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Investment Strategy Update **Second Quarter 2018**

Concerns about Trump administration policies, trade wars and world conflict are overshadowing improving world economies. In this environment, the recent market volatility has allowed us to shift to a modestly aggressive asset allocation relative to each client's personal benchmark, based on market valuations.

Robin Smith, CFA, CFS, EA

We have moved from a neutral to a modestly aggressive asset allocation, when compared to each client's personal benchmark. This action is based on continued world economic expansion, driven by technological advancement in an environment of low inflation and low interest rates. These positive factors are supported by recent improvement in equity valuations, tax relief and regulatory reform here in the United States, combined with major improvement taking place in the standard of living for residents of developing countries.

Unfortunately, these positive factors, which have the potential to extend the current bull market significantly, are being overshadowed by a few potentially meaningful factors. First, equity markets have returned to more normal volatility levels, which can be unsettling for clients that have become used to far less volatility over the past couple of years. Second, we have become less optimistic about the prospects for a meaningful infrastructure spending bill this year, which would represent a significant contribution to corporate earnings and GDP growth over the next few years, should one be enacted. Third, the Trump administration is creating concerns with a shakeup in Trump's outside legal team; combined with new concerns surrounding the direction of foreign, national security and economic policy, with the arrival of Mike Pompeo as Secretary of State, John Bolton as National Security Adviser and Larry Kudlow as the White House National Economic Council Director. Fourth, concerns surrounding renewed weakness in the U.S. dollar and the potential for an inverted yield curve in the U.S., which could portend yet unforeseen world economic and financial weakness.

The most immediate concern would be an inverted yield curve. An inverted yield curve can foreshadow yet unforeseen economic and/or financial concerns. While not a perfect predictor, it would create uncertainty in equity markets. We will be monitoring this very closely.

At times like these, I like to step back and take a longer term perspective. It is my view that we are in just the fifth year of a young bull market in equities, which started for me when the S&P 500 index achieved a sustained breakout into new all-time high territory around mid-2013. Corrections in individual sub-market indexes are common during bull market periods and the S&P 500 index did drop 10% from its latest all-time high on January 26, 2018, as of the close of trading February 8, 2018 and retested that near term low on March 24, 2018.

At this point a high level review of the long term history of bull markets, bear markets and corrections might be helpful as we try to put the current market volatility in proper perspective. Using yearend S&P 500 index historical pricing data, not inflation-adjusted and provided by Standard & Poor's, the current bull market and the possibility that it has a significant way to go can be put into perspective.

From the end of the year 1870 until the end of 1924, the S&P 500 index increased 138%, which translates into a 1.6% compound annual increase in index value during that time period. During this fifty four year period, bull markets were brief and weak at best. From the end of 1924 to the end of 1928, a brief bull market period saw the S&P 500 index increase by 135%. It wouldn't be until the end of 1952, that the S&P 500 index would once again achieve a sustained breakout into new all-time high territory. It has only been since the end of 1952, that we have experienced the type of bull market periods to which we have become accustom.

Since the end of 1952, we have experienced a twenty year bull market period when the S&P 500 index increased 352%; followed by what I refer to as a basing out period of ten years when the S&P 500 index was volatile but increased only 22%; followed by a seventeen year bull market period when the S&P 500 index increased 888%; followed by a basing out period of thirteen years when the S&P 500 index was volatile but increased only 4%; and finally, the most recent five plus year bull market period when the S&P 500 index increased only 78% as of the close of trading on March 23, 2018, including the current correction.

The takeaway from this analysis is that bull markets are driven most by economic expansion and technological advancement in an environment of low inflation and low interest rates. We currently have all four moving in our favor today. We also have compelling equity valuations.

Our modestly aggressive asset allocation is based on continued world economic expansion, driven by technological advancement in an environment of low inflation and low interest rates. Fixed income investments favor short and intermediate term corporate and treasury bonds.

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