Montecito Bank & Trust®
Wealth Management

JULY 2017 IN REVIEW

August Update | As of July 31, 2017

ECONOMY:
U.S. ECONOMY REBOUNDS IN Q2

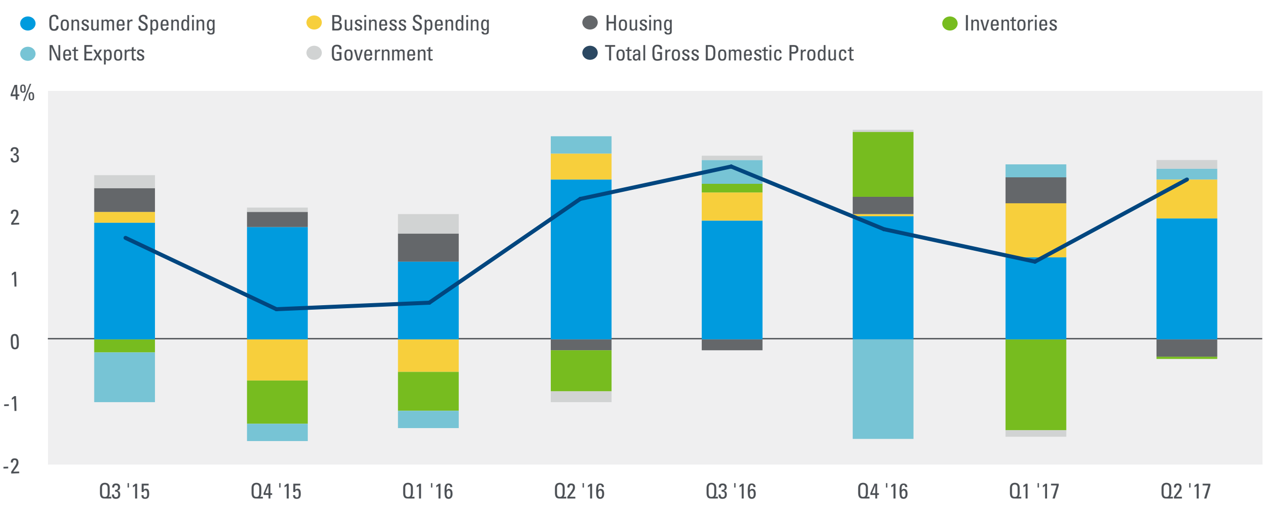
Economic Data

Economic reports released in July 2017, which mostly reflect economic activity in June, indicated that the economy continued to rebound in the closing month of the second quarter following weak growth in the first quarter. The stronger June data was reassuring after an initial bounce back in April was followed by weakness in May. Consensus expectations for 2017 real (inflation-adjusted) economic growth held steady at 2.2% throughout July, according to Bloomberg-surveyed economists.

July brought us the first estimate of second quarter gross domestic product (GDP), which while backwards looking, remains the best overall measure of economic growth. According to the report, the economy grew at an annualized rate of 2.6% in the second quarter, slightly missing consensus expectations of 2.7%, following downwardly revised growth of 1.2% in the first quarter. Looking inside the numbers, the data tilts more positive. Consumer spending rebounded solidly after a weak first quarter and business spending on equipment grew 8.2%, the most in almost two years. The two big disappointments were residential construction, which slowed after a strong first quarter, and inventories, which were expected to bounce after sharp contraction in the first quarter but were basically flat.

Consumers continue to be the primary driver of the economy, but business spending is playing an increasing role. Consumer strength has been supported by an improving labor market, low interest rates, and generally strong economic confidence. On the jobs front, the economy added 222,000 jobs in June versus consensus expectations of 178,000. An upward revision of 47,000 jobs in April and May added to the solid labor market picture. Hourly wages rose 0.2% versus May's 0.1% and expectations of a 0.3% increase. Wage growth was disappointing given the strong jobs number, but modest wage growth helped

CONTRIBUTION TO REAL GDP GROWTH BY ECONOMIC SECTOR



Source: LPL Research, U.S. Bureau of Economic Analysis 07/31/17 limit concerns about inflation. Despite the positive backdrop, June retail sales disappointed, contracting 0.1% ex-autos and gasoline versus expectations of fairly robust 0.4% growth. While confidence remains elevated and consumer spending did rebound in the second quarter overall, consumer behavior remains somewhat cautious.

Data on June business activity was stronger. The Institute for Supply Management's (ISM) Manufacturing Purchasing Managers' Index (PMI) surged to 57.8, topping expectations of 55.3 (above 50 indicates expansion). Weakness in Markit's competing Manufacturing PMI at 52 calls for some caution, but nevertheless also indicated expansion. ISM's Non-Manufacturing Composite also showed strength, climbing to 57.4. Hard data on manufacturing also showed some upside. The manufacturing component of industrial production rose 0.2% in June after contracting 0.4% in May.

