2017 Year End Review & Outlook

Market Overview: Winds of Change Delayed But Likely Coming…

" The key to successful investing is not predicting the future, but looking at the present with clarity"

-Dr. David Kelly, CFA, Chief Global Strategist, J.P. Morgan

2017 surpassed just about every market observer's expectations, providing a strong year of returns for equities both here and abroad. While a pro-business climate including the potential for less regulation, tax reform and infrastructure spending were themes heading into the year, only the unwinding of significant regulation put in place over the prior decade or so actually impacted the broader economy and financial markets in a meaningful fashion. While tax reform legislation was enacted very late in 2017, its impacts won't be felt until February at the earliest and not fully until much later in 2018. That said, equity markets did respond positively to the legislation, rallying into year-end and more thus far in 2018, but the full benefit likely remains to be seen. Additionally, infrastructure spending, the third leg of the administration's growth stool has no better than 50/50 odds of being approved given the partisan rancor in Washington. Financial markets and equities really liked what they have seen thus far and animal spirits for higher growth in the coming years are visibly present. The current bull market in equities is in its later stages (and can continue for some time) requiring a greater level of discipline from an allocation and valuation perspective.

Our allocation to equities is neutral at current given diverging points of focus, a strengthening macro environment versus elevated valuations on many fronts. As a result, we must remain cognizant of risk as we navigate these later moments of the current cycle. It is our belief that at some point financial markets will experience some turbulence. We view the current landscape as elevated from a valuation perspective but not at irrational levels (i.e. The late 90's dot com craze when valuations were approximately 50% higher on average.) That said, elevated valuation landscapes can continue for some time, especially given the low interest rate environment currently at play. We continue to try to read the tea leaves in ascertaining which direction markets move next but admit this is not so easy. The current course of equities moving higher has merit given tailwinds from a strong macroeconomic growth, an increasingly favorable regulatory environment and increased optimism from both corporations and consumers. This said, our predisposition is to maintain our neutral stance with respect to equity allocation, making sure our portfolios are exposed even at this potentially later moment in the business cycle. Conversely, with fixed income our stance has become more cautious as the risk/reward relationship has shifted downward and headwinds have presented themselves in the form of the limited supply of enticing paper in the marketplace and a burgeoning inflation landscape. As always, we believe a properly allocated portfolio is one that is well-diversified across asset classes and is cognizant of the risk

Equity Markets

Equity markets, both domestic and international provided investors with strong returns in 2017 and the table is set for continued, albeit more modest positive returns into 2018. We believe that much of the strong performance is a result of an improved global macroeconomic backdrop driving strong year-over-year earnings increases and more recent "on the come" benefits from tax reform (mainly at the corporate level but to a lesser extent from consumers who will see their disposable incomes rise). S&P 500 earnings estimates are expected to increase approximately 15% (including the tailwind from tax reform) in 2018, presenting a positive backdrop and lending support to slightly elevated valuation levels. That said, given a nine-year bull market and what feels like the later innings of the current market cycle, we continue to feel risks are rising and stock selection at some point will become more critical. Our hope is that an environment takes hold where not all stocks increase in unison but that better operators and strong stewards of capital are rewarded meaningfully through earnings growth and not necessarily from multiple expansion which seems somewhat limited at current.

Exhibit 1[1], Returns are annualized

Exchange Traded Fund Equity Indexes	Performance through December 31, 2017				
Index ETF	Ticker	Year to Date	1 Year	3 Years	5 Years
Vanguard Total Stock Market	VTI	21.21%	21.21%	11.13%	15.57%
iShares MSCI EAFE	EFA	25.10%	25.10%	7.88%	7.41%
Vanguard FTSE Emerging Markets	VWO	31.48%	31.48%	7.49%	3.37%

Source: Morningstar

In 2017 domestic markets saw large- and mid-caps perform best, benefiting from a stronger global macroeconomy as the percentage of sales coming from international markets is on average greater than that of small cap companies. On a blended basis, large caps outperformed mid caps by 3.30% and small caps by 7.20%. Internationally, the emerging market category was the standout increasing 31% during 2017, driven by strong returns in China (+54%) and India (+39%) while developed markets rose 28% on average, buoyed by solid performance across much of Europe. Coming back to the U.S., growth outperformed value across the board as prospects for a stronger domestic economy as well as better than anticipated global growth drove a shift towards risk assets within equities. Across capitalization ranges the average gap between growth and value was 14.3% with mid caps experiencing the narrowest gap 12.7%. Sector performance was led by Technology, Materials, Consumer Discretionary, Financials and Health Care all outperforming by the broader market, while Industrials, Consumer Staples, Utilities, Real Estate, Energy and Telecommunications lagged by varying margins.

