Quarterly
Investment Briefing
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INDIANA TRUST
& Investment Management
COMPANY

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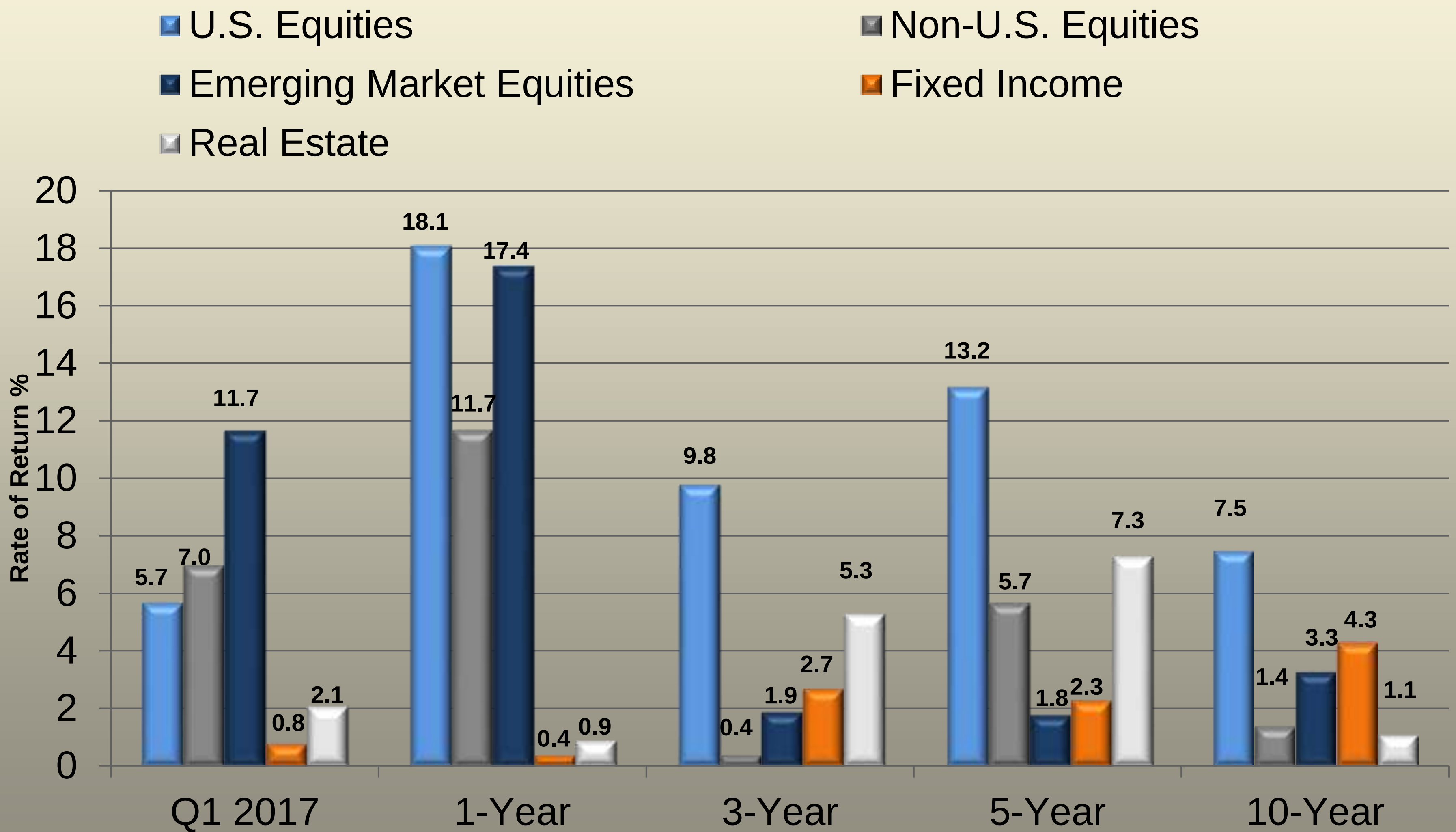
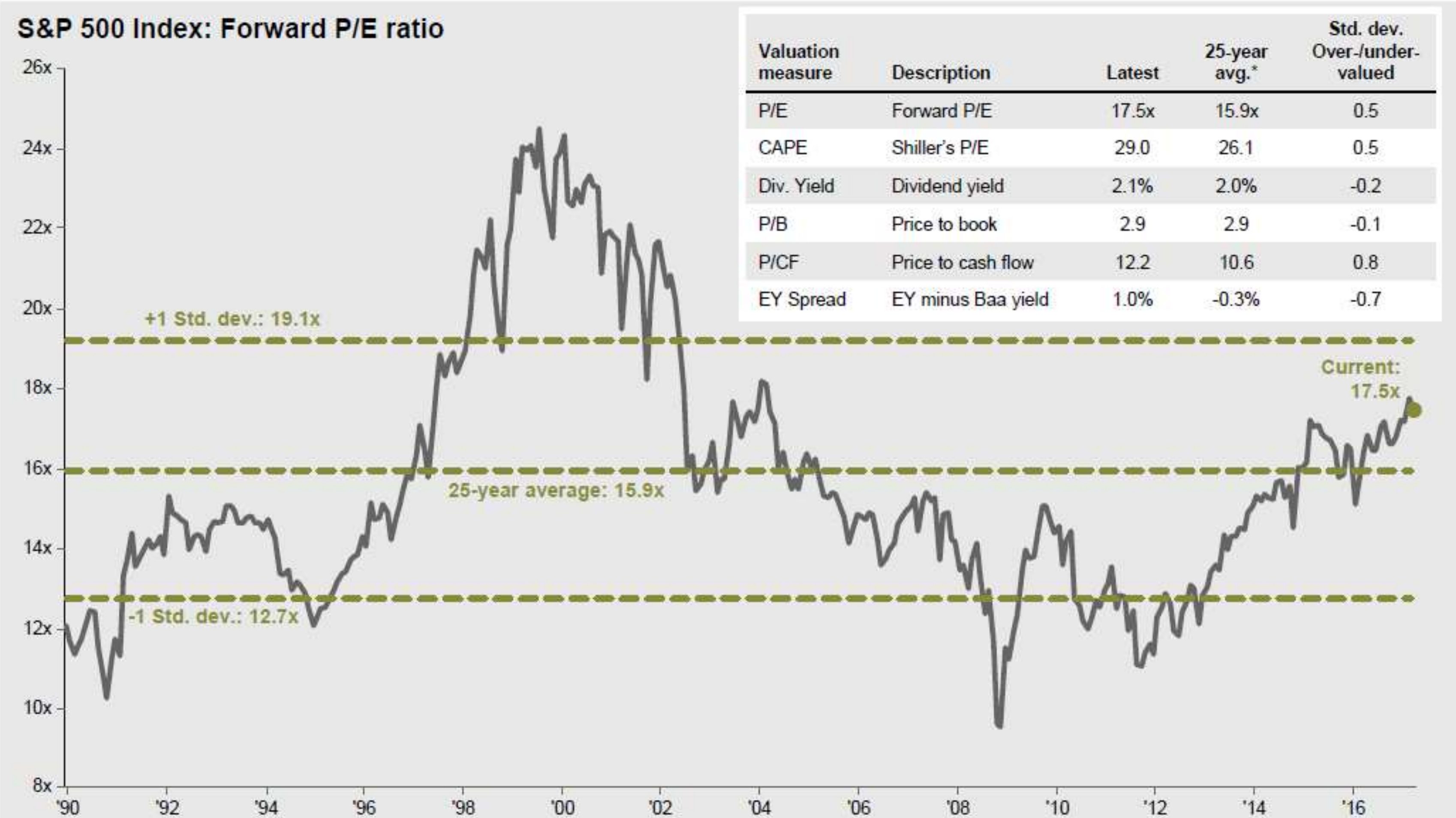
Capital Market Returns Current & Annualized Period Ending March 31, 2017