LEADING INDICATORS SIGNAL LOW CHANCE OF RECESSION

Source: LPL Research, Conference Board 07/31/17

Actual economic activity compared to consensus estimates can also provide a helpful real-time gauge of economic activity. The Citi Economic Surprise Index, a rolling average of standardized economic surprises, had been trending downward since mid-March, as data failed to keep up with elevated expectation, but showed a clear reversal higher in July, although surprises, on average, remain to the downside. Meanwhile, indicators that tend to lead economic activity continue to suggest below-historical odds of recession in the next year. The year-over-year change in the Conference Board's Leading Economic Index (LEI), an aggregate of 10 leading indicators, accelerated +4.0% in June. The LEI got a boost from a sharp pick-up in housing permits after recent weakness.

Overall, the July data painted a picture of an economy growing a little better than the 2.2% average we've seen since the end of the Great Recession with no apparent threat of a downturn on the immediate horizon.

Central Banks

After raising rates for the third time in six months in June, the Federal Reserve (Fed) left rates unchanged at 1.0–1.25% during its July 25–26 policy meeting, as was widely expected. There were few takeaways from a largely unchanged policy statement, with the Fed's view of the labor market, household spending, and business fixed investment remaining positive. A slight downgrade in the language around inflation, from characterizing it as "running somewhat below 2 percent" to "running below 2 percent", was viewed by market participants as a small concession given the Fed's view that recent declines in inflation were largely due to temporary factors. There was also greater clarity around the timing of the start of balance sheet normalization, the language changing from a timeframe of "this year" in the June statement to "relatively soon" in the July statement.

The European Central Bank (ECB) also left rates unchanged in July. ECB President Mario Draghi's comments following the meeting were largely seen as an effort to calm markets following remarks at a June conference highlighting recent European economic strength that led to concerns that the ECB would start tapering its asset purchases ("quantitative easing") earlier than expected. The Bank of Japan (BOJ) also maintained its current policy at its July meeting, but, in what may be viewed as a largely symbolic move given possibly unrealistic expectations, moved the target date for achieving its core inflation target to fiscal year 2019/20.

GLOBAL EQUITIES:
ANOTHER POSITIVE MONTH FOR U.S. STOCKS; EVEN BETTER OVERSEAS

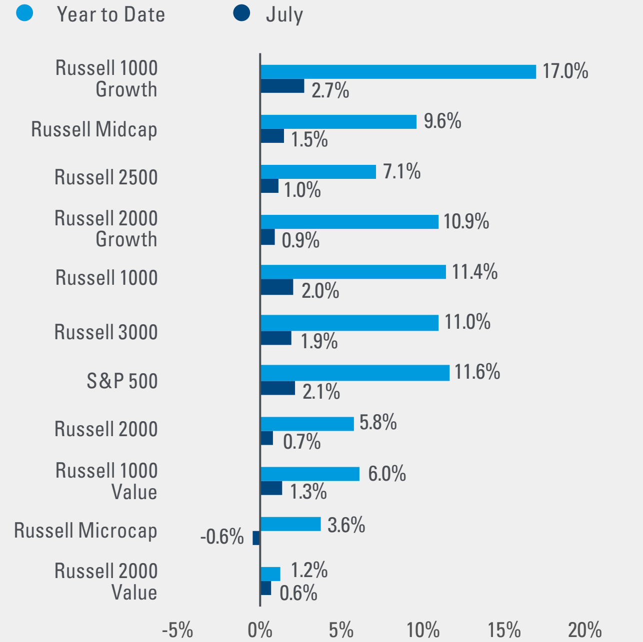
U.S.

In July, U.S. stocks picked up where they left off in the first half of the year with another positive month. The S&P 500 Index gained 2.1% in July, the ninth straight month with a positive total return, bringing its year-to-date return to 11.6%. Low volatility and an absence of pullbacks remained hallmarks of the latest leg of the bull market. The Dow Jones Industrials Average and Nasdaq Composite fared even better, gaining 2.7% and 3.4%, respectively. On the strength of the technology sector, the Nasdaq leads major U.S. equity indexes with a 17.9% year-to-date advance.

Markets in the U.S. have remained well supported by economic and earnings growth. U.S. GDP rebounded solidly from the weak first quarter and incoming data began to beat expectations again at an improved rate after mostly falling short in prior months. Second quarter earnings season, which kicked into high gear in mid-July, impressed on both the top and bottom lines, putting the S&P 500 on pace for a second consecutive quarter of double-digit year-over-year earnings gains. Management teams' outlooks and continued U.S. dollar weakness, which increases the value of overseas earnings for U.S. companies, pointed to a positive near-term earnings picture.

