2017 Capital Markets Review

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All Time High

2017 is on pace to be one of the least volatile U.S. equity market environments in history. Any way you look at it, the S&P 500 has experienced one of the calmest periods ever recorded. The broad market benchmark has posted nine consecutive positive months to start 2017 - the S&P 500 has never experienced a calendar year without at least one negative month. Year-to-date, the largest drawdown by the S&P 500 has been 2.6%, extending the streak of consecutive trading days without a 3% market pullback to 226, second only to the 241 trading days in 1995/1996. Over the last year, monthly volatility for the S&P 500, as measured by standard deviation, has been 5.5%, a level comparable to bonds historically. Even intra-day movements have been muted as the daily swing between the market's high for the day and low for the day averaged 0.4% in September, the lowest level recorded in the last forty years.

There are several factors that have contributed to this extended period of nearly uninterrupted prosperity, with the S&P 500 climbing higher in eighteen out of the last nineteen months: (1) Central bank policies, which have pushed yields down to historic lows around the world, supporting the relative attractiveness of equities over bonds; (2) An improving, albeit very slowly, global economy and robust corporate earnings growth; (3) The rise in popularity of passive investing, resulting in the indiscriminate buying of equities; and (4) A "buy the dip" investment mentality. Humans are natural pattern seekers and the recent pattern within equity markets has been every pullback just represents a short-term profit opportunity. As this pattern has continued, the dips have become shallower with investors moving faster to take advantage of what has recently seemed like a riskless profit opportunity.

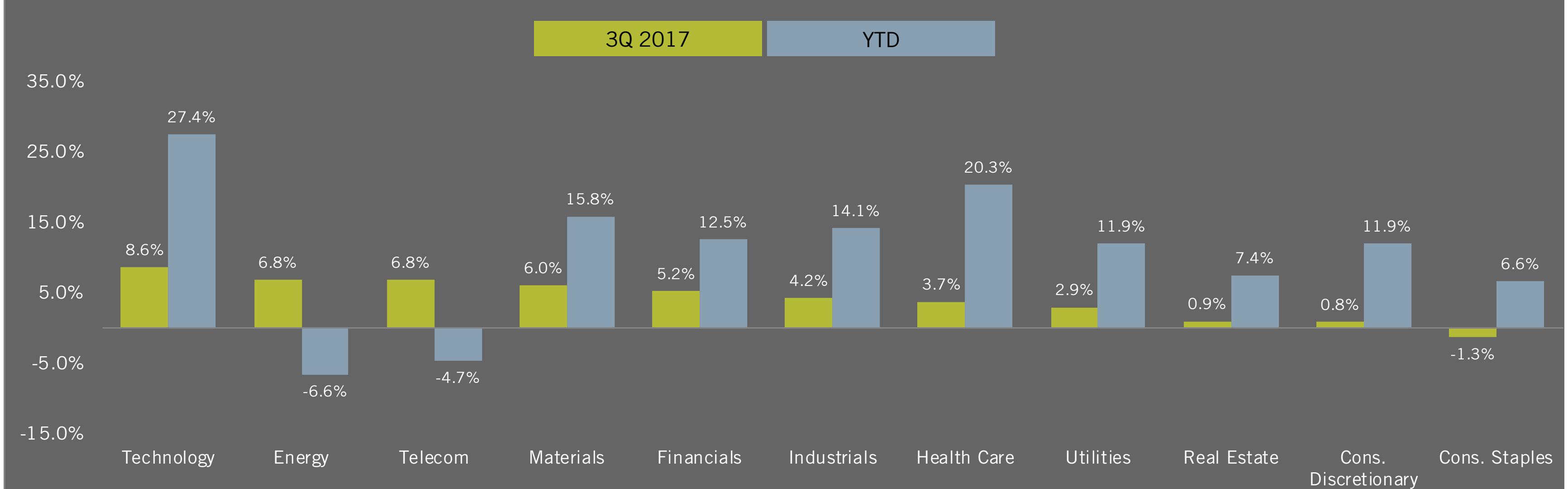
But, we caution investors not to be lulled to sleep by the unprecedented period of tranquility. The Federal Reserve has been slowly removing its foot off the artificial stimulus accelerator, raising short-term interest rates and announcing plans to reduce the size of its balance sheet. Despite strong earnings growth, equity market valuations remain elevated and if the pattern of "buy the dip" breaks, the indiscriminate buying from passive investors could reverse, resulting in indiscriminate selling, putting significant pressure on equity markets. Finally, the political climate is toxic and the threat of a geopolitical event, the one source of market volatility in 2017, remains heightened. Nobody knows when markets will take a breather, and we certainly do not list these concerns as an indication of an impending market problem. However, understanding the potential headwinds markets could face will hopefully enable investors to be better prepared to defend against the recent siren song of low risk/high return equity investing.

Against this backdrop, a closer look at the third quarter capital market environment follows.

