MIDDLETON & COMPANY, INC.

Investment Update

April, 2017

2017 First Quarter Update

Review: The S&P 500 rose 6.1% in the first quarter of 2017 on the expectation of accelerating earnings growth. Political developments in Washington continued to play a strong role in market returns. As hopes for bipartisan agreements on immigration and healthcare dimmed, the anticipated timetable for fiscal stimulus was pushed back.

In U.S. equity markets, this led to a reversal of the post-election leadership. Less cyclical sectors like Information Technology outperformed the S&P 500, while more cyclical sectors like Energy lagged. Likewise, mid cap and small cap equity returns lagged large caps, rising 3.9% and 1.1% respectively. A Federal Reserve interest rate hike in March caused shorter maturity yields to rise, while longer maturity yields were stable to lower, as income-sensitive investors supported longer maturities.

In non-U.S. developed markets, investors gained more confidence that economic growth might be improving and the financial system would continue to heal. Important upcoming European elections, particularly in France and Germany, are being watched closely. In Japan, sustainable economic growth remains challenging and inflation is running close to zero. Emerging market returns were strong, benefitting from continued investor inflows and a somewhat softer U.S. dollar.

Period	1Q17	4Q16	2016	2015
S&P 500	6.1%	3.8%	12.0%	1.4%
MSCI EAFE*	7.4%	-0.7%	1.5%	-0.8%
MSCI Emerging Markets	11.5%	-4.1%	11.6%	-14.9%
Barclays U.S. Aggregate Bond	0.8%	-3.0%	2.7%	0.6%
Barclays Muncipal Bond	1.6%	-3.6%	0.3%	3.3%

*Europe, Australia, Far East

Despite the Federal Reserve's March rate hike and stated intention for additional increases, ongoing demand for income continues to cap the ability of longer domestic yields to rise dramatically. Also acting as a cap on rates are robust bond-buying programs by the European Central Bank and the Bank of Japan that keep their government interest rates artificially low.

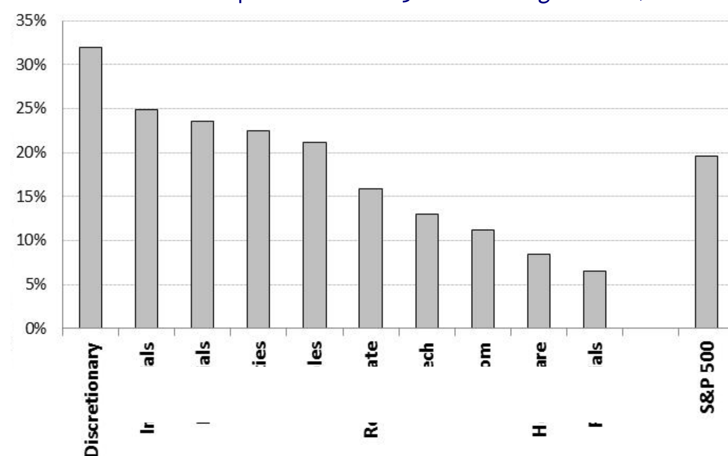
Economy: Current Federal Reserve projections call for 2017 U.S. GDP to grow 2.0-2.2%, assuming that consumer spending remains resilient and deferred corporate capital expenditures are reinstituted. For all of

2016, the U.S. economy only grew 1.6%, the slowest pace since 2011. Overall Inflation remains close to 2%, with wages expected to rise 3% this year, as job growth remains healthy.

2017 Eurozone economic growth is expected to increase slightly to 1.8% following a 1.7% rise in 2016. Stronger bank lending and rising exports are expected to be favorable tailwinds. Japanese economic growth should remain sluggish, rising only 1.0% in 2017, matching 2016. China and India are expected to remain the most robust Emerging Market economies with China's official growth target of 6.5% and India projecting a growth range of 6.75-7.5%. Emerging Markets growth continues to remain highly dependent on commodity markets, as well as the U.S. dollar.

Strategy: Although we are cautious near-term due to valuation and political uncertainty, equities continue to offer better risk-adjusted returns than fixed income based on projected rising earnings in excess of inflation. Conversely, bond coupons and yields offer less of an inflation cushion. As seen in the chart below, the S&P 500's valuation is currently 20% above its 15-year average. However, there is broad dispersion around that valuation at the sector level. We believe this differentiation creates opportunities to add value. For individual stock selection, we continue to favor companies with strong, recurring revenue-based business models.

Current Sector Multiples* as % of 15-Year Average Levels, excluding Energy



Although we favor U.S. equities, we are monitoring global relative valuations closely, in particular Europe, where positive election outcomes might provide an uplift to multiples. Despite attractive Emerging Market returns to date, we remain unconvinced that the current cyclical upturn in global commodity demand is sustainable and those returns will be validated. In fixed income, we continue to be defensively positioned and favor the incremental yields over government bonds offered by investment grade taxable bonds and municipals.