

Nauset Market Commentary Fourth Quarter 2017

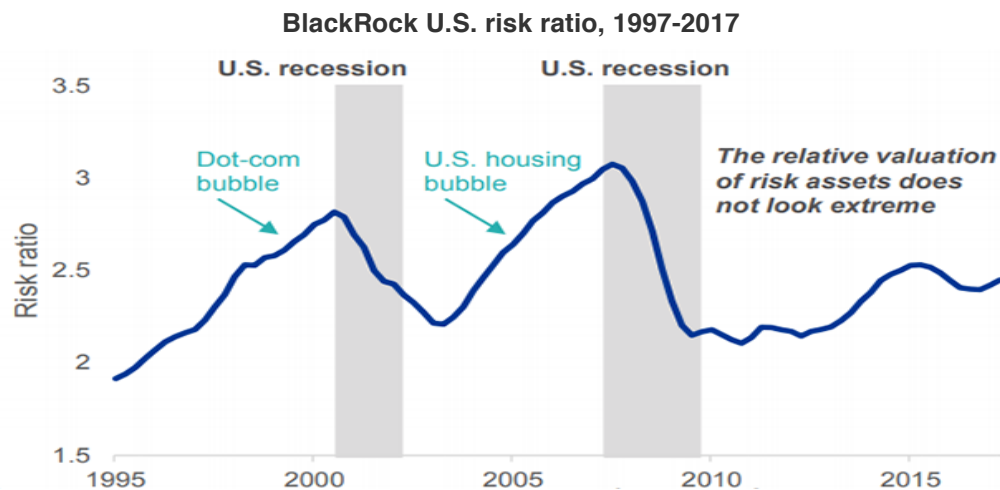
Market Performance Recap: **Stocks Finish Strong**

Stocks closed out an exceptional year with another strong quarter of gains for both US and international indices. Anticipation and eventual passage of a tax reform bill that favors corporations was a boost to US stocks. The Russell 1000 US stock index rose +6.6% in Q4 to finish the year at +21.7% following another solid earnings period. The tech and consumer service stock sectors led the way, while telecom and utilities lagged. International stocks posted 2017 gains of +25.0% for EAFE and +37.3% for Emerging Markets indices. After a third Fed rate hike in 2017, bonds slipped -0.2% to finish the year at +2.1% as measured by Barclays Intermediate Gov't/Credit bond index.

Economic & Market Discussion: **2018 Outlook**

Following the strong and smooth stock rally of 2017, we expect a more challenging year for investment returns. Our outlook sees positive momentum for the US economy following the historic tax reform bill coupled with solid global growth. This bodes well for equities, but could spark increased central bank action and upward pressure on interest rates that might increase odds of a recession late in the year or in 2019.

- Room to Run? – The risk ratio chart below shows that risk assets have grown over the past four years, but may be able to continue to climb before the eventual next recession. We agree that gains are possible and we are not defensive given positive US economic indicators and sentiment in the markets.



Sources: BlackRock Investment Institute, with data from the U.S. Federal Reserve, November 2017. Notes: The risk ratio is calculated by taking the value of outstanding U.S. risk assets (defined as equities, corporate bonds, mortgages and bank loans) and dividing this by the value of perceived safe-haven assets (government and agency mortgage securities and bank deposits) excluding central bank holdings.

- Rates on the Rise – The US rate tightening cycle will continue in 2018, and the risk is that the Fed may tighten too much or too quickly. The Fed is trying to strike a delicate balance of supporting a growing economy while containing future inflation with the blunt tool of rate hikes. The potential for missteps and growth-choking monetary action is much higher in 2018 than it was last year.
- Rockier Road Ahead – Stock market volatility is likely to move up from its historic low as measured by the lack of 1% moves in the S&P 500 stock index in 2017. Partisan politics, Fed action and potential geopolitical events are likely to make more significant impact on stock prices this year than last.

Portfolio Strategy: **Staying with What is Working**

Although the calendar flipped, our market strategy remains in place – we favor stocks over bonds. However, we have lowered our return expectations given valuations, and have diversified by opportunity.

- Stay in Equities – We continue to overweight stocks with a two-prong approach – emphasis on specific US sectors of tech, finance and health care and higher allocations to both non-US developed and emerging markets stocks.
- Underweight Fixed Income – As rates continue to rise, we are defensive in our fixed income allocations. Our income-producing investments are focused on hedged fixed income, business development corporations, and infrastructure securities.
- Use Alternatives to Balance Risk – We are committed to managing risk by using alternative investments that seek returns regardless of major market movements. We expect these investments like option writing and risk arbitrage, to lessen portfolio volatility while providing a different source of return over time.

Market Performance % Change for Periods Ended 12/31/2017

Market Index	Fourth Quarter	2017	1-Year	3-Year Annual.	5-Year Annual.
Russell 1000	6.59	21.69	21.69	11.23	15.71
MSCI EAFE – Non-US	4.23	25.04	25.04	7.80	7.90
Russell 2000	3.34	14.65	14.65	9.96	14.12
MSCI Emerging Markets Equity	7.35	37.17	37.17	9.07	4.32
DJ US Real Estate	2.57	9.84	9.84	6.46	9.34
NASDAQ 100	7.26	32.99	32.99	16.12	20.68
Barclays Gov't/Credit Intern. Bond	-0.20	2.14	2.14	1.76	1.50
Wilshire Liquid Alternative	1.50	5.06	5.06	1.25	1.87
3-Month T-Bill	0.27	0.77	0.77	0.35	0.23