Morningstar Market Barometer Report
Time Period2017, full year

Exhibit 2[3]

The Morningstar Market Barometer provides a visualization of the performance of the Morningstar Indexes. The color scale (red for losses and green for gains) allows you to instantly assess which areas of the market are performing strongly and which areas are showing weakness.

The Morningstar Indexes consist of a family of 16 indexes that track the U.S. market by capitalization and investment style using a comprehensive, rule-based approach. The Morningstar Index family is based on the same methodology as the well-known Morningstar Style Box , and it provides an integrated framework that can be used for all stages of investment process.

Fixed Income Markets

While debt markets performed admirably in the first half of 2017, the back half of the year presented challenges as rising interest rates negatively impacted returns. The aggregate bond category produced 3% returns in 2017, though much of this was realized by mid-year with the second half underperforming versus most expectations. Standout categories within the asset class included: emerging market bond (+13% in local currency; +10% in USD) and high yield (+7%) though the latter half of the year was pressured. Weaker categories included: U.S. Treasuries (short- and intermediate-term), mortgage-backed securities (MBS) and treasury inflation protected securities (TIPS) all of which underperformed the broader fixed income market.

Pressures likely endure throughout 2018 as the Federal Open Market Committee signals additional interest rate raises while continuing to negotiate a slow to modest unwind of its approximate $4T balance sheet. With that backdrop, bond selection within the broader fixed income category likely becomes increasingly challenging. To this end, we likely become more cautious with respect to term and quality of the inventory being pushed our way. Shorter durations likely see increased allocation, while more cyclically sensitive corporates which are less impacted by rising interest rates provide support.

Exhibit 3[1], Returns are annualized

Exchange Traded Fund Fixed Income Indexes	Performance through December 31, 2017				
Index	Ticker	Year to Date	1 Year	3 Years	5 Years
iShares Core US Aggregate Bond	AGG	3.55%	3.55%	2.14%	2.06%
SPDR Barclays High Yield Bond	JNK	6.48%	6.48%	4.34%	3.92%

Gaining Perspective

A well-grounded financial plan is fundamental to financial success.

Every year since 1995, the S&P 500 has experienced a decline of 5% or more at least once during periods of elevated uncertainty. Furthermore, declines of 2% and 3% occur on average at least monthly, with full recovery taking only a few weeks. As such, short-term pullbacks historically have occurred frequently and should not, in and of themselves, be reasons for anxiety.

Exhibit 4[2],

Drawdown Threshold*	Historical Frequency	# Per Annum	Typical Recovery Time
20%	Once per Market Cycle	0	20 Months
10%	Annually	1	8 Months
5%	Quarterly	4	2-3 Months
3%	Monthly	11	2-6 Weeks
2%	High Frequency	18	1-4 Weeks

FREQUENCY BY SIZE DRAWDOWN, THRESHOLDS ANALYZED INDEPENDENTLY*
* Analysis based on each type (size) of drawdown being independent. For example, the market does not typically see four 5% drawdowns and one 10% drawdown in the same year, but rather those 5% drawdowns may compound into a single 10% drawdown for the year. Data as of 1/31/15.

Asset Allocation & Financial Planning

A competent financial plan considers potential outcomes through multiple market environments as a way to balance the risk of shortfall. That is, not achieving a stated goal. Critically, for investment goals, asset allocation is a major factor used to derive the range of potential outcomes. Perhaps the largest factors in determining an investor's asset allocation is their risk tolerance and time horizon. An accomplished financial planner can use that information in statistical models to craft a portfolio with the necessary confidence to achieve stated goals.

