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INVESTMENTS

Investment Letter, Q2 2017

April 7, 2017

Selective Opportunities in Today's Market

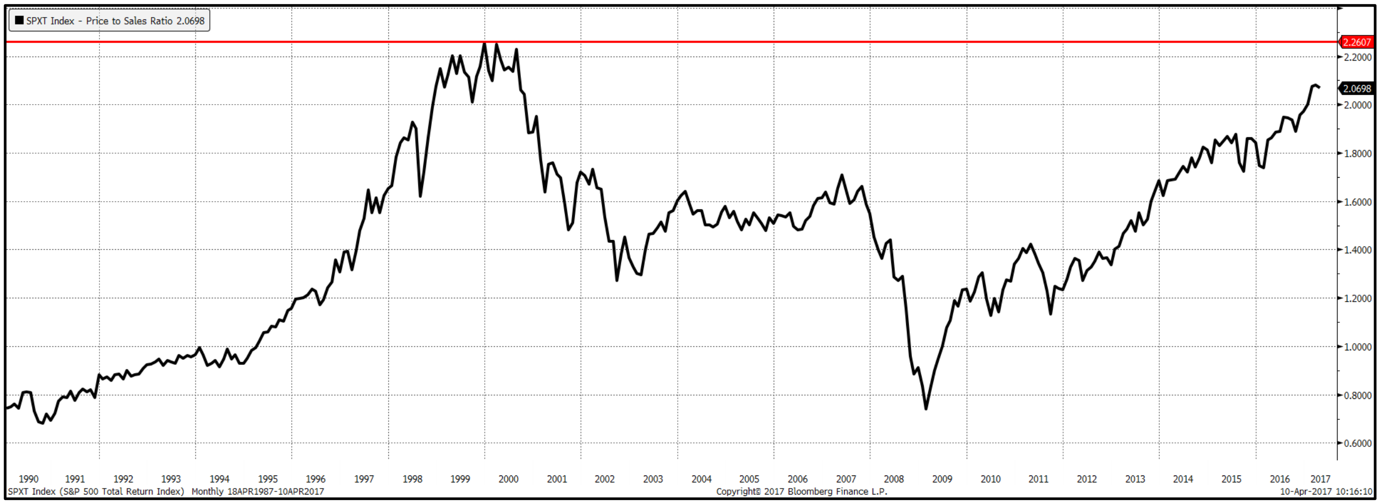
With the stock market hovering near all-time highs, everyone wants to know whether we are at an intermediate-term top or not. High hopes for lower taxes, less regulation, smarter trade deals, and infrastructure spending programs dominated the investment landscape in the first quarter. We saw most indexes do well through March 31, 2017; however, none of the policy initiatives of the Trump administration so keenly anticipated have materialized yet, and we are seeing the first manifestations of the wide gap between policy formation and policy implementation with the initial failure to repeal Obamacare. Here are the performance numbers for the major indexes and fundamentals year-to-date and projected for 2017:

	2017 Q1
S&P 500 Total Return	6.07%
NYSE Composite Total Return	4.58%
Barclays Aggregate Bond Index	0.82%

	12/31/2016	**3/31/2017**
U.S. 2017 GDP Estimates	2.3%	2.2%
S&P 500 Earnings Growth Est. (Fwd 12-Month)	23%	19.9%
S&P 500 P/E (Current)	21.18	21.69
S&P 500 P/E (Fwd 12-Month)	17.24	18.27

Source: Bloomerg

The table above shows the forward P/E has risen so far this year instead of fallen. This is significant because much of the move in Q1 was predicated on a fairly rapid material advance in corporate earnings per share. We hope this materializes, but no one can be sure that the animal spirits unleashed during the initial "Trump bump" will be proven correct by an ultimate increase in real earnings per share delivered this year by corporate America. At the core of our analysis, the market remains well-valued—and historically so by many measures, including metrics like price-to-sales (following chart) and the CAPE ratio (Cyclically-Adjusted P/E ratio) among others.



Historical S&P 500 Price-to-Sales Ratio (01/31/1990 – 04/07/2017)

Bonds remain somewhat expensive relative to the risk of inflation and rising rates along with the Federal Reserve poilicy statement that suggests multiple increases of the Fed Funds rate this year. Historically, the Fed will raise rates until something "breaks" (see chart below). It is still early in the rate increase cycle, but this is something to be aware of and keep in consideration. We continue to see cash as an unusual, but reasonable, asset class alternative for a portion of an investment portolio given current risk/reward dynamics in other asset classes. We will generally look to put more cash to work in periods of volatility.

Chart 4: Fed tightening usually ends with a financial "event"

Source: BofA Merrill Lynch Global Investment Strategy, Global Financial Data

A quick look at the fundamentals in place just prior to the major bull market launch in 1982 shows a much different landscape today by comparison and provides an interesting contrast:

	1982	Today		1982	Today
Fed Funds Rate	18.00%	0.50%	Annual Inflation Rate (CPI)	8.00%	1.60%
10 Year Treasury Yield	15.00%	2.30%	Personal Savings Rate	10.00%	5.00%
Mortgage Rate	16.25%	3.87%	Labor Force Participation	64.00%	63.00%
Household Debt to Income	62.00%	130.00%	S&P 500 - CAPE10	7	26
U.S. Government Debt to GDP Ratio	30.00%	105.00%	S&P 500 - Median Price to Sales Ratio	.50x	2.20x
Total U.S. Debt to GDP Ratio	.90x	3.60x	Median Age Baby Boomers	26	60
Productivity Growth	2.00%	0.25%	Global Trade Barriers	Falling	Rising

Data Courtesy: St. Louis Federal Reserve (FRED), Bloomberg, Bureau of Economic Analysis 2/21/17

None of this means that investors should completely withdraw to the sidelines. We do not see the systemic extremes that existed in 2008, such as excessively easy credit, or in 2000 with excessively positive sentiment and completely unsupportable valuations. In fact, most investors express to us a healthy amount of skepticism and some general concern about economic and political conditions. This push and pull of generally negative sentiment against generally higher-valued conditions may be a cause for increased volatility, but we do not see a major recession on the horizon at this time, barring some unforeseen exogenous event. We are optimistic about the future and will stay the course by generally keeping betas and risk lower; looking at larger-capitalization US securities, tending towards higher-dividend-paying securities; keeping maturities shorter on fixed income holdings; and even strategically holding some cash when appropriate. We continue to believe that there will be good entry points at lower prices if we exercise a little patience and caution right now for at least a portion of the portfolio(s). We look forward to continuing to help you reach your long-term financial goals and to speaking with you throughout the year.

Sincerely,

Todd Walsh & the ACI Portfolio Management Team

Source: Data presented herein was sourced 4/6/2017 from Bloomberg.