C&N Vantage Point

Quarterly Market Recap & Outlook

First Quarter, 2017

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This Quarter's Content

Key Interest Rates	2017			
	6/30/16	9/30/16	12/30/16	3/31/17
2-yr Treasury Note	0.58	0.77	1.2	1.27
10-yr Treasury Note	1.49	1.6	2.45	2.4
30-yr Treasury Note	2.3	2.32	3.06	3.02
30-yr Fixed Mortgage	3.75	3.66	4.41	4.33
Corp. Bond Index	2.86	2.85	3.38	3.33
High-Yield Bond Index	7.4	6.57	6.46	6.18

Sources: Northern Trust/JP Morgan

Key Equity Indexes - As of Quarter End	%YTD Return	NTM P/E	P/B	Dividend Yield
S&P 500	6.07	17.55	3.03	2.02
Russell 2000	2.47	24.03	2.14	1.51
Russell 1000 Growth	8.91	19.55	5.73	1.60
Russell 1000 Value	3.27	16.22	2.02	2.65
MSCI EAFE	4.85	14.77	1.62	3.07
MSCI EM	7.80	12.14	1.56	2.44

Sources: Northern Trust/JP Morgan

Economic Indicators Data	2016				2017				Q4 to Q4 Change			Annual Change		
	16:1a	16:2a	16:3a	16:4f	17:1f	17:2f	17:3f	17:4f	2015a	2016f	2017f	2015a	2016f	2017f
Real Gross Domestic Product (% change, SAAR)	0.8	1.4	3.5	2.1	1	2.5	2.1	2.2	1.9	2	2	2.6	1.6	2
Consumer Price Index (% change, annualized	0.1	2.3	1.8	3.1	1.8	1.5	2.2	2.1	0.4	1.8	2	0.1	1.3	2.3
Civilian Unemployment Rate (% average)	4.9	4.9	4.9	4.7	4.7	4.6	4.5	4.5	-	-	-	5.3*	4.8*	4.6*

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

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NEGOTIATING TACTICS

First Quarter 2017

Donald Trump's 1987 book, *The Art of the Deal*, received renewed interest post-election as many – investors, executives and politicians alike – sought a glimpse into the new president's mindset. Given the state of global affairs, another helpful read may be Avinash Dixit and Barry Nalebuff's *The Art of Strategy*. The authors analyze both real and theoretical negotiations, identifying the various tactics employed. One common tactic is brinkmanship – the practice of maneuvering a situation to "the brink" in order to secure the best deal. Brinkmanship is a favorite of politicians, used to varying levels of success. And its use will likely continue as the Trump administration settles in; the United Kingdom exits the European Union (EU); and world leaders look to craft new trade agreements.

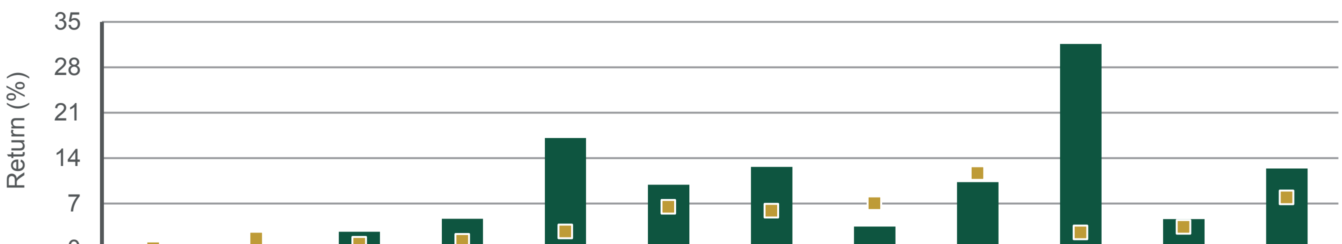
Starting in the United States, the first quarter of 2017 gave Republicans a taste of how difficult reform will be without party unification and bipartisan cooperation. The first litmus test was their first stab at replacing the Affordable Care Act. While its failure did not have a direct impact on the economic outlook, it did raise questions over the ability of Congress to achieve more important goals (tax reform) or avoid self-made crises (debt ceiling). Meanwhile, as expected, the UK triggered Article 50 of the Lisbon Treaty on March 29, notifying the European Council of its intention to leave the EU. This launches a two-year negotiation period to establish a new political and economic relationship. If Dixit and Nalebuff's work on the topic is any guide, they will take the full time allotted.