Source: Russell, Barclays, Bloomberg and FTSE NAREIT

Valuations of U.S. stocks have risen

Earnings-based valuations have inched higher, raising the possibility of muted future returns.



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-valued
P/E	Forward P/E	17.5x	15.9x	0.5
CAPE	Shiller's P/E	29.0	26.1	0.5
Div. Yield	Dividend yield	2.1%	2.0%	-0.2
P/B	Price to book	2.9	2.9	-0.1
P/CF	Price to cash flow	12.2	10.6	0.8
EY Spread	EY minus Baa yield	1.0%	-0.3%	-0.7

Source: FactSet, FRB, IBES, Robert Shiller, Standard & Poor's, J.P. Morgan

Post-election global equity market strength

Unforeseen dollar weakness in the first quarter was a tailwind for international equity asset classes, outpacing U.S. markets.

Strong returns in the weeks following the election have U.S. equities ahead of non-U.S. equities…

…however this trend has reversed as non-U.S. equities outperformed in 1Q2017

Source: Russell 1000 Index, Russell 2000 Index, Russell Developed ex-U.S. Index, Russell Emerging Markets Indexl

U.S. rally has altered global equity market dynamics

U.S. market share has increased proportionally relative to international markets, in part because of rising valuations.

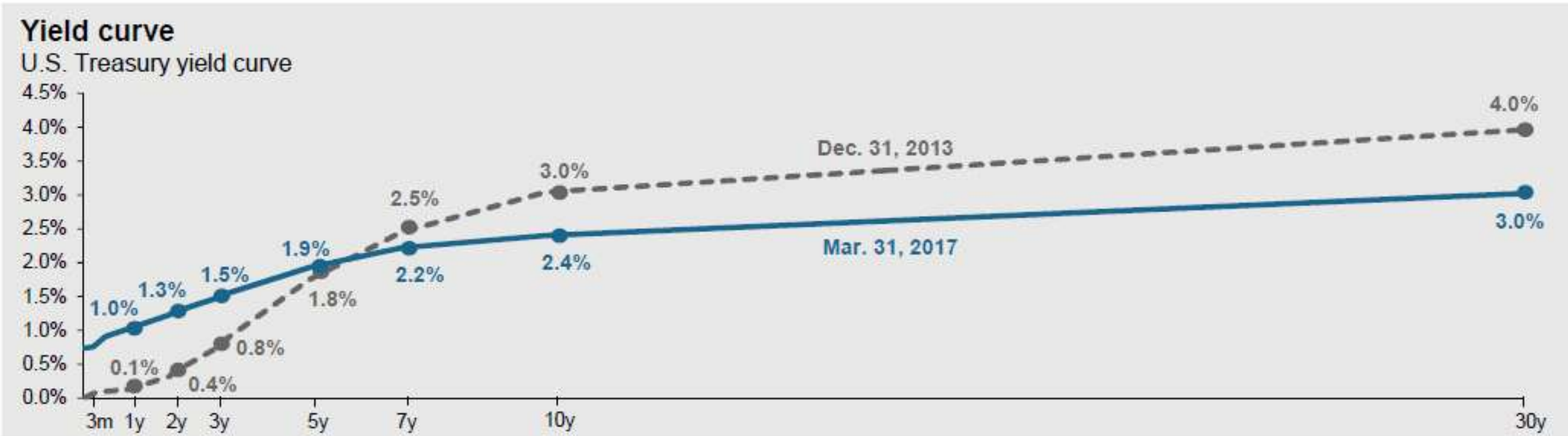
Country	March 2017		
	Five-year annualized return %	P/E	P/B
United States	12.5%	18.3	3.1
Pacific Basin	6.3%	15.1	1.4
Europe	5.6%	15.1	1.8
Canada	1.3%	16.9	2.5
Emerging	0.8%	13.0	1.6

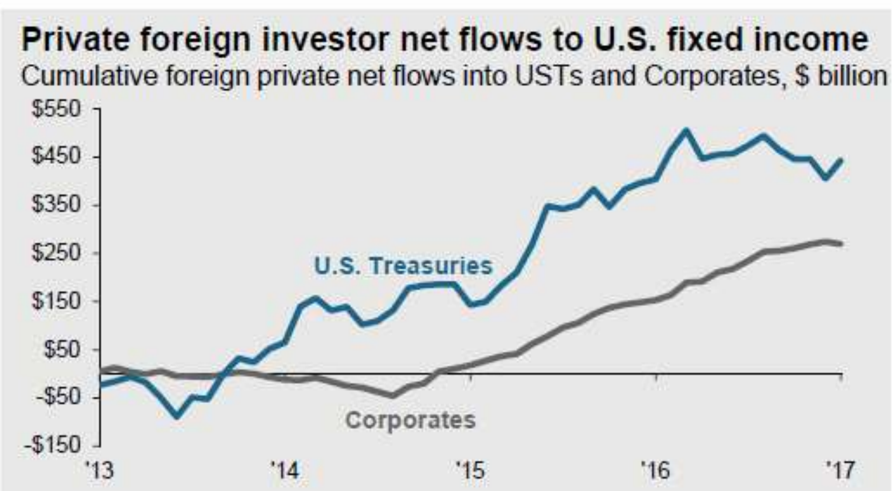
- U.S. stock market rally has created relatively rich fundamentals
- Valuations appear more attractive in other regions
- Long-term return expectations influenced by current valuations

