

Nauset Market Commentary Second Quarter 2017

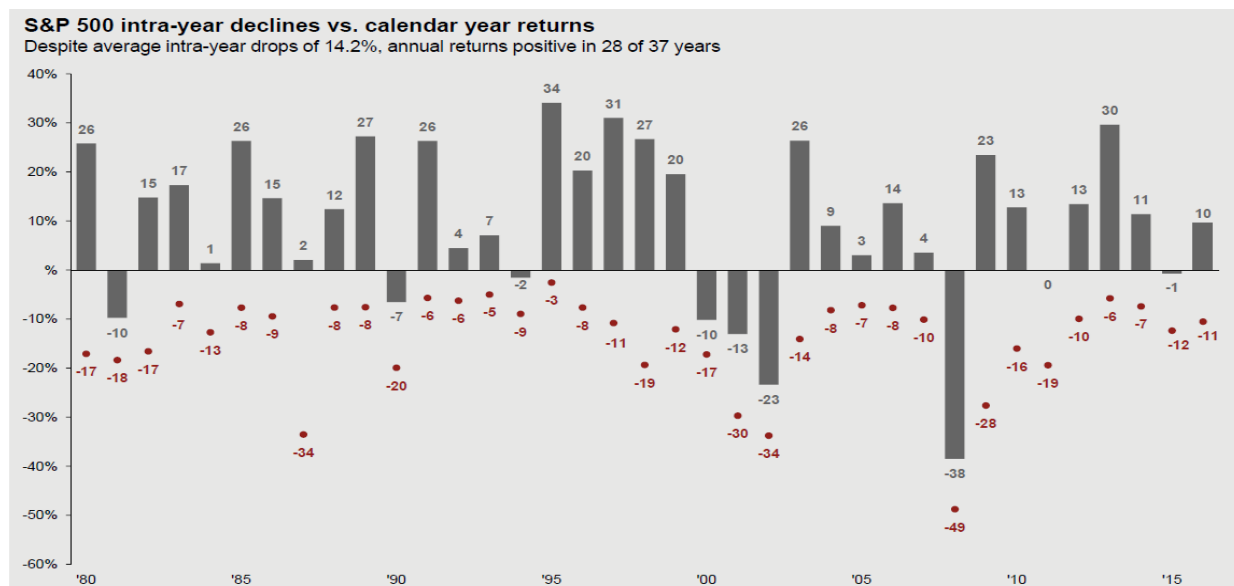
Market Performance Recap: **Global Stock Rally Continues**

Stocks around the globe pushed higher in Q2 as economic activity continued its modest climb. International stocks led the way with a gain of +6.1% in EAFE and +6.3% in Emerging Markets indices. The Russell 1000 US stock index moved up +3.1% in Q2 on a slightly improved US economy and expectations of beneficial policy reform. Tech was a leader as the NASDAQ rose +4.2%. Also within sectors, health care and financials stock sectors performed well, while utilities, telecom and energy lagged. Despite the Fed raising rates in June, bond index Barclays Intermediate Gov't/Credit Index returned +0.9%.

Economic & Market Discussion: **Waiting for Godot?**

The chorus of investment pundits calling for an end to the current US stock rally has grown larger and louder and yet, the market continues higher. Let's examine why a correction will happen, why predicting it is hard (and potentially hazardous to your portfolio) and what we are doing about it.

- Corrections have a strong track record of showing up (unlike Godot), as part of a normal market. A correction is commonly defined as a -10% decline. The average intra-year decline is historically -14%. Even in positive years, it is unusual not to experience a mid-to-high single digit decline. (See chart).



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2016.
Guide to the Markets – U.S. Data are as of December 31, 2016.

- We have been waiting for a correction (like Godot), but not for very long. The last S&P 500 correction began in the summer 2015 and hit its low for the year in October. The drop happened to be a decline of about -12%. From November 2015 until February 2016 the market again took a double-digit dive. Since then the market has climbed +33% with fresh highs being set on July 12, experiencing one measly -6% drop along the way.
- Based on history we expect a correction to occur before the end of the year. However, timing and duration are elusive and we are not trying to predict it. A correction may be triggered by almost any event – Fed Reserve action, oil prices, a poor jobs report, or a geopolitical incidence. Rather than trying to guess the timing, the key is to understand the drivers of any correction in order to assess new investment opportunities.

Portfolio Strategy: **Cautious and Ready**

Amid rising rates and fully-valued, maybe over-valued, US equity markets, our managed-risk asset allocation approach is cautious, mostly neutral, and focused on the following strategies:

- Stay in Stocks, and Diversify – We continue to favor equity over fixed income despite current valuations. We have increased our non-US stock exposure during the past six months as we see better relative opportunities offshore.
- Rising Rates Increase Risk – Rising rates present risk across nearly all asset classes, especially income-producing classes and subclasses. As such, we favor holdings less affected by rising rates, including hedged fixed income, business development corp. investments, and infrastructure.
- Ready to Rebalance – We are not trying to time a possible market correction by raising cash levels. Instead, we will react to volatility by rebalancing as needed from non-equity holdings in alternative investments and fixed income to new opportunities in equity.

| Market Index | Market Performance | | | | |
|------------------------------------|--------------------------------------|----------|--------|----------------|----------------|
| | % Change for Periods Ended 6/30/2017 | | | | |
| | Second Quarter | 2017 YTD | 1-Year | 3-Year Annual. | 5-Year Annual. |
| Russell 1000 | 3.06 | 9.27 | 18.03 | 9.26 | 14.67 |
| MSCI EAFE – Non-US | 6.12 | 13.81 | 20.27 | 1.15 | 8.69 |
| Russell 2000 | 2.46 | 4.99 | 24.60 | 7.36 | 13.70 |
| MSCI Emerging Markets Equity | 6.27 | 18.43 | 23.74 | 1.07 | 3.96 |
| DJ US Real Estate | 2.59 | 5.89 | 1.42 | 8.33 | 9.27 |
| NASDAQ 100 | 4.18 | 16.78 | 29.39 | 15.03 | 18.17 |
| Barclays Gov't/Credit Intern. Bond | 0.94 | 1.73 | -0.21 | 1.91 | 1.77 |
| IQ Hedge Multi-Strategy | 1.21 | 3.12 | 2.20 | 1.32 | 3.42 |
| 3-Month T-Bill | 0.18 | 0.30 | 0.46 | 0.20 | 0.15 |