Despite growing political entrenchment, continued – and synchronized – global growth pushed risk assets higher in the first quarter; and allowed the Fed to take another quarter-point step towards policy normalization without negative reaction from financial markets. Global economic strength has also kept investors patient with ongoing negotiations – whether it be the U.S. pro-growth regime shift, Brexit or global trade. This patience allows time to find solutions to which all can agree. The academic foundation here is the Nash equilibrium*, which represents the best choice for all after considering the intentions of all others. Negotiations can advance more easily as these equilibrium points are identified through interaction. President Trump views himself as a dealmaker. His and other world leaders' grasp of these negotiating tactics will determine their ability to further support the currently solid growth environment – and not fall off "the brink".

*The Nash equilibrium is nicely explained and exemplified in a scene from the academy award winning, *A Beautiful Mind.*

FIRST QUARTER REMAINED RISK ON, BUT EMPHASIZED DIFFERENT ASSET CLASSES

United States post-election optimism spread to other regions in the first quarter of 2017.

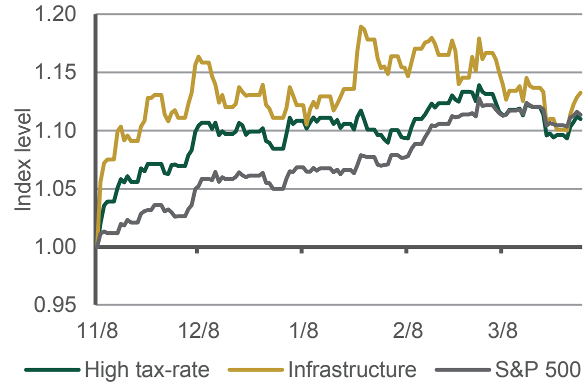


	Fixed Income					Equities			Real Assets		
	Cash	Muni	Inv. Grade	TIPS	High Yield	Em. Markets	United States	Dev. ex.-U.S.	Em. Markets	Natural Res.	Global Real Estate	Global Listed Infra.
2016	0.3	0.2	2.6	4.7	17.1	9.9	12.7	3.5	10.3	31.6	4.6	12.4
1Q17	0.1	1.6	0.8	1.3	2.7	6.5	5.9	7.1	11.7	2.6	3.4	7.9

Source: Northern Trust Investment Strategy, Bloomberg. Indexes are gross of fees and disclosed on last page.

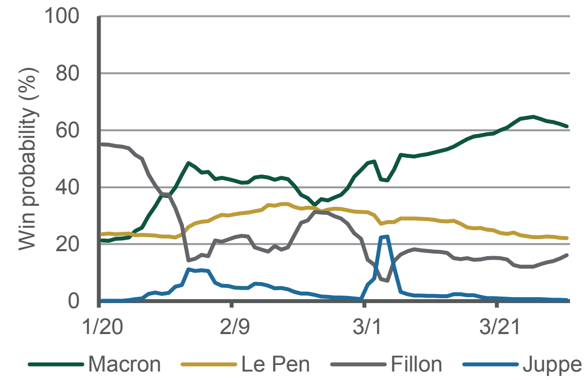
U.S. LEGISLATIVE SETBACK

The Republican repeal and replace of Obamacare is proving easier said than done. Concessions requested by Freedom Caucus members (wanting full repeal) meant lost support from centrist members (wanting smaller tweaks). Short on votes, the bill has yet to make it to the House floor. Healthcare reform is more of a social (vs. economic) issue, but its struggles call into question the GOP's ability to deliver on its pro-growth agenda (tax reform, fiscal stimulus). Even prior to this setback, markets had reduced expectations for tax reform and fiscal spending as implied by the recent weakness (relative to the broader market) in "high-tax" and "infrastructure-sensitive" stocks (see chart).



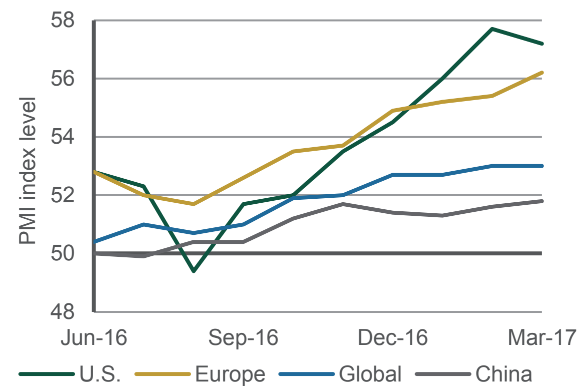
BIG TESTS AHEAD FOR THE EUROPEAN UNION

On March 29, the UK hand-delivered a six-page letter to European Council President Donald Tusk, formally notifying the EU of the UK's Brexit intentions and triggering the two-year negotiation window. The upcoming French elections will also shape the EU's future. A win by anti-EU candidate Marine Le Pen would be a big blow to EU viability. With previous front-runner (and pro-EU) Francois Fillon's campaign derailed by nepotism charges, Emmanuel Macron is the best bet to preserve the EU status-quo. Polls show Le Pen/Macron finishing "1-2" in first-round voting (4/23), while Macron is expected to win in the run-off (5/7). Markets place Macron's odds of victory at 61% (see chart).



