C&N Vantage Point

Quarterly Market Recap & Outlook

Second Quarter, 2018

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This Quarter's Content

Key Interest Rates	9/29/17	12/29/17	3/30/18	6/29/18
	2018			
2-yr Treasury Note	1.47	1.89	2.27	2.52
10-yr Treasury Note	2.33	2.4	2.74	2.85
30-yr Treasury Note	2.86	2.74	3.06	2.98
30-yr Fixed Mortgage	4.11	4.16	4.69	4.84
Corp. Bond Index	3.17	3.26	3.77	4.02
High-Yield Bond Index	5.98	6.16	6.5	6.66

Sources: JP Morgan Weekly Market Recap & Oppenheimer Markets Review At-a-Glance
Past performance does not guarantee future results, which may vary.

Key Equity Indexes As of Quarter End	%YTD Return	NTM P/E	P/B	Dividend Yield
S&P 500	2.65	16.14	3.21	1.95
Russell 2000	7.66	21.93	2.08	NA
Russell 1000 Growth	7.25	20.32	6.82	NA
Russell 1000 Value	-1.69	13.76	2.02	NA
MSCI EAFE	-2.37	13.62	1.64	3.17
MSCI EM	-6.51	11.34	1.68	2.58

Sources: JP Morgan Weekly Market Recap
Past performance does not guarantee future results, which may vary.

2018 YTD Performances	US Equity Style			MSCI World Style			US Fixed Income Maturity			
Equity Size	Value	Core	Growth	Value	Core	Growth	Short	In termed.	Long	Quality
Large	-1.69%	2.85%	7.25%	-3.61%	0.44%	4.72%	-0.28%	-0.69%	-3.00%	Government
Medium	-0.16%	2.35%	5.40%	-2.05%	0.39%	2.07%	-0.51%	-1.60%	-6.77%	Corporate
Small	5.44%	7.66%	9.70%	0.11%	2.70%	5.28%	0.11%	0.33%	-2.74%	High Yield

Source: Goldman Sachs Asset Management Market Monitor & Oppenheimer Markets Review At-a-Glance
US Equity Style Returns - Russell Indices
Past performance does not guarantee future results, which may vary.

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THE GUIDING LIGHT

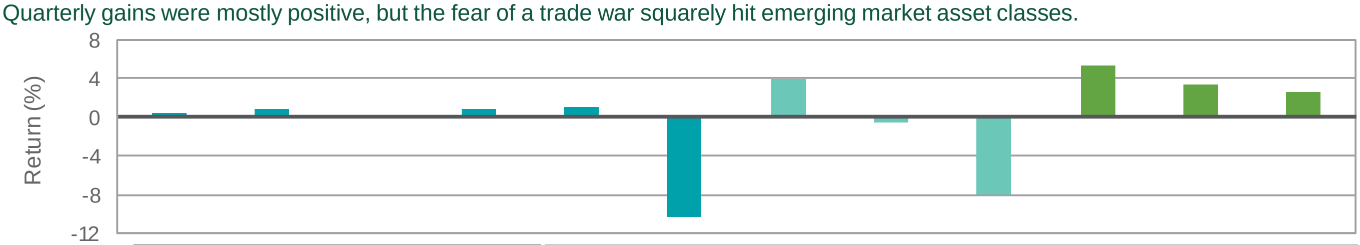
The Guiding Light holds the title of the longest-running soap opera of all time. When it was canceled in 2009, it had tallied 18,262 episodes over 57 seasons. The show started its run in 1952 – coincidentally at the height of the Korean War, a soap opera in its own right that continues on to this day (an armistice was agreed to in 1953 but no peace treaty was ever signed). The Korean plot thickened this past quarter, surrounding the much-hyped Singapore summit between U.S. President Donald Trump and North Korean leader Kim Jung Un. First it was on, then it was off. Ultimately it took place, with both sides vowing to work toward denuclearization of the Korean peninsula. A disarmed North Korea would be historic and its re-admittance to the global economic community would be constructive – at the very least reducing a persistent risk to financial markets over the last couple decades. But this plotline will likely be long and twisting.