Despite challenges policymakers faced with reforming healthcare, market participants continued to express some confidence in tax reform based on the stock market's continued ascent. Low interest rates continued to support stock valuations as the Fed helped ease the market's concerns that rates would be raised rapidly. Budget battles heat up in Washington, D.C. in August, but stocks thus far have not reflected any concerns about a possible debt ceiling conflict or government shutdown in the fall. The market also shrugged off potential conflicts stemming from North Korea's nuclear ambitions.

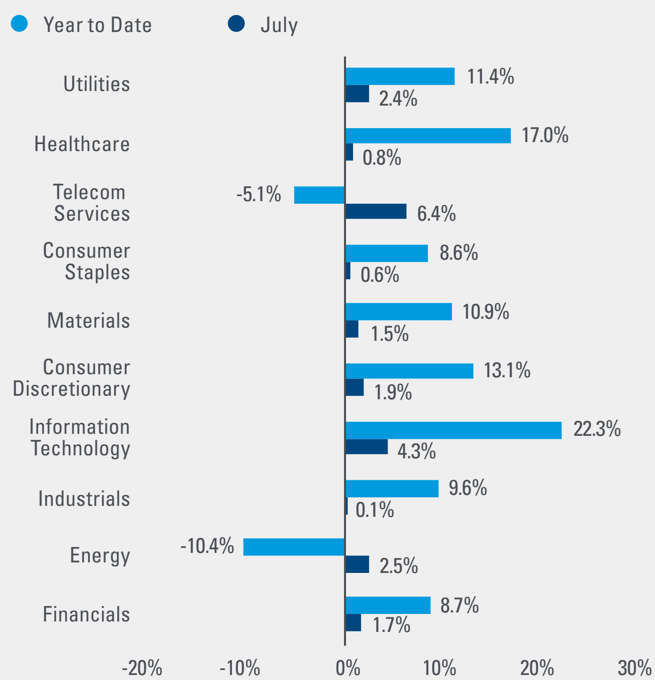
DOMESTIC INDEX PERFORMANCE



Source: LPL Research, FactSet 07/31/17

Indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

S&P 500 SECTOR PERFORMANCE



Source: LPL Research, FactSet 07/31/17

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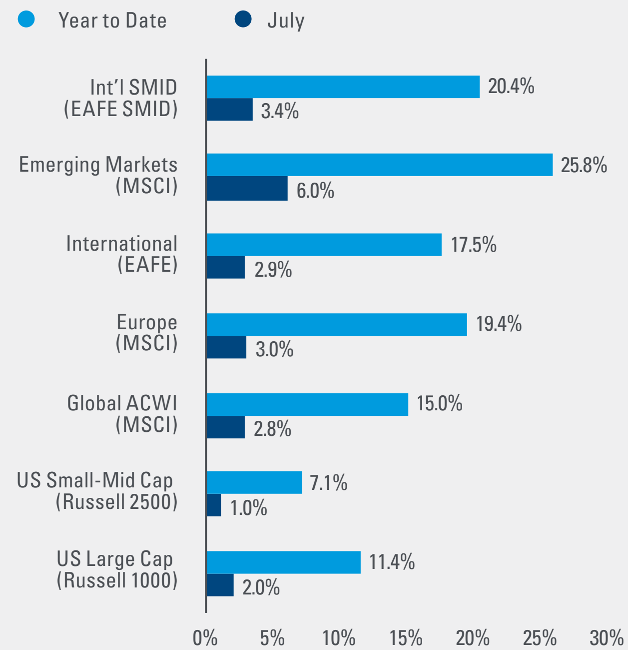
Stock investing involves risk, including loss of principal.

Because of its narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

GLOBAL INDEX PERFORMANCE



Source: LPL Research, FactSet 07/31/17

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International and emerging markets investing involves special risks, such as currency fluctuation and political instability, and may not be suitable for all investors.

The June rotation out of technology reversed in July as the sector's 4.3% return paced the market. Year to date, technology leads all sectors with a 22% return on strength in internet and software stocks. The narrow telecommunication services sector gained 6.4% for the month after well-received earnings. Energy, with its 2.5% gain, also outperformed thanks to oil's 9% rally back to $50 per barrel. On the flip side, weakness in transports and conglomerates weighed on industrials while policy uncertainty contributed to healthcare's underperformance.