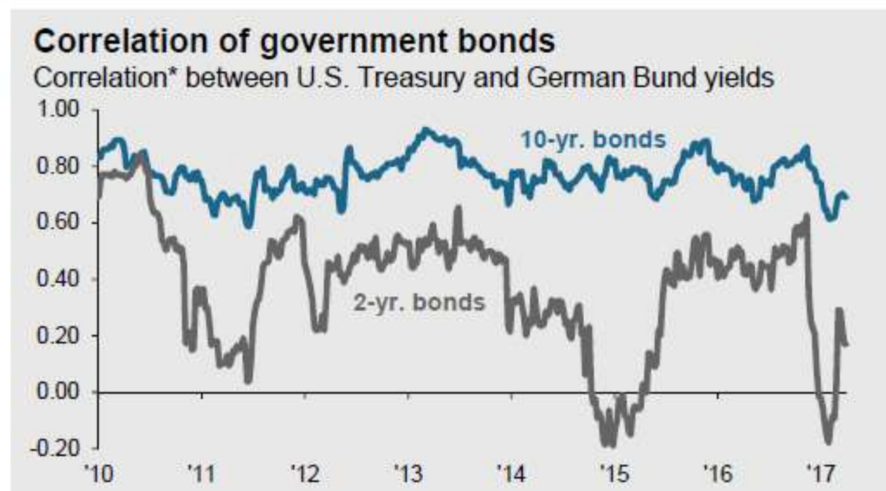
Source: MSCI Index Series, MSCI United States Index, MSCI Pacific Basin Index, MSCI Europe Indes, MSCI Canada Index, MSCI Emerging Markets Index

Yield curve has twisted over last three years

Bond portfolios positioned at an intermediate duration capture a good percentage of the total yield available along the curve.