The developments in Korea represented just one part of the financial market soap opera that became quite climactic for investors in the second quarter. Many of the typical storylines you would expect in a soap opera were present – from power struggles to "family" feuds. Representing the former was the political crisis worked through in Italy. The coalition formed between the populist Five Star Movement (M5S) and Lega (League) political parties was rejected by the Italian President Sergio Mattarella because of the coalition's pick for Finance Minister – eurosceptic Paolo Savona. A blowout in Italian government bond yields quickly brought the political leaders back to the negotiation table. An agreement was struck on June 1 to make M5S-backed Giuseppe Conte the next Prime Minister of Italy, but with a pro-euro Finance Minister in Giovanni Tria. Italian yields retreated from multi-year highs but remain elevated. Meanwhile, energy markets were captivated by developments within OPEC, as member nations (plus Russia) quarreled over oil production targets in the face of rising oil prices. In late June, a compromise was eventually reached to increase aggregate production targets by up to one million barrels per day. Oil prices rallied on the news as the increase was not viewed as enough to offset production outages elsewhere (Venezuela, Libya, Iran).

The biggest drama during the quarter, however, was the fear of a full on trade war as the U.S. seeks a more balanced trading relationship with China. With steel and aluminum tariffs already enacted, the Trump administration is ready to place tariffs on an additional $50 billion of Chinese goods (the first $34 billion scheduled to go into effect July 6). China has vowed to retaliate in kind – blow for blow. Ultimately, a full on trade war is in the interest of very few. It will be hard for the U.S. to target a set of Chinese goods broad enough to have a real impact on China without materially hurting U.S. companies. Despite all this drama, and the material fall in the prices of emerging market assets, global equity markets were positive for the quarter. Solid global economic growth and contained inflation are still providing *The Guiding Light* for investors. But, if the trade spat continues, that light is at risk of fading.

SECOND QUARTER 2018 TOTAL RETURNS

Quarterly gains were mostly positive, but the fear of a trade war squarely hit emerging market asset classes.



	RISK CONTROL			RISK ASSETS								
	FIXED INCOME						EQUITIES			REAL ASSETS		
	Cash	Muni	Inv. Grade	TIPS	High Yield	EM Debt	U.S.	Dev. Ex-U.S.	EM	NR	GRE	GLI
2Q 2018	0.4	0.9	-0.2	0.8	1.0	-10.4	4.0	-0.5	-7.9	5.4	3.5	2.6
YTD	0.8	-0.2	-1.6	0.0	0.2	-6.4	3.3	-2.2	-6.7	3.7	0.0	-3.1

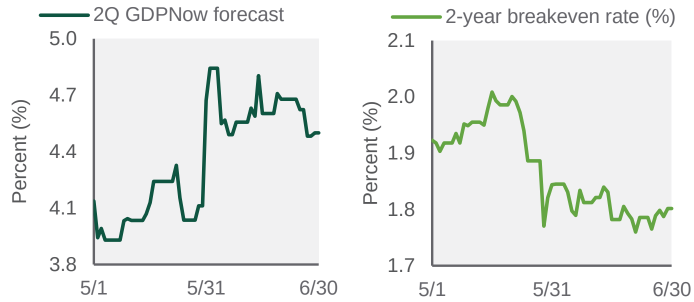
Source: Northern Trust Global Asset Allocation, Bloomberg. NR = Natural Resources; GRE = Global Real Estate; GLI = Global Listed Infrastructure.
Indexes are gross of fees and disclosed on last page.

KEY DEVELOPMENTS

Growth Up, Inflation Expectations Down

Global growth continued into the second quarter, with all major purchasing manager indexes indicating economic expansion – though the momentum shifted back to the United States from other global economic regions. As European retail sales softened and Chinese private growth metrics decelerated, U.S. growth moved higher. Official numbers will not be released until late-July but second quarter growth estimates suggest growth could be around 4%. As 2Q growth estimates went higher, two-year inflation expectations actually fell slightly with wage growth remaining tepid and investors expecting some moderation in economic demand as the fiscal stimulus from last year's tax reform bill begins to wear off.

