Market Commentary

2ND QUARTER 2017

The Stock Market

At mid-year, the U.S. stock market posted a total return of 9.3% year-to-date as measured by the Dow Jones Industrial Average and the S&P 500 Index (CHART 1). Nine of the eleven S&P Sectors had positive performance led by Information Technology, Health Care and Consumer Discretionary. Only Telecommunication Services and Energy posted negative performance. This makes six consecutive up quarters for the S&P 500 (CHART 2) in which stocks' returns ranged from 1.3% to 6.1%.

Such consistent returns, we believe, are abetted by the cost of money, which in large part is dictated by the Federal Reserve's monetary policy. As long as the Fed holds rates artificially low, there is less competition for investors' dollars, making equities attractive even at elevated valuations. Positive and steady returns encourage investor confidence and complacency. The Fed has just recently begun the process of raising the cost of money and restricting liquidity. Even so, by all measures, Fed policy remains accommodative. Historically, the beginning stages of Fed tightening are viewed as a vote of confidence in the economy's resilience. However, as rates rise, there comes a tipping point where investors view the higher rates as a threat to economic growth and are induced to reduce stock holdings and invest in lower risk investments. We don't believe we have reached this point in the cycle, but some caution is warranted.

In the first half of 2017, the ten largest stocks in the S&P 500 contributed 29% of the Index's gain while representing only 19% of the Index market capitalization.

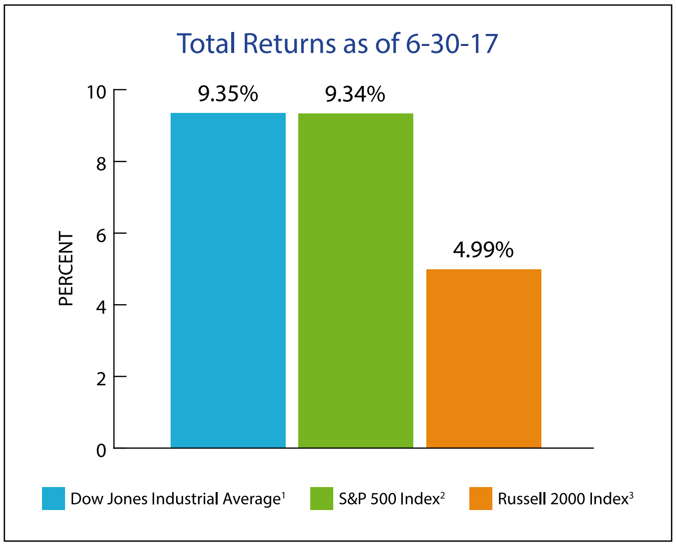

Chart 1

SOURCE: MORNINGSTAR DIRECT

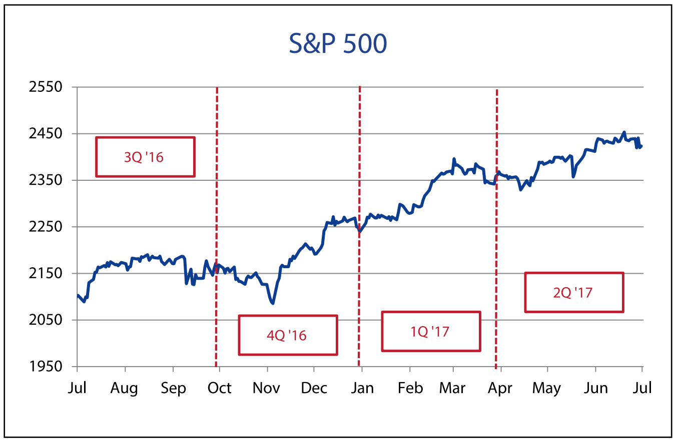

Chart 2

SOURCE: STRATEGAS RESEARCH PARTNERS
"QUARTERLY REVIEW IN CHARTS" – JULY 5, 2017

Past performance does not guarantee future results. You cannot invest directly in an index.
[1] The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ.
[2] The S&P 500® Index is a capitalization weighted unmanaged index of 500 widely traded stocks, created by Standard & Poor's. The index is considered to represent the performance of the stock market in general.
[3] The Russell 2000® Index is an unmanaged index of the smallest 2,000 stocks in the Russell 3000® Index.

The Stock Market (CONTINUED)

Amazon, which was up 29%, is now the third largest stock in the S&P 500 Index with a $468 billion market cap, and trades at a 145x PE multiple on $2.6 billion of earnings. This compares to its largest retail competitor, Wal-Mart, with a $227 billion market cap and a 17.5x PE multiple on $13.6 billion of earnings. Amazon's strong stock performance, relative to Wal-Mart this year and since the last recession (CHART 3), is certainly a testimony to Amazon's business model and growth. But, we suspect there are a couple of other factors helping Amazon. The first has been the availability of massive doses of low-cost capital facilitated by the Fed's ultra-loose monetary policy. This has made it cheap and easy to finance growth. The second has been the proliferation of popular passive investment strategies. Index funds and ETF's continue to pour cash into the largest stocks in proportion to their weight in the Index, rather than based on their investment merits. This, in effect, creates a positive feedback loop. The big get bigger because they are big, and not necessarily because they have the best investment merits. At some point, this feedback loop may reverse when passive strategies fall out of favor, or when individual companies' business stumble and their stocks decline, triggering even more selling from the indexers. At what multiple is Amazon an attractive investment? Probably much lower than 145 times earnings.