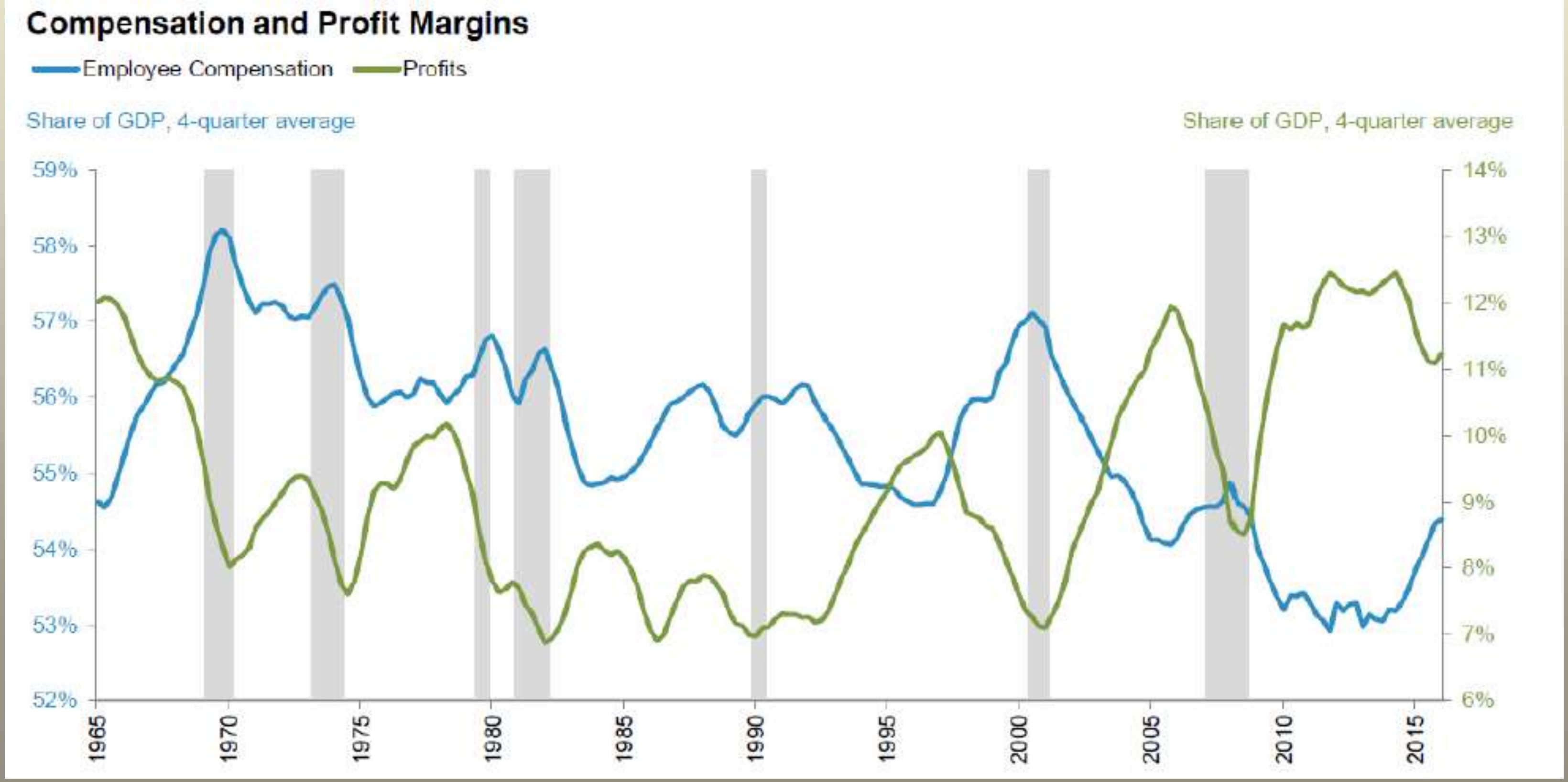




Source: FactSet, J.P. Morgan Asset Management; (Bottom left) U.S. Treasury

Rising wages chip away at record-high profit margins

In a multi-decade trend reaching extremes in recent years, worker compensation dropped to all-time lows as a share of U.S. economic output, while the share of corporate profits rose to record highs. Amid signs of a secular peak in globalization and a cyclical pick-up in wages, these trends have faded, indicating the difficulty companies may have in expanding profit margins from such elevated levels.