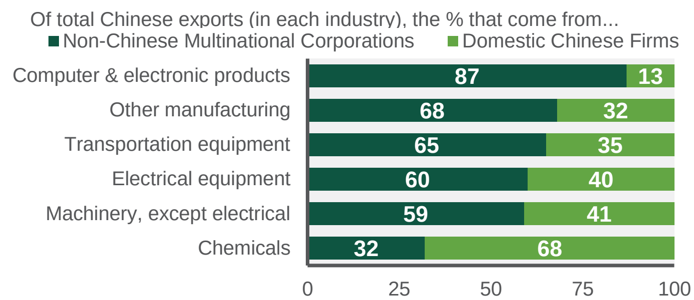
U.S. GROWTH AND INFLATION EXPECTATIONS



Escalating Trade Rhetoric

If ever a "right" time for the United States to engage China in a trade war, this could be it. With U.S. and Chinese growth momentum going in opposite directions, the hope is that the U.S. can secure a "fairer" relationship with China – both on trade and for corporations (intellectual property rights). But the duration of this battle may outlast the economic momentum the U.S. currently enjoys. The Chinese have vowed to punch back and Trump's base support has not waned. The scope of the conflict may ultimately be limited by the reality that neither side can materially hurt the other without hurting themselves. For example, as seen in the chart, 87% of all Chinese exports of electronic products were from non-Chinese companies.

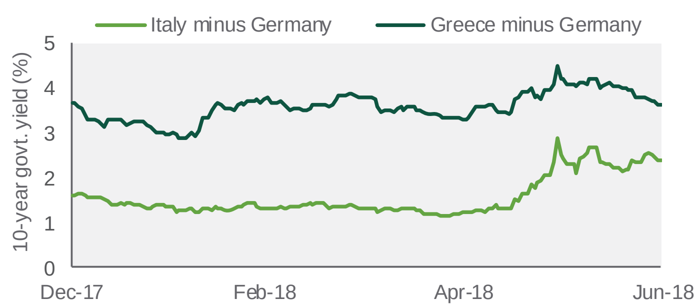
COMPOSITION OF CHINESE EXPORTS TO U.S.



The Italian Tragedy?

The political drama in Italy has calmed. Paraphrasing political advisor James Carville, nothing intimidates politicians like the bond market – and the spike in Italian debt yields (shown in the chart as the spread above German bunds, and compared to that of Greece) prompted M5S to tone down its anti-euro rhetoric. Nevertheless, the reenergized embrace of populism across Europe has caught investors' attention, with the euro down 5% against the dollar this quarter. Still, there are reasons to remain hopeful about the continued viability of the eurozone. Trump's "America First" doctrine has incented greater coordination to strengthen the union, including compromises on immigration and a common eurozone budget.

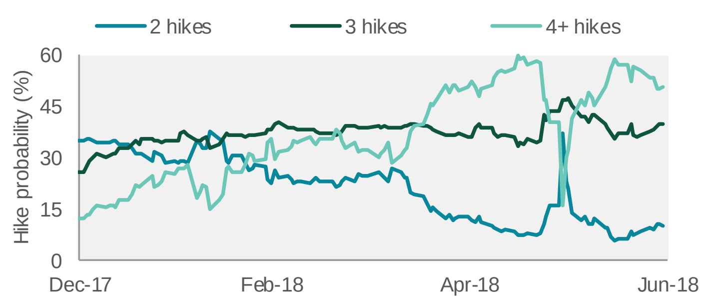
ITALIAN AND GREEK CREDIT SPREADS



Fed Rate Hikes: Three or Four (or Two)?

