April 2017

Dear Client:

"Progress is impossible without change; and those who cannot change their minds cannot change anything."

- George Bernard Shaw

The Investment Management Group passed a major milestone this quarter, surpassing $3 billion in assets under administration. Having a well-defined, consistent investment process has been critical to achieving this goal. The three fundamental elements of this process (quality security selection, portfolio diversification, and downside protection) have remained in place over the 14 years I have led the group. However, the process, while consistent, is far from static. In this quarterly letter, in addition to our quarterly market update, I will share some details of how we are evolving our mutual fund selection process to improve risk adjusted returns.

The post-election advance in stocks persisted into the first quarter of 2017. Market expectations remain high that President Trump will make good on his campaign promises to reduce taxes, reduce regulations, and increase infrastructure spending. Further supporting the market rise was a raft of generally positive economic reports suggesting, even without fiscal stimulus, the U.S. economy is fairly healthy. Bonds, which sold off after the election, posted positive returns in the first quarter, despite the Federal Reserve rate hike in mid-March.

Traditional Asset Class Returns Q1:2017		
Asset Class	**Benchmark**	**Q1 and YTD 2017**
US Stocks	S&P 500	6.07%
US Gov't Bonds	Barclays Capital Intermediate Gov't	0.54%
Cash	3 Month T-Bill	0.10%

US Economy

The U.S. Economy continues on its slow growth trajectory. At the March meeting of the Federal Reserve, Chair Yellen characterized the U.S. economy as, "doing nicely." She highlighted solid income gains by consumers and firming business investment. Unemployment of 4.5% in March as well as inflation of almost 2% suggests that the Federal Reserve remains on target for one to two more interest rate increases in 2017. When asked about the possible impact of President Trump's proposals, Chair Yellen emphasized that current assumptions for economic growth did not include any expected effects from this potential stimulus. This would suggest an even better outlook for the economy should President Trump meet with success on any of his economic proposals.

US Stocks

Technology had a banner quarter, with S&P 500 tech stocks surging 12.6%. Most notably, sector heavyweights, Apple and Facebook were up over 20% in the quarter, although there was strength across the sector. Consumer discretionary and healthcare sectors also demonstrated strength – bouncing back from weak fourth quarter performance related to the Presidential election and potential adverse policy decisions. On the flipside, energy stocks moved down in sympathy with energy prices in the quarter and telecom stocks suffered as wireless competition heated up.

US Bonds

The yield curve flattened in the first quarter, as short term rates rose while long term rates declined. The yield on the 3-Month U.S. Treasury bill increased twenty four basis points to 0.76%, while the yield on intermediate (3-10 years) and long (greater than 10 years) maturity bonds dropped slightly. Since bond prices rise when yields decline, almost every sector of the market posted a positive return with longer maturity bonds out performing short maturity bonds. In contrast to the optimism implied by strong stock market performance, a flattening yield curve could suggest that bond investors are less optimistic about future economic growth.

Diversifying Asset Classes

Asset Class	**Benchmark**	**Q1 and YTD 2017**
Foreign Stocks	MSCI EAFE	7.25%
Emerging Markets Stocks	MSCI Emerging Markets	11.45%
US Mid Cap Stocks	Russell Mid-Cap	5.15%
US Small Cap Stocks	Russell 2000	2.47%
REITs	MSCI US REIT	0.99%
Commodities	Bloomberg Commodity	-2.33%
MLPs	Alerian MLP	3.95%
Managed Futures	Morningstar US Managed Future	0.01%
Foreign Bonds	Citigroup Non-USD WGBI	2.02%
Emerging Market Bonds	JPM EMBI Global	3.90%
US Inflation Protected Bonds	BarCap US Treasury TIPS	1.26%
Floating Rate Loans	Credit Suisse Leveraged Loan	1.20%
US High Yield Bonds	BarCap US Corp High Yield	2.70%
Convertible Bonds	BofAML Convertible Bonds	5.75%

Developed and emerging market equity classes were the top performers in the first quarter driven by improving economic prospects globally as well as lower valuations relative to the U.S. market. Only commodities posted a negative return in the quarter. Investors fretted that, despite improving economic conditions, demand in China and other resource intensive economies would not substantially draw down global inventories.

Conclusion

I want to conclude with some thoughts on our fund selection process and recent developments in this approach. Most of our clients appreciate the work that we put into managing investment grade bond and large cap quality equity allocations. What may be less well understood is our process for selecting other asset classes. Many of our competitors simply buy the best performing funds and sell those that are under-performing. This approach is easy, appears intuitive, and can be readily justified to clients. However, our research strongly suggests that this approach results in buying high and selling low – the exact opposite of what one needs to do to be a successful investor. There are tried and true quantitative measures indicative of future out-performance that are core to our manager selection process, but historic performance is no longer one of them. We have progressively given more weight to qualitative factors which help us to identify funds with a unique, disciplined, and consistent process that we believe will provide clients with superior risk adjusted returns over time. To identify these funds requires extensive work by our team, often detailed explanations and, sometimes, counter-intuitive actions (i.e. why would we add a fund that has poor historic performance?). As clients who have been with us for a while already know, we do not shy away from extra work and communication when we know it will produce better results!

While change has been a theme of this letter, what will never change is our gratitude for your business. Your willingness to select Rockland Trust to assist you in achieving your financial goals explains why we continue to thrive as an organization.

Sincerely,

David B. Smith, CFA
Chief Investment Officer
Investment Management Group