Market Update and Model Portfolio Reviews 9/30/2017

In summary, three of the eight asset allocation models outperformed net of fees year to date as of 9/30/2017 when compared to their benchmarks. For the month of September, domestic large cap equities were up 2.06% whereas domestic investment grade bonds gave back some of their prior months gains coming off by -0.48% . The big story this month was the return of Small Caps and the Banking sector. The Russell 2000 (small caps) returned a whopping 6.24% and our low volatility exposure to the Russell 2000 Index returned 3.98% over the month. Our best performing allocation over the month was to the basket of retail banking stocks returning 6.85% led by the top three holdings in the basket, Wells Fargo & Co, Citigroup Inc and Bank of America Corp each returning over 6% for the month. The model allocations have been positioned defensively year to date and we believe will remain defensively positioned for the foreseeable future. The risk off strategies are intended to outperform in modestly positive, flat and negative market environments. We expect relative underperformance if markets delivery average historical returns or strong bull market like returns.

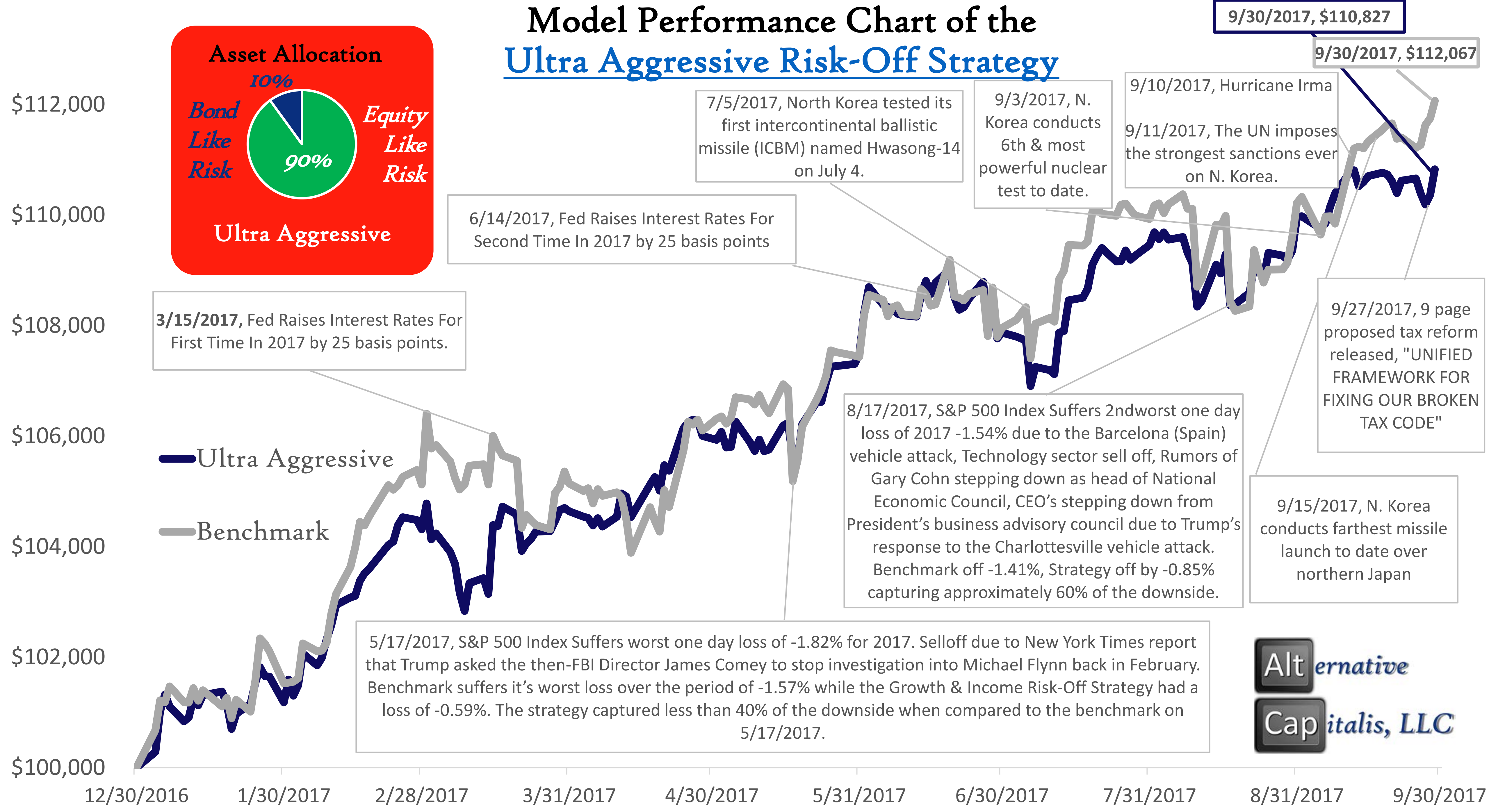
YTD 9/30/17 Net of Fees	% Return Strategy	% Return Benchmark	Relative Over (Under) Performance
Ultra Conservative	5.28%	4.50%	0.77%
Conservative	5.83%	5.58%	0.25%
Moderate	7.01%	6.67%	0.34%
Balanced	6.86%	7.75%	-0.88%
Growth and Income	7.30%	8.83%	-1.53%
Growth	8.63%	9.91%	-1.28%
Aggressive	8.88%	10.99%	-2.10%
Ultra Aggressive	10.83%	12.07%	-1.24%

MTD 9/30/17 Net of Fees	% Return Strategy	% Return Benchmark	Relative Over (Under) Performance
Ultra Conservative	0.08%	-0.14%	0.23%
Conservative	0.13%	0.11%	0.01%
Moderate	0.25%	0.37%	-0.11%
Balanced	0.28%	0.62%	-0.34%
Growth and Income	0.43%	0.88%	-0.45%
Growth	0.51%	1.14%	-0.63%
Aggressive	0.52%	1.39%	-0.87%
Ultra Aggressive	0.76%	1.65%	-0.88%

Month over month all the model portfolios yielded positive results net of fees, yet all but two lagged their respective benchmarks. The relative outperformers are attributed to our focus on maintaining lower duration (interest rate sensitivity) by holding a basket of more traditional banking stocks that tend to track changes in interest rates due to net interest margins (see last months commentary for more on this).

