LANIER
ASSET MANAGEMENT LLC

Building Confidence and Security in Your Financial Future

Monthly Update

March 2017

Valuation – A History Lesson

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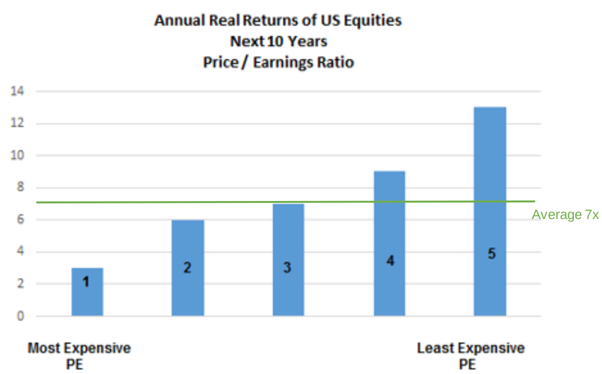
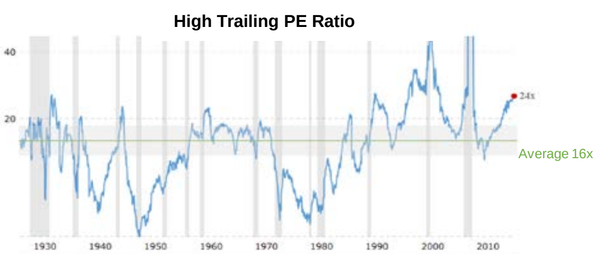
Valuation methodologies are truly excellent predictors of future stock market returns over long periods of time. Each methodology has its fans and each has its critics. We prefer to take a gander at quite a few, and apologize for the granularity.



Source: AQR



Source: Macro Trends

The valuation story is a simple one – when you buy an asset low, your return will be above average. Conversely, if you buy high, returns by definition will be below average. It's just math. Real returns have averaged about over 7% the last century. This chart illustrates that, if you purchase when Price/Earnings (PE's) are in the top quintile of history, your real return the subsequent ten years is approximately 3% annually. Conversely, if you buy in the least expensive PE environment, the market provides double digit returns. We are currently in the top quintile and even the top decile of historic PE multiples.

Next, let's look at actual or trailing PE Ratio. The average is approximately 16x over the last century. We are currently at 20x assuming actual non-GAAP 2016 earnings of $118 in 2016 and an S&P 500 at 2370. Using GAAP earnings, the PE is approximately 24x. This is the most tried and true valuation methodology, with the downside being it is backward looking. Interpretation – Pricey. P.S. We remained perplexed with a bit of skepticism of the growing gap between GAAP and the higher non-GAAP earnings.

Let's look to the Forward PE Ratio. This averages a slightly lower multiple at 14x and is currently at 17-18x. This assumes 2017 earnings of $133 or 12% increase of non-GAAP earnings. The downside of looking at this expected earnings methodology is that analyst estimates are historically quite bad – a C- from this professor! In addition, estimates almost always come down as the year unfolds – every year! Combined, these drawbacks cloud the usefulness of the Forward PE Ratio. Drawbacks aside, interpretation – Not Cheap!

Very High CAPE* Ratio

* Shiller's Cyclical Adjusted Price Earnings Ratio (CAPE)

Another oft-used valuation measure is the Cyclical Adjusted Price Earnings (CAPE) Ratio created by Yale economist Robert Shiller. This measure uses the 10 year average earnings, adjusts for inflation and smooths out the volatility of the business cycle. We are currently at 29x versus the average of 16x. 80% of the time, the CAPE is between 8 and 20. Interpretation – Nose Bleed!

So if you average the valuation tools that pertain to earnings, they average about 50% overvalued and 1.5 standard deviations above their long term medians. This statistically puts earning valuation measures in approximately the 90th percentile. Interpretation – Caution.

Each of the above measures are based on the earnings of the market. There are other valuable valuation measures that do not use earnings, including Price-to-Book, Free Cash Flow Yield, Enterprise Value/Sales, Median Price/Revenue Ratio, Price-to-Sales, PE to Growth (PEG) Ratio, and Market Cap/GDP.

S&P 500 Valuation Summary

	Aggregate index		Median stock	
Metric	**Current**	**Historical %ile**	**Current**	**Historical %ile**
P/E to growth (PEG)	1.5 x	97 %	1.9 x	100 %
EV / Sales	2.1 x	94	2.7 x	100
EV / EBITDA	11.3 x	88	11.4 x	99
Price / Book	2.9 x	76	3.3 x	98
Forward P/E	17.4 x	88	17.7 x	95
Free cash flow yield (FCF)	4.4 %	43	4.8 %	30
Cyclically adjusted P/E (CAPE)	23.7 x	85	NA	NA
Median		**88 %**		**98 %**

Source: Goldman Sachs

A recent chart by Goldman Sachs that combines both earnings and non-earnings valuation measures illustrates some concerning data. They use seven metrics looking at the aggregate index and the median stock in the S&P 500 and then compare each to its historic norm. The averages collectively suggest we are, ironically, in the 90th percentile. No opinions here – just facts and history! Look out below!

