30 Braintree Hill Office Park, Suite 201
781.849.9200
uswealthmanagement.com

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Dear Valued Investor:

The first quarter of 2018 is wrapping up, and it's time to spring forward and look ahead to what we could expect in the coming months. After a large market drop kicking off the month of February, March has been relatively calm for stocks so far. The biggest event of the month was the Federal Reserve (Fed) meeting held on March 21—the first with new Fed Chair Powell at the helm.

As anticipated by the markets, the Fed raised the fed funds rate by 0.25% (25 basis points), bringing its target interest rate to 1.50–1.75%. The Fed also upgraded its outlook on economic growth and kept its inflation projection unchanged.

So what does this latest step forward mean for markets overall? Although sometimes markets react negatively to rate hikes, these increases tend to signal the Fed's confidence in the U.S. economy. The Fed's dual mandate seeks to balance the often-competing goals of maximum employment and low, stable inflation. With the economy growing above potential and job growth steady, the Fed's attention has been increasingly focused on finding a rate hike path that does not lead to any bubbles in markets or cause the economy to overheat.

One of the contributing factors to the market decline in early February was the January employment report, which showed a surprise uptick in wage growth. As a result, this increased concerns regarding inflation and whether a faster path of rate hikes was on the horizon. Since then, fears of escalating inflationary pressures may have faded somewhat, although price pressures could continue to build in the coming months. LPL Research continues to believe the Fed will need to see a sustained pace of higher inflation, and potentially a wage growth number as high as 4% annually, before becoming significantly more aggressive.

In addition to the Fed and inflation, there are a number of factors that could have meaningful implications down the line, including:

- **Economic growth:** Market participants generally expect the U.S. economy to get a boost from the new tax law, which supports both consumer spending and business spending.
- **Earnings:** Corporate America produced the best earnings growth in several years during the fourth quarter of 2017, while 2018 has seen the biggest upward revision to S&P 500 Index earnings to start a year since these data have been collected.
- **Trade policy:** LPL Research believes trade policy is among the biggest risks facing stocks right now. The recently announced tariffs may have limited immediate economic impact, but the big concern is China's intellectual property trade practices.

Although there may never be a dull moment when watching the markets and economy in this day and age, the latest action by the Fed was taken in stride. However, it is important to acknowledge the possibility for further volatility, given geopolitics and trade protectionism. Overall, LPL Research's outlook remains positive for the remainder of 2018, as continued economic and earnings growth may help offset trade tensions.

If you have any questions, I encourage you to contact me.

Sincerely,

John P. Napolitano, CFP®, CPA, PFS, MST
President & CEO

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Economic forecasts set forth may not develop as predicted.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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