HAVERFORD

2017 OUTLOOK

HAVERFORD

A Message from the Chairman

As we head into another New Year there is both excitement and uncertainty ahead. But the uncertainty in 2017 is slightly different than in years' past. Instead of market volatility, we're faced with the unknown of a new administration following a highly-charged and unpredictable presidential election. While it's difficult to know exactly what will happen under President-elect Trump, you can rest assured that there is no question about the consistency of our investing approach. *Quality Investing* is our North Star. In times of turmoil, we look to our *Quality Investing* approach to get us home, and get your portfolio where it needs to be.

But while our investing philosophy remains steady, we never stand pat as an organization. This year we hired five new team members and significantly expanded our office space to help accommodate the growth of the firm. These moves are indicative of our broader investment in areas that help provide value to all of you. We'll also be launching a brand-new website in the first quarter of 2017, and we're set to roll out a new service that we're very excited about. Stay tuned for an announcement on that soon.

And while we're all looking forward to what lies ahead, we believe that it's important to reflect and learn from the previous year. At Haverford Trust, we are always looking for new ways to improve your experience with us. That's why one of our most important initiatives of 2016 was our client and partner satisfaction survey. We are so appreciative of the many clients and intermediaries who participated. If you didn't get a chance to fill out the survey, don't worry! Our team is always available for additional feedback, and we would love to hear from you. We are continuing to absorb your insights and we are taking steps to act on your input and make improvements in key areas.

We are also very proud of the work we were able to do in 2016. Our client retention rate — 97% through year-end — is one of our benchmarks, and we're happy to have lifelong relationships, and friendships, with our clients. Along with our responsibility to you comes the responsibility we feel to the community. This year, we combined our holiday party with a bike building initiative to benefit individuals who receive services from Bringing Hope Home and The Village. We built 17 bikes that were delivered in time for the holidays. We also continue to support other causes throughout the region. In fact, our President Binney Wietlisbach will be the keynote speaker at the Women's Resource Center Annual Leadership Luncheon in 2017. Binney has always been dedicated to the advancement of women in life and finance, and she'll continue to do so in the new year.

We've received strong feedback on our educational programs — the Speaker Series for Women and our Educational Series for Nonprofits, for example — and we look forward to growing those programs this year. We enjoy seeing and speaking with all of you at these events, and hope you'll be able to join us again.

We're glad that throughout all of the inevitable changes, you have chosen to rely on us year after year. And if you've been with us for a long time, you know that this time of year is one of our favorites. Our annual *Outlook* is a labor of love for most of us. It's a way for us to look back, and give some thought to what the next year will bring. We hope it provides you with a glimpse into what our team talks about every day, from the economy to the markets and all of the other trends and topics important to you.

I am extremely proud to work for this great company and with this talented team of professionals. Together, we've built an extraordinary organization that is one of the most respected and trusted wealth management firms in the region. You can always count on our hard work and dedication to you — no matter the circumstances. If you have any questions or feedback, please don't hesitate to reach out to us. Here's to a happy, healthy, and quality 2017.

Sincerely,

JOSEPH J. MCLAUGHLIN, JR.
Chairman & *CEO*
The Haverford Trust Company

2016, A Look Back:

Bull Market Busts through the Wall of Worry

The legendary Wall Street adage, "bull markets climb the wall of worry," doesn't seem to do justice to a year full of surprises. Instead of climbing, this market reminds us of a 300-pound lineman running straight through the wall.