We have always spoke of the importance of sound economic policies and that they are essential for strong economic growth. We feel the pro-growth strategies coming out of Washington – lower tax rates, less regulation, etc. – may very well be quite positive for the markets. However, they could be offset with the retreat of globalization (i.e., protectionism), the debt bomb and aging demographics. Increasing interest rates, followed by an orderly descent of the Fed's balance sheet are also strong headwinds.

We have studied earnings growth rates in various economic times and under various tax policies. It is difficult to get a 12% to 20% collective growth rate in earnings in a 1.5-2.5% GDP growth environment even with more pro-growth tax structure. Revenue growth of the largest companies has remained elusive for five years.

And the market rolls onward and upward! With each passing advance, the valuation metrics discussed become even more stretched. We think this environment begs for a well-diversified strategy using more alternatives and less traditional assets – including equities! The risk/reward tradeoff is as compelling as 2000 and 2008 – where each era experienced a 50% decrease in equities.

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Performance Update

	Investment Vehicle	Total Return (%)							
						Annualized			
		February	QTD	YTD	1-Year	3-Year	5-Year	7-Year	10-Year
TRADITIONAL ASSETS									
Cash									
Vanguard Reserve Prime Money Market		0.1%	0.1%	0.1%	0.6%	0.3%	0.2%	0.2%	0.9%
Fixed Income									
Domestic (Barclays US Agg)		0.7%	0.9%	0.9%	1.3%	2.5%	2.1%	3.4%	4.2%
Vanguard Total Bond Market	VBMFX	0.7%	1.0%	1.0%	1.4%	2.5%	2.1%	3.3%	4.1%
Eaton Vance Floating Rate	EIBLX	0.5%	1.2%	1.2%	13.9%	3.5%	4.3%	4.7%	3.8%
US Preferred Stock ETF	PFF	2.1%	4.5%	4.5%	6.9%	6.2%	5.9%	6.6%	4.2%
High Yield (Barclays US Corp HY)		1.3%	2.6%	2.6%	18.5%	4.3%	3.2%	5.0%	5.2%
Short Term High Yield	SJNK	1.1%	2.2%	2.2%	17.9%	-	-	-	-
Equities									
Domestic Large Cap (S&P 500 TR)		4.0%	5.8%	5.8%	24.8%	10.5%	13.9%	13.8%	7.6%
S&P Equal Weight	RSP	3.1%	5.2%	5.2%	26.3%	9.4%	14.1%	14.3%	8.2%
Domestic Mid Cap (S&P 400 TR)		2.6%	4.3%	4.3%	31.7%	9.4%	13.7%	14.5%	9.1%
Vanguard Mid-Cap ETF	VO	3.1%	6.1%	6.1%	26.0%	8.6%	13.3%	14.1%	7.9%
Domestic Small Cap (S&P 600 TR)		1.6%	1.2%	1.2%	34.1%	9.5%	14.8%	15.5%	8.9%
Vanguard Small-Cap ETF	VB	2.3%	3.9%	3.9%	32.1%	7.4%	13.5%	14.3%	8.4%
Developed Intl. (MSCI EAFE)		1.4%	4.4%	4.4%	15.8%	-0.7%	5.1%	5.2%	1.0%
MSCI EAFE	EFA	1.2%	4.5%	4.5%	16.0%	-0.7%	5.2%	5.1%	0.9%
Emerging Intl. (MSCI EM)		3.1%	8.7%	8.7%	29.5%	1.3%	-0.4%	2.4%	2.9%
Vanguard FTSE Emerging Markets ETF	VWO	2.3%	8.1%	8.1%	29.2%	2.6%	-0.2%	2.4%	2.8%
Real Assets									
Real Estate (FTSE NAREIT US REIT)		4.2%	4.4%	4.4%	17.4%	10.3%	11.2%	13.7%	4.5%
Mortgage Real Estate	REM	5.7%	7.1%	7.1%	34.4%	7.8%	8.5%	7.9%	-
REIT ETF	VNQ	3.5%	3.3%	3.3%	16.6%	11.0%	11.4%	14.1%	5.0%
Commodities (Thomson Reuters/Jefferies CRB Index)		0.8%	1.0%	1.0%	30.0%	-16.6%	-11.5%	-6.2%	-5.6%
DBC	DBC	-0.2%	-0.8%	-0.8%	23.3%	-17.2%	-12.4%	-6.4%	-4.8%
Gold	GLD	3.2%	8.8%	8.8%	0.5%	1.6%	-4.4%	2.5%	7.0%
DIVERSIFYING STRATEGIES									
Hedge Funds									
HFRI WCI		1.0%	2.3%	2.3%	10.8%	2.7%	4.0%	4.2%	3.4%
INFINITY*	OCEAN	-0.1%	0.9%	0.9%	6.8%	5.3%	7.5%	7.0%	6.8%
Boston Partners Long/Short Equity	BPLEX	0.8%	1.5%	1.5%	20.4%	9.7%	8.2%	10.4%	10.6%
QIM Tactical Aggressive*	QIM TA	2.9%	12.3%	12.3%	38.2%	11.9%	10.4%	14.9%	18.0%
Hedge Fund Plus*	HF+	0.7%	3.3%	3.3%	15.9%	8.1%	8.7%	9.7%	10.3%
Boston Partners Global Long/Short	BGLSX	1.5%	2.0%	2.0%	8.7%	3.8%	4.9%	4.9%	3.9%
Managed Futures									
Barclays CTA Index		0.4%	-0.9%	-0.9%	0.0%	3.3%	1.2%	1.8%	3.2%
WINTON*	WINTON	1.9%	0.3%	0.3%	-8.8%	0.0%	-1.3%	0.5%	2.6%
QIM*	QIM	1.2%	4.1%	4.1%	7.1%	4.0%	3.4%	1.1%	4.1%
AQR Managed Futures Strategy	AQMNX	1.1%	1.8%	1.8%	-10.9%	2.6%	2.9%	2.6%	3.6%
Natixis ASG Managed Futures Strategy	ASFYX	2.2%	2.3%	2.3%	-10.2%	6.0%	3.3%	3.8%	4.6%