The most recent reading on the Fed's preferred inflation measure, the core Personal Consumption Expenditures index, came in right at the Fed's targeted level of 2%. This marks the first time the Fed's target has been reached in six years. The first question is where does inflation go from here. The last time core inflation reached these levels, it quickly rolled over and was back at 1.5% a year later. Today, there is less economic slack (3.8% unemployment) but also less accommodative Fed policy. The second question is where does the Fed go from here. Most investors still expect two more rate hikes this year (four total) but some think the Fed should pause, taking notice of the flattening yield curve and falling inflation expectations.

NUMBER OF EXPECTED RATE HIKES IN 2018



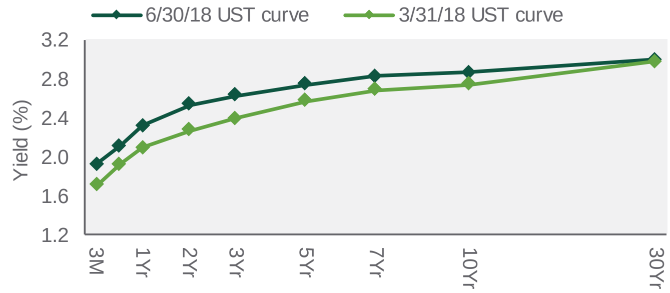
Source: Northern Trust Global Asset Allocation, Bloomberg, Atlanta Fed, Peterson Institute for International Economics.

MARKET REVIEW

Interest Rates

The yield curve continued to flatten in the second quarter as the Fed pushed through another rate hike (Fed policy rate now at a range of 1.75 to 2%) and the 10-year U.S. Treasury yield fell in response (ending the quarter at 2.86% from an earlier-quarter high of 3.11%). This puts the "2s-10s spread" (the difference between the 10-year and 2-year yields) at 0.33% – a level not seen since 2007. Investors are watching the shape of the yield curve closely as yield curve inversion (when longer-dated yields are lower than shorter-dated yields) has historically signaled a recession is on the way. Despite the continued flattening of the yield curve, the Fed appears determined to push forward with its slow rate hike campaign, telegraphing its intentions for two more hikes in 2018.

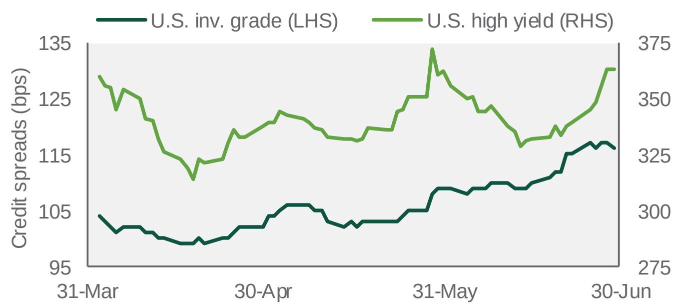
YIELD CURVE



Credit Markets

Investment grade credit spreads ticked up during the second quarter – ending at 1.2% – more driven by technical factors (supply/demand dynamics) than fundamental concerns. Exemplifying the still-solid fundamental backdrop, high yield credit spreads remained mostly range-bound, ending the quarter near decade lows at 3.6%. Defaults on high yield bonds have started to tick lower, ending the quarter at 3.9% and expected to trend down below 2% over the next year. Returns for the quarter were mixed with investment grade bonds down 0.2% and high yield bonds up 1.0%. Year-to-date, investment grade bonds are down 1.6% and high yield bonds are up 0.2%. Going into the back half of the year, investment grade and high yield indexes are yielding 3.3% and 6.5%, respectively.

