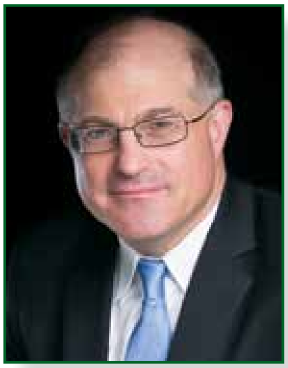
Zacks
INVESTMENT
MANAGEMENT

Q1 2017

Personalized Wealth Management

IN THIS ISSUE:

April 26, 2017



Mitch Zacks
Senior Portfolio Manager

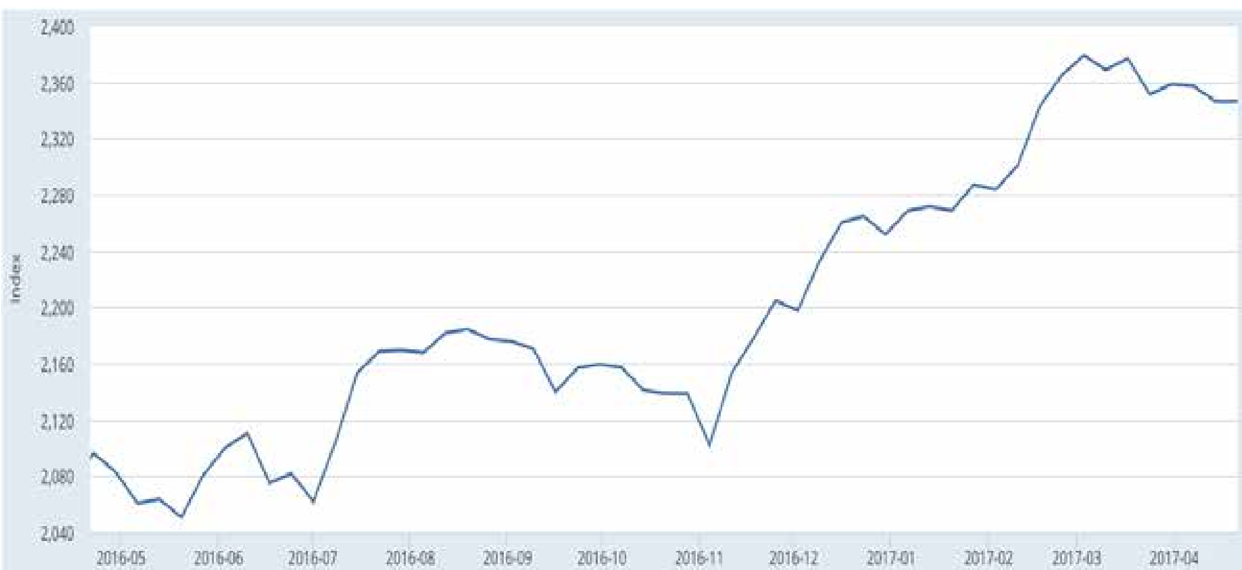
Mitch's Outlook

The last three, and twelve, months have demonstrated the U.S. stock market's resiliency. Last year saw brutal campaign rhetoric in the U.S., Britain's unexpected exit from the EU, consistently negative earnings in the U.S. (in aggregate), and a rocky start for the Trump Administration with multiple investigations, 'tweetstorms,' and hurdles in replacing the Affordable Care Act. Certainly, noteworthy headlines dominated.

Yet, while the 'mania' swirled, the global economy and bull market pressed forward. In 2016, the S&P 500 climbed a remarkable 12% buoyed by a global economy that grew 2.6%. Say what you will about recent politics, but economic activity was 'business as usual.'

The first quarter of 2017 saw the equity market surge with the S&P 500 achieving 6.1% growth. This growth occurred mostly in January and February followed by the market moving 'sideways' in March as expectations for legislative change were tempered. Still, 6.1% growth for the S&P 500 over the quarter is undeniably strong.