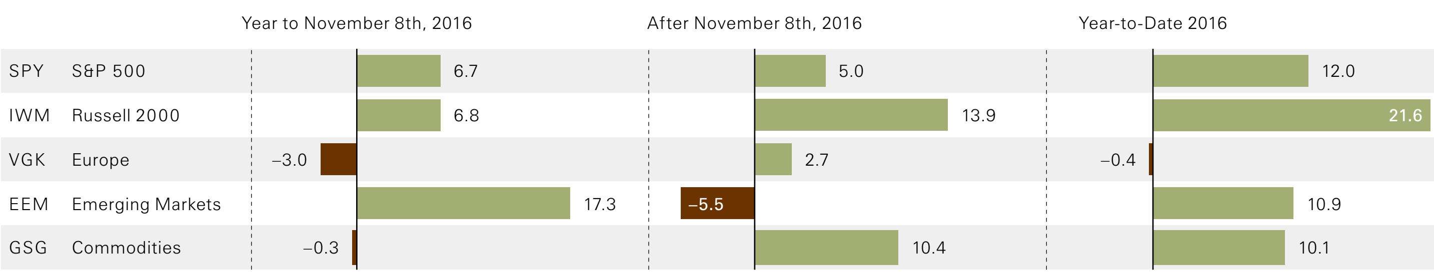
2016 began with the worst five-day and five-week start to any calendar year, and by February 11th the S&P 500 was down 13.5%. The specter of rising rates and fears of a Chinese currency devaluation and economic hard-landing, coupled with a U.S.-led industrial recession, had brought sentiment to levels not seen since early 2009. Economic growth in the United States was tepid during the first half of the year, and then investors had to digest the fears and uncertainty of the U.K. vote to leave the Eurozone (Brexit). A five-quarter-long earnings recession — the longest in modern history not associated with an economic recession — and a surreal presidential campaign was followed by the election of the most unconventional candidate in history, yet the stock market continued to grind higher.

By the end of the year, all the major U.S. stock indices had reached all-time highs, and the recessionary fears proved unfounded. China averted a hard landing while the U.S. economy expanded in the first half of the year, albeit at a 1% growth rate.

Capping a bad year for pollsters, the chances of a Republican sweep was given a scant 5% probability in the early days of November. As it became apparent that Donald Trump was going to be our 45th president, the Dow Jones Industrial Average (DJIA) futures sold off nearly 900 points overnight. At the close of trading the day after the election, the DJIA had made a 1,200-point reversal. Investors went from fearful to giddy in less than 24 hours.

Investors have swiftly priced in the probability that a Trump presidency and Republican congress will likely result in more pro-growth fiscal policies. Market participants believe some combination of lower taxes, less regulation, and increased infrastructure spending is on the horizon. So far, the biggest beneficiaries of the so-called "Trump trade" have been the Financial, Industrial, Energy, and Basic Materials sectors, as well as small- and mid-cap stocks. Other segments of the financial markets — fixed income and defensive, higher yielding stocks (i.e., Utilities, REITs, Consumer Staples) — have suffered on expectations of rising interest rates. Emerging Market equities have been among the worst performers as the dollar soared and investors contemplated the prospect of less favorable trade policies.

World Market Performance



Source: FactSet Research Systems

The Economy: The Known and the Unknown

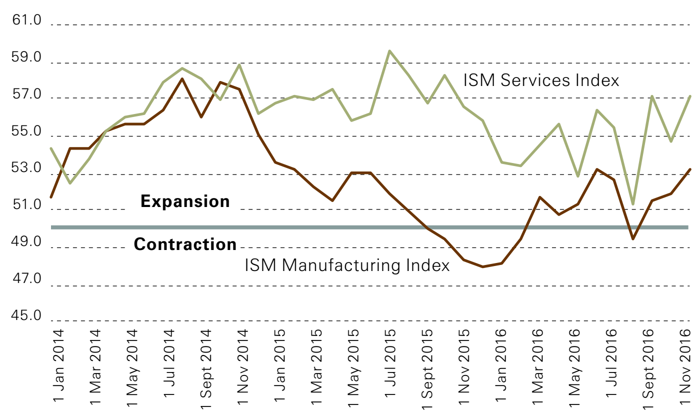
In 2002, then Secretary of Defense Donald Rumsfeld stated at a briefing, "There are known-knowns. There are things we know that we know. There are known-unknowns. That is to say, there are things that we now know we don't know. But there are also unknown-unknowns. There are things we do not know we don't know." Upon first hearing his statement, some initially thought it was nonsense. However, the statement makes eminent sense and the concept of the unknown-unknown existed long before Donald Rumsfeld gave it a new audience.

The Presidency of Donald Trump likely contains more unknown-unknowns than any before it. The businessman president, elected on a populist platform, with a penchant for using Twitter in lieu of press conferences, will inject a great deal of uncertainty into anyone's view of the future. What we know at present, though, is that many business leaders and investors are cautiously to outright optimistic that a business-friendly ally is in the Oval Office.

In past *Outlooks*, we often lamented the need for more pro-growth fiscal policy to ease the burden placed upon monetary policymakers to foster economic growth. An increasingly uncompetitive corporate tax code, spending sequestration, and a record number of new regulations all contributed to hampering Gross Domestic Product (GDP) growth beyond the headwinds lingering from the financial crisis, changing demographics, and lackluster productivity gains. We know Donald Trump's election victory, combined with Republican's control of congress, has raised the prospects of major fiscal stimulus in 2017.

