DANN ASSET ADVISORS, LLC

Fourth Quarter 2017 Update

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4Q17 Highlights

- Stocks continue rising, capping a strong and surprising year
- Fourth quarter may mark the third consecutive quarter of 3%+ U.S. GDP growth
- Fed raises rates in December and forecasts three quarter-point increases for 2018
- Republicans pass tax legislation with corporate rate falling to 21%

The table below summarizes the performance of some key indices during the fourth quarter and full year:

Market Performance		
Index	% Ch. 4Q17	% Ch. YTD
S&P 500	6.6	21.8
MSCI Developed Markets (excl US)	4.2	25.0
MSCI Emerging Markets	7.4	37.3
MSCI All Country World	5.7	24.0
US Aggregate Bond (1)	0.4	3.5
Liquid High Yield (1)	0.0	6.3
US Dollar Emerging Markets Bond (1)	1.2	10.5

(1) Barclays indices

Equities. U.S stocks (as measured by the large company S&P 500 index) topped off a strong 2017 with a 6.6% return in the fourth quarter. The full year return was the best since 32% in 2013, and the fourth best in the last 15 years. 2017 also was remarkable for a lack of downside volatility, with a key index of market volatility at or near record low levels most of the year. For the 14 months through December 2017, the S&P 500 did not register a down month, the longest such streak of monthly gains on record according to The Wall Street Journal.

While the headline numbers and records are exciting, they masked a more mixed market. For example, the S&P 500 Growth index gained 27.4% while the S&P 500 Value index gained only 15.4% – continuing a multiyear trend of growth stocks outperforming value. Smaller company stocks lagged those of larger companies, with the Russell 2000 index up 14.7% (compared with the S&P 500 index at 21.8%). And the difference between small growth and small value stocks was especially large, with the Russell 2000 Growth index up 22.2% for the year and the Russell 2000 Value index up only 7.8%. Finally, within the large company growth category, technology was the place to be in 2017 – its 37% gain was 13 percentage points ahead of the next closest sector.

International markets did better than the U.S. for the first time since 2012, and emerging markets, led by China, had their strongest returns since 2009. Similar to the U.S., 2017 economic growth was better than expected in many international economies, and this likely helped stock markets. The unexpected decline in the U.S. dollar also provided a tailwind for U.S investors. Despite the large advance in 2017, emerging markets in aggregate remain the least expensive major geographic sector. Technology stocks accounted for 27% of the Emerging Markets index at year-end, and this heavy weighting could lead to unanticipated volatility down the road.

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Fixed income. Ten year Treasury yields rose slightly from 2.33% during the quarter and ended the year at 2.41%, essentially unchanged from 2.45% at the end of 2016. We believe the combination of lower rates in other developed countries (increasing demand for U.S. Treasuries) and U.S. inflation remaining below Fed targets has helped keep a lid on 10 year yields. However, the rise in two year treasury rates – which are more sensitive to Fed actions – was significant, increasing from 1.20% at the end of 2016 to 1.89% at year end 2017. Two year rates remain low compared with historical averages. As indicated in the table, more speculative, higher yielding sectors of the bond market fared better than the Barclays U.S. Aggregate Bond index in 2017, as investors continue to search for yield in what remains a low rate environment.

Market sectors. The best performing broad U.S. market sectors during the fourth quarter were consumer discretionary stocks (includes retail, restaurants, entertainment), technology and financials. Generally speaking, these groups tend to perform well when the economy is strong or improving, and that was the case during the quarter. As mentioned earlier, technology was the big winner for the year with a 37% gain. Five other sectors registered full-year gains of 20%-24%.

The fourth quarter's worst performing sectors were telecommunications, utilities and REITs, sectors that typically do poorly as interest rates are rising or anticipated to rise. We believe telecommunications stocks also were hurt by price competition and the Justice Department's suit to block AT&T's acquisition of Time Warner. For the year, telecommunications, energy and REITs were the worst performing sectors. Despite being down modestly for the year, energy stocks had a strong rebound in the second half as oil prices rose to their highest level in two years.