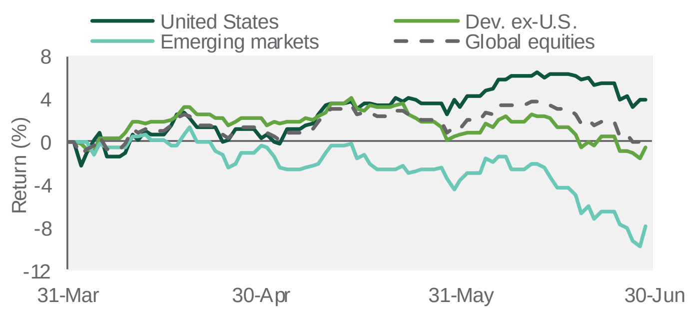
CREDIT SPREADS



Equities

Global equities posted a positive quarter (up 0.7%) with notable dispersion across the major regions. Benefiting from growing economic momentum, U.S. equities reasserted themselves as the top performer (up 4.0%) after taking a back seat to non-U.S. equities for much of the previous year. Developed markets outside the U.S. struggled to a -0.5% return as growth momentum slowed and political risks reemerged (including the installation of a populist government in Italy). Emerging market equities had the toughest time in the second quarter – down 7.9% – hit by the double whammy of dollar strength and escalating trade rhetoric. Year-to-date global equity markets are slightly negative (-0.1%), with U.S. equities (+3.3%) offsetting negative returns in non-U.S. markets.

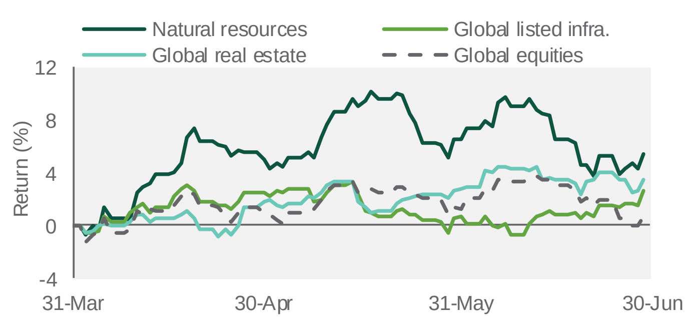
REGIONAL EQUITY INDICES



Real Assets

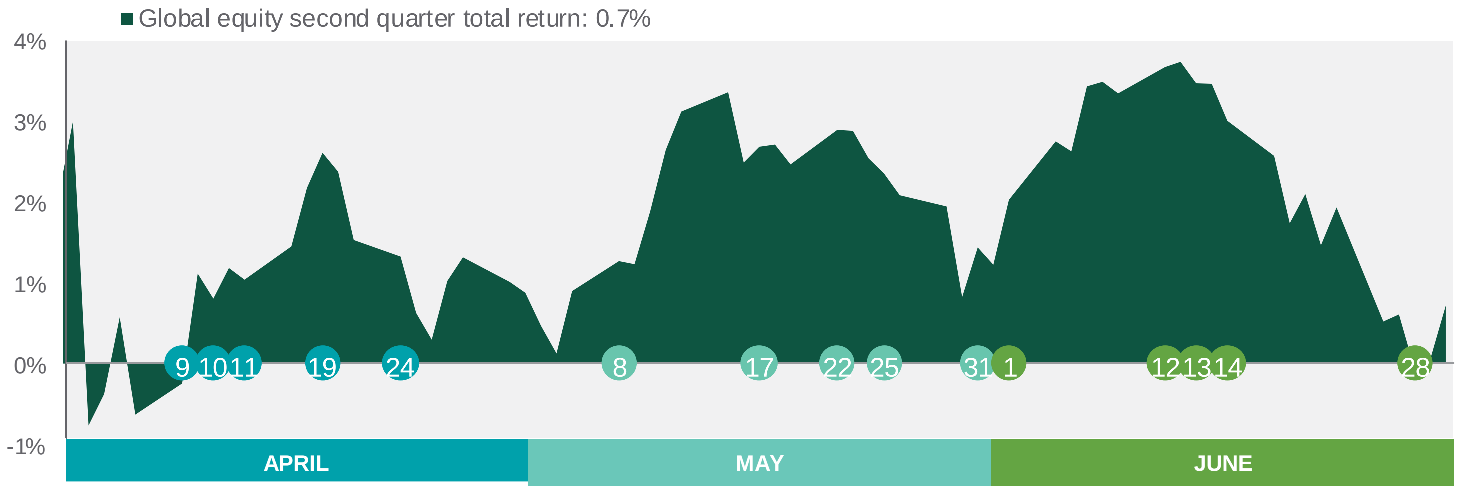
Real assets provided portfolio stability in the second quarter, with all asset classes in positive territory and ahead of global equities. Natural resources was the top performing asset class, with a second quarter return of 5.4%. Driving natural resources higher was the surge in oil prices, including a 13% price spike in the last week of the quarter, as strong demand whittled away OPEC-controlled supply and geopolitical events forced oil production from Venezuela, Iran and Libya offline. Meanwhile, global real estate and listed infrastructure both posted solid second quarter returns as well, helped by falling longer-dated interest rates towards the end of the quarter. Year-to-date, natural resources is up 3.7%, global real estate is flat and global listed infrastructure is down 3.1%.