The perception and reality of a soft economy — the weakest expansion since WWII — was a contributing factor for the Trump win. The irony is that after a slow first half, U.S. GDP growth is set to accelerate. Third-quarter GDP jumped to 3.5%, the fastest quarterly growth rate in two years. Consumer spending rose a healthy 2.8%. Business investment, a missing ingredient in the past several years, expanded a robust 10.1%. The unemployment rate has fallen to 4.6%, the lowest level since 2007, and consumer confidence has risen to a nine-year high. In November, the ISM Manufacturing Index rose to a five-month high at 53.2, reflecting that the U.S. factory sector is gradually recovering from the impact of the U.S. dollar's surge in late 2014 through 2015. The ISM Non-Manufacturing (services) Index spiked to a 13-month high reading of 57.2. Taken together, these ISM readings correlate to an economy growing between 2.5% and 3.0%. Clearly, President-elect Trump has been dealt a good hand for his first year in office.

ISM Survey of Economic Activity



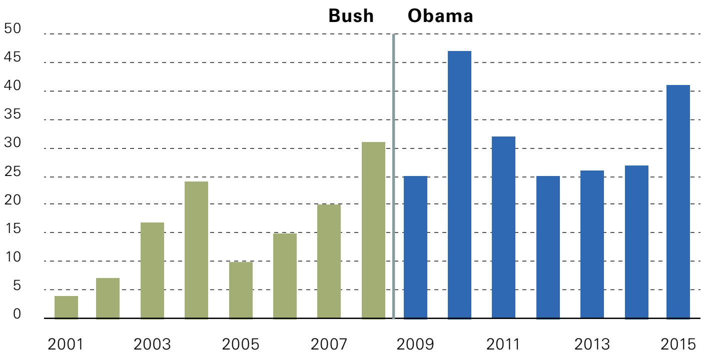
Source: FactSet Research Systems

President-elect Trump has stated he will promptly undo many executive orders President Obama used to circumvent Congress. Executive orders regarding immigration will likely receive the most attention, but a rollback of Obama-era Environmental Protection Agency (EPA) and labor mandates could have significant economic impact. Notably, the long drawn-out battle over oil and natural gas pipelines will likely end and restrictions on energy exploration and development will be eased. This would mean approval for the highly symbolic Keystone XL Pipeline. The rollback of costly regulations implemented by executive order should have an immediate positive impact on the economy.

Beyond Mr. Trump's first few days in office, the unknowns begin to mount and with them the uncertainty of his policy initiatives and their long-term economic impacts. Currently, there are high expectations embedded in market assumptions regarding these initiatives.

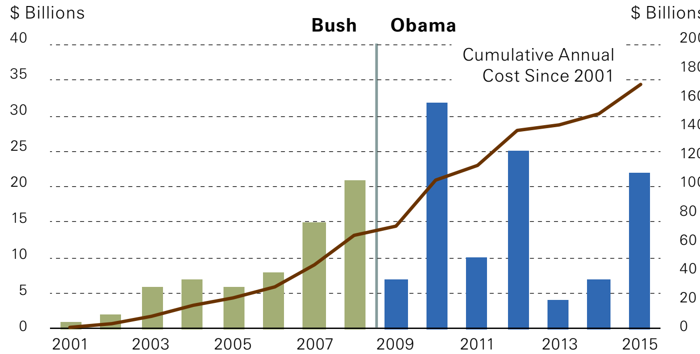
Almost everyone is in favor of personal income and corporate tax reform, but the devil is in the details. A modest and temporary reduction in tax rates and repatriation of foreign earnings could be achievable in five to six months, assuming

