Q4 2017 MARKET RECAP

JANUARY 8, 2018

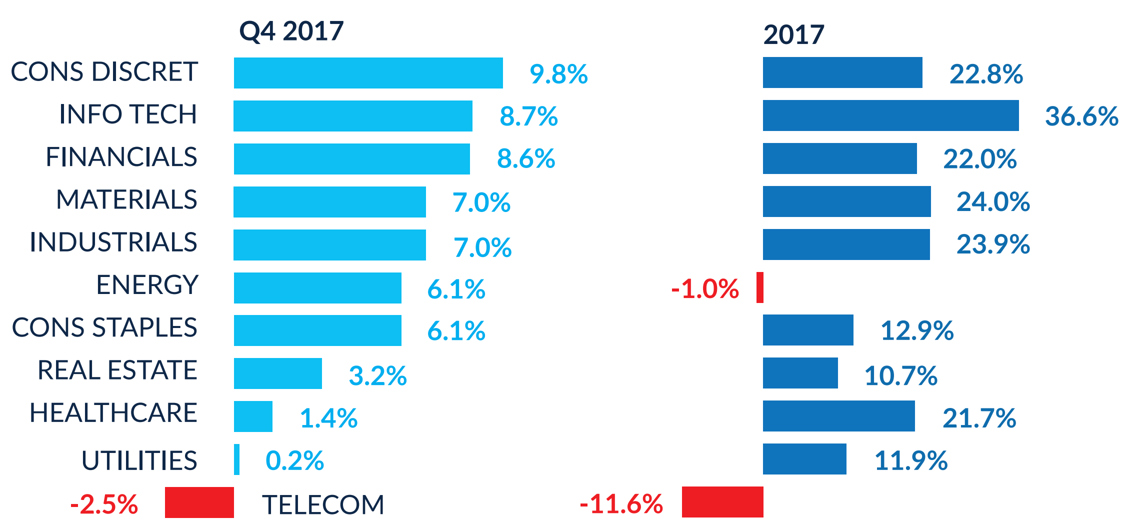
STRONG GROWTH, IN LINE WITH PREVIOUS QUARTERS OF 2017

If the rest of the year was any indication, markets moved ever higher in the fourth quarter. For the first time in quite some time, Commodities led the way for the various asset classes, posting a very strong +9.4% gain in Q4, and bringing their annual return positive to +4.5%. Emerging Markets led the way again in equities, returning +7.3%. Foreign Developed Market equities returned +4.5%, lagging domestic equities as the S&P 500 TR posted its strongest quarter of the year, returning +6.6%. The Nasdaq Composite returned +6.3% in Q4, its second highest quarter of the year, behind Q1's 9.8%. Like the S&P 500, the Dow Jones Industrial Average also saved its best for last, closing the year with a whopping +11.0% in Q4. For the full year, the S&P 500 lagged the Nasdaq and DJIA, returning +21.8% to the Nasdaq's +28.2% and the DJIA's +28.1%. The best sectors in Q4 were Consumer Discretionary, up +9.8%, and Information Technology, up +8.7%. The worst were Utilities, up +0.2%, and Telecom, the sole negative sector, down -2.5%. For fixed income, the Barclays Aggregate Bond Index was up +0.4% in Q4, bringing the annual return to +3.6%.

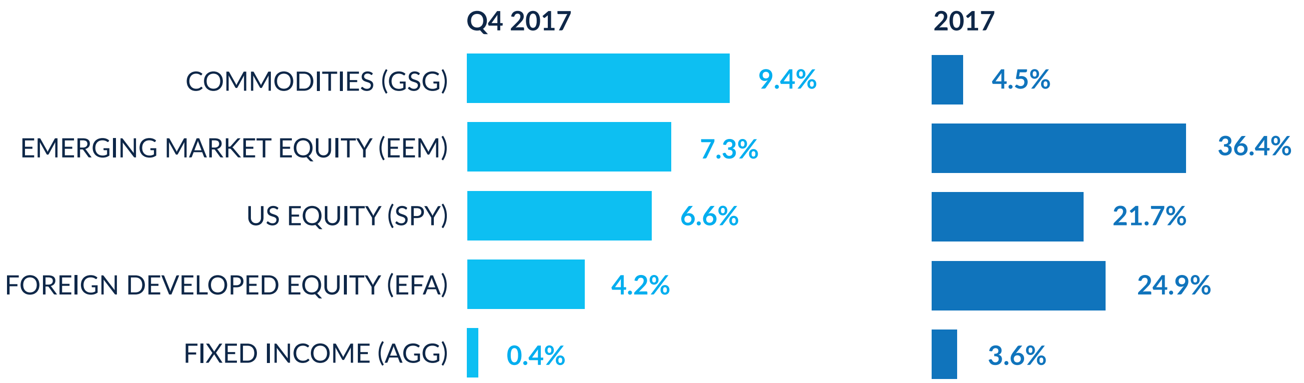
VOLATILITY REMAINS LOW

Another theme of 2017, besides markets moving higher, was low volatility. Just when it seemed as though things couldn't remain as low as they'd been, the VIX averaged a meager 10.31 in Q4, the lowest quarter of 2017. For some perspective, the 1-year average is 11.11, the 3-year average is 14.54, and the 10-year average is 20.08. The question is whether this is due to complacency or due to simply a lack of fear as economic growth around the globe continues to strengthen. In the US, third quarter GDP was reported at 3.16%, marking the second quarter in a row of growth above 3%. This is the first time we've had consecutive quarters above 3% since Q2-Q3 2014. The strong economic data made the Federal Open Market Committee comfortable enough to once again raise rates in December to 1.25-1.50%. It remains on target for 3 more rate hikes in 2018. However, bond yields did not

Sector Returns As of 12/31/17



Asset Class Returns As of 12/31/17



move higher as anticipated. The 10-year Treasury moved from 2.33% to 2.40% during Q4 while the 30-year Treasury declined from 2.86% to 2.74%. Currently, the FOMC is forecasting another 3 hikes in 2018, which would bring the rate to 2.00-2.25%. For some perspective, the median long-run rate is 2.75%. While the US economy is growing strongly, the global economy continues to do so as well. Manufacturing PMIs around the world are hitting multi-year highs, especially in Europe. As indicated previously, both Emerging and Developed International equity markets outperformed the US in 2017.

THE ROLE OF TAX REFORM

One of the biggest events in the fourth quarter was the passage of the tax plan under President Trump. The bill slashed the corporate tax rate to 21% from 35% and it encourages domestic businesses to repatriate their overseas cash. It remains to be seen what effect this will have on corporate spending, but it is now more attractive for companies to bring back cash from overseas. On an individual level, the brackets are changed, the personal exemption is eliminated, and the deduction for state and local taxes is capped. Again, the effects remain to be seen once this plan is put into action, but it is the biggest change to our tax code in decades.

Heading into 2018, we remain constructive overall as economic data around the world continues to be strong. We are keeping an eye on valuations as markets continue higher, especially as it is coupled with strong positive sentiment, which some are calling complacency. We have not had a significant pullback in a very long time and if history is any indication, we are due for one. But, any pullback may be short-lived as the economy appears strong and any signs of a recession seem several quarters away. The FOMC's meetings will certainly garner a lot of attention in the coming year, as will the mid-term elections, which could significantly alter the dynamics in the government.

Sincerely,

Kim David Arthur
CEO and Portfolio Manager