S&P 500 Trending Higher



Source: Federal Reserve Bank of St. Louis

Politics Aside…

With daily, hyper-attention on the White House, investors will ideally remember to focus on factors likely to move stock prices meaningfully. These include fundamentals such as earnings growth, earnings expectation changes, economic growth and the shifting outlook, inflation, interest rates, monetary policy, actual legislative change (versus proposals) and so forth.

In Q1, the global economy improved (particularly in Europe). For the first time in nearly four years, none of the 19 Eurozone economies experienced deflation, a sign that extraordinary monetary policies may be yielding positive results. Growth was modest, but growth is still growth.

Global manufacturing is growing at the fastest rate since 2014, though this benchmark isn't high given weakness the past two years. Global trade reached a seven-year high, even as protectionist sentiment creeped into political discourse. President Trump lambasted NAFTA, the Trans-Pacific Partnership and China's trade surplus with the U.S., but the president appears to have retreated somewhat from those positions recently.

In a worst-case scenario, the U.S. would find itself in trade wars with our largest trading partners and see inflation rise as the cost of goods increase. This could cause the Federal Reserve to accelerate the pace of interest rate increases, which could stifle economic growth. In a best-case scenario, no new tariffs would be applied and tax breaks, or other incentives for corporations to invest domestically, would come to fruition. Perhaps the Trump administration will find a way, via a tax bill, to allow businesses to immediately deduct the full cost of their capital purchases? If companies could expense a new factory and all related equipment, I'd assume companies would move forward with those investments. That would be economically beneficial, but time will tell.

Global economic data remains positive and leading economic indicators appear to be trending higher. In the U.S., the stock rally suggests the economy has already improved during Trump's first 100 days. But, investors need to be cautious and separate hard from soft data. The soft data is positive – consumer confidence is at a 16-year high, business confidence is up, homebuilder confidence is up, and PMI manufacturing sentiment indicators are also moving favorably.

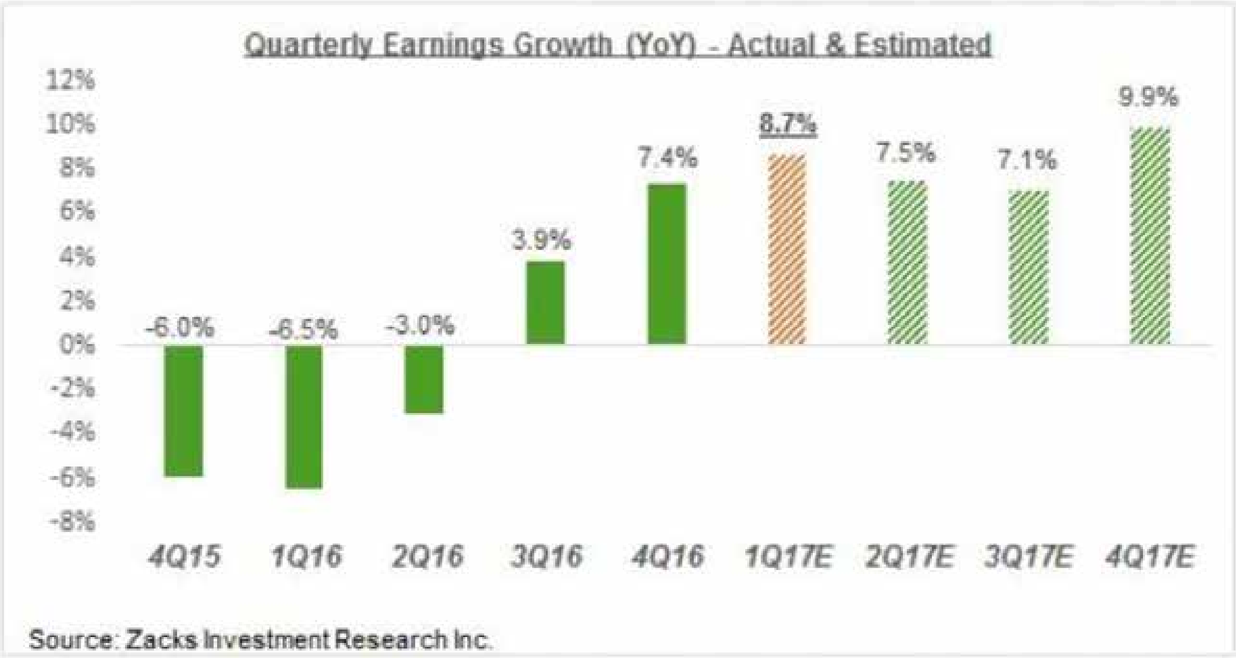
The hard data isn't clear yet as it's unreasonable to expect sweeping economic or legislative changes in the first 100 days of a new administration. Market participants and analysts constantly seek clues and build expectations around proposals, but until 'change' is signed into law, it's just hearsay. The economy added a robust 235,000 jobs in February pushing unemployment down to 4.7%, but the March report was weaker. In Q1, U.S. economic growth of 1.5% - 2% is expected which, if true, means "more of the same" versus an acceleration. Consumer spending was soft and auto sales were weak in 2017's first quarter.

