THE

A QUARTERLY PUBLICATION · AUGUST 2016

ADVISOR

MANAGING WEALTH. SECURING LEGACIES.

Please join us for the next Quarterly Investment Briefing.

Thursday, November 17th 2016
4:00 p.m. to 6:00 p.m.
Windsor Park Conference Center
4020 Edison Lakes Parkway
Mishawaka, IN 46545

Founded in 1988, Indiana Trust and Investment Management Company is an independent trust company chartered under the Indiana banking statutes. It is a single purpose financial institution dedicated exclusively to providing investment management and trust services to individuals, trusts, employee benefit plans, corporations, and not-for-profit organizations.

MANAGING WEALTH. SECURING LEGACIES.

Unexpected outcomes, unexpected performance

U.K. voters approved a referendum in June to leave the European Union, an event referred to in the media as "Brexit." This was a most unexpected outcome. No country has ever left the E.U. The uncertainty surrounding this event created quite a stir in global markets. Investors sought safety in bonds around the world, and interest rates fell. Stock markets around the world also fell, quite dramatically, on the day after the vote.

Until the day of the vote, markets had been grinding up in 2016. Corporate earnings expectations had been lowered for the year, although the semi-recovery in oil prices pointed to better-than-expected overall results for the second quarter. Also, prior to the referendum, most prognosticators believed that voters would choose to stay in the E.U. – or, to "Bremain." Based on polls which pointed to Bremain in the weeks leading up to the vote, most foreign stock markets had advanced with many markets outpacing the U.S. market. The referendum outcome reversed those gains.

More telling, though, has been the performance of stocks since the turbulence subsided. The U.S. market in particular shrugged off the U.K. referendum. Through mid-July, the U.S. stock market was up over 7% for the year, nearly doubling its performance for the first six months. Developed markets recovered some of their losses and are now flat, while emerging markets performed very strongly post-Brexit and are up over 10%.

A driving force behind the recovery in U.S. stocks is the global low interest rate environment. Expectations are for rates to stay low and trend even lower in many countries. The Federal Reserve has seemingly hit the brakes on its plan to raise rates in the U.S. this year, and one reason is that higher interest rates would once again introduce the specter of a

(continued on page 2)

ASSET CLASS	2Q 2016	2016 YTD
EQUITIES		
Large Cap US Equities (S&P 500)	**2.5%**	**3.8%**
Mid/Small Cap US Equities (Russell 2000)	**3.8%**	**2.2%**
International Developed Market Equities (MSCI EAFE)	**-1.5%**	**-4.4%**
Emerging Market Equities (MSCI Emerging Markets)	**0.7%**	**6.4%**
FIXED INCOME		
Barclays Capital US Aggregate Bond Index	**2.2%**	**5.3%**
BofA Merrill Lynch Municipals, 3-7 years	**1.2%**	**2.3%**
ALTERNATIVES		
Real Estate (FTSE EPRA/NAREIT Developed Index)	**3.7%**	**9.4%**

Founded in 1988, Indiana Trust and Investment Management Company is an independent trust company chartered under the Indiana banking statutes. It is a single purpose financial institution

dedicated exclusively to providing investment management and trust services to individuals, trusts, employee benefit plans, corporations, and not-for-profit organizations.

Unexpected outcomes, unexpected performance

(continued from page 1)

strengthening dollar. Because of the continued ultra-low interest rate regime, investors continue to seek opportunities for growth and yield around the globe.

"Defensive" sectors in the stock market—dividend-paying sectors such as utilities and REITs—have been in vogue so far this year, much of which has been driven by falling interest rates. They have also benefitted from the flight to safety and from this yield-seeking pattern. Defensive stocks valuations on utilities and dividend-paying stocks have risen dramatically relative to their historical averages, as investors have placed a premium on yield. The flip-side to this is that, given the elevated level of valuations on defensive names, any upswing in rates increases the likelihood for dividend-payers to move lower.

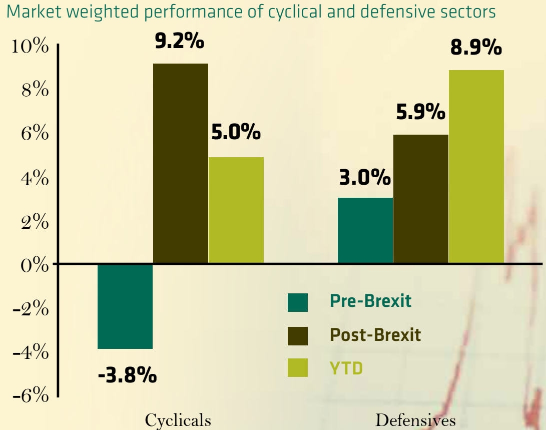
"Cyclical" sectors, such as technology and consumer discretionary, also picked up the pace since the end of June. This may indicate that investors have a brighter outlook on U.S. economic performance. Also, headwinds on earnings improvement, such as a stronger dollar and oil prices, have abated.