Number of Major Regulations that Increase Burdens



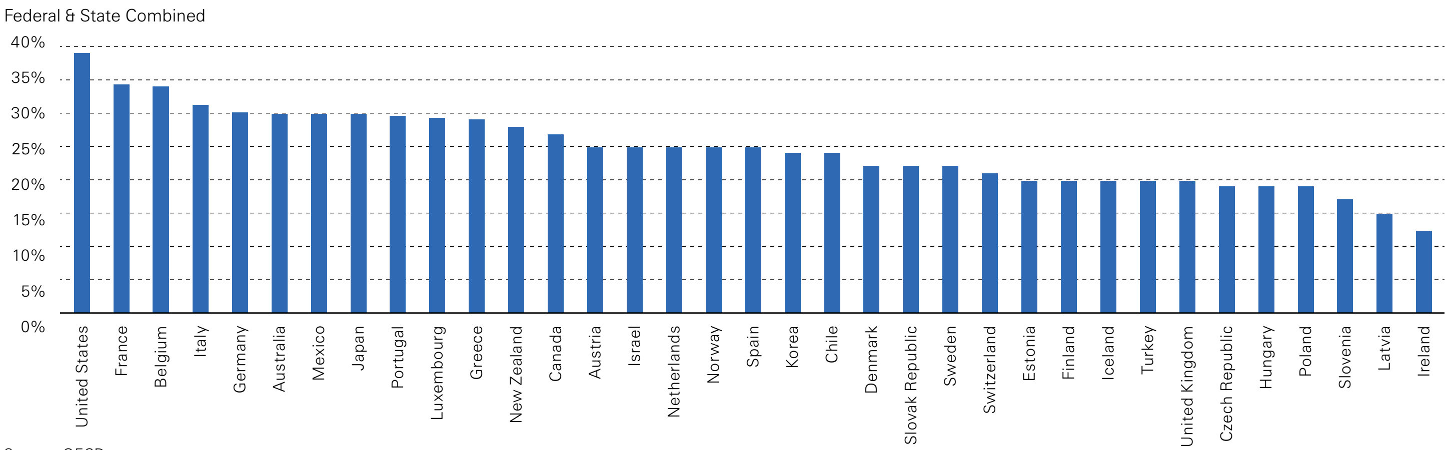
Source: Heritage Foundation, U.S. Goverment Accountability Office, May 2016

Costs Due to Major Regulations



Source: Heritage Foundation, U.S. Goverment Accountability Office, May 2016

Global Corporate Tax Rates



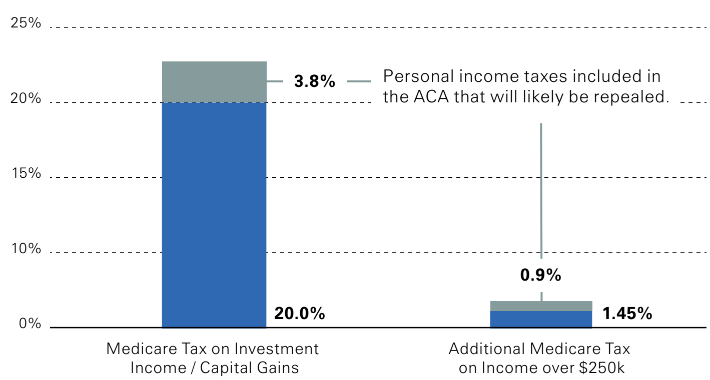
Source: OECD.org

deficit hawks don't hold sway. And if made retroactive to the start of the year (as were the 2003 tax cuts), the tax cuts could immediately jump-start GDP growth. But broader tax reform will likely take several years and significant political capital, if it can be done at all. The last major U.S. tax reform was in 1986, a full two years following Reagan's reelection in a 49 state landslide. Trump certainly did not receive an electoral landslide "mandate," but he does have a Republican congress, which Reagan did not.

President-elect Trump has also promised to spend $1 trillion over 10 years on infrastructure. As we learned eight years ago, there are few "shovel ready" infrastructure projects. The approval process takes time and must occur at multiple levels of government, even assuming a streamlined regulatory environment. This part of the stimulus package, if it comes to fruition, will have little immediate impact on the economy. Any positive effects will not likely be felt until the latter years of Trump's presidency and beyond.