Sources: Bureau of Economic Analysis, NBER, Haver Analytics, Fidelity Investments (AART), as of 12/31/16

Components of return on equity not moving in lockstep

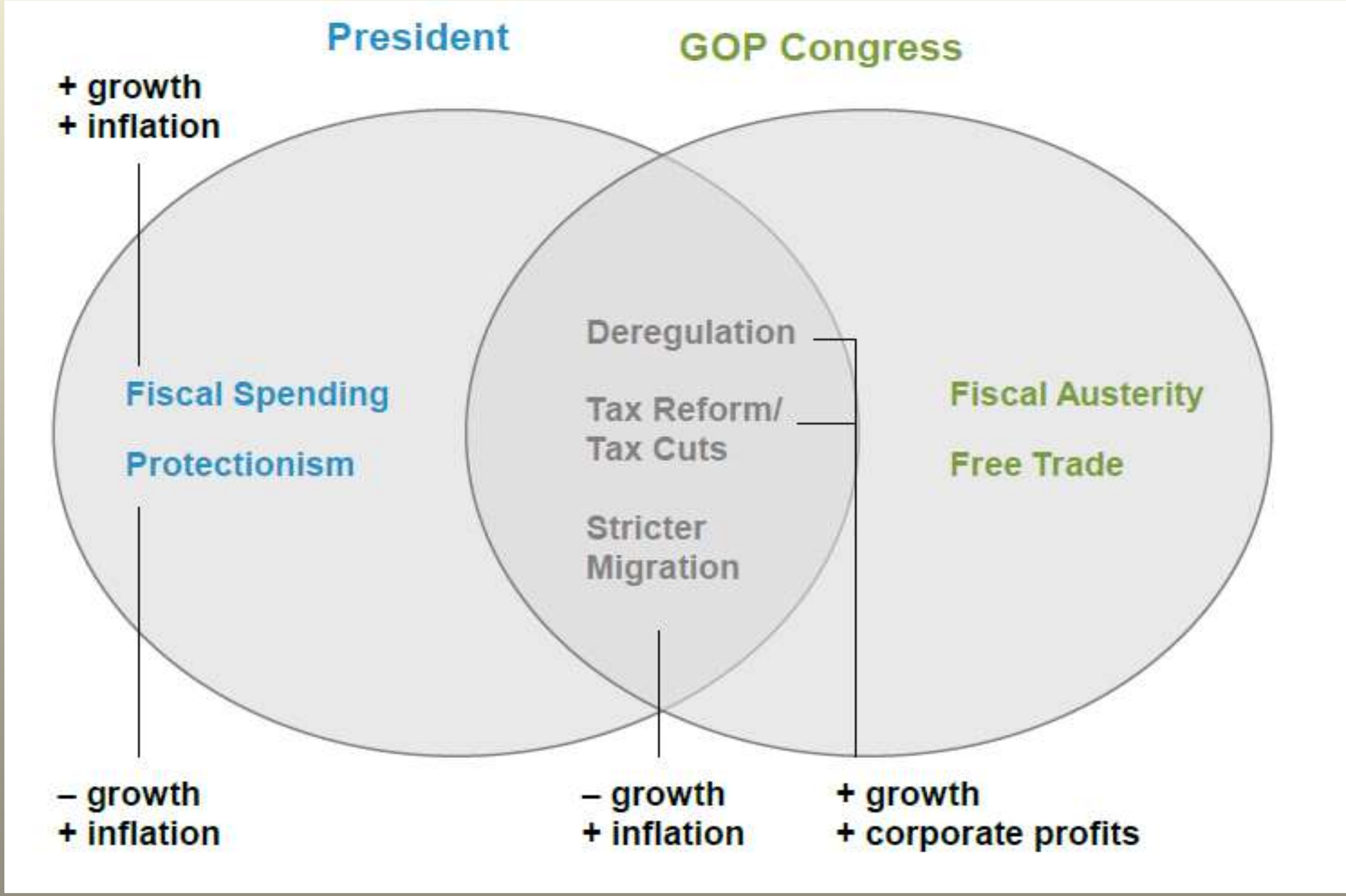
Corporate earnings growth is rebounding off the profit-recession lows of early 2016, but the outlook points to a more moderate growth trend ahead. Historically high profit margins and corporate leverage will be increasingly difficult to expand if wages and interest costs continue to rise, although the possibility of a cut in the corporate tax rate offers a potential positive offset for profit growth.