The bright spot now is corporate earnings. Corporate earnings are slated for a strong Q1, but that was our expectation before the new administration took office (based on earnings momentum and energy price stabilization). As of this writing, 57 S&P 500 companies have reported earnings and they are up +18.7% from the same period last year on +6.4% higher revenues (75.4% beat EPS estimates and 54.4% beat revenue estimates). This earnings and revenue pace is tracking notably above what we saw from the same group of companies in past periods – a good sign.

Earnings for the Financial Sector, so far, are up 26.8% from the same period last year on +8.5% higher revenues (76.5% beat earnings per share estimates and 52.9% beat revenue estimates).

Overall, the picture emerging from the Q1 earnings season is one of accelerating growth, with earnings and revenue tracking higher than in other recent periods. If solid reporting continues, we could see the strongest growth pace for the S&P 500 in almost two years.

Actual and Estimated Quarterly Earnings



Bottom Line for Investors

Investing based on fundamentals means being allocated to equities to the greatest extent your investment objectives allow, in my view. I expect corporate earnings to continue showing strength in the upcoming quarter and possibly the next. Additionally, though valuations are a bit stretched, I believe there is still room for multiple expansion. Keep in mind too that the market's multiple can contract while stock prices rise – earnings just need to outpace stock price growth. This is possible given our earnings outlook.

All-Cap Core Strategy

For the quarter ending March 31, 2017, the Zacks All-Cap Core Strategy returned +6.10% gross and +5.64% net. Return for the strategy was comparable to the Russell 3000 index (+5.74%) and the S&P 500 (+6.07%). Since inception, the Zacks All-Cap Core Strategy ranks in the top 7% out of 667 managers in the Morningstar All Domestic Equity Managers universe.

Stock selection and sector allocation in the All-Cap Core Strategy contributed, nearly equally, to relative returns. Among the major allocation decisions made in the quarter, the strategy's overweight to Technology stood out as the Russell 3000 Technology Sector was up +11.85% relative to the Russell 3000 Index return of +5.74%. Technology was the best performing sector during the quarter, and the All Cap Core Strategy was overweight to it by 5.10% on average.

Stock selection in all sectors was advantageous, apart from Energy and Health Care. Notable stock performers were Universal Display (52.25%), Micron Technology (+30.70%), Symantec Corp (+28.74%), and Facebook (+23.47%).

Dividend Strategy

For the first quarter of 2017, the Zacks Dividend Strategy returned +4.35% gross and +3.90% net, outperforming the Russell 1000 Value Index (+3.27%). The dividend yield on the strategy was 3.15%, versus a yield of 2.43% for the Russell 1000 Value Index. Since inception, the Zacks Dividend Strategy ranks in the top 2% out of 821 managers in the Morningstar Large Cap Value universe.

The market entered the quarter with strong corporate profits, global economic growth, and optimism for U.S. fiscal policy (on taxes, regulatory reform, and infrastructure investment). However, the first three months fell short in convincing market participants that change would come rapidly. The lack of legislative progress on taxes and infrastructure spending reset expectations downward for near-term acceleration of economic growth.