Mr. Trump campaigned on repealing the Affordable Care Act (ACA) and gutting the Dodd-Frank Act. Republicans will likely vote to repeal the ACA as soon as possible. With repeal, taxes will be cut on capital gains, dividends, and wages levied on high-earners. However, replacing the ACA will be much more difficult to accomplish, with no resolution expected in

ACA Taxes on High Earners



Source: IRS.gov

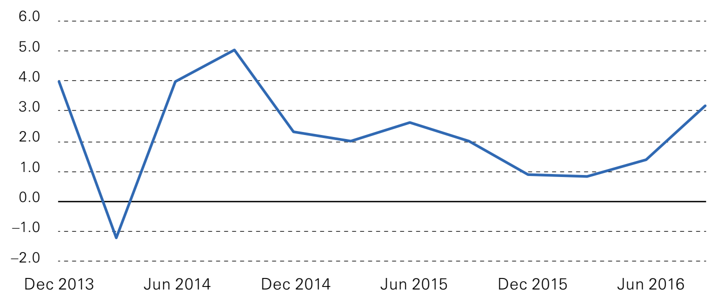
the first year. Trump has softened his tone regarding some of the more popular aspects of the current system, and actually changing such a complex government program will likely be easier said than done. Reworking Dodd-Frank will likely be a bit more straightforward and have a more immediate and positive effect on the economy.

A potential thorn in an otherwise rosy scenario is Trump's rhetoric surrounding trade. Trade barriers and tariffs are anathema to growth. We have little doubt that improvements to existing trade deals, such as the North American Free Trade Agreement (NAFTA), can be made. However, tearing up trade pacts could create more risk and uncertainty for the economy. We hope the new president's trade policies are more bark than bite, but this will bear close scrutiny in the new year.

Depending on the execution of these various fiscal policy levers, and assuming there are limited drags from trade policy, we could see U.S. GDP growth in the range of 2.5%-3.0% for 2017. As the details emerge throughout the new year, and the unknowns become knowns, we will adjust our outlook accordingly.

The economic outlook for international markets is perhaps less rosy. Economists expect just 1% GDP growth in 2017 for the U.K., the slowest pace since the 2008 financial crisis. Although the country's economy has performed better than expected since the June 2016 referendum, rising inflation and a volatile currency, combined with the sheer uncertainty of the Brexit negotiations, are sapping business confidence. Until companies have clarity regarding their access to the European Union (EU), investment decisions will likely be delayed. In continental Europe, political fears are rising as

Real GDP Quarterly Year-over-Year %

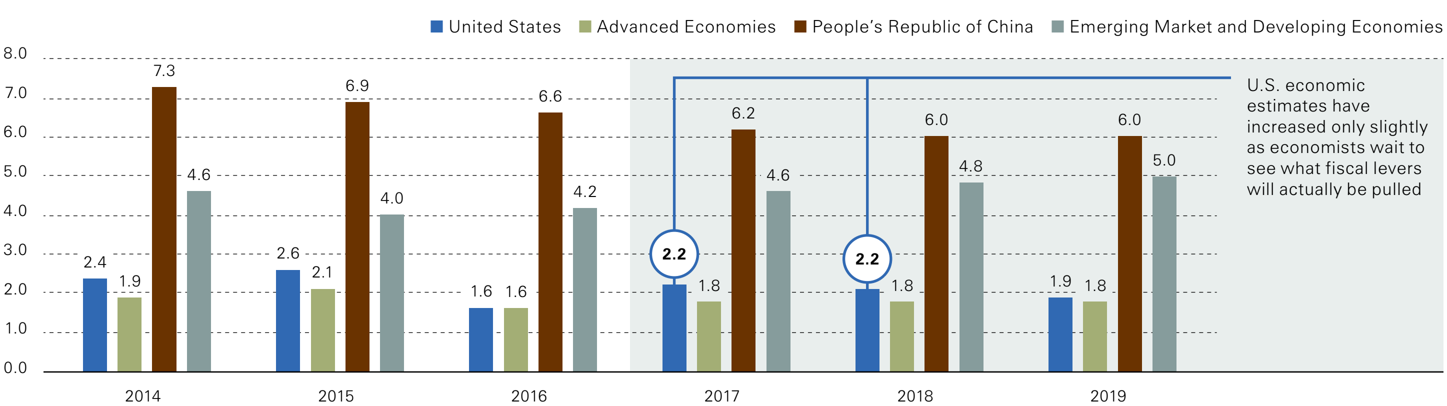


Source: FactSet Research Systems, December 2016

anti-EU parties gain increasing popularity ahead of key elections in 2017. Voters will head to the polls in France, Germany, and the Netherlands, where political establishments are being blamed for the EU's continued economic malaise. Meanwhile, voters in Italy rejected constitutional changes in the recent referendum, which would have made it easier for the government to implement much needed fiscal reforms. As a result, the EU faces further political and economic uncertainty in 2017.