ROE =	Profit Margins	x	Operating Efficiency	x	Interest Burden	x	Leverage	x	Tax Burden
Outlook	High but falling		Peaking		Low but rising		High but peaking		High but might fall
	Cost of labor, goods, interest rising		Sales growth up but productivity growth waning		Will rise as borrowing rates rise		Will be hard to add to high level as rates rise		Corporate tax cut legislation possible

Source: Fidelity 3/31/17. ROE is return on equity. The equation represents an illustrative diagram of the DuPont formula: ROE = (earnings before interest and taxes/sales) x (sales/assets – interest expense/assets) x (assets/equity) x (1 – tax rate).

A wide distribution of U.S. policy outcomes

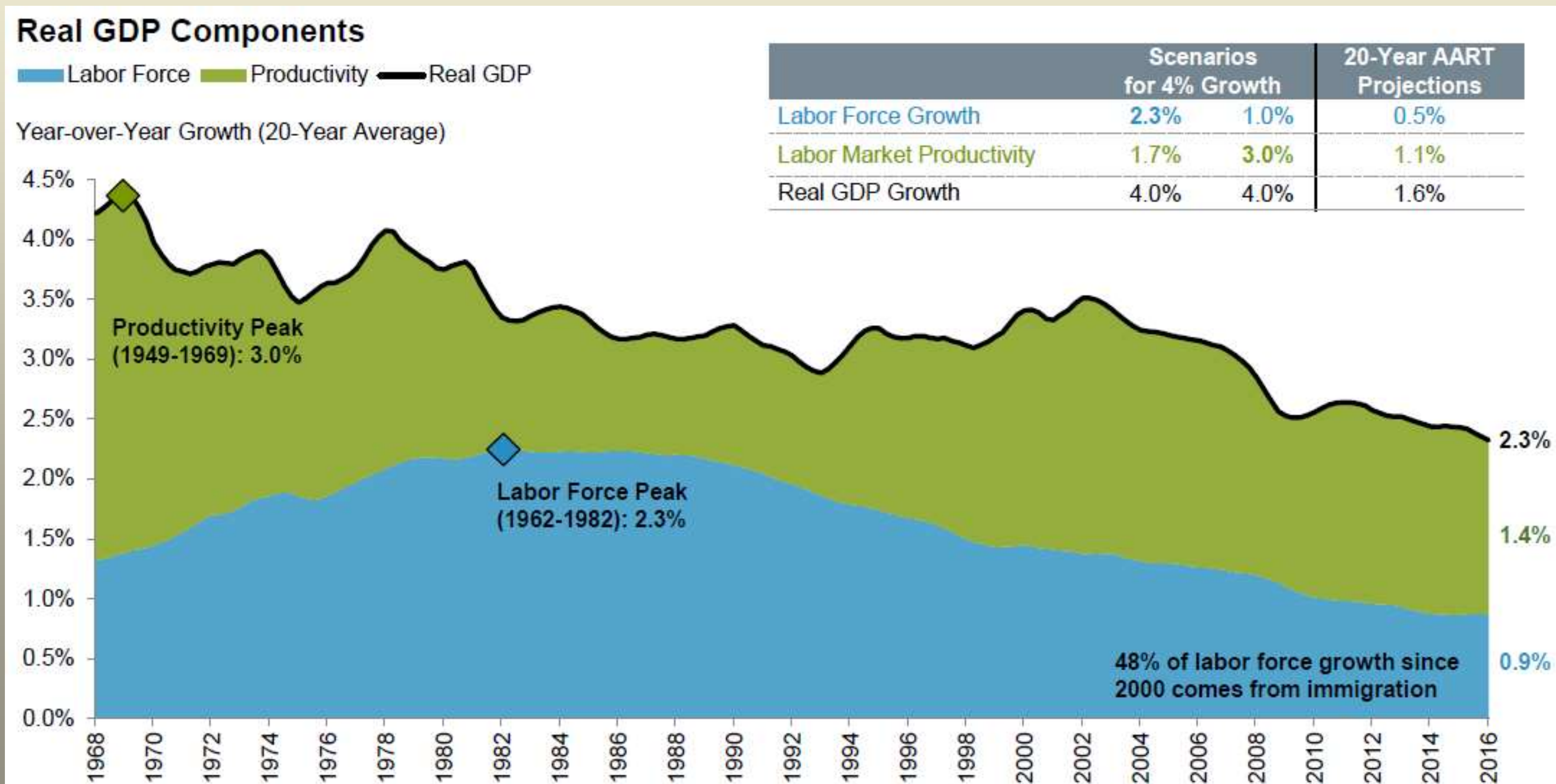
President Trump and the GOP Congress generally intersect on pro-growth deregulation and tax-cut policies, but they have different views of fiscal and trade policy. Many of these policies tend to boost inflation, making the most likely outcome an upside risk to prices regardless of the policy mix.