A DALBAR study illustrates the importance of having professional guidance through a Wealth Management Advisor. **The S&P 500 returned an average of 8.91% annually across the 20 years ending on December 31, 2015 while the average investor's portfolio returned just 4.67% per year.** Read more at: http://www.prenticewealth.com/why-having-a-financial-professional-matters/

Recent Increases in Trading Activity

Due to changes which include a broader offering of index, sector and other asset class instruments in a zero-transaction cost manner within TD Ameritrade Institutional's ETF Market Center platform over the past couple of months most of our client accounts experienced elevated trading activity versus normal. We were able to take advantage of a free-trading window on exiting ETFs while transitioning to similarly-exposed, commission-free ETFs on a go-forward basis in an effort to maintain the integrity of our alpha beta framework which requires limited or no-cost transaction fees on our most highly traded positions. After months of due diligence around the offerings both exiting and entering the platform we believe we have replicated the alpha beta framework position requirements with minimal impact to strategy integrity. For most of the key ETFs employed, we were able to reduce overall costs while maintaining exposure levels and in one instance where costs have increased we shifted to a mutual fund (Franklin Mutual Global Discovery A (TEDIX)) from an ETF (Vanguard Total World Stock ETF (VT)) as our rationale was that in more volatile markets we wanted an investment manager with active management exposure as opposed to a passive index ETF. We believe that while VT served our portfolios well over the past few years it was prudent to harvest those gains (as it had outperformed most active funds) and pivot to an active manager who has a track record of performing better when volatility in markets presents itself. Below is a table consisting of the changes effected to many of our client accounts as a result of the TD Ameritrade's ETF Market Center transition.

FROM		TO
Vanguard Total World Stock ETF (VT)	➡	Franklin Mutual Global Discovery A (TEDIX)
Vanguard REIT ETF (VNQ)	➡	iShares Core US REIT ETF (USRT)
Vanguard FTSE Emerging Markets ETF (VWO)	➡	SPDR Portfolio Emerging Markets ETF (SPEM)
Vanguard Total Stock Market ETF (VTI)	➡	SPDR Portfolio Total Stock Market ETF (SPTM)
iShares Core US Aggregate Bond ETF (AGG)	➡	SPDR Portfolio Aggregate Bond ETF (SPAB)
Vanguard Total International Bond ETF (BNDX)	➡	JP Morgan Global Bond Fund Opportunities (JPGB)
SPDR Bloomberg Barclays High Yield Bond ETF (JNK)	➡	JP Morgan Disciplined High Yield ETF (JPHY)
iShares TIPS Bond ETF (TIP)	➡	SPDR Bloomberg Barclays TIPS ETF (IPE)

KbC Equity Strategy Model Portfolios

Equities performed above most market observers' expectations during 2017. With approximately 20% domestic returns and even higher international returns one has to wonder if equities have moved too far too fast and gotten ahead of fundamentals or if this a confirmation of stronger global macroeconomic growth, increased earnings (at levels maybe higher than observers are anticipating) and potentially a broader asset rotation (to equities, away from fixed income and from cash held on sidelines). We will likely get the answer to this sometime over the next year or so as we seem to be in the later stages of the current bull market for equities. Our KbC equity strategies performed above expectations in absolute terms, though lagged somewhat in relative terms as did most active managers in 2017. While our expectations called for high single digit percentage growth for domestic equity markets, the year significantly surpassed these expectations. With equities rallying strongly, our core/near-core strategies had trouble keeping up with the broader market. We admit to having patience and discipline in executing the strategies and that we don't chase returns, believing that over a number of years or a full market cycle, our approach will be rewarded on a risk-adjusted basis. As mentioned earlier, the backdrop for domestic equities remains favorable though investor expectations should be tempered from the levels experienced in 2017. That said, we will use extended domestic equity rallies as an opportunity to trim elevated positions (against our price targets) and reallocate those proceeds into the beta isolator (index ETF) as a way to remain exposed to the broader market but to do so with an increasing eye with respect to risk.