REAL ASSET INDICES



Source: Northern Trust Global Asset Allocation, Bloomberg. UST = U.S. Treasury. Indexes are gross of fees.

MARKET EVENTS



APRIL	MAY	JUNE
9 China President Xi Jinping announces a reduction in tariffs on imported vehicles and greater access to markets from foreign investors.	8 President Trump withdraws the U.S. from the Iran nuclear deal and plans to reimpose sanctions.	1 Guiseppe Conte of the populist 5-Star-League coalition is sworn in as Prime Minister of Italy.
10 The spread between the 10-year and 2-year Treasury yield goes below 0.5% for the first time since 2007.	17 The 10-year Treasury yield hits 3.11% – its highest level since 2011 – but ultimately ends quarter at 2.86%.	12 Donald Trump and Kim Jong Un meet in Singapore, with North Korea agreeing to denuclearize for U.S. military concessions.
11 Facebook CEO Mark Zuckerberg testifies before Congress about data collection at Facebook and its relation to Cambridge Analytica.	22 Congress rolls back Dodd-Frank regulations, removing the strictest Federal oversight for banks with less than $250 billion in assets.	13 The Federal Reserve hikes interest rates for the second time in 2018 bringing the Fed funds rate to the 1.75% to 2% channel.
19 President Trump announces intent to nominate Richard Clarida as Fed Vice Chair and Michelle Bowman as board member.	25 The General Data Protection Regulation (GDPR) begins in Europe requiring companies to receive consumer consent on data use.	14 ECB will cut bond buying program to €15B in Sept. and phase out by year end. Draghi says first rate hike unlikely to occur before Sept. 2019.
24 The 10-year Treasury hits 3% for the first time in four years.	31 The U.S. exemption period for Canada, Mexico, and the EU ends, placing tariffs on aluminum and steel at 10% and 25%, respectively.	28 An EU agreement is reached to deal with the inflow of immigrants across member states – a major source of friction within the bloc.