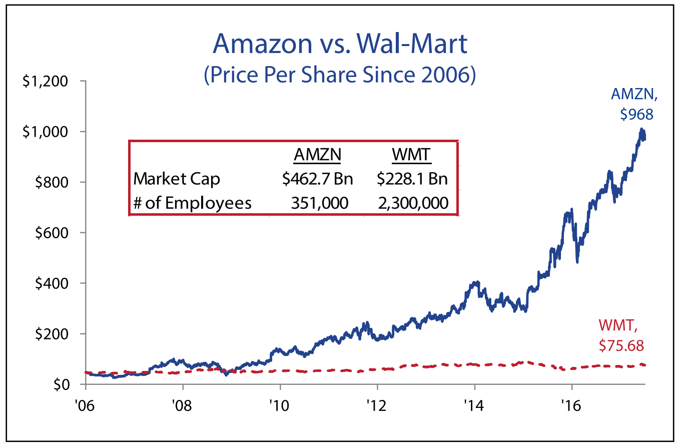

Chart 3

SOURCE: STRATEGAS RESEARCH PARTNERS
"QUARTERLY REVIEW IN CHARTS" — JULY 5, 2017

The Bond Market

The Federal Reserve added another quarter percent bump to short rates in June, raising the Fed Funds target to 1-1¼%. They also announced the details of its balance sheet normalization (SHRINKING) progress. These moves by the Fed seem long overdue. It is hard to justify a Fed

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The Bond Market (CONTINUED)

Funds rate well below inflation given the growing state of the economy. Corporate profits are growing, unemployment is under 4.5%, consumer and business confidence is healthy and global growth is improving. Recently released European Central Bank June meeting minutes show more confidence in Eurozone growth. The German ten-year bond yield broke above 0.5% for the first time since January, 2016. They also revealed discussions contemplating dialing back their very aggressive bond purchases. The Banks of Japan and the U.K. are also slowing their purchases. Chart 4 shows just how expansive global monetary policy has become over the years as reflected in short rates. While interest rates are beginning to rise, they remain very low. Recessions, as indicated by the shaded bars, tend to occur after a sustained period of rate increases. The risk of rising interest rates to economic growth seems small at this time. One note of caution for the U.S., however, is that roughly 50% of our government debt matures in the next three years (CHART 5). As these maturities are refinanced at higher rates, the already increasing federal deficit will become more burdensome, as a greater portion of tax dollars are allocated toward interest expense, a large portion of which is paid to foreign investors.

In spite of rising short rates, the ten-year Treasury note yield was little changed in the quarter, remaining below 2.5%. Argentina, a country that has defaulted eight times, successfully floated $2.75 billion of 100-year bonds. In fact, they were three times oversubscribed at 7.9%. Investors either believe inflation has been forever tamed, or maybe they are simply starved for yield. Either way, bond investors seem even more complacent than equity investors.