KbC Dividend Strategies

KbC Dividend Strategies ended the year on a high note and seemed well positioned heading into 2018. Our philosophy towards income producing strategies is to employ a barbell approach of holding both consistent dividend payers and those increasing their dividend at outsized rates versus the broader market. The outsized dividend growers, mostly with higher growth characteristics outperformed the consistent dividend payers, which exhibit more value features and this corroborated growth's outperformance of value throughout the year. Though the bend within the strategy began tilting modestly towards outsized dividend growers in early 2017, the failure of the 10-year U. S. Treasury yield to break out above the 2.5% level for most of the year likely negatively impacted performance. As we begin 2018, the likelihood of a higher 10-year U. S. Treasury yield seems to be building and this should mesh nicely with the modest tilt aforementioned. That said, we don't manage our portfolio strategies for the near-term but instead try to identify and hold companies that we feel have a greater success of outperforming over an entire market cycle. Strong performance during 2017 was seen in a host of positions including Ameriprise Financial (AMP), UnitedHealth Group (UNH), Lockheed Martin (LMT), PPG Industries (PPG) and Blackstone Group

(BX), all outperforming the broader market. Conversely, there were a few underperformers including Allergan (AGN), Kraft Heinz (KHC), Energy Select Sector ETF (XLE), Starbucks (SBUX) and JM Smucker (SJM). New positions in the second half of 2017 include: DowDuPont (DWDP), Honeywell International (HON), Industrial Select Sector SPDR ETF (XLI) and Walgreens Boots Alliance (WBA); while exited positions include: British American Tobacco (BTI) and Reynolds American (RAI)--a longstanding position within the strategy after the BTI takeover of RAI was finalized along with VF Corp (VFC).

KbC Market Strategies

KbC's Market Strategies posted solid absolute returns during 2017, though lagged their respective benchmark Vanguard Total Stock Market ETF (VTI). The strategies' relative underperformance can mainly be traced to exposure in defensive-leaning positions including core holdings JM Smucker (SJM) and Kraft Heinz (KHC) which were left behind by the market as it rotated towards growth throughout most of the year. Additionally, smaller positions in Energy Select Sector ETF (XLE), Hain Celestial Group (HAIN) and Starbucks (SBUX) had minor negative impacts towards performance but remain well-positioned within their respective spaces to rebound and hopefully as outsized drivers of potential alpha generation moving forward. Positives performers within the strategy included Ameriprise Financial (AMP), UnitedHealth Group (UNH), Technology Select Sector SPDR ETF (XLK), Industrial Select Sector SPDR ETF (XLI) and Citigroup (C). One new position was initiated during the second half of 2017, RenaissanceRe Holdings (RNR) while one position was exited, VF Corp (VFC).

KbC Mid Cap Strategies

KbC's Mid Cap Strategies faced multiple challenges during 2017 and significantly lagged their respective benchmark SPDR S&P MidCap 400 ETF (MDY). From Walgreens Boots Alliance (WBA) failed acquisition of Rite Aid (RAD) which negatively impacted performance in a significant fashion to Range Resources (RRC) where management missteps have weakened the broader investment thesis to underperformance in Newell Brands (NWL) and Pitney Bowes (PBI) the strategy had a difficult year. For RAD we continue to believe there is significant value in what will remain of the company post disposition of nearly 2,000 stores to WBA with leverage greatly reduced as a result and opportunity to focus on the remaining legacy stores. Strong performance during 2017 was seen in a host of positions including New Relic (NEWR), Ameriprise Financial (AMP), Andeavor (ANDV), PPG Industries (PPG) and Jacobs Engineering (JEC), all which outperformed the broader market. New positions in the second half of 2017 include: Adamas Pharmaceuticals (ADMP), Cognizant Technology Solutions (CTSH), Mednax (MD), RenaissanceRe Holdings (RNR) and Validus Holdings (VR)-which subsequently was acquired this month at a 40%-plus premium by American International Group (AIG); while exited positions include: Acacia Communications (ACIA), Assurant (AIZ), Crown Holdings (CCK), Oclaro (OCLR) and Tyson Foods (TSN)—which was a solid alpha generator but hit our upside price target and was sold as a result.

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1: Data Source: Morningstar Office, returns are annualized.

2: Source: Standard & Poor's, FactSet, JP Morgan Asset Management. Returns are based on price only and do not include dividends. For illustrative purposes only.

3: Morningstar Market Barometer provides a visualization of the performance of Morningstar Indexes. ©2018 Morningstar