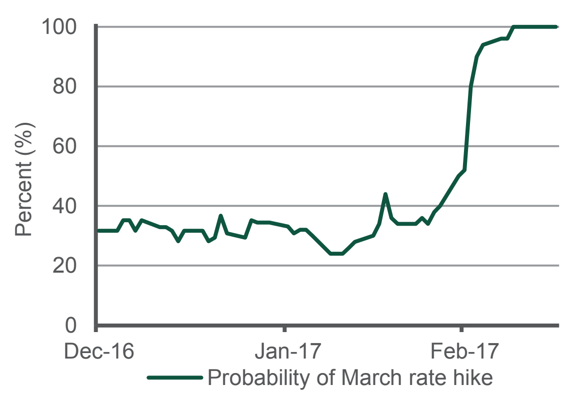
GLOBAL GROWTH ACCELERATING

Overshadowed by the political headlines is the continued global economic growth acceleration that started last June. The global purchasing manager index now sits at 53.0 (above 50 indicates growth), increasing from 50.4 over the past nine months (see chart). Importantly, all three of the world's largest economic blocs have contributed, resulting in a global growth synchronization not seen since the period just after the global financial crisis. Purchasing manager indexes are a "soft" reading of economic activity based on surveys. But the harder data is also reassuring, including notable improvements in industrial production and retail sales across many regions.



FED SEIZES OPPORTUNITY TO HIKE RATES

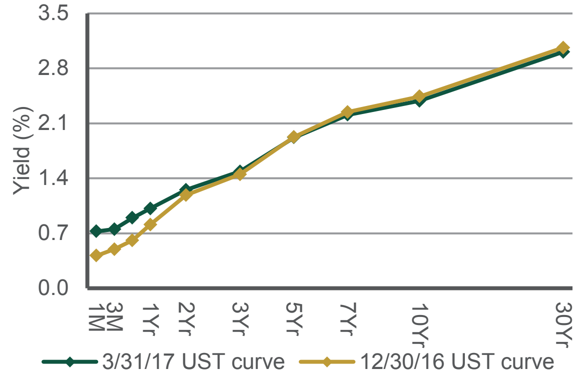
The Fed took advantage of the improving global economy and falling financial market volatility by raising rates a quarter-point on March 15. Well-orchestrated comments from several Fed voting members quickly raised the market-based odds of a rate hike from a 50-50 shot to a near-certainty over the span of three days just two weeks before the Fed meeting (see chart). U.S. equity markets were up nearly 1% on Fed decision day as investors approved of the Fed maintaining its expectations for two more rate hikes in 2017 (signaling the March move was a "dovish hike"). Markets have priced in 57%/80% odds of rate hikes at the Fed's June/September meetings, respectively.



Source: Northern Trust Investment Strategy, Bloomberg, GS Investment Research.

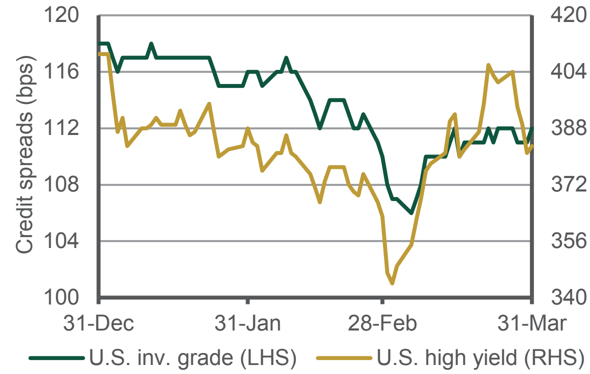
INTEREST RATES

In the battle between improving fundamentals and supply/demand dynamics, the latter won in Q1. Economic growth has accelerated, which should result in higher interest rates across the curve. But investors' insatiable demand for U.S. Treasuries (UST) – especially further out the yield curve – resulted in a flatter yield curve over the course of Q1. The 3-month UST moved higher by about 0.25% (in-line with the Fed rate hike) but anything more than two years out the curve saw little change; and yields on maturities beyond seven years actually fell slightly. Part of the demand is coming from non-U.S. investors, where "low" U.S. rates compare favorably against their negative rates.



