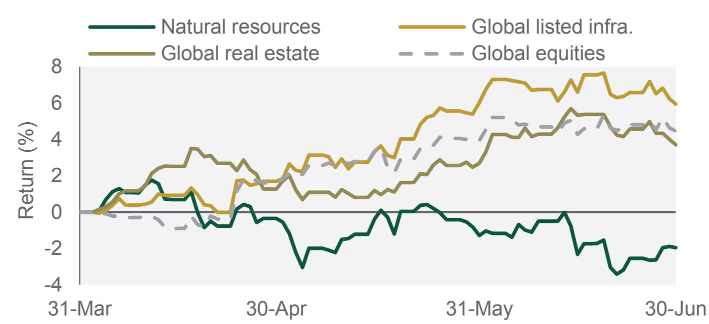
REGIONAL EQUITY INDEXES



Real Assets

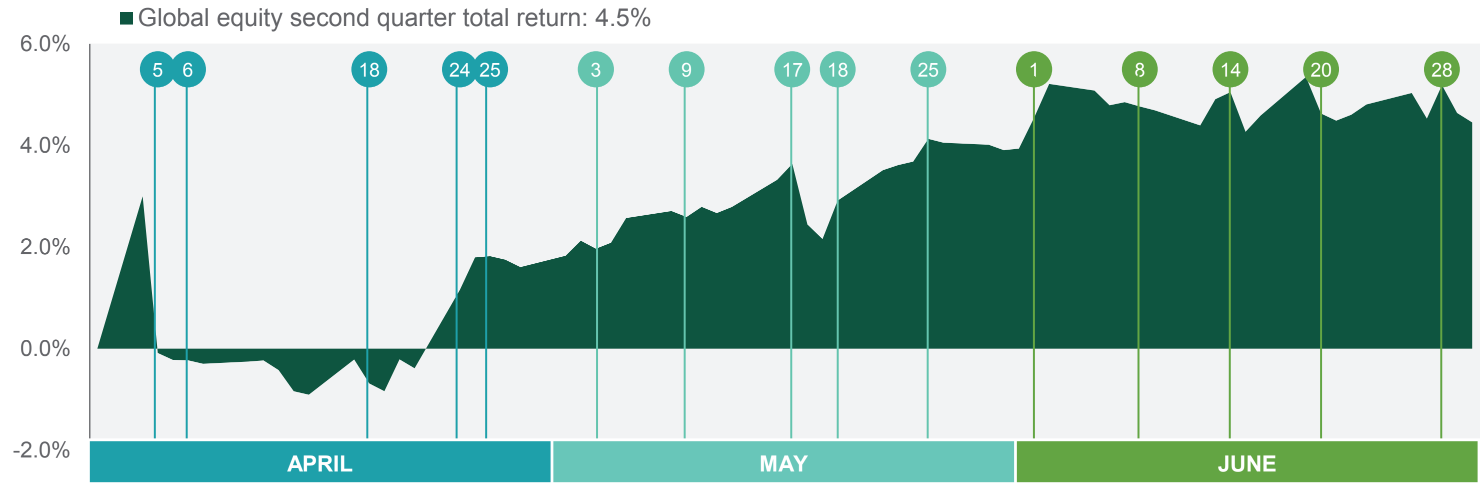
Global listed infrastructure was the best-performing real asset in the quarter, gaining 6.0% (14.4% year-to-date). As we have noted in the past, the companies within the index merely maintain infrastructure, but don't directly benefit from its build-out. As such, the returns of these cash flow assets are more driven by falling interest rates than falling odds on infrastructure spending. Natural resources fell (-2.0%) after a strong 12-month run (+23.6%). Despite healthy demand and OPEC mostly sticking to agreed-upon production quotas, oil inventories remain stubbornly high as unconventional (fracking) production growth continues. Global real estate mostly tracked global equities for the quarter, up 3.7% (7.2% year-to-date).

REAL ASSET INDEXES



Source: Northern Trust Investment Strategy, Bloomberg. UST = U.S. Treasury. Indexes are gross of fees.

MARKET EVENTS



APRIL	5 Republican law-makers change Senate rules to end Democrat filibuster and confirm Neil Gorsuch as Supreme Court justice	6 United States directs an airstrike at the Syrian airbase sus-pected of deploying chemical weapons earlier in the week	18 United Kingdom Parliament accepts Prime Minister Theresa May's request for a snap election on June 8	24 MSCI Europe up 2.2% after French voters support Emmanuel Macron for president; beats Marine Le Pen in runoff two weeks later	25 Indicative of global expansion, machinery company Caterpillar reports earnings per share that far outpace expectations; CAT stock jumps 6%
MAY	3 Congress passes $1.1 trillion bill to avoid government shut down, providing funding through September 30	9 FBI director James Comey is fired over alleged mishandling of Hillary Clinton email investigation	17 U.S. equities fall by 1.8% on heightened concerns over potential Trump obstruction of FBI probe into Russian connections	18 Brazil equities fall ~10% on report of President Michel Temer directing a businessman to pay bribes to silence former congressman	25 OPEC announces nine-month quota extension, but continued non-OPEC production mutes impact on oil prices
JUNE	1 President Trump announces his intentions to with-draw the United States from Paris climate accords	8 UK Conservative Party loses its governing majority in parliament, weaken-ing UK's hand in Brexit negotiations	14 The Federal Reserve raises policy rate to range of 1-1.25%; unveils plan for slowly shrinking $4.5 trillion balance sheet	20 MSCI announces plans to add China A shares to emerging markets index in one year's time and in a scaled fashion	28 The Fed announces approval of capital plans for all 34 banks participating in the Comprehensive Capital Analysis & Review (CCAR)