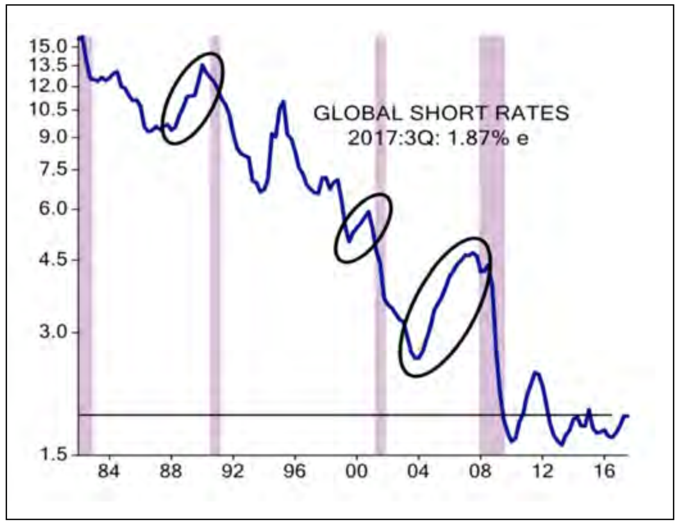

Chart 4

SOURCE: EVERCORE ISI
"DAILY ECONOMIC REPORT" – JULY 7, 2017

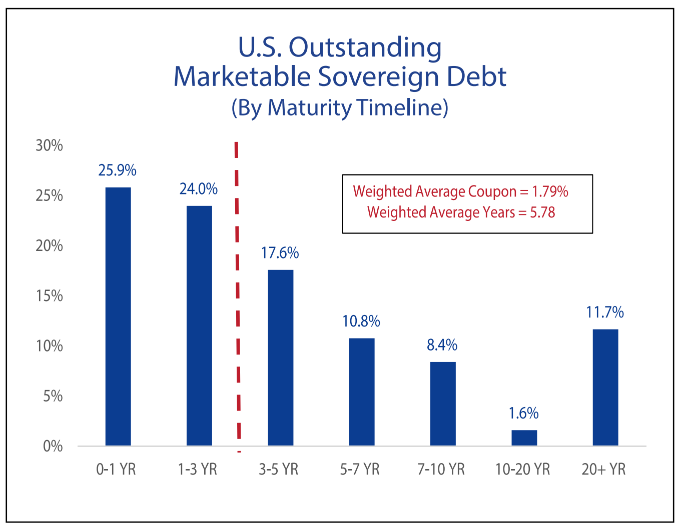

Chart 5

SOURCE: STRATEGAS RESEARCH PARTNERS
"QUARTERLY REVIEW IN CHARTS" – JULY 5, 2017

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The Economy

This economic expansion is now entering its ninth year, just two years short of a record. Unemployment is 4.4%, the lowest in sixteen years. Resurrecting a moniker from the past, this is truly a Goldilocks economy: not too hot, not too cold. We expect real GDP growth of 2-3% to continue into next year. The profits recession of last year has clearly ended. Second quarter earnings growth was probably up double digits from last year, and we expect that profits for the full year will be up mid-single digits or better, depending on oil prices and tax reform legislation (CHART 6). Auto sales appear to have peaked. Pent up demand still exists for housing and capital goods, however. Home prices in most major cities have now returned to levels of ten years ago, before they crashed in the rubble of risky financing. The housing recovery has been slow and new home starts remain below last cycle's peak. Favorable demographics and steady job growth should support further expansion, more than enough to compensate for slower auto sales. Demand for manufactured goods is increasing in the U.S., Europe, China and Japan. We are clearly in a synchronized global expansion.

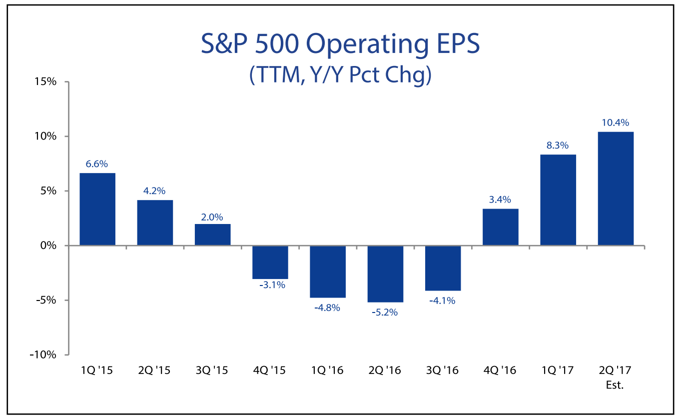

Chart 6

SOURCE: STRATEGAS RESEARCH PARTNERS
"MARKET BALANCE SHEET" — JULY 10, 2017

Politics

The mainstream media can hardly contain their glee over the Republican Congress' seeming inability to repeal and replace Obamacare. While the House passed its version of the legislation by a narrow margin with no Democrats in favor, the Senate, as of this writing, has been unable to muster the necessary votes to pass its version, which has substantive differences from the House version. The next three months will be busy. Passage of the budget, debt

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Politics (CONTINUED)

ceiling and appropriations bills will be messy, but should clear the agenda for serious discussions on tax reform/reduction in the fourth quarter for passage in 2018.

Meanwhile, the 2018 mid-term elections are quickly approaching. The numbers seem to favor Republican gains in the Senate with 23 Democratic seats in play versus only 8 for Republicans. However, mid-term elections are most often a referendum on the President. With Trump's record low 37% approval rating, not many Republican lawmakers are anxious to run for contested Senate seats, even in states that Trump carried in the general election. In the House, current generic ballot polls suggest that the Republican majority is at risk. The narrow margins of victory for Republican candidates in recent special elections held in traditionally strong Republican Congressional districts are not encouraging. Legislative progress and a strong economy are a must for the Republicans to retain their majorities next year.

While Congress seems bogged down, the Trump administration is moving forward the President's promises to roll back regulations. His withdrawal from the Paris Climate Change Agreement, rescinding the EPA's overreach on clean water rules, and approval of major energy infrastructure projects are a breath of fresh air compared to the stifling Obama era. But will these regulatory victories provide enough stimulus to the economy to win votes? Despite an apparent lack of legislative victories, simply knowing that we are unlikely to be burdened with new regulations and higher taxes has been a huge positive for the markets.

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