Source: Fidelity Investments, as of 12/12/16

Much higher 4% GDP growth unlikely long-run

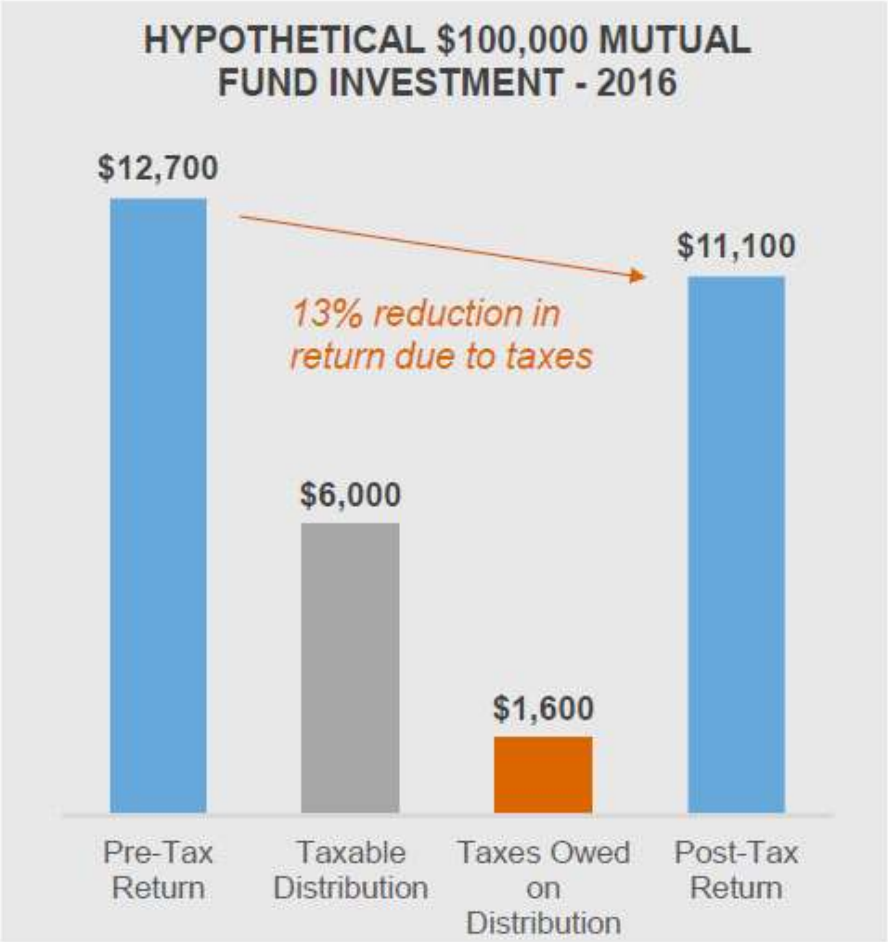
A jump to 4% GDP growth on a secular basis would require some unlikely developments. Labor force growth would need to accelerate back to peak levels seen in the 1960s-’70s or productivity would need to rise to the pace of the postwar 1950-60’s boom. While government policy changes could boost the long-term outlook, slower population growth and aging demographics make a sustained move to much higher growth a tough proposition.