Indexes used: Bloomberg Barclays (BBC) 1-3 Month UST (Cash); BBC Municipal (Muni); BBC Aggregate (Inv. Grade); BBC TIPS (TIPS); BBC High Yield 2% Capped (High Yield); JP Morgan GBI-EM Global Diversified (Em. Markets Fixed Income); MSCI U.S. Equities IMI (U.S. Equities); MSCI World ex-U.S. IMI (Dev. ex-U.S. Equities); MSCI Emerging Market Equities (Em. Markets Equities); Morningstar Upstream Natural Resources (Natural Res.); FTSE EPRA/NAREIT Global (Global Real Estate); S&P Global Infrastructure (Global Listed Infra.)

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DOWNGRADING INFLATION

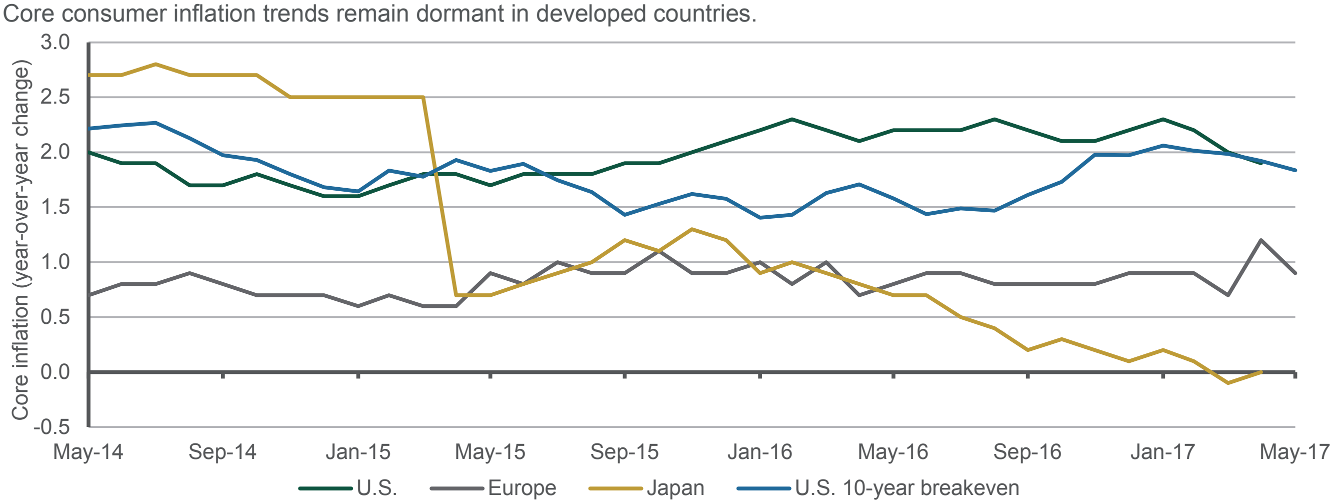
Last month we wrote about the increased political clarity in key countries, a development that has supported risk taking and has advanced further this month across Europe. With low volatility in the economic data, investor focus remains trained on these political developments as potential catalysts. Certainly, the 5% decline in the U.S. dollar this year – and 6% and 7% rallies in the yen and euro, respectively – looks to be influenced more by changing political fortunes than mundane drivers like interest-rate differentials. While the incumbent political powers in the United States and United Kingdom are struggling to advance their agendas, more positive progress is being made in France and Italy. French President Emmanuel Macron looks set to secure a majority in the French Parliament, while the populist National Front was handily defeated. In Italy, the populist Five Star party suffered numerous defeats in regional elections this past weekend, failing to even make the run-off elections in many. A fading populist movement strengthens the hands of pro-European Union politicians, reducing risk around the EU's stability.

While the developments in Europe are constructive, the impact political leaders have on the real economy can be exaggerated. Prime Minister Shinzo Abe's policies have had a much greater effect on the Japanese financial markets than on the real economy. Meanwhile, Barack Obama was caricatured as being anti-energy and anti-business, yet the fracking revolution and domestic oil and gas production greatly accelerated during his administration. Leading economic indicators are at new highs across many developed economies, and relatively stable in emerging economies with some recent moderation in China.