Growth expectations could have been stifled further when the Federal Reserve raised interest rates in March. Steady gains in employment, and inflation approaching the Fed's target, prompted the Federal Reserve to bump the fed funds rate by a quarter percentage point. In this rising rate environment, with curbed expectations for faster growth, the market favored companies that, historically, have performed better in a moderate economic growth environment. Dividend stocks fit this mold.

In the 'large value' space, Consumer Staples, Health Care, and Technology stocks outperformed over the quarter. Energy, Financials, and Industrials underperformed. The strategy's underweight in Energy and overweight to Staples and Technology supported relative performance in the quarter.

If favorable fiscal policies are implemented and runaway inflation is avoided, the Federal Reserve will likely maintain a market-friendly approach to raising interest rates. With that outcome, we believe U.S. and global economic growth should continue positive momentum, which should also bode well for stocks. Ultimately, we believe the Dividend Strategy is positioned to produce attractive returns in this environment.

Finally, due to the tax-advantaged nature of dividend payments and attractive yield of 3.15% in Q1 2017, versus the 10-year US Treasury yield (2.38%), we believe the strategy remains well-suited for investors seeking moderate growth and income.

International Strategy

In the first quarter of 2017, the Zacks International Strategy returned +8.56% gross and +8.10% net versus its benchmark, the MSCI EAFE, which returned +7.39%.

Among our major calls, increased weight to Australia, Austria, Canada, and Chile added value to the portfolio. For the 12-month period ending March 31, 2017, Australia (EWA) returned +21.86%, Austria (EWO) +18.09%, Chile (ECH) +20.30% and Canada (EWC) rose +15.41%. Among our calls to reduce or remove country positions in the strategy, reducing exposure to the UK (EWU) and removing Israel (EIS) supported returns.

Focus Growth

In Q1 2017, the Zacks Focus Growth Strategy returned +8.54% gross and +8.07% net versus the Russell 1000 Growth index which returned + 8.91%. Despite slight underperformance to its benchmark, the Zacks Focus Growth Strategy continues to rank in the top 1% out of 966 managers in the Morningstar Large-Cap Growth universe since inception.

As the Trump administration came into office, corporate earnings from Q4 came in strong along with pledges to reduce taxes, reduce regulations, and boost infrastructure spending. Following this, the market went into risk-on mode. Several sectors, including Technology, Health Care, and Consumer Staples outperformed their peers nicely. The Zacks Focus Growth Strategy is overweight to Technology, which positively contributed to performance. Solidly performing investments in the strategy were Apple Inc., Alphabet Inc. (Google) and Amazon. The Health Care sector also outperformed the index, contributing to relative performance.

Still, the Consumer Cyclicals, Energy and Utility sectors hampered performance. Specifically, model selection in the Consumer Cyclicals and Energy sectors underperformed.

Q1 2017 marked the first opportunity for investors to assess the new administration's governance, while closely eyeing fiscal policy relating to tax reform. The conclusion: it's too early to tell. Big legislative action and reforms take time to implement, and with many cabinet positions still unfilled it's likely to be months before substantial legislation is signed into law. The performance of growth stocks, and perhaps stocks in general, hinges on the new administration's ability to advance their economic agenda. We believe that economic growth in 2017 will happen regardless of big policy change, which should benefit growth stocks looking ahead. To what degree remains to be seen.

Mid-Cap Core Strategy

The Zacks Mid-Cap Core Strategy returned +7.58% gross and +7.12% net in the first quarter of 2017 outperforming its benchmark, the Russell Midcap Index, which returned +5.15%. Since inception, the Zacks Mid-Cap Core strategy ranks in the top 2% out of 332 managers in the Morningstar Mid-Cap Blend universe.

