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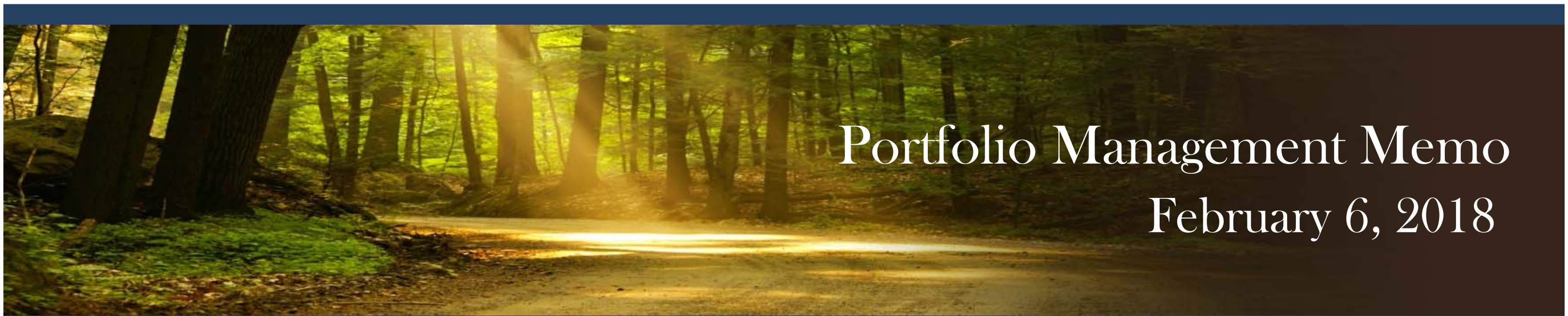

Portfolio Management Memo

February 6, 2018

Last Friday, the S&P 500 fell 2.1% finishing the week down 3.9%, the biggest weekly loss in two years. That was followed by a 4.1% loss for the index on Monday. There was no specific news or fundamental data that has driven these declines. The market may have gone a little too far too fast, and pullbacks are not only normal, but common and healthy. Moreover, selling often begets more selling. In today's market, automated trading programs often sell at key technical levels that can exacerbate normal market activity. We saw this first hand in the "Flash Crash" of 2010, when the Dow Jones Industrial Average fell 1000 points in 10 minutes due in part to program trading.

The current market movements appear to reflect a reassessment of the outlook for the U.S. and global economies. Specifically, inflation and interest rates have raised concerns. The labor market is tightening, which is a factor that can drive wages higher. Wages represent a company's biggest single cost and have a significant impact on inflation for the entire economy. In 2017, average hourly earnings (wages) grew 2.9%, which represents the fastest annual growth rate since the start of the current economic expansion in mid-2009. While wages are growing, productivity, a key factor in offsetting rising inflation, slowed in Q4 2017. Rising inflation expectations have driven interest rates higher. The yield on the 10-year U.S. Treasury rose from 2.4% to 2.8% in the past month, while the yield curve flattened considerably in 2017. This continued trend has seen both inflation and interest rate expectations move steadily higher over the last six months or so. Considering we have a new Federal Reserve Chairman, the market is concerned that rates may move higher than expected to offset inflationary pressures, thus dampening economic growth. While equity markets continued to rise unabated, there seem to be growing concerns over the ultimate implications for growth.

It is hard to argue that the current stock market valuations are cheap. However, earnings expectations continue to rise, in part due to the benefits of tax reform and strong consumer spending. Despite rising inflation, there are currently no signs of a pending recession and major economic indicators continue to signal growth. At the same time, we cannot completely dismiss the possibility of further market weakness. Recent gains have left the market vulnerable to a pullback that should not be entirely unexpected. Global equities have fallen by more than 10% in two-thirds of the years since 1979, yet most of the time still posted a gain for the year.

The irony is that the last market pullback in 2016 was over fears of a global economic slowdown, driven primarily by China. Now the fear is the economy could be growing too fast, meaning a more rapid shift in monetary policy, higher interest rates, a recession, and ultimately a bear market. The reality is that most economic data points remain strong. In Japan and the Eurozone, policymakers continue to work to get inflation up to sustainable levels. Rising wages are good for the consumer, and the U.S economy is driven by consumption (nearly 70% of U.S. GDP). Rising inflation due to strong economic growth can also help to drive earnings growth.

So the question then becomes: What should you do? At the expense of sounding like a broken record – nothing. Continue doing exactly what you are doing.

- **Stay diversified** – While global equities have seen significant declines over the past few days, other asset classes have not. This is when you see the benefits of holding cash, fixed income, and alternatives. These asset classes have helped reduce portfolio losses.

- **Rebalance to your risk profile** – We continue to rebalance our client's portfolios to maintain the appropriate risk profile. In the past five calendar years, the S&P 500 has gained nearly 110%. By consistently rebalancing your portfolio, we capture these market gains to reinvest in other asset classes. This forces us to "sell high and buy low."

- **Stay the course** – While it sounds so cliché, staying invested is one of the most rewarding investment strategies. Missing just a few of the best days in the market each year can have a significantly negative impact on your portfolio.

- **Put this into perspective** – The sky is not falling and the world in not coming to an end. Stock markets move up and stock markets move down. We have been in a relatively unprecedented market environment, marked by extraordinary gains and low volatility. What has happened over the past few days is much more normal than what has happened over the past few years. Even with the recent declines, the S&P 500 finished Monday down less than 1% YTD.

As always, if you have any questions or concerns, please feel free to contact us.