Growth returned as the leader after value's June outperformance, based on the Russell 3000 style indexes. Technology strength was the biggest growth driver, while modest financials sector underperformance hurt the value side, due in part to the lack of movement in interest rates and subdued trading activity. Year to date, the Russell 3000 Growth Index return is about 11% ahead of value.

After a strong June, small cap stocks lagged in July. Although the broad market's advance likely reflects some confidence in the pro-growth agenda in Washington, D.C., recent underperformance from small caps seems to reflect some doubt about tax reform. Lower corporate tax rates would generally benefit small cap companies more than large due to their higher tax rates and more domestic focus. Year to date, large caps have outperformed small caps by about 5%, based on the Russell indexes.

International

International equities enjoyed solid performance during July, aided by U.S. dollar weakness, with both the developed foreign MSCI EAFE Index (+2.9%) and MSCI Emerging Markets Indexes (+6.0%) outperforming the S&P 500's 2.1% return. Year-to-date returns have also been lifted by dollar weakness, as the MSCI EAFE and Emerging Markets Indexes have returned 17.5% and 25.8%, respectively, well ahead of the S&P 500's 11.6% return.

Beyond the currency impact, the macroeconomic backdrop has generally improved overseas as global growth expectations and earnings growth have increased. Moreover, markets seemed comforted by the latest updates from key central banks, as the ECB and BOJ both kept the status quo in place.

All major country markets contributed to gains in the international equity indexes in July. On the developed market side, Australia (+4.5%), which benefited from rising commodity prices, was a top performing market, while France (+2.7%) also outperformed. In emerging markets, China (+12.7%) was the top performer for the month, aided by a strong second quarter GDP report. Other strong markets included Brazil (+11.0%), which recovered from its corruption scandal, and India (+7.5%), despite the implementation of a new goods and services tax.

FIXED INCOME:
ALL SECTORS POSITIVE IN QUIET MONTH FOR INTEREST RATES

Treasury yields were mixed and fairly quiet during July, with the exception of the longest maturity (30-year) which rose 7 basis points (0.07%), driven mainly by a pickup in inflation expectations. A quiet month for interest rates and continued improvement across spread sectors led to a positive month for all sectors within fixed income.

The broad Bloomberg Barclays Aggregate Bond Index returned 0.4% during the month, with Treasuries underperforming, returning 0.2% (Bloomberg Barclays U.S. Treasury Index). Investment-grade corporates outperformed the broad high-quality market, returning 0.7%, as valuations continued to richen over the month.

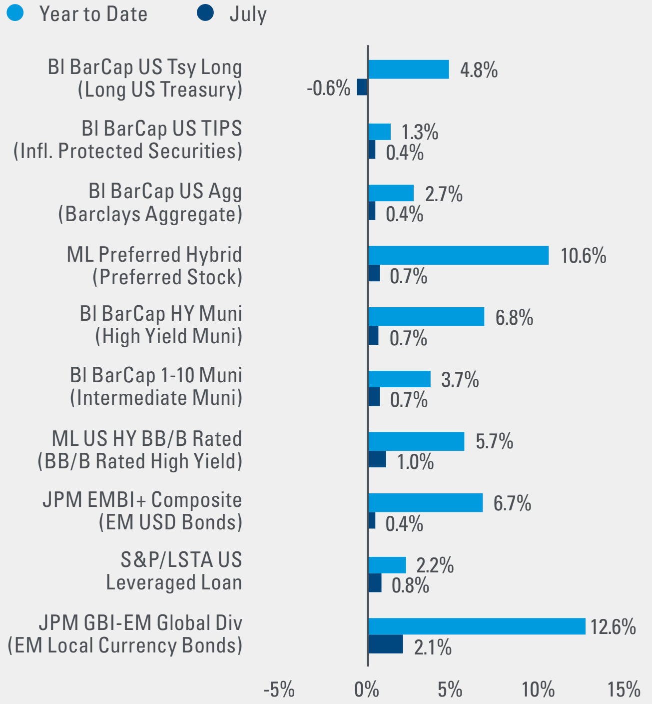
Economically sensitive sectors of fixed income were boosted by sharply positive equity markets and a rebound in the price of oil, which rose 9.0% during July. Emerging market debt returned 0.4% (JPM EMBI+ Composite), high yield 1.0% (ML US High Yield BB/B Rated), and bank loans 0.8% (S&P/LSTA US Leveraged Loan). Unhedged foreign bonds were a standout with a 2.8% return,* benefited by a 2.9% decline in the dollar.

*Based on the Citigroup Non-US Government Bond Index (Unhedged)

Investing in foreign and emerging markets debt securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards.