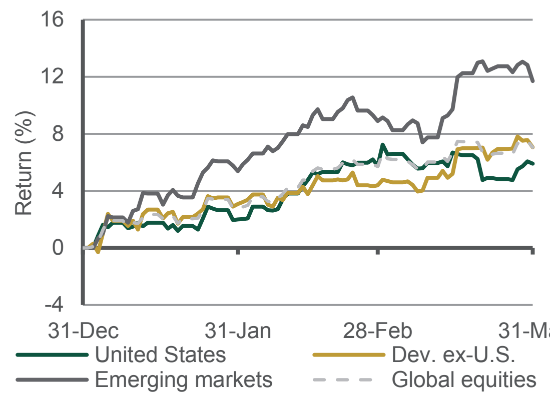
CREDIT MARKETS

Credit spreads tightened modestly in the investment grade and high yield markets during Q1. Driving the improvement was the combination of positive fundamentals and some renewed "search for yield" as interest rates pulled back. Market technicals (supply/demand) added some volatility in March, especially in junk bonds. High yield spreads went as low as 3.4% driven by sparse issuance, only to move materially higher over the next three weeks – hitting 4.1% – as issuance flooded the market. The oil price pullback also created some risk aversion in energy sector issues. Overall though, it was a positive quarter, with investment grade fixed income up 0.8% and high yield up 2.7%.



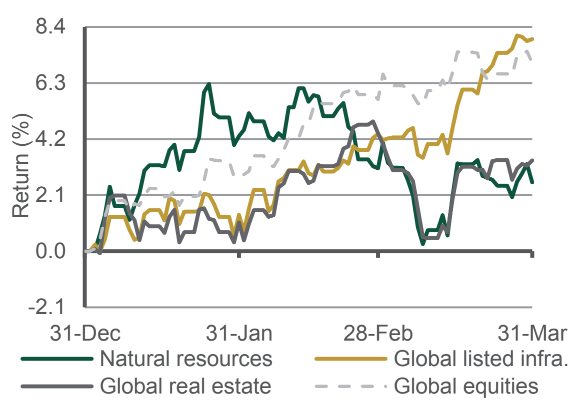
EQUITIES

Global equity markets returned 7.0% in Q1. The rally was truly global in nature – not just pulled along by U.S. markets. In fact, as U.S. equities consolidated in the month of March, Japanese and European equites pushed higher. For the full quarter, U.S. equities were up 5.9% while non-U.S. developed market equities were up 7.1%. Especially noteworthy was the outperformance of emerging market equities (EM). After suffering immediately after the U.S. election in the face of a strong dollar and protectionist threats, EM rallied strongly in Q1 (up 11.7%) as global growth continued to strengthen and concerns over potentially negative impacts from Fed and D.C. policy faded.