Mid-cap stocks slightly underperformed large-caps, but outperformed small-cap stocks during the quarter. President Trump's rhetoric has focused on domestic fiscal stimulus, tax cuts and infrastructure investments. Still, the quarter lacked concrete legislative progress. This was to be expected as sweeping changes under a new administration takes time. However, the slow progress filling cabinet posts, and inability to bring the American Health Care Act to a vote, appeared to dampen market expectations for immediate acceleration of the U.S. economy. This sentiment shift may have been a driver behind the outperformance of companies and sectors better positioned to maintain and grow earnings in a more moderate U.S. growth environment. The Financials and Energy sectors, for example, were among the top performers in Q4 last year, but were low performers in Q1 this year.

The Mid-Cap Core Strategy was overweight to the underperforming Financials sector which suppressed relative performance. By contrast, the strategy's underweight to the underperforming Energy sector supported relative performance.

If fiscal policy is implemented in a manner conducive to stronger U.S. economic growth, then growth-sensitive mid-cap stocks should continue to see strong gains. The administration appears determined to make economic and job growth a priority, but it remains to be seen what this will actually look like. Mid-cap stocks, in particular, could benefit in this environment if investors wish to strike a risk/reward balance between that of large and small-cap stocks.

Small-Cap Core Strategy

The Zacks Small-Cap Core Strategy returned +4.21% gross and +3.76% net in Q1 2017, outperforming the Russell 2000 Index (+2.47%). Since inception, the Zacks Small-Cap Core strategy ranks in the top 6% out of 609 managers in the Morningstar Small-Blend universe.

Small-cap stocks underperformed large and mid-cap stocks during the quarter. Presidential election campaign rhetoric focused on domestic-oriented fiscal stimulus, tax cuts and infrastructure investments. However, the post-election period lacked concrete legislative progress. This was to be expected as sweeping changes spurred by a new administration takes time. However, slow progress filling cabinet posts, and inability to bring the American Health Care Act to a vote, tempered market expectations. This sentiment shift may have driven outperformance of companies positioned to grow earnings in a modest U.S. growth environment, as opposed to small-cap companies.

The Small-Cap Core Strategy was overweight to the outperforming Technology sector and underweight to the underperforming Financials sector; this buttressed the strategy's relative performance. Additionally, the strategy's underweight to the outperforming Health Care and Materials sectors dampened relative performance.

If domestic-oriented fiscal policies are implemented, growth-sensitive small-cap stocks could continue to see strong gains as investor appetite for risk increases. Still, time will tell how effectively the new administration can advance their economic agenda.

Quantitative Strategy

The Zacks Quantitative Strategy returned +3.52% gross and +3.07% net in the first quarter of 2017 versus the S&P 500 which returned +6.07%.

In the first two months of the year, the Quantitative Strategy's overweight to small and mid-cap stocks bolstered relative performance and accounted for approximately 90.7% of total holdings. Also, the strategy's underweight to the Energy sector supported relative performance as energy prices fell.

Still, sentiment shifted notably late in the quarter as investors showed concern regarding the Trump administration's capacity to implement policy reforms. Small and micro-cap stocks felt pressure as market participants hedged pro-business legislation bets. At the same time, investors shifted into large-cap stocks, perhaps preparing for more moderate economic growth forecasts. This shift dragged on the strategy's relative performance.

In 2017 the U.S. economy is expected to grow at 2.1%, a solid pace and better than originally expected. We believe corporate earnings growth will remain strong throughout the year and, if market sentiment remains positive, that could provide a solid foundation for returns this year. The possibility for upside earnings surprises, for which the Quantitative Strategy can take advantage, remain reasonably high as plans for fiscal stimulus and deregulation favors growth.

Market Neutral Strategy

In Q1 2017, the Zacks Market Neutral Strategy NAV back-tracked as the market shifted significantly. The Utilities sector is one example of the shift; one of the best performing sectors for Market Neutral in late 2016, performance in Q1 2017 was substandard. Opening short positions in the strategy dragged on performance as the sector rallied.

Additionally, the reversal of fortune for low-quality stocks in Financials surprised as long positions in high-valuation stocks did not make up for short position performance. Continued discussion of deregulation created demand for distressed financial stocks, which impacted the strategy negatively as these stocks rebounded sharply. Still, Technology and Energy positioning was advantageous as both sectors performed relatively well in our long and short exposures.