The Pacific region is expected to fare better, but its contribution to GDP growth is below levels seen just a few years ago. Expectations are for India to grow at a 7% pace, slightly ahead of China's sub-7% GDP growth. In aggregate, emerging markets are being held back by subdued expansions in the developed world — Japanese economic growth makes Europe's look robust. Additionally, tightening credit conditions and a smaller Chinese stimulus package will likely be headwinds in 2017.

GDP Expectations



Source: IMF October 2016, FactSet Economic Estimates

Fixed Income

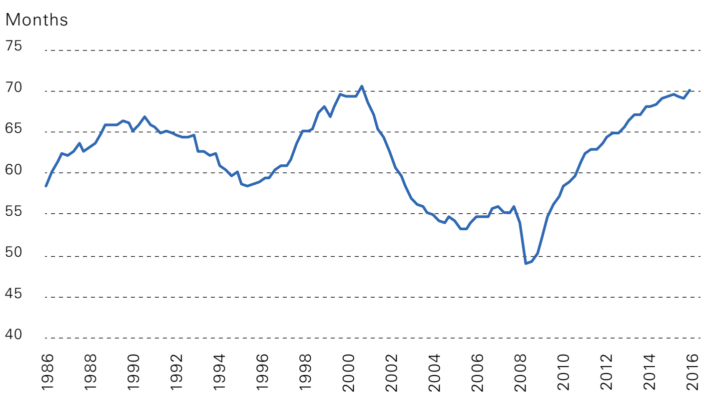
For several years we have said that accommodative monetary policy could only be so effective without pro-growth fiscal policy. Expectations of fiscal policy changes in 2017 will allow the Fed to move from being extraordinarily accommodative to neutral. Thus far, the Federal Open Market Committee (FOMC) has been glacial in its approach to raising the Fed funds rate: two ¼-point hikes in two years. We expect the pace of rate hikes will accelerate somewhat, but still remain gradual by historical standards. We anticipate two to three hikes of ¼ point in 2017. But the exact path forward will always be unknown, even for the members of the FOMC. We take the Fed at their word and know they will remain data dependent with a watchful eye on inflation.

The U.S. Treasury market reaction following the election was dramatic. The yield on the benchmark 10-year Treasury note rose 65 basis points, from 1.85% to 2.50% in less than a month following November 8th. This is in sharp contrast to reactions to past geopolitical events. For example, the 10-year Treasury yield fell 40 basis points in the two weeks following Brexit. It took the market three months to recover and get back to even. This post-Brexit action was typical of the sharp moves of the past several years, but almost all were to lower yields. Going forward, we believe there is a higher likelihood that spikes in yields will be higher.

We expect to take advantage of any sharp moves higher as buying opportunities to capture yield. Among the many factors that we see favoring purchasing bonds is that 10-year Treasury notes now provide a positive real return above inflation. Longer-term maturities are also more attractive due to a combination of higher yields and a steeper yield curve. We will monitor both the real yield (i.e. inflation-adjusted) and the term premium (i.e. yield curve) as factors to determine the allocation to the Treasury sector.

An unknown factor that may significantly affect government bond issuance is the possibility of infrastructure spending.

Average Maturity of U.S. Treasury Debt



Source: Bloomberg

There has been speculation that the new administration would take advantage of interest rates that remain historically low by issuing ultra-long bonds. These bonds could have a maturity as long as 50 or 100 years. The Treasury has already lengthened the average maturity of the debt from 49 months in February 2009 to the current 69 months. Whether or not the Treasury issues such bonds will not impact our clients' portfolios that emphasize intermediate maturity bonds.

In our opinion, the outlook for corporate bonds remains very favorable. The rising equity markets certainly validate that positive outlook. Most corporations have taken advantage of several years of historically low interest rates to lock in low-cost, long-term debt and greatly reduce any exposure to rising rates. Various proposals for corporate tax changes could further enhance the outlook for the sector. Proposed tax incentives could repatriate from overseas as much as $1 trillion cash, an amount equivalent to the past year's total issuance of investment-grade corporate debt. The combination of higher rates, less short-term debt, and unencumbered cash reserves would likely result in lower debt supply in 2017. With the potential for both improving fundamentals and favorable supply factors, we expect to continue to overweight corporate bonds in client portfolios.