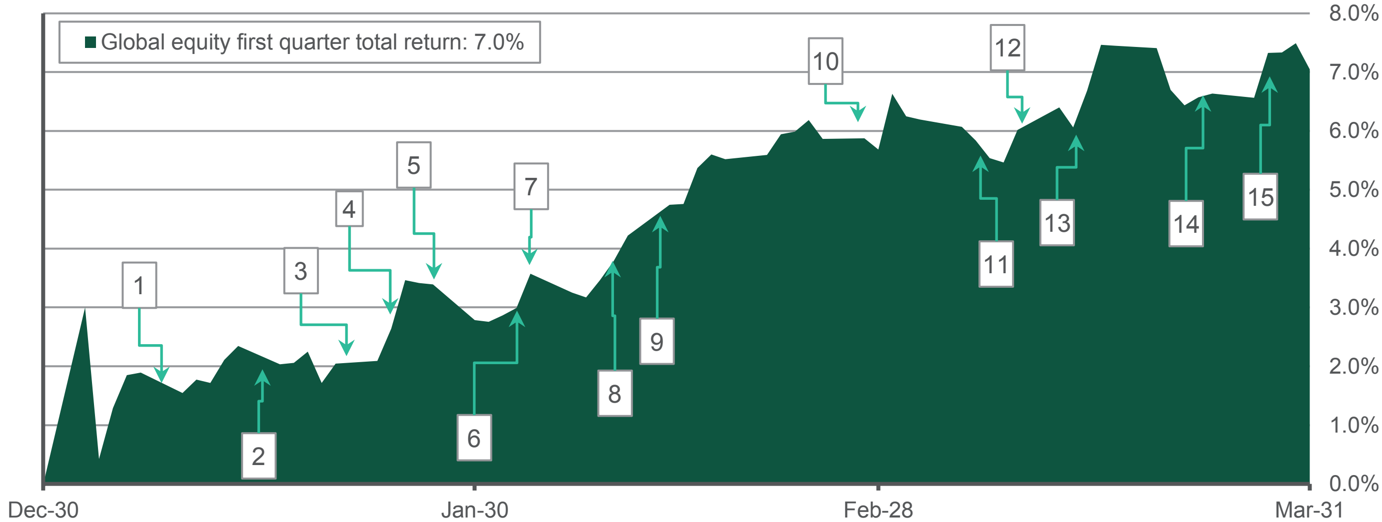
REAL ASSETS

Global listed infrastructure (GLI) was a standout performer, representing the only real asset to outperform global equities in Q1 (7.9% vs. 7.0%). Most of GLI's outperformance came in March as investors were once again attracted to its 3.7% dividend yield amidst falling interest rates and its downside protection as enthusiasm faded around the Republican pro-growth agenda (reminder: despite its name, GLI would not be expected to directly benefit from an infrastructure spending bill). Global real estate – the more volatile "cash flow asset" – lagged GLI, returning 3.4%. Meanwhile, natural resources dealt with commodity supply headwinds but managed a 2.6% return.



Source: Northern Trust Investment Strategy, Bloomberg.

FIRST QUARTER 2017 NOTABLE EVENTS



1	Small business optimism increases to levels last seen in 2004, according to National Federation of Independent Business survey
2	In a major speech, Theresa May sets forth plans for a “hard” Brexit; pound rallies on the increased clarity
3	Trump inauguration ushers in one-party control of government policy after six years of split power in Washington D.C.
4	Dow passes the 20,000 mark for the first time, backed by strong corporate earnings and growing economic optimism
5	Trump signs a host of executive actions, the most controversial being a travel ban on seven predominately-Muslim countries
6	Leading French Presidential candidate Francois Fillon falls dramatically in polls over nepotism scandal
7	"Goldilocks" U.S. jobs report is released – more jobs added but higher participation rate actually raises unemployment rate
8	Stocks jump as Trump announces that a "phenomenal" tax plan would be coming soon and top Fed regulator Daniel Tarullo resigns
9	Michael Flynn, President Trump's national security adviser, resigns amidst controversy over discussions with Russian officials
10	President Trump focuses on pro-growth reforms in his first joint meeting of Congress, sending the S&P 500 up 1.4% the next day
11	ECB President Draghi highlights a reduction in deflationary risks but the ECB continues its accommodation with no changes in policy
12	Pro-reform Prime Minister Narendra Modi’s BJP party scores big election win in India’s largest state; emerging markets jump 1.3%
13	After telegraphing the move for the prior two weeks, the Fed hikes a quarter-point at its March meeting; S&P 500 finishes up 0.8%
14	Republicans fail to bring the American Health Care Act (Obamacare replacement) to the House floor, lacking the votes needed
15	The United Kingdom invokes Article 50 of the Lisbon Treaty, formally triggering the start of Brexit negotiations

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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ANOTHER UPGRADE