Forward-looking economic data continues to support markets. Some investors are concerned about the relatively flat yield curve, which historically has been a signal of economic slowdown. But we see plenty of other market signals confirming a more sanguine outlook, including the strong performance of corporate credit. We attribute the low level of long-term interest rates to a strong demand for yield and a more benign outlook for inflation. As shown below, core levels of consumer price inflation in the United States, Europe and Japan have all been very stable over the last year, leading to a reduced expectation for inflation over the next 10 years. We expect this to feed into a slow but steady approach from the Federal Reserve as it edges up short-term interest rates and looks to slowly shrink its balance sheet.

QUIESCENT INFLATION

Core consumer inflation trends remain dormant in developed countries.



Source: Northern Trust Investment Strategy, Bloomberg.

C&N PORTFOLIO POSITIONING: MODEST OVERWEIGHT TO RISK

C&N Vantage Points - July 2017

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Market Views:
Slow Growth Continues - Domestic Equity Valuations Will Remain Stretched
Diversification Remains Paramount
A Market Correction Would Be An Opportunity

Market Risks:
Fed Miscalculates Balance Sheet Reduction Effect
Fed Rate Hikes Lead To A Flat Or Inverted Yield Curve
Geopolitical Risks & Trade War Risks Increase

Risk Type	Asset Class	Sector Category	Under Weight	Neutral	Over Weight	Viewpoints
Risk Control	Cash/Cash Alternatives	Ultrashort Bonds		●		These sectors give us easy-to-deploy cash in the event of a market correction. With the Fed targeting rate hikes, we become opportunistic in redeploying these monies.
Risk Control	Alternatives (Fixed Based)	Absolute Return			●	In a low-rate environment, we maintain our increased exposure to these sectors to provide better-than-money market returns while decreasing our overall risk profile.
Risk Control	Alternatives (Fixed Based)	Inflation-Linked Bonds			●	TIPS appear attractive on a relative basis compared to their targets. Inflation expectations have begun to rise so we continue to monitor impact to spreads and valuations.
Risk Control	Fixed Income	US Investment Grade Bonds	●			We have a slight overweight to IG Corps but increase our underweight to U.S. Govt bonds due to a tightening Fed and inflationary forces building. Overall, the category goes to underweight.
Risk Control	Fixed Income	International Bonds	●			Foreign central banks are beginning to talk down their continuation of extraordinary policies which may leave this category stretched in its valuation.
Risk Control	Fixed Income	Emerging Markets Bonds		●		Spreads are not expected to tighten much from current levels. EM valuations appear fairly valued. Potential Trump Administration policies remain a cause for caution.
Risk Assets	Fixed Income	High Yield Bonds			●	High-Yield's relative coupon remains attractive - for now. The effects of oil and a potentially flattening yield curve could impact our future bias to this sector. We will continue to monitor.
Risk Assets	Equities	US Large Cap			●	Although fairly valued, with a pro-business Trump Administration, the bias is to the upside by year end. We move to a slight overweight in LCV and LCG and look to buy on market pullbacks.
Risk Assets	Equities	Developed Ex-US		●		Monetary policies are expected to remain supportive. Valuations are reasonable compared to the U.S. As political headwinds subside, this category's weighting may be re-assessed.
Risk Assets	Equities	US Mid & Small Cap		●		Mid and Small Caps outperformed in 2016. They've lagged YTD, but remain fully valued. We remain neutral given their dependency on policy outcomes, which have diminshed lately.
Risk Assets	Equities	Emerging Markets		●		Even after their recent outperformance, EM valuations and opportunities remain fair. Potential Trump Administration policies are a cause for caution as well as a strong dollar.
Risk Assets	Alternatives (Equity Based) & Real Assets	Real Estate		−		Fundamentals remain solid for the REIT category, but a tightening Fed and retail shopping center challenges create headwinds. The risk/reward scenario leads us to reduce our allocation.
Risk Assets	Alternatives (Equity Based) & Real Assets	Commodities/Natural Resource		+		A tightening Fed, building inflationary forces and a positive demand/supply story expected in metals in the coming years leads us to increase in this category, even as oil is challenged.

Note: Views are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.
Client portfolios may or may not be at the recommended weightings above due to, but not limited to: distributions, tax management limitations, systematic purchases, etc.

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Meet Our Experts

Deborah E. Scott

Executive V.P. & Director Trust Division

Debbie is the Executive Vice President, Trust Department Director and Senior Trust Officer and has been with C&N since January 1998. Prior to joining C&N, she spent 17 years with First Citizens Community Bank. She holds her Bachelor of Arts degree in Modern Foreign languages, French, from The King's College and her Masters of Science degree in Financial Planning from The College for Financial Planning. She is also an ABA National Trust School graduate. Debbie serves as Treasurer of the Blossburg Memorial Library and is a member of the Endless Mountain Music Festival Board.

Debbie, and the remainder of the Trust and Financial Management Group, provide clients with options tailored to meet their individual needs. She believes this is the reason that Citizens & Northern stands out from its competitors. "We focus on what is right for the client, not pushing a product. We are small enough to give individualized attention, but large enough to have the requisite expertise."