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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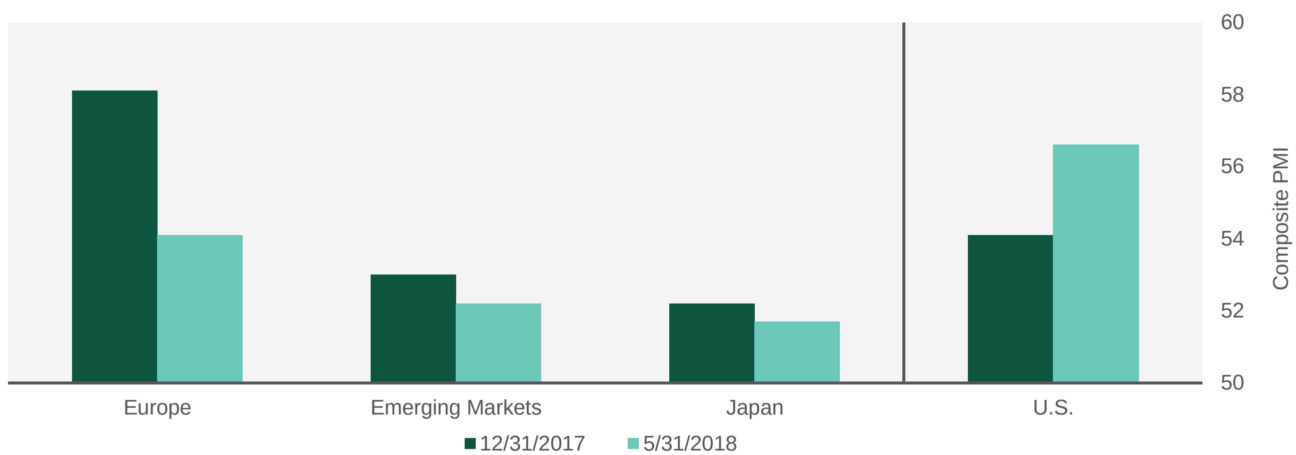
SHIFTING MOMENTUM

Momentum has shifted across the major developed economies, both economically and politically. As shown below, Europe entered 2018 with the strongest composite growth outlook, while the other major economies remained in a solid growth position. Momentum now has shifted to the United States for several reasons. An improved business climate, supported by significant tax cuts, has boosted sentiment. In addition, the euro's strength through the first quarter is a headwind to European exports. Temporary factors, such as poor weather, also may have hurt Europe. So some momentum may return as the year progresses.

In the meantime, historical political alliances continue to be challenged by both external and internal forces. President Donald Trump's focus on renegotiating existing trade and political agreements has disrupted the post-World War II order. The continued pressure of populist politics is also leading to new governing alliances in countries like Italy and Germany – challenging the historic support for key tenets of the European Union. In the United States, the mid-term elections have historically heralded a swing in power away from the incumbent party. This year, the swing may be insufficient to alter control of the House of Representatives. But even a change in control of the House would be unlikely to materially change the policy outlook because government would be divided. The result is relative stability in domestic policy within the United States – a redux of our old theme of "Political Volatility, Policy Stability."

The shifting momentum in growth and more uncertain political picture across Europe and trade could restrain central bankers. Fixed income markets have been buffeted recently by developments in Italy, where the new coalition government has taken a more aggressive stance toward the European Union. We have also heard from several Federal Reserve governors who have noted the relative flatness in the yield curve and their lack of desire to risk inverting the yield curve through excessive rate hikes. We don't expect an inflationary jump to force their hands. The Fed has communicated that it is willing to let inflation run above its 2% target because it was lower for so long. While we are hearing about cost pressures from company managements, our belief is that any inflation that makes its way through to consumer prices will likely be a shorter-term cyclical phenomenon vs. a secular move. In that situation, central bankers are likely to stay accommodative longer than the market believes.

GLOBAL MOMENTUM SHIFTING TOWARD THE UNITED STATES
Europe has lost the most relative momentum, but growth remains at a solid level.



Source: Northern Trust Global Asset Allocation, Bloomberg.

C&N PORTFOLIO POSITIONING: MODEST OVERWEIGHT TO RISK

C&N Vantage Points - July 2018

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Market Views:
Domestic Equity Fairly Valued. Small & Mid Cap Remain Appealing Due To Trade War Noise
Diversification Remains Paramount. Remaining Invested Is Important
A Sustained Market Correction Would Be An Opportunity

Market Risks:
Fed Rate Hikes Lead To A Flat Or Inverted Yield Curve
Geopolitical Risks & Trade War Risks Increase
Consumer Sentiment Begins To Fall