Municipal bonds are subject to availability, price, and to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rate rise. Interest income may be subject to the alternative minimum tax. Federally tax-free but other state and local taxes may apply.

FIXED INCOME PERFORMANCE



U.S. TREASURY YIELDS

Security	06/30/17	07/31/17	Change in Yield
3 Month	1.03	1.07	0.04
2 Year	1.38	1.34	-0.04
5 Year	1.89	1.84	-0.05
10 Year	2.31	2.30	-0.01
30 Year	2.84	2.89	0.05

AAA MUNICIPAL YIELDS

Security	06/30/17	07/31/17	Change in Yield
2 Year	1.05	0.97	-0.08
5 Year	1.45	1.37	-0.08
10 Year	2.15	2.07	-0.08
20 Year	2.81	2.72	-0.09
30 Year	2.97	2.89	-0.08

Source: LPL Research, Bloomberg, FactSet 07/31/17

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Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise, and bonds are subject to availability and change in price.

Bank loans are loans issued by below investment-grade companies for short-term funding purposes with higher yield than short-term debt and involve risk.

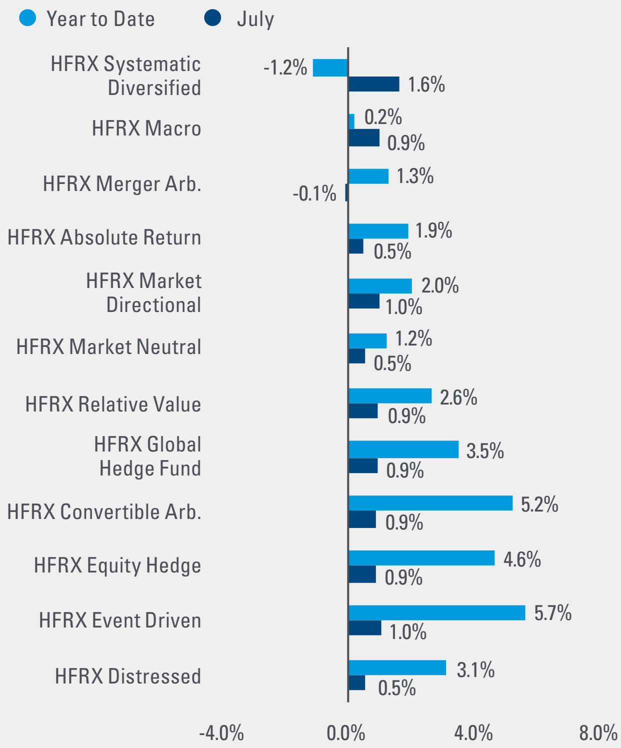
ALTERNATIVES:
EQUITY MARKET STRENGTH SUPPORTS MANAGED FUTURES REBOUND

Managed futures performance rebounded from a difficult month in June, as the HFRX Systematic Diversified Index gained 1.6%, leading all alternative investment sub-strategy returns. Returns were concentrated in the equity market, as long exposure within the United States and emerging markets positively contributed to returns. Currency positioning also supported returns, as long Australian and Canadian dollar positions were profitable during the month. Strong commodity market gains (oil, coffee, gold) helped drive both currencies higher. At the end of the month, long equity and long bond exposure continue to compose the largest allocations, while many strategies are also increasingly adding to their long exposure against the U.S. dollar in international and emerging market currencies.

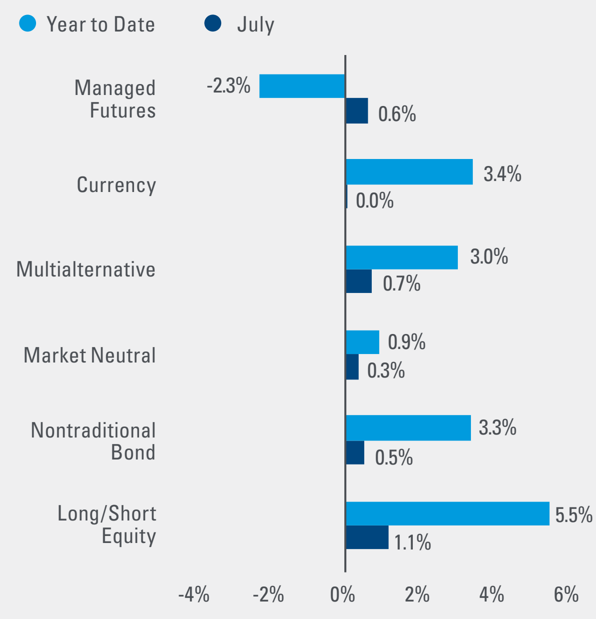
Gains were widespread. In the equity space for instance, the HFRX Equity Hedge Index gained 0.9%, bringing year-to-date returns to 4.6%. However, strategies that have increased emerging market exposure continue to outperform, as the MSCI Emerging Markets Index gained 6.0% during the month and has now returned 10.37% over the past three months. At the sector level, the industry maintains an overweight to growth related holdings, specifically in the technology and consumer discretionary sectors.