August's winners (our safe havens and "Risk Off" allocations) were Septembers losers as the "Trump Reflation Trade" regained its footing. Our gold exposure gave back a portion of their generous August returns of 4.2% to return -2.22% for the month of September. Our long duration allocation (highly sensitive to interest rate changes) which returned 4.89% in August came off by -3.16% as Fed Chair Janet Yellen unveiled her plan for unwinding the bloated Fed balance sheet and continued rate normalization (gradually raising rates and well telegraphed in the Fed's earlier commentary leading up to the September FOMC meeting). Trump's fiscal expansionary theme also brought back inflation concerns which as we have stated earlier, will likely force the Feds hands on raising rates at a more rapid pace (in summary, we view this round of fiscal stimulus too late in the economic cycle and it gives the government less options to aid the economy if we entered into another recession – 'Can't have your cake and eat it too' – we will elaborate more here as we discuss the latest tax proposals and North Korea below. Higher interest rates driven by Fed policy will at least, in theory, slow these inflationary concerns and act as the other crutch so our central bank will have slack to let out if the economy were to soften in the future). All of the events impacting markets in September cannot be summarized in two pages, but as we indicated last month, September would be full of new catalysts for the markets to digest.

Model Performance Chart of the Ultra Aggressive Risk-Off Strategy



See "Model Disclosure" page for important disclosures and information – Period Measured 12/30/2016 – 9/30/2017. Model Performance presented net of highest advisory fee and trading costs.

Markets Continued to break through new all time highs:
Forward earnings guidance remains positive. Low volatility in US large cap equities continues to be the story in 2017. On average U.S. large cap equities have pulled back by 2% or more four times per year from 2012-2016 (The 5 years measured had 21 days with pullbacks of 2% or more). So far, we have not experienced a pull back of 2% or more in 2017. If we start from the financial crisis, that average pull back count doubles, but we have opted to leave this out as it is a far cry from a normal market environment. Statistically, we would expect to see some form of a more pronounce pullback, and that may come if the administration fails to pass new tax reform as it has with repealing/replacing the Affordable Care Act.

Our take on the September Tax Reform proposed (as always, from an investment standpoint!):
It is not simultaneously possible to lower tax rates and stay fiscally revenue neutral (the government budget deficit would have to increase in the short run and be recaptured over time with this proposal). For this proposal to make up for the tax collection shortfall, it aims to increase the volume of taxable dollars, albeit at a lower tax rate (in other words, although not technically correct, "tax savings to spur more spending to be taxed again"). When the proposal speaks to "broadening the tax base" it attempts to incentivize a favorable tax environment for businesses to conduct operations in the U.S. (repatriating profits back to the U.S. at a favorable tax rate, territorial tax system, etc.). Again, it's intended to speed up the money velocity expended relative to today's spending habits while doing this at a lower tax rate. Whether you view the one page summary, nine page outline or extrapolate from last year's 35 page proposal, we see a lot of benefits washed away for businesses creating a net result that should be relatively positive but not likely as positive as advertised. One cannot ignore the animal spirits of this proposal and hence the renewed market rally into the end of September driven by sector rotation and money coming out of safe havens. Most importantly, this is still just a proposal and it is too early to predict how it will work its way through the legislative process, "This unified framework serves as a template for the tax-writing committees that will develop legislation through a transparent and inclusive committee process."

Eyes on North Korea and Sanctions – Current Status: Economically Irrelevant – Future Status: TBD
From a global standpoint, North Korea's status is economically irrelevant. The humanitarian concerns and unpredictability within the region is a different story. Historically, when the U.S. has gone to war, it has generally led to better results for the economy as fiscal stimulus increases. That said, this is assuming the war is not on the homeland. North Korea depends on China for approximately three quarters of their imports and exports. North Korea's GDP is almost a rounding error relative to China's GDP. From 2015 numbers, the relative size of North Korea's economy to China's economy is approximately 0.15%. The North Korean sanctions imposed from the UN should not create cause for economic concern in China given their continued elevated GDP growth rates. Outlined in the recent UN resolution is a 30% reduction of oil provided to North Korea, a ban on all North Korean textile exports and an end to joint ventures (banning future foreign investment to the region). This last item is also important given the aging infrastructure in North Korea. Retaliation from North Korea continues to be the outlier concern on markets and will only be known over time.

The month ahead
We will continue to watch comments from the federal reserve and chair Yellen. There are strong talks that Yellen will not likely be elected for another term in February of 2018 and that President Trump will unveil his decision to maintain status quo or replace the chair in the middle part of October. This is important as the list of probable replacements lean towards a more aggressive monetary tightening policy (more so than where we are currently). We do have a Friday the 13th this month, although there is data that suggests events based on history for the 13th of Fridays we see it as more noise than anything else. For Friday the 13th we'll focus on the released results and commentary of the IMF meeting, CPI, Retail Sales, Business Inventories, and Consumer Sentiment.

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Model Disclosure

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The results do not represent actual trading and actual results may significantly differ from the theoretical results presented.