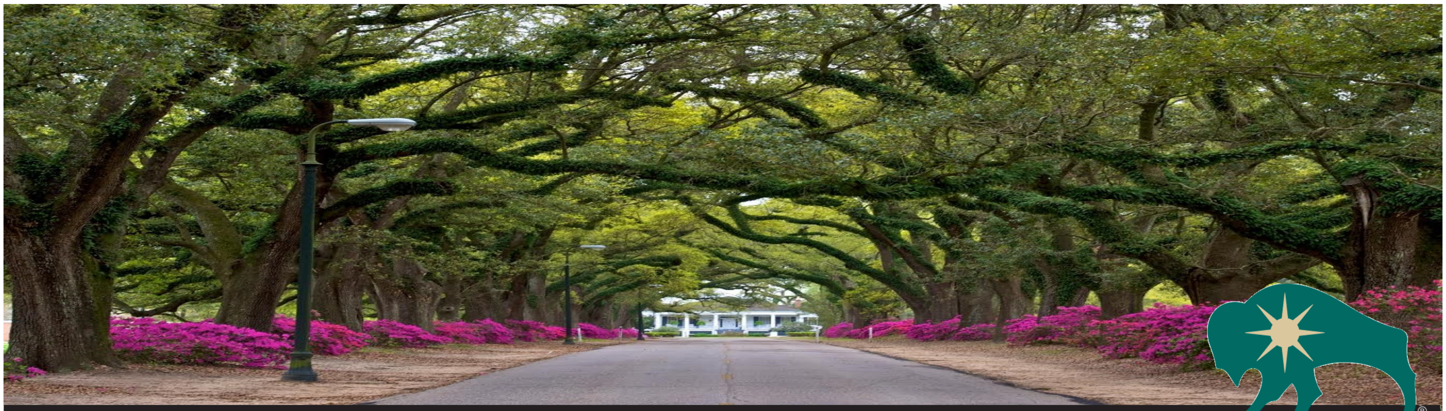

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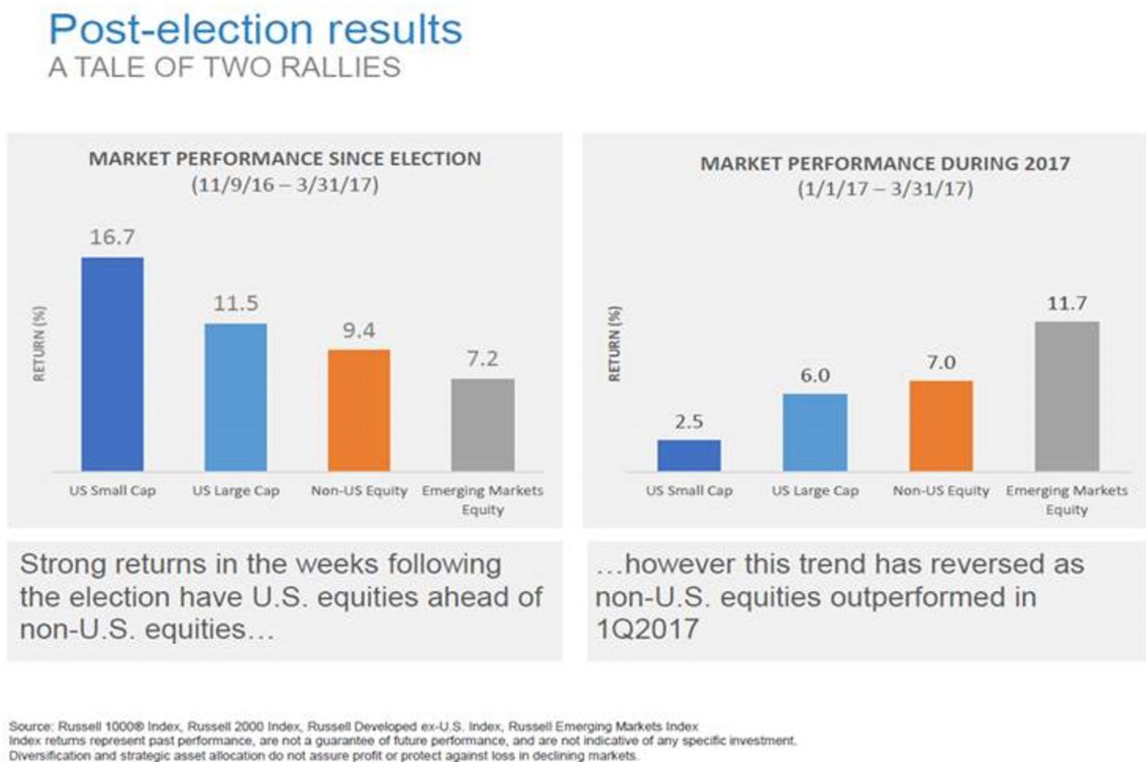
Spring 2017