Overall, the equities market posted the strongest quarter in three years as corporate earnings and expectations for business-friendly fiscal policy and infrastructure spending buoyed the market. The cloudy future for health care reform, and failure to get a vote on the American Healthcare Act, created doubt the new administration can sufficiently execute. ‘Uncertainty’ is the theme in geopolitics today and, to the extent it adversely affects market sentiment and performance, the Zacks Market Neutral Strategy could benefit.

Fixed Income Strategy

The tug-of-war between economic optimism and political uncertainty in the U.S. and abroad influenced bond markets in Q1 2017.

Rates on the short end of the yield curve rose slightly as the Fed raised the fed funds rate by a quarter percentage point at their March meeting. Yields on longer-term bonds dropped during March and ended the quarter nearly flat from the beginning of the quarter, as investors priced-in the possibility that gridlock in Washington might hold back regulatory and tax reform.

After failing to repeal and replace Obamacare, the possibility of a quick tax reform deal looks remote. For an economy looking for the next jump-start, this is disappointing news. With a Republican majority in Congress, the hope was that regulatory and tax reform bills would easily pass and benefit the U.S. economy this year. However, Republican Party infighting held up the bills. Even if tax reform gets passed this year, positive effects may not be realized until mid-2018. So far, we’re pleased that protectionist policies espoused during the election cycle have been delayed or nixed. That is good news on the inflation front.

U.S. economic data, mostly, continues to be better than expected and earnings momentum is picking up. Still, there are pockets of concern around commercial real estate and the consumer auto loan market. In January, Janet Yellen referred to some commercial real estate valuations as “high.” We have seen a slowdown in deal volume as well. The Federal Reserve forecast at least two more rate hikes in 2017 and indicated intent to shrink their balance sheet this year (and beyond). This means the Fed will slow, or cease, reinvesting the proceeds from their current holdings. How, when, and pace of the program is yet to be announced. What we do know is that the Fed's shift will remove a major purchaser of Treasuries and Mortgage Backed Securities from the market (which have kept interest rates low). The bond market reaction to this news has been muted, however we may see more reaction once program details are announced.

The Two-Year US Treasury bond ended Q1 2017 with a yield of 1.25%, up slightly from 1.19% at the beginning of the quarter. The Ten-Year US Treasury bond ended Q1 with a yield of 2.387%, down slightly from 2.44% at the beginning of the quarter. The 10-year bond failed to move above the 2.60% resistance level and is currently testing its support level at 2.30%. If upcoming economic news disappoints, or if there is a risk-off shift toward safer assets, we could see yields fall further. The yield curve flattened substantially over the quarter, and the yield spread between the two-year and ten-year treasury bonds narrowed to the lowest levels of the year. Concurrent with expectations of a slower economic start to the year, inflation expectations have declined as well. Sovereign bond yields of developed countries dropped significantly during March as French elections took center stage in Europe and investors sought safety. The spread of comparable US Treasuries over the majority of developed sovereign bonds was near its highs for the quarter.

Credit spreads bounced off the lows in March, but are still well below their long-term averages. Investment grade bond issuance was up 11% year-over-year to $510.375 billion, the highest quarterly figure since 2014. Anticipating the Fed would raise rates at least two more times in 2017, many corporations locked-in funding while rates were still low. If the Trump administration succeeds in getting companies to repatriate overseas cash holdings back to the U.S., we might see a slowdown in new issuance.

After initial concern regarding a negative impact from potential income tax cuts, the municipal bond market stabilized during the quarter. Both President Trump and the House GOP want to reduce the top personal income tax rate from 39.6% to a maximum of 35%. Where we end up on tax rates will largely depend on the satisfaction of deficit hawks in Congress and whether the deal is revenue neutral. Nonetheless, tax rates would have to come down substantially (think half of current levels) for the tax free rates on municipal bonds to yield less (on an after-tax basis) than corporates and treasuries. Financially, a majority of the states and localities are in much better shape than they were 5 to 10 years ago. We are still concerned about the levels of unfunded pensions and expect this to burden the market for some time.