The HFRX Event Driven Index returned 1.0%, with year-to-date gains of 5.7%. At roughly 6%, the average annualized merger and acquisition deal spread has remained steady for a majority of the year and the market has yet to experience any major deal disruptions. Special situation managers also performed well, gaining 1.21% as the strategy has benefited from a variety of idiosyncratic events such as post-bankruptcy reorganizations, spin-offs, and the use of activism investment techniques.

HFRX INDEX PERFORMANCE



MORNINGSTAR INDEX PERFORMANCE



Source: LPL Research, FactSet 07/31/17

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Alternative strategies may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses.

STRONG MONTH FOR INTERNATIONAL ASSETS

Liquid real assets followed global equities broadly higher in July, with the strongest gains coming from global infrastructure and international real estate. Commodities, master limited partnerships (MLP), and domestic real estate also produced gains of over 1%. A weaker U. S. dollar, and stable, low interest rates and inflation globally provided support.

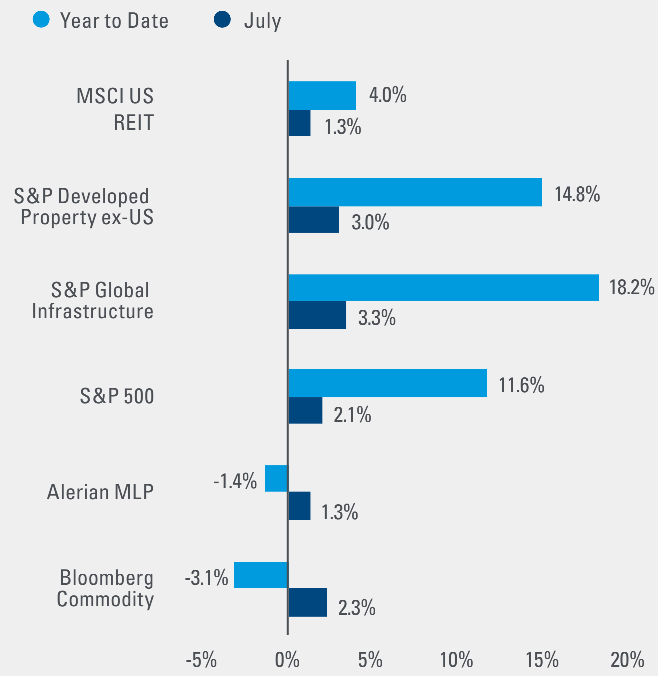
MLPs

The Alerian MLP Index rose 1.3% in July, rebounding from June's declines, as higher oil prices, and stable and low interest rates helped offset the drag from falling natural gas prices. The Trump administration's ongoing deregulation efforts and generally healthy credit markets also contributed to a favorable backdrop for MLPs. Annual distribution growth for midstream MLPs has moderated to 2–3% year over year but remains positive while yields on distributions remain very attractive at roughly 7%, based on the Alerian MLP Index.

REITs & Global Listed Infrastructure

Global infrastructure was the top performing liquid real asset category during July. The S&P Global Infrastructure Index returned 3.3% for the month, outpacing the global equity benchmark, the MSCI Global ACWI Index, which produced a 2.8% return. The weaker U.S. dollar propped up all international asset categories, including international infrastructure and international real estate, although U.S. REITs (+1.3%) and U.S. utilities (+2.4%) each produced gains as well, based on the MSCI U.S. REIT and S&P 500 Utilities Indexes. Low interest rates and relatively dovish commentary from global central banks helped drive REIT performance, with particular strength in the industrial category.

LIQUID REAL ASSET PERFORMANCE



Source: LPL Research, FactSet 07/31/17

Commodities

The Bloomberg Commodity Index rose 2.3% in July, supported by the weaker U.S. dollar. Crude oil rose almost 9% as Saudi Arabia suggested further production cuts. The base metals sub-index rose 4.3%, led by a 6.7% advance for copper. Stability from China supports most commodities, but especially base metals. Volatile natural gas prices fell about 8% on forecasts for continued cooler weather across the northern U.S., reducing demand for electricity and boosting stockpiles. The agriculture sub-index rose 0.8%, aided by dry weather across the western part of the Midwest, though both corn and wheat prices were lower for the month.