Risk Type	Asset Class	Sector Category	Under Weight	Neutral	Over Weight	Viewpoints
Risk Control	Cash/Cash Alternatives	Ultrashort Bonds			⊕	These sectors give us cash in the event of a market correction. With the Fed hiking rates and trade war risks rising, we move to overweight from rebalancing and await better opportunities.
Risk Control	Alternatives (Fixed Based)	Absolute Return			●	With market uncertainties rising, we maintain a maximum allocation at this time. We strive for better-than-money-market returns while decreasing our overall risk profile and await opportunities.
Risk Control	Alternatives (Fixed Based)	Inflation-Linked Bonds		●		We decreased duration in TIPS during 4Q17 to offset the Fed rate hike impact. Inflation expectations increased leaving TIPS fully valued. We move to neutral seeking to increase risk asset exposure.
Risk Control	Fixed Income	US Investment Grade Bonds	●			We have a slight overweight to IG Corps and remain underweight to U.S. Govt bonds due to a tightening Fed and inflationary forces building. Overall, the category remains underweight.
Risk Control	Fixed Income	International Bonds	●			Foreign central banks continue 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 remain tight, but EM fundamentals appear solid. Recent volatility has created opportunities. We moved to overweight earlier in 2018. The strong US Dollar and slow to move ECB are headwinds.
Risk Assets	Fixed Income	High Yield Bonds		●		High-Yield's coupon remains attractive and tax reform will help companies, but spread tightening may hurt total return. Given the business cycle stage, we retain our neutral position favoring EM bonds.
Risk Assets	Equities	US Large Cap			●	Although fairly valued, we believe growth continues amidst a bumpy market. We retain an overall overweight but take profits when rebalancing.
Risk Assets	Equities	Developed Ex-US		●		Monetary policy transitioning has been slower than expected. Valuations are reasonable compared to the U.S. We continue to favor domestic equities but look to maintain our positions through rebalancing.
Risk Assets	Equities	US Mid & Small Cap			●	With tax reform, fiscal stimulus talks & the dollar decline less likely to impact them, we maintain our risk assets through this category. We will take some profits from recent run-ups.
Risk Assets	Equities	Emerging Markets		●		EM valuations and opportunities remain fair. Fundamentals have improved but trade war risks have risen given tariff threats and NAFTA negotiations. We remain neutral given the uncertainties.
Risk Assets	Alternatives (Equity Based) & Real Assets	Real Estate		●		Fundamentals remain solid for the REIT category, but a tightening Fed and tight spreads gives us caution. The risk/reward scenario leads us to maintain our allocation.
Risk Assets	Alternatives (Equity Based) & Real Assets	Commodities/Natural Resource		●		Oil finding a base, a tightening Fed, building inflationary forces and a positive demand/supply story expected in metals in the coming years leads us to maintain our position and monitor it.

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Second Quarter, 2018

Meet Our Experts

Josh Sivers

Senior Retirement Plan Administrator

Josh has been serving local financial services customers in a wide variety of roles since 2003. He joined Citizens & Northern Bank in 2014 and currently serves as Senior Retirement Plan Administrator. His duties include overseeing all aspects of employer-sponsored retirement plan administration for the Trust & Financial Management Group's clients.

Administering an employer-sponsored plan requires a significant amount of time with employees, and that is where Josh's job satisfaction starts from. "It is a great day when I can spend a few hours at a factory or professional office and leave knowing I helped six or eight people take an important first step toward future financial success," Josh said.

Josh is a 1999 Lycoming College graduate with a B.A. in Communications, and he also earned a Masters of Business Administration from Bloomsburg University in 2001. "Working with the 401(k) Plans for local companies fits me pretty nicely. I can exercise my brain with all of the technical detail and then walk into a meeting ready to translate that into practical meaning for an employer sponsor or employee participant," Josh said. In 2017, Josh was awarded the Qualified 401(k) Administrator (QKA) credential by the American Society of Pension Professionals and Actuaries.

Josh lives in Watsontown, PA with his wife Katharine, and his two children. He has volunteered his time to serve as a coach for the Warrior Run AYSO and the Warrior Run Little League. He currently serves as the Little League's Treasurer and Safety Officer. Josh is a member of the Unitarian Universalist Congregation of the Susquehanna Valley.