In addition to rising rates, uncertainty regarding future tax policy has adversely affected tax-exempt municipal bonds. The month of November 2016 proved to be the worst single month for municipal bonds since the financial crisis in 2008.

While the specifics are unknown, there is speculation that tax-reform could include changes to the taxation of municipal bond income. We believe it is highly unlikely that any future tax reform will eliminate the tax-exemption of municipal bond income. We continue to believe that municipal bonds offer relative value to U.S. tax-paying investors when compared to equivalent-quality corporate bonds. The valuation particularly supports municipal bonds at any marginal tax rate above 30%.

As the top marginal bracket for individual income taxes has only been below that 30% rate for a short period of time in modern history, fears concerning lower tax rates are also overdone. An ancillary benefit for municipal bonds in balanced portfolios is that state and local bonds historically have a lower correlation to the equity market than do corporate bonds.

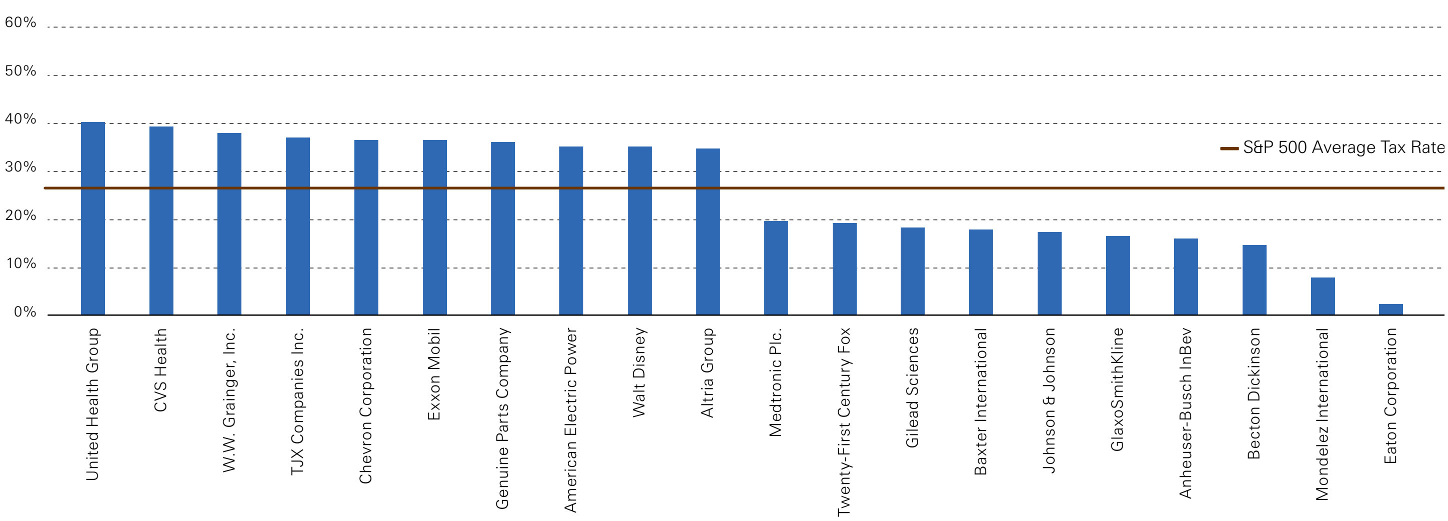
Equity Markets

After five consecutive quarters of year-over-year declines, the profit recession finally ended in the third quarter of 2016. S&P 500 earnings increased 3.3% while overall (i.e., both public and private corporations) corporate profits rose 6.6%. Fourth-quarter profits will likely come in higher as the Energy sector laps the worst of crude oil's decline. Peering into 2017, and assuming our GDP forecast is in the ballpark, S&P 500 profits could increase 8-10% over the Factset 2016 aggregate estimate of $118. Profits could increase even more on favorable tax changes. A potential fly in the ointment could be an even stronger dollar, which has negatively affected the earnings of multi-national companies. For most of 2016 the dollar traded in a relatively narrow range, having appreciated precipitously in the previous year. The dollar began rising again following the U.S. election, but unlike in 2015, commodity prices have kept firming. This indicates the market's confidence in U.S. and global growth.

With inflation and interest rates ticking up, stock market returns should come from earnings growth rather than Price/Earnings multiple expansion. Assuming $127 in 2017 S&P 500 operating profits, the index currently trades at a P/E multiple of 17.7x. If multiples remain constant and earnings grow as expected, the S&P 500 could trade at 2,430 by year-end.