Changing of the guard?

Golf can teach us much about investing. Play 'conservative'; is it worth the 'risk'?; drive for show, putt for dough! Well maybe not all golf vernacular works. We make this point because as we watched the end of the Masters earlier this month, we noticed something eerily similar to today's current market environment. But before we get to that, let's recap how we got here. This years Masters ended in dramatic fashion as Spain's Sergio Garcia made birdie on the first playoff hole to defeat England's Justin Rose. This marked Sergio's first major victory, erasing his name from the list of greats who haven't won the big one. It took Sergio 18 years or 74 attempts to accomplish this 'major' feat. Per usual, during nearly every major golf championship, but specifically the Masters, we are reminded of arguably the greatest golfer of all time, American Jack Nicklaus. Jack holds the all time record for major championship victories at 18. He competed in a record 154 consecutive major championships in which he was eligible, spanning from the 1957 U.S. Open to the 1998 U.S. Open. What may be as remarkable as his record 18 victories is the amazing stat that Jack also finished 2nd place 19 times and 3rd place 9 times. Another American, Tiger Woods, sits in second place with 14 major championships (he's been on that number since 2009). With what is now his fourth back surgery in three years, the likelihood of him hoisting another major championship trophy seems slim. Much like Jack's time, Tiger's domination lasted for an amazing stretch from 1997 to 2008. Now, back to this years Masters. As we sat back and watched history unfold once again as the leaders turned through 'Amen Corner' something jumped out at us. Not only was the domination by a single player gone, but also gone was the domination from American golfers as a whole. As Sergio donned his new, perfectly tailored green jacket, the full field scores were posted. In the top 10, there were 3 Americans. We dug deeper to see if this was an anomaly or a pattern. There are 4 majors each year. From 1997 through 2006, an American golfer won 29 of 40 or 73% of the time. From 2007 to this month at the Master's, American golfers have won 17 of 41 or 41% of the time. There has been a shift. Let's be clear; We are not saying there is a correlation between golf's major championship winners and the markets (The Spanish market index - IBEX, is up approximately 11% year to date, however, at the time of this writing - Sergio! Sergio! Sergio!). What we are saying, is that we see a shift, not only in market valuations, but also in market performance similar to what we've seen in the world of golf. A shift away from the United States and one towards international or non-United States based companies.

Case in point is the chart below:



The U.S. markets extended gains post election through the end of March 2017, outperforming nearly every other global equity market from election date to year end. However, since January 1st of this year, Non-US equity markets have outpaced U.S. equity markets. As of this writing, Presidency assumptions in France have pushed both international and domestic markets even higher.

Recently, in our Russell Balanced Model portfolio, changes within the allocation have been made to adjust for the continued rise in the U.S. equity markets by rebalancing the 22% U.S. equity exposure down to 19%, spreading the difference into global assets and fixed income. This is not a dramatic shift whatsoever, merely an opportunity re-adjust some over-performing assets into those with better valuations, while still remaining true to the allocation. We are not pessimistic on the U.S. economy or equity markets. Much like golf (think Jordan Spieth and Dustin Johnson), the U.S. market, in our view, still has potential to see continued upside movement. Three key specifics provide us with this confidence.