= Benchmarks
= Lanier Selections

* For Accredited Investors

Our Team

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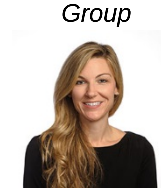

Stephanie E. Milby
Investment Associate

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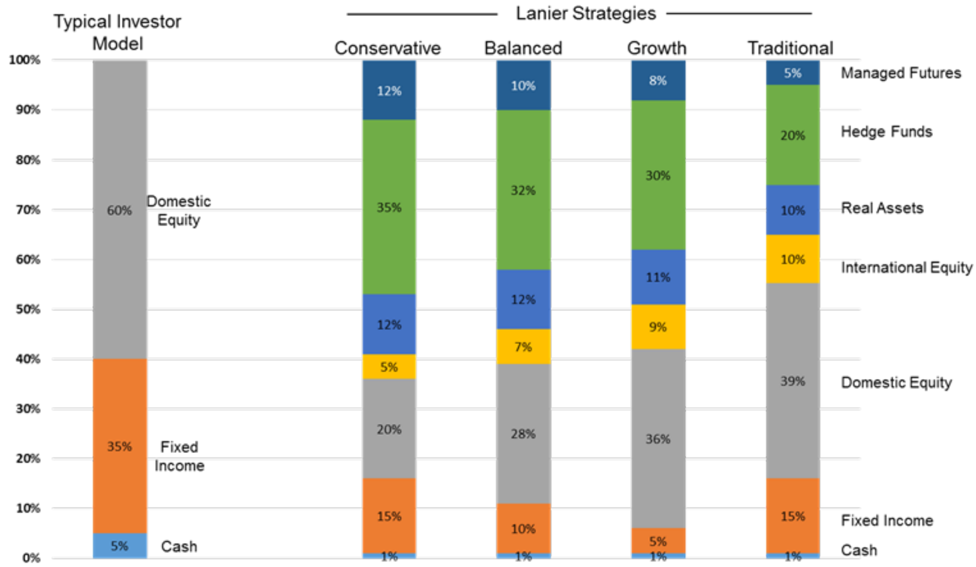
Our Approach

At Lanier, we believe that portfolios designed to deliver superior performance and lower correlation with the overall markets must decrease reliance on stocks and bonds and be complemented with a set of diversifying strategies and alternatives



Each of our clients has a unique set of needs (based on age, risk tolerance, income need, etc.) and an asset allocation model designed specifically to meet those needs. Consequently, actual client investment models can and do vary from the allocation percentages listed above.

Lanier Asset Management is an independent Registered Investment Advisory firm. Our mission: ***To Build Confidence and Security in our Clients' Financial Future***. We use an open architecture investment structure to combine the best of proprietary and independent investment strategies. At Lanier, we deliver superior service and performance to our clients as a result of four distinguishing elements:

- **People**: we are an independent firm, providing objective advice from experienced investment professionals working in your best interests
- **Investment Philosophy**: we seek to smooth investment returns, providing superior investment performance and a significantly lower correlation to the overall market
  - Focus on projected returns rather than historic for all asset classes
  - Similar to the largest U.S. endowments
- **Investment Process**: combine active and passive management in traditional asset classes; complement with diversifying strategies/ alternatives
- **Conviction**: we believe in our approach – this is how we invest our own money

Past performance is no guarantee of future results. Investing entails risk, including possible loss of some or all principal. Historical performance results for investment indices and/or categories have been provided for general comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges. It should not be assumed that your account holdings correspond directly to any comparative indices.

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