Fund flows and the return of animal spirits could drive this bull market higher. Since the election and through the first week of December, domestic equity mutual funds saw net inflows of over $35 billion, reversing $108 billion in outflows year-to-date through October. Bond fund redemptions totaled $16 billion since the election, reversing the trend of inflows of $207 billion YTD through October. This may be the beginning of a great rotation into stocks, reversing an eight-year trend that saw approximately $750 billion sell out of domestic equity funds, while simultaneously $1.5 trillion moved into fixed income funds. Most investors buying bond funds over the past four years were not making a tangible statement regarding their confidence, optimism,

Effective Tax Rates of Select Companies



Source: FactSet Research Systems, Company Filings greed, or euphoria. Rather, they were expressing their anxiety and fear, by their willingness to accept a minimal return so as not to lose money. A change in that psychology would likely be beneficial for the equity markets.

The potential impact of corporate tax reform could drive a further move up in earnings expectations and with it, higher equity markets. President-elect Trump is proposing to cut the Federal corporate tax rate from the current rate of 35% to just 15%, a level not seen in the U.S. since the 1940s. JP Morgan estimates that Trump's plan would boost S&P 500 earnings by 12% in 2017. More modest cuts have been proposed by House Speaker Paul Ryan. His plan for a 20% Federal tax rate would add 8% to S&P 500 earnings.

It should be noted that the benefit of lower taxation will not be felt evenly across the market. The current effective tax rate for S&P 500 companies is 27%. Domestically focused companies such as United Healthcare, and retailers CVS Health Corp and TJX Companies, pay much higher rates and as such, tax cuts will have much greater implications. Corporations with large international operations, such as Anheuser-Busch and Mondelez, have lower effective tax rates and will benefit less. Balancing that, multi-nationals would disproportionately benefit from Trump's proposal for the repatriation of overseas profits at a one-time reduced rate of 10%. With stranded overseas profits estimated in the trillions, even a fraction of these repatriated funds would significantly boost corporate cash balances in the U.S. Apple alone is estimated to have $216 billion in overseas cash. We expect that the billions in excess cash as a result of these proposed tax changes will significantly boost dividends and share buybacks in the quarters ahead.

Volatility Will Still be with Us

Despite our rosy outlook for GDP expansion, accelerating earnings growth, and increased shareholder returns, investors must anticipate corrections in the year ahead. As we all know, markets do not go up in a straight line. We are seeing abrupt changes in all aspects of U.S. domestic and foreign policy, and a sharp shift from monetary to fiscal policy drivers. While these changes present us with many possible rewards, they also pose risks as well in the year ahead.

Already geopolitical risks are rising as the incoming administration re-evaluates long held views on Taiwan, Iran, and Russia, among others. And of course, tax reform and deregulation efforts are far from certain. The market has priced in high expectations, but delays and disappointments are likely. Add in the steepening yield curve, the likelihood of several successive interest rate hikes, and the dollar at record levels, and the equity markets could be in for a roller-coaster ride in 2017. However, as has been the norm throughout this almost eight-year-old bull market, we expect future corrections to be brief and swiftly reversed.

About Haverford Trust

As an independent, privately owned wealth management firm, The Haverford Trust Company has the strength of more than $6.5 billion* in assets under management and offers a wide breadth of services. From serving a wide range of investors, Haverford has learned how to translate real-world situations into effective financial strategies.

Our clients all have one thing in common — a wealth management need that may be fulfilled by the goals of *Quality Investing*: preservation and growth of capital, stable income growth, lower volatility, predictability, objective advice, risk management, stability, and service.

We are uniquely positioned to service those investors with $1 million or more of investable assets, including:

- Individuals and Families
- Institutions and Institutional Consultants
- Endowments
- Private Foundations
- Employers
- Employee Benefit Plans
- Nonprofit Organizations
- Trusts and Estates
- Religious Organizations
- Financial Advisers

* Including assets under management or consultation for The Haverford Trust Company as of 12/31/16.

With the right people, the right solutions, and the right client experience, let us show you the difference Haverford *Quality Investing*® can make. Please contact your Haverford Relationship Manager or, if you have yet to meet with us, call our offices to arrange a time that is right for you. Either way, we're looking forward to getting to know you.

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QUALITY INVESTING

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