Equity Market Review

At the end of the third quarter, U.S. equity markets can be summarized simply – all-time high. Large cap benchmarks and small cap benchmarks, growth styles and values styles, nearly every broad U.S. equity index ended the third quarter at record levels. The S&P ended the quarter up 4.5%, bringing its year-to-date total return to 14.2%. Reviewing sector results, the Technology sector led the way, gaining 8.6% for the quarter. Investors continued to be attracted to the sector, driven by strong balance sheets, the potential for cash repatriation

S&P 500 Performance by Sector



Source: Morningstar Direct

Capitalization and Style Performance

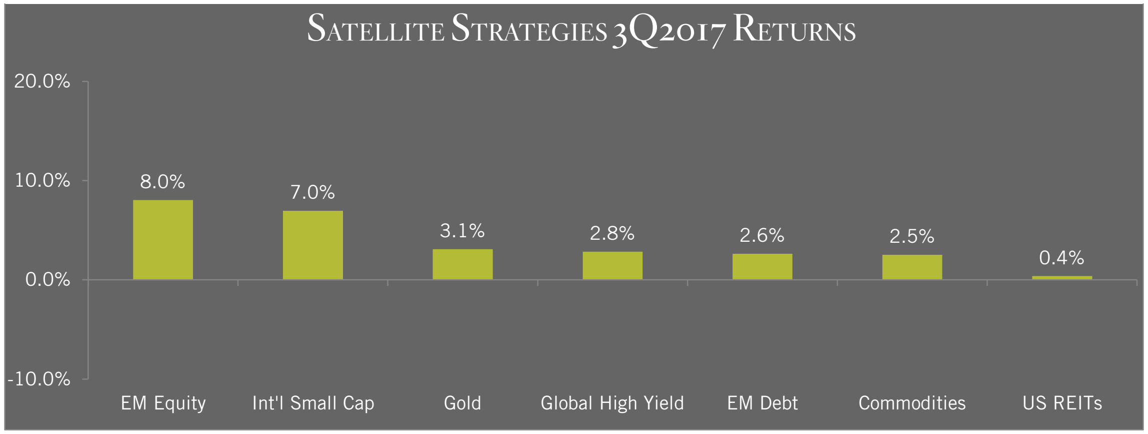
		Value	Core	Growth
Large	3Q 2017	3.1%	4.5%	5.9%
	2017 YTD	7.9%	14.2%	20.7%
Mid	3Q 2017	2.1%	3.5%	5.3%
	2017 YTD	7.4%	11.7%	17.3%
Small	3Q 2017	5.1%	5.7%	6.2%
	2017 YTD	5.7%	10.9%	16.8%

Source: Morningstar Direct, Russell Indices

and a possible tailwind as corporate America reinvests in technology after an extended period of underinvestment. Outside of the Technology sector, Energy and Telecom, the two lagging sectors over the first half of the year, experienced solid gains, climbing 6.8%. Despite the strong quarter, both areas remain negative year-to-date. On the opposite end of the spectrum, the Consumer Staples sector was the only area that failed to gain ground during the third quarter.

Reviewing U.S. equity markets by capitalization and style, small cap stocks were the exception to the low volatility rule, falling 4% early in the period before rallying in excess of 10% over the final thirty trading days of the quarter. The dramatic rally resulted in smaller cap companies outpacing their larger cap counterparts for the quarter, but they continue to trail year-to-date. From a style perspective, growth benchmarks continued their relative dominance over value benchmarks across the capitalization spectrum, increasing their year-to-date lead into double digits.

Robust gains were not limited to the U.S. markets. Foreign equity markets sustained the momentum generated by improving economic growth and favorable currency conditions, generating a 5.5% quarterly return for the MSCI EAFE Index ($). The strong quarter has pulled the year-to-date return for the broad-based developed market index over 20%. Rising confidence, economic growth and corporate



Source: Morningstar Direct, Welch Hornsby, Inc. - Emerging Mkt Equity: MSCI EM Index ($); Global High Yield: BBgBarc Global High Yield TR ($); US REITs - DJ US Select RESI TR ($); Emerging Market Debt - JPM EMBI Global Diversified TR ($); Commodities - Bloomberg Commodity TR ($); Int'l Small Cap: S&P Developed Ex US Small TR ($); Gold - S&P GSCI Gold ($)

profits, combined to boost European ex UK markets sharply higher while Japanese equities benefited from an 18% year-over-year increase in exports.

Fixed Income Review

Expectations for another Federal Reserve rate hike in December climbed, pushing short-term yields higher. Longer-term yields fell early in the quarter, but climbed higher in September ending the period basically unchanged. The late quarter bond-market sell off was in response to the Fed's announcement it would start reducing its balance sheet commencing in October. Outside of the Treasury sector, the "risk-on" environment across the globe continued to support spread sectors as credit outperformed similar duration government bonds. For the period, U.S. bonds, as measured by the Barclays U.S. Aggregate Bond Index increased 0.8%, bringing its year-to-date total to 3.1%, recovering all of the losses experienced during Q4-2016. Finally tax-exempt bonds benefited from strong supply/demand technicals as new issue supply has failed to keep pace with elevated demand.

Satellite Strategies

Foreign equity markets continued to be the top performers as the global economic outlook gained momentum. Against this backdrop, emerging market equities and international small cap equities led the way during the quarter, gaining 8.0% and 7.0%, respectively. Finally, gold rallied after a difficult second quarter, gaining 3.1% to bring its year-to-date return in to double digits.