Overall, the S&P 500 maintained a stiff upper lip in the face of Brexit turmoil, and it rose 2.5% in the second quarter of 2016. Shares of Apple slid by 12% on declining iPhone sales, while Amazon soared 21% on strong earnings. Energy shares advanced 12% as they continue to recover from their recent declines.

Developed markets stocks trailed U.S. stocks in the second quarter. Stock markets in Europe returned 1% in local currencies for the three months ending in June – a surprisingly positive result given the political turmoil in the U.K. Unfortunately, the sell-off of the British pound lowered the U.S. dollar return for European stocks which ended down 3% in dollars. Conversely, the Japanese yen has appreciated almost 15% versus the dollar in 2016, and returns for international stocks on the whole have been boosted by a broadly weaker dollar in 2016. In dollar terms, international developed markets stocks are down 4% in 2016.

Equities in emerging markets were flat for the quarter and are up over 6% for the year. Brazil's market surged by 14%, aided by the tailwind of a strengthening currency. Emerging markets in Asia were higher, led by India and Indonesia. China was flat for the quarter and is down 5% for 2016 as investors continue to question the efficacy of the Chinese government's most recent fiscal stimulus package.

Post-Brexit performance has been all about cyclical sectors
Market weighted performance of cyclical and defensive sectors



Source: JP Morgan Asset Management

Fixed Income Markets

The U.S. bond market had a tremendous first half of the year. After the Brexit vote, the resulting flight to safety around the world pushed interest rates down. In early July, the 10-year U.S. Treasury note hit an all-time low yield of 1.37%, just below the 1.4% reached in July 2012. (Data on the 10-year note goes back to 1790, when the U.S. issued bonds to pay off Revolutionary War debt.) Falling interest rates boost bond prices and help bonds' total return. Thus, the investment-grade U.S. bond market was up 5.3% for the first half of 2016. High-yield bonds and investment-grade corporate bonds have performed well this year as their yields relative to U.S. treasury bonds – those differences are referred to as "spreads" – have fallen.

Low inflation (current and expected) is one factor driving exceptionally low interest rates. Trailing one year inflation is roughly 1%, so real yields (nominal yield minus inflation) were positive despite lower nominal yields. From this perspective, real yields are not at all time lows. Another factor is the gravitational pull that foreign sovereign bond markets have exerted on U.S. interest rates. The German 10-year note yield turned negative in June. Investors seeking income in Japan and Europe – where interest rates range from negative to zero – have shifted into the U.S. bond market. Finally, investors now expect that already-loose monetary policy conditions may become even more so. The Federal Reserve may choose not to raise its short term target rate again in 2016.

Portfolio Management Comments

Although direct exposure to the U.K.'s stock market represents under 5% of ITC's allocations to stocks, and while markets have recovered quite strongly, the reverberations of the U.K.'s decision will continue to be felt across all equity markets. The diversification built into ITC client portfolios guards against concentrations in the hardest hit stock markets in western Europe and the sectors hurt the worst so far, namely global banks.

In portfolios with fixed income allocations, we utilize foreign bonds in order to diversify sources of bond returns. When constructing those allocations, we chose a currency-hedged approach to guard against the type of currency volatility we are witnessing now.

"Brexit" was a risk stalking markets in a similar way that plummeting oil prices, the strong dollar, and concerns about China created short-lived volatility back in August 2015 and in January and February this year. For that reason, we again stress the importance of looking through the noise to focus on fundamentals such as corporate earnings and stock market valuation metrics – particularly in light of the current low inflation and interest rate environment.

We encourage dialogue with our clients during the mass-media bombardment which unfailingly accompanies these types of geopolitical events. Despite the media's proclivity to simplify and editorialize these occasions, the meaning of these events can be nuanced and the outcomes unknown for some time. Each relationship team at Indiana Trust welcomes the opportunity to assimilate this information and to help our clients better understand the multiple perspectives at play.

As always, we will be watching portfolios for rebalancing opportunities to take advantage of performance divergence across asset classes.

INDIANA TRUST
& Investment Management
COMPANY

4045 Edison Lakes Parkway
Suite 100
Mishawaka, IN 46545
Phone: 574 271-0374
Fax: 574 271-0378

315 West Adams Street
Muncie, IN 47305
Phone: 765 254-3500
Fax: 765 254-3510

307 South Main Street
Suite 311
Elkhart, IN 46516
Phone: 574 294-3500
Fax: 574 294-3506

CHECK OUT OUR WEBSITE!

WWW.INDTRUST.COM

Welcome our newest service team member
Jennifer Williams

Jennifer Williams joined Indiana Trust in 2016 and has over six years of experience in the Trust profession. She is part of the Muncie service team that works directly with clients, their families, and the community. Jennifer received her bachelor's degree from Purdue University. She currently serves as a member of the David Owsley Museum of Art Friends Advisory Council, the First Presbyterian Preschool Advisory Board, and the Psi Iota Xi service sorority board.

Jennifer and her husband Jim have a daughter who is a senior at DePauw University and a son who is a freshman at Indiana University. Jennifer enjoys gardening, traveling and playing the guitar.