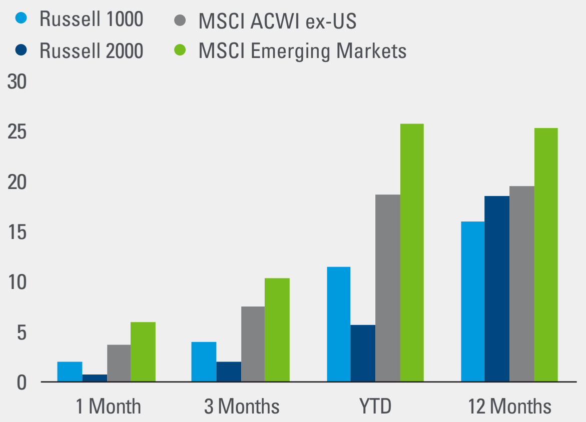
Investing in real estate/REITs involves special risks such as potential illiquidity and may not be suitable for all investors. There is no assurance that the investment objectives of this program will be attained.

Investing in MLPs involves additional risks as compared with the risks of investing in common stock, including risks related to cash flow, dilution, and voting rights.

MLPs may trade less frequently than larger companies due to their smaller capitalizations, which may result in erratic price movement or difficulty in buying or selling. MLPs are subject to significant regulation and may be adversely affected by changes in the regulatory environment, including the risk that an MLP could lose its tax status as a partnership. Additional management fees and other expenses are associated with investing in MLP funds.

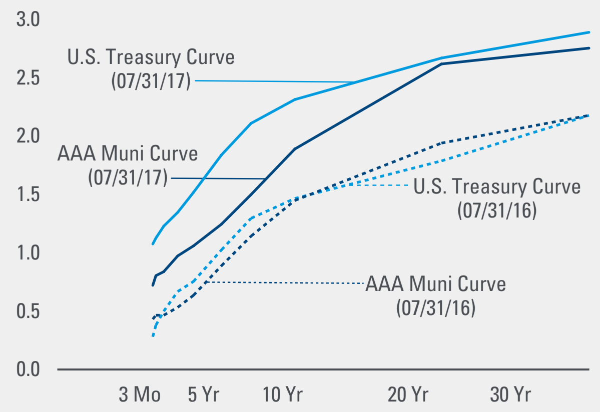
MONTHLY PERFORMANCE REPORT

EQUITY PERFORMANCE



Source: LPL Research, Bloomberg, FactSet 07/31/17

DOMESTIC YIELD CURVE



Source: LPL Research, Bloomberg, FactSet 07/31/17

		1 Mo	3 Mos	YTD	12 Mos
Large Cap	S&P 500	2.06	4.14	11.59	16.04
	DJIA	2.68	5.21	12.28	21.81
	Russell 1000	1.98	4.00	11.44	15.95
	Russell 1000 Value	1.33	2.88	6.05	13.76
	Russell 1000 Growth	2.66	5.05	17.02	18.05
Small/Mid Cap	Russell 2000	0.74	2.11	5.77	18.45
	Russell 2000 Value	0.63	0.91	1.18	19.21
	Russell 2000 Growth	0.85	3.37	10.91	17.76
	Russell Microcap	-0.56	2.21	3.65	20.58
	Russell Midcap	1.47	3.42	9.58	13.04
	Russell Midcap Value	1.33	2.52	6.57	12.69
	Russell Midcap Growth	1.67	4.41	13.26	13.39
All Cap	Russell 3000	1.89	3.86	10.99	16.14
	Russell 3000 Value	1.28	2.73	5.65	14.17
	Russell 3000 Growth	2.52	4.92	16.55	18.02
International Markets	MSCI EAFE	2.89	6.65	17.53	18.32
	MSCI ACWI ex US	3.71	7.56	18.70	19.55
	MSCI Europe	2.99	7.05	19.40	20.40
	MSCI Japan	2.02	6.24	12.34	14.57
	MSCI AC Asia Pacific ex Japan	5.22	10.10	26.20	24.81
	MSCI EAFE SMID	3.39	7.36	20.35	19.34

		1 Mo	3 Mos	YTD	12 Mos
Int'l - Continued	MSCI ACWI ex US SMID	3.57	7.11	19.79	17.74
	MSCI Emerging Mkts	6.04	10.37	25.77	25.30
	MSCI EMEA	6.01	3.89	11.52	13.91
	MSCI Latin America	8.30	6.50	19.48	18.43
	MSCI Frontier Markets	2.13	7.23	18.35	20.72
Sectors - S&P 500 GICS	Consumer Discretionary	1.87	1.79	13.08	13.90
	Consumer Staples	0.57	1.11	8.65	4.39
	Energy	2.50	-1.16	-10.43	0.19
	Financials	1.72	6.95	8.73	32.99
	Healthcare	0.77	6.29	16.97	8.00
	Industrials	0.06	2.98	9.57	18.31
	Information Technology	4.33	5.97	22.31	29.48
	Materials	1.54	3.32	10.90	14.58
	Telecom Services	6.36	2.25	-5.06	-7.03
	Utilities	2.44	3.90	11.41	5.70

Source: LPL Research, Bloomberg, FactSet 07/31/17

(Data continued on following page.)