*"Two Rallies" chart from Russell Investments: 2017 Economic and Market Review. Printed with permission.

Earnings:

As of today (with 58% of the companies in the S&P 500 reporting actual results for Q1 2017), 77% of S&P 500 companies have beat the mean EPS estimate and 68% of S&P 500 companies have beat the mean sales estimate.

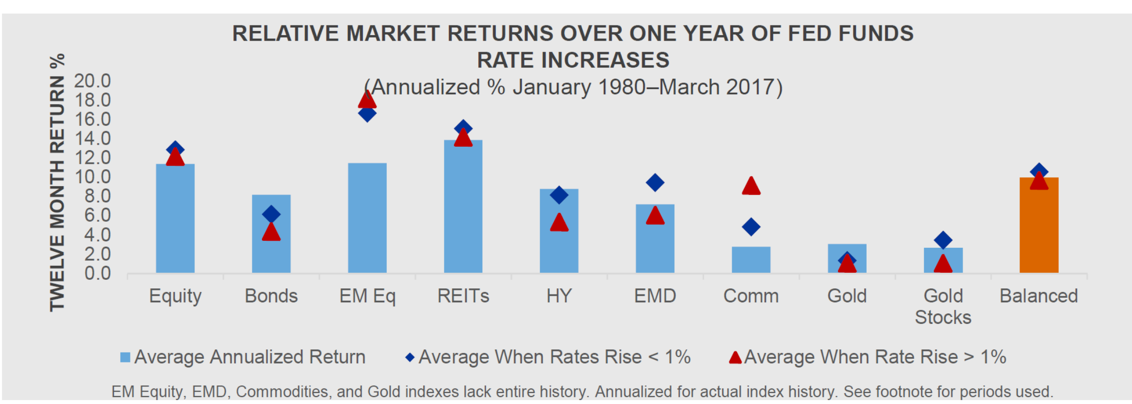
Also, beyond just earnings beats, ten sectors are reporting year-over-year growth in revenues, led by the Energy sector. The only sector reporting a year-over-year decline in revenues is the Telecom Services sector.

Interest Rates:

A topic we have discussed in great detail before, as we've been hopeful rates would rise for years now. It seems that we may be there. It has been some time since we have embarked on an environment of rising rates. Not only can this be a positive from an income standpoint within fixed income assets and cash equivalents but history tells us this can be good for the equity markets as well.

When Fed Funds rate increases, do returns fall?

RESULTS TEND TO BE MIXED



- Equities have done marginally better than average during Fed rate increases
- Not surprisingly, bonds tend to return less during similar periods
- Other assets classes have produced mixed results
- Factors such as valuations, economic cycle, and sentiment also play a role

*"Mixed results" chart from Russell Investments: 2017 Economic and Market Review. Printed with permission.

Corporate Taxes:

Finally the wild card. Corporate tax cuts. President Trump has proposed reducing the corporate tax rate from 35% to 15%. Recently, UBS managing director, Vinay Pande noted that every 5% cut in the corporate tax rate translates into a 4% increase in earnings per share growth. Based on his estimate, the 20% proposed cut in corporate taxes could lead to upward earnings per share revisions of 16%. “These are very big numbers, gigantic numbers,” Pande concluded.*

As we close, we are reminded and grounded in the fact that it is tough to make predictions, especially about the future. What we do know, however, is that fundamentals within corporate America are strong, and the US and world economy continues to improve as it works it’s way out of the great recession. We are bullish on the world and believe a well diversified portfolio mirrors that of owning the entire field of a golf tournament. It is exciting to root for our favorite, but at the end of the day, we benefit from a win, regardless of who’s wearing the jacket.

Enjoy your spring,

Randy, Trevor and Ashley

*www.CNBC.com, “Impact of Trump corporate tax cut could be ‘gigantic’, says UBS’ Vinay Pande”

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