Portfolio Positioning

For most clients we were modestly more active during the fourth quarter compared with the third. On fixed income for several clients we initiated a small position in what we view as one of the more conservatively managed floating rate bond funds. In essence, these types of funds invest in very short duration, secured, noninvestment grade loans issued by banks and other financial institutions. Accordingly, there is significant credit risk (risk of default) compared with investment grade bonds, but in our opinion the short duration focus and good analysis by fund mangers should serve to moderate the risk of losing capital. Income from the fund is substantially higher than from similar duration investment grade funds.

On equities for many clients we initiated a position in a mid cap, value focused mutual fund. Funds for the purchase in most cases came from cash and/or more growth-oriented mutual funds, our feeling being that growth stocks, especially in the technology sector, are overpriced relative to value stocks. Per its investment mandate, this particular fund can invest in international stocks, which currently account for nearly 40% of fund value. We like the additional international exposure.

2018 stock market outlook. In our 2017 stock market outlook we predicted that "single digit gains" were the most likely outcome for 2017 while "acknowledging that we really have no idea what the market will do …". At least we were right in part of what we said!

More seriously, we understand and often have highlighted that stocks anticipate improvements in the economy and corporate earnings. This occurred in 2017, with stocks moving up during the first half of the year, accurately predicting that the economy and earnings would come in stronger than initially expected over the second half of the year. Then, beginning late in the summer, it appears that the market began anticipating the increased likelihood that tax legislation would be

enacted. We've seen estimates that the reduction in corporate tax rates may add as much as 10% to S&P 500 earnings. Although we had thought some of this impact already was reflected in stock prices, the market moved up further into year end.

At the end of 2017, consensus estimates for 2018 earnings for the S&P 500 were around $145. If we were to add another 7% to this for lower corporate tax rates, we'd have earnings in the $155 range. With the S&P closing the year at 2674, the forward price earnings multiple was 17.3x. As has been the case in recent years, this is on the high side of historical multiples in the 14x-15x range. Of course, interest rates remain low compared with historical norms and this tends to support higher multiples.

The current bull market is the second longest on record for U.S. stocks. Downside volatility (as measured by the VIX index) has been at or near record low levels for most of the past year. We appreciate that the bull market may continue and volatility remain low indefinitely – records are made to be broken and "things could be different this time." However, if one has respect for historical valuations and volatility, as we do, one would expect that current ebullient trends would change sooner rather than later. We of course don't know what could spur that change.

With that as a long-winded preface, our guess is that the market is up at most mid single digits in 2018. We wouldn't be surprised to see it down for the year, and would be most surprised to see it up another 10% or more. In other words, looking out for the next year only, we see more downside than upside potential. However, being long term investors, we're more interested in (and optimistic about) where the market is five years from now than at the end of 2018.

Despite our tepid near-term outlook, we appreciate that we can't time the market and that trends can persist longer than we expect. Accordingly, we're keeping clients invested in line with their existing strategies but holding what we view as generally more conservative funds in the actively managed portion of clients' equity portfolios. We expect these funds as a group to participate in further upside should it occur and to moderate declines, relative to the market, if stocks turn down.

Economy

U.S. GDP grew 3.2% in the third quarter, similar to the 3.1% advance of the second quarter. Combined, these were the first consecutive quarters above 3% since 2014. Consumer spending remained reasonably strong with 2.2% growth (down from 3.3% in the second quarter) and business investment with a 10.8% advance was the strongest in three years. We attribute the latter to the ongoing rebound in energy prices, but it may be that reduced regulation is making businesses more comfortable investing. Inflation remained below the Fed's target of 2%, with the core personal consumer expenditure price index rising only 1.4%.

Initial expectations for fourth quarter GDP (to be reported later this month) are for 3.0% or higher. The economy appears to be in the midst of a modestly stronger period of growth. If corporations spend money saved on taxes on growth projects in 2018, this momentum could continue well into the year.

The unemployment rate is currently 4.1%, the lowest it's been since 2000. We understand that the Internet, global wage competition and demographics have served to dampen inflation in recent years. However, in our opinion, an increase in inflation above the Fed's targeted 2% range

could be one of the surprises of 2018. If this were to occur, depending on the overall health of the economy and markets, the Fed could increase rates more aggressively than currently anticipated.

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