All data represent total returns, where applicable. Information contained in this report is from sources deemed to be reliable. We cannot guarantee the accuracy or completeness of such information and we assume no liability for damages resulting from or arising out of the use of such information. Further, please note that past performance is not indicative of future results.

		1 Mo	3 Mos	YTD	12 Mos
Fixed Income	BI BarCap US Agg	0.43	1.10	2.71	-0.51
	BI BarCap 1-10 Muni	0.64	1.26	3.42	0.66
	BI BarCap HY Muni	0.66	1.97	6.83	1.22
	BI BarCap Inv. Grade Credit	0.73	2.20	4.56	1.55
	BI BarCap Muni Long Bond -22+	0.97	2.99	5.56	-0.24
	BI BarCap US Agg Securitized MBS	0.45	0.67	1.81	0.19
	BI BarCap US TIPs	0.45	-0.55	1.30	-1.04
	BI BarCap US Treasury Interm	0.32	0.45	1.53	-1.05
	BI BarCap US Treasury Long	-0.62	1.75	4.76	-9.82
	BI BarCap US High Yield Loans	0.77	0.99	2.20	5.82
	ML Preferred Stock Hybrid	0.66	2.97	10.57	5.36
	ML US High Yield BB/B Rated	1.05	2.03	5.64	9.64
	ML US Convert ex Mandatory	1.98	3.86	10.92	16.63
	JPM GBI Global ex US Hedged	0.22	0.10	0.39	-2.01
	JPM GBI Global ex US Unhedged	2.71	4.56	8.42	-3.59
	JPM GBI-EM Global Div	2.07	4.55	12.65	7.97
	JPM ELMI+	1.62	3.24	8.94	6.21
	JPM EMBI+ Composite	0.41	0.65	6.71	3.29

		1 Mo	3 Mos	YTD	12 Mos
Alternatives	HFRX Absolute Return	0.48	0.90	1.86	1.79
	HFRX Market Directional	0.97	-0.39	2.03	7.21
	HFRX Convertible Arb.	0.86	1.91	5.25	7.27
	HFRX Distressed	0.51	0.88	3.08	10.80
	HFRX Equity Hedge	0.87	1.16	4.64	6.88
	HFRX Market Neutral	0.51	-0.40	1.22	-0.12
	HFRX Event Driven	1.00	1.91	5.66	11.04
	HFRX Merger Arb.	-0.11	0.70	1.25	2.85
	HFRX Relative Value Arb.	0.91	1.39	2.64	4.67
	HFRX Global Hedge Fund	0.93	1.39	3.51	5.45
	HFRX Macro Index	0.94	1.01	0.18	-2.72
	HFRX Systematic Diversified	1.63	0.49	-1.18	-6.60
	Bloomberg Commodity	2.26	0.71	-3.12	0.77
	DJ Wilshire REIT	0.92	2.81	2.29	-5.66
	Alerian MLP	1.29	-3.91	-1.40	1.13

		Latest Mo End (07/31/17)	3 Mos Ago (04/30/17)	Latest Yr End (12/31/16)	12 Mos Ago (07/31/16)
Currency	US Dollar Index Value	92.86	99.04	102.21	95.52
	USD vs. Yen	110.26	111.53	116.90	102.09
	Euro vs. USD	1.18	1.09	1.05	1.12
Cmdtys	Gold ($ per Troy Ounce)	1268.80	1267.70	1150.90	1350.40
	Crude Oil ($ per Barrel)	50.17	49.33	53.72	41.60

This information is not meant as a guide to investing, or as a source of specific investment recommendations, and Montecito Bank & Trust make no implied or express recommendations concerning the manner in which any client's accounts should or would be handled, as appropriate investment decisions depend upon the client's investment objectives. The information is general in nature and is not intended to be, and should not be construed as, legal or tax advice. In addition, the information is subject to change and, although based upon information that Montecito Bank & Trust consider reliable, is not guaranteed as to accuracy or completeness. Montecito Bank & Trust make no warranties with regard to the information or results obtained by its use and disclaims any liability arising out of your use of, or reliance on, the information.