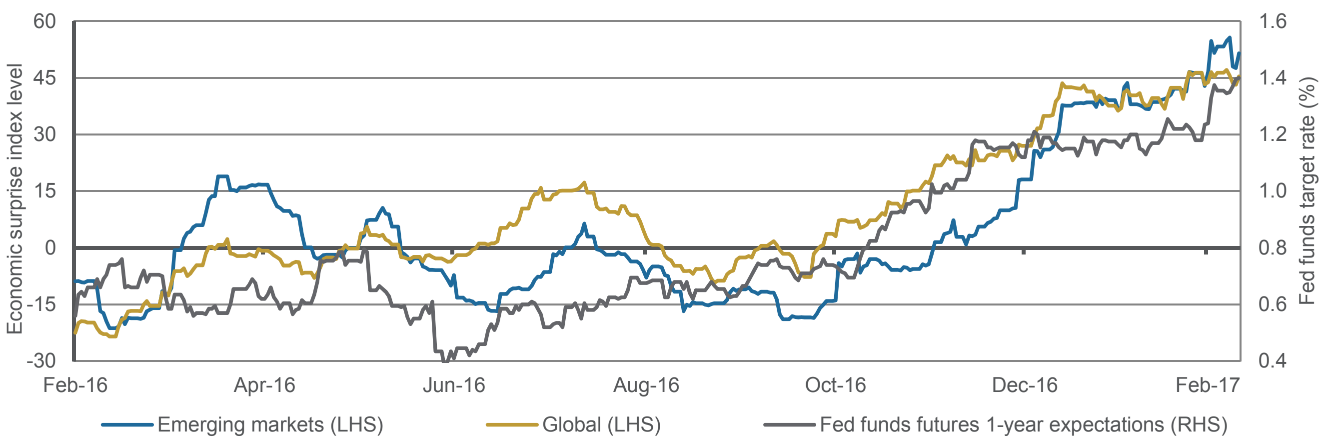
Earlier this year we highlighted our upgraded view toward growth in Europe and developed Asia because they are benefitting from solid domestic demand and relatively weaker currencies. This month we upgraded our outlook for emerging market growth and correspondingly boosted our recommended emerging market equity allocation. We had some concerns that upcoming policies to boost U.S. growth could come at the expense of emerging market economies (e.g., increased tariffs), but that concern is receding as the U.S. growth pickup appears more organic. This now leaves us with a positive view on the economic outlook for all major regions of the global economy, which is an important pillar of our overweight to risk assets.

The upturn in economic growth is also relieving some pressure on central bankers, who have been lonely among their fellow policy makers in efforts to boost the global economy. Markets have moved in a short period to price in a 100% probability of a Fed Funds rate-hike in March, and the Fed's rhetoric has become more balanced. Communications from the European Central Bank (ECB) have remained dovish overall, but the ECB is acknowledging the improving growth outlook across the region. The political calendar is likely a cause for some hesitancy among ECB members, with national elections in the Netherlands, France and Germany this year.

The next two months will bring the Dutch (mid-March) and French elections (first round, April 23; likely second round, May 7). While the populist candidates are garnering substantial support in both countries, current data suggest neither would be able to cobble together a majority coalition. With polling ahead of both Brexit and the U.S. election leading to faulty conclusions, however, investors will likely remain concerned about this risk until the final results are in. Our theme of "market stability" continues to hold; financial markets are more focused on economic developments than the latest Tweet coming from the new U.S. president. The positive aspect of the U.S. political system's checks and balances is the reduction in risk. The negative aspect is the resulting slower progress, which is starting to play out in the new administration's legislative priorities. The initial focus on repealing/replacing the Affordable Care Act is delaying action on tax reform and infrastructure spending. While further delays are a new risk case for us, current economic momentum appears sufficient for now to continue supporting our positive view on risk taking.

POSITIVE ECONOMIC DEVELOPMENTS GIVES THE FED SOME ROOM

Better economic data has led to increasing rate expectations from the Fed.



Source: Northern Trust, Bloomberg. Data through 3/10/2017.

C&N PORTFOLIO POSITIONING: MODEST OVERWEIGHT TO RISK

C&N Vantage Points - April 2017

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Market Views:
US Markets Maintain Leadership
Diversification Remains Paramount
A Market Correction Would Be An Opportunity

Market Risks:
Trump Policies Fall Short
Fed Plays Catch Up With Rate Increases
Political Headline Risks

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. but political headwinds remain in Europe, which holds this category at neutral.
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 may dampen the total return from this asset class. Assessment of our allocation becomes on-going.
Risk Assets	Alternatives (Equity Based) & Real Assets	Commodities/Natural Resource	●			For now, a slight underweight is maintained. But a tightening Fed, building inflationary forces and a firming commodity environment leads us to assess moving to neutral sooner, not later.

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

Jay Over

Investment Officer

Jay brings over 8 years of experience in asset management and investment research to Citizens & Northern Bank's Trust and Financial Management Group. In the course of his professional career, Jay has worked extensively with portfolio trading and rebalancing, selecting investment managers, and analysis of investment performance. He enjoys the challenges and the continuing evolution offered by the investment management field but derives the most satisfaction from helping clients achieve their financial goals.

Jay holds the Certificate in Investment Performance Measurement (CIPM) designation and is currently a Level II Candidate in the CFA Program. He graduated summa cum laude from Saint Francis University with Bachelor of Science degrees in Accounting and Finance.

Jay is originally from the Altoona area and currently lives in Wellsboro. He enjoys bicycling and is an avid NASCAR fan.