As noted in last quarter's commentary, many uncertainties remain. The Trump administration is learning how difficult it can be to turn campaign promises into law. It is still too early to forecast how the administration will govern for the remainder of the year and term. Based on recent speeches from officials, the Fed's posture may be more aggressive than the market anticipates. We continue to favor corporate and municipal bonds for investors seeking income and diversification. As always, credit quality remains foremost in our selection method.

DISCLOSURE Past performance is no guarantee of future results. Results for Zacks Strategies ("Strategies") are shown both gross and net of fees. Results for the Strategies reflect the reinvestment of dividends and other earnings. The results portrayed are the performance history of a single representative managed separate account that ZIM believes is representative of client accounts invested in the Strategy. A representative account must meet the following ZIM criteria to be selected: 1) there are no restrictions placed on the account, 2) ZIM has discretionary authority over the account, 3) the account has no capital additions and withdrawals and 4) dividends are reinvested. If the single representative account in use no longer meets ZIM selection criteria, ZIM will replace the representative account with another that meets the above ZIM selection criteria.

Prospective clients and clients should not assume identical performance results to those shown would have been achieved for their account if it was invested in the Strategies during the period. Clients of the firm may receive different performance than the representative account. Client performance may differ due to factors such as timing of investment(s), timing of withdrawal(s), and client-mandated investment restrictions. Wholesale, retail and institutional clients of the firm may have differing performance due to timing of trades.

Investments in the Strategies are not deposits of any bank, are not guaranteed by any bank, are not insured by FDIC or any other agency, and involve investment risks, including possible loss of the principal amount invested. Net of fees performance is based on the maximum fee of 1.75% for a $500,000 account. Lower fees may apply to larger accounts; higher fees may apply to smaller accounts. Separately managed account minimums apply. Inherent in any investment is the potential for loss. Standard management fees are available on request and are described in Part 2A of Form ADV.

Morningstar Rank:

The Morningstar Universes used for comparative analysis are constructed by Morningstar (median performance) and data is provided to Zacks by Zephyr Style Advisor. The percentile ranking for each Zacks Strategy is based on the gross comparison for Zacks Strategies vs. the indicated universe rounded up to the nearest whole percentile as of 03/31/17. Other managers included in universe by Morningstar may exhibit style drift when compared to Zacks Investment Management portfolio. Neither Zacks Investment Management nor Zacks Investment Research has any affiliation with Morningstar. Neither Zacks Investment Management nor Zacks Investment Research had any influence of the process Morningstar used to determine this ranking.

Indexes Presented:

The S&P 500 Index is a well-known, unmanaged index of the prices of 500 large company common stocks, mainly blue-chip stocks, selected by Standard & Poor's. The S&P 500 Index assumes reinvestment of dividends but does not reflect advisory fees or other expenses. An investor cannot invest directly in this Index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

The Russell 2000 Index is a well-known, unmanaged index of the prices of 2000 small-cap company common stocks, selected by Russell. The Russell 2000 Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

The Russell Mid Cap Index is a well-known, unmanaged index of the prices of approximately 800 mid-cap company common stocks, selected by Russell. The Russell Mid Cap Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

The Russell 1000 Growth Index is a well-known, unmanaged index of the prices of 1000 large-company growth common stocks selected by Russell. The Russell 1000 Growth Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

The Russell 1000 Value Index is a well-known, unmanaged index of the price of 1000 large-company growth common stocks selected by Russell. The Russell 1000 Growth Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot directly invest in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

The Russell 3000 Index is a well-known, unmanaged index of the prices of 3000 broad U.S. equity company common stocks, selected by Russell. The Russell 3000 Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

The MSCI EAFE is an index from Morgan Stanley Capital International. The MSCI EAFE is a well-known, unmanaged index representing developed nation countries around the world. The MSCI EAFE Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

Zacks Investment Management may utilize mutual funds in some client portfolios. Zacks Investment Management is the advisor to these funds and will receive compensation from the funds and their shareholders for advisory services. Additional information is available upon request.

Zacks
INVESTMENT
MANAGEMENT