	Scenarios for 4% Growth		20-Year AART Projections
Labor Force Growth	**2.3%**	1.0%	0.5%
Labor Market Productivity	1.7%	**3.0%**	1.1%
Real GDP Growth	4.0%	4.0%	1.6%

Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Haver Analytics, Fidelity Investments as of 12/31/16

Managing taxes eases their drag on returns

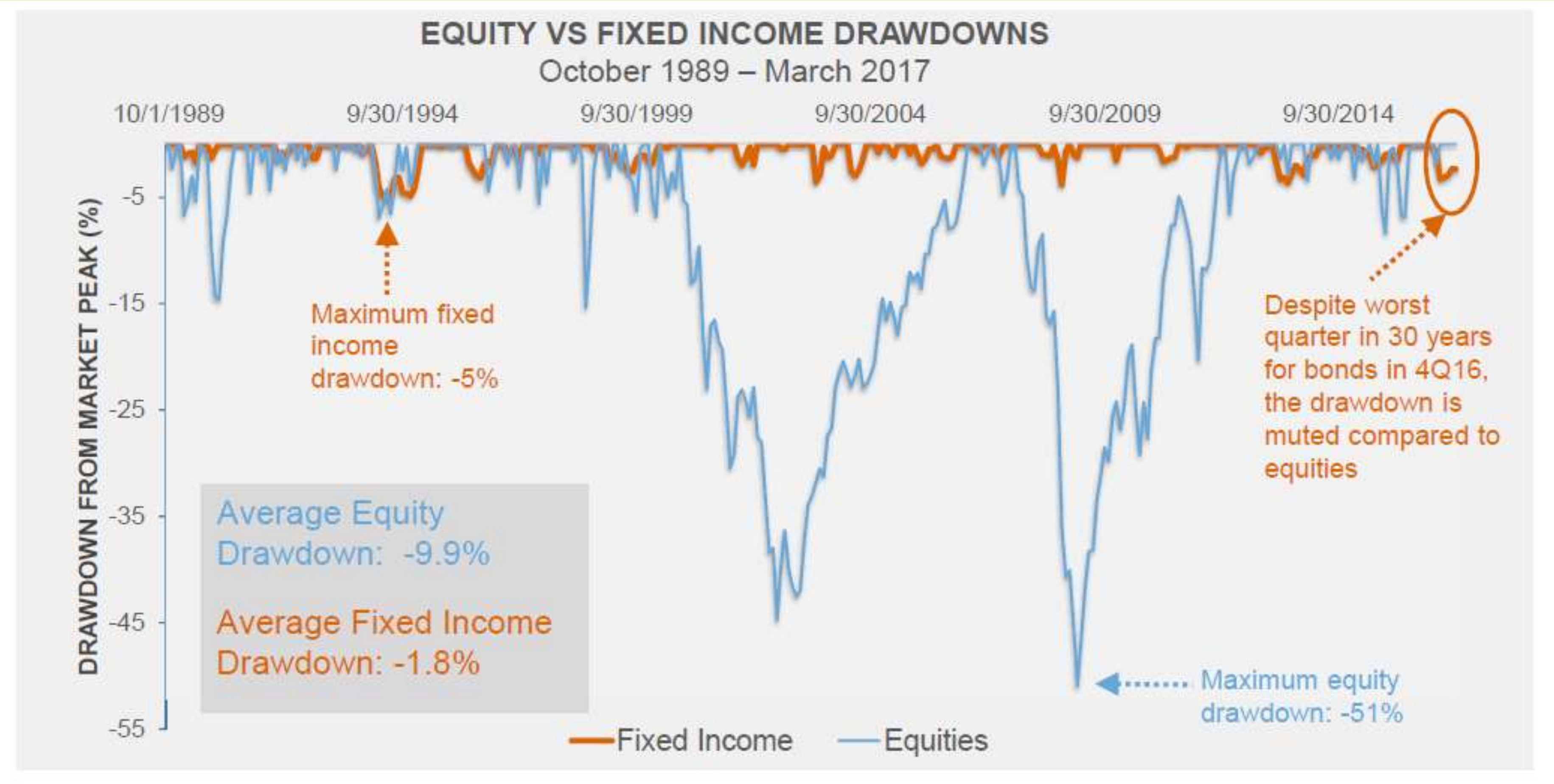


- The U.S. equity market returned 12.7% in 2016
- The average U.S. equity mutual fund made a 6% taxable distribution in 2016
- These distributions directly reduce investors' after-tax returns
- That reduction averaged 13% of the return
- Be mindful for opportunities to manage taxes

Source: Rusell

The reason for owning fixed income

Bonds act as the shock-absorber in portfolios for stock market volatility



Pullback: The peak-to-trough decline during a specific period. Quoted as the percentage between the peak to the trough

Source: Russell