MARKET COMMENTARY
4th Quarter 2017

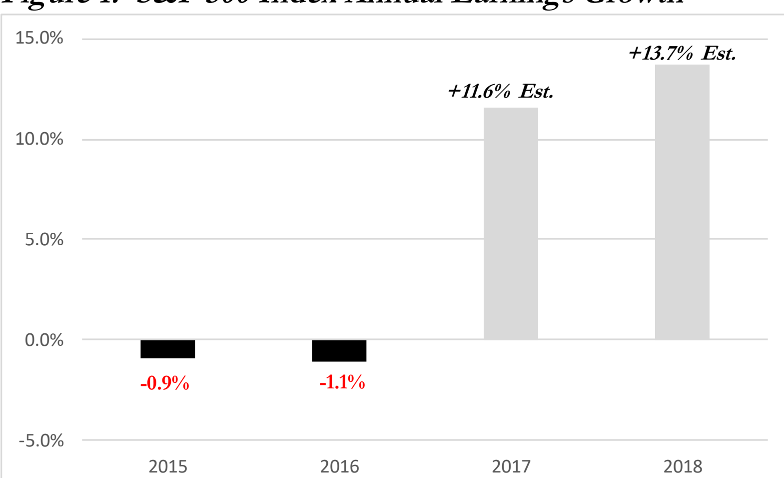
Economic Update

2017 equity markets surprised many investors, as synchronized global growth spurred by continued monetary and fiscal stimulus produced strong returns with historically low volatility. The year saw a governing change in the U.S., with one party controlling both houses of Congress and the White House, resulting in a reform of individual and corporate taxation. The economic impact of tax reform will be more fully realized in 2018 and 2019, but we know it represents an estimated $1.5 trillion of fiscal stimulus over 10 years and will provide a tax cut to most U.S. families and businesses. It is projected that the reduction in corporate tax rates will add 5% to 8% of earnings growth in 2018. The turnaround in U.S. earnings in 2017 was a significant driver of market performance and continued optimism. Figure 1 illustrates S&P 500 annual earnings growth since 2015, with Q4 2017 and 2018 earnings estimated based on current corporate guidance.

The U.S. middle class comeback in 2017 has largely gone unnoticed and under-reported. The cohorts identifying as middle and upper middle class have grown to 62% of the population, with lower middle and lower class declining to 36%. A recent survey indicates that 59% of those surveyed see this as a good time to find a quality job.

Business confidence in the U.S., China, Korea, Japan and Europe remain at high levels, while unemployment in the developed world is close to a 40-year low. Inflation has been mysteriously missing, as the Federal Reserve is still in the early stages of imposing monetary restraint. From a broader perspective, Keel Point tracks 26 economic and capital market growth indicators on a weekly basis. The latest reading shows 65% of the indicators currently signaling strong continued growth, while only 8% are indicating weakness. While U.S. political stability and the global geopolitical landscape remain a concern, current economic data and the pricing of risk within capital markets are both supportive of continued economic growth and positive equity market performance.

Figure 1: S&P 500 Index Annual Earnings Growth



Source: Bloomberg

Capital Markets Update

The MSCI All Country World Index return in the table below shows that global equity markets had an outstanding year in 2017, with most global indices up over 20% (the U.S. small cap sector being a notable exception at +14.6%). The S&P 500 produced positive returns every month during the year for the first time in history. International equity markets delivered a payoff for global investors – both the developed and emerging regions outperformed the S&P. Keel Point's risk benchmark returns finished 2017 ranging from roughly 10% to 22%.

Broad Market Indices	4Q 2017	YTD 2017
MSCI All Country World ("ACWI")	5.7%	24.0%
Barclays Aggregate Bond ("AGG")	0.4%	3.5%
Portfolio Risk Level Benchmarks		
Aggressive (90% ACWI / 10% AGG)	5.2%	21.8%
Growth (75% ACWI / 25% AGG)	4.4%	18.6%
Balanced (55% ACWI / 45% AGG)	3.3%	14.4%
Conservative (35% ACWI / 65% AGG	2.2%	10.3%

Source: Bloomberg

U.S. interest rates surprised many (including us) last year, with the 10-year Treasury yield starting the year at 2.45% and ending at 2.41%. The year in rates, however, was anything but stable. The 10-year yield bottomed at 2.04% in September before trending higher to close the year close to where it began. The Federal Reserve raised the Fed Funds rate 3 times in 2017, and the yield curve generally flattened during the year, which is usually considered a bearish market signal. However, we do not believe this is currently the case, as a historically low Treasury supply and the fact that U.S. rates are higher than most developed sovereign yields (both the result of global quantitative easing) are anomalies working to constrain longer-term U.S. rates.

Alternatives posted mixed performance for the year. REIT's lagged equities (up roughly 9%), while diversified commodities, like U.S. rates, trended down in the first half of the year before moving higher with choppy trading in the second half. MLP's were down close to 7% while gold was up 13%. Across capital markets we saw a distinct change in trading patterns during the 3rd quarter as risk appetite and growth expectations increased, and positive market performance sustained going into year end.

Performance and Positioning

We have been pleased with performance since our September repositioning, with most Keel Point model portfolios outperforming risk benchmarks. For the year, model composites moderately underperformed benchmark returns, but generally exhibited less risk. During a year of such strong equity returns, diversifying alternatives (both aggressive and defensive) were the primary source of benchmark underperformance. The fixed income sleeve continued its strong performance, outperforming the Barclays Aggregate Bond benchmark in 2017.

Two of our enhanced strategies performed well during the year. The Keel Point tactical strategy had a strong 2nd half and outperformed its benchmark in 2017. The strategy, which is managed with dynamic risk positioning, currently has roughly 96% of its capital in aggressive risk investments. The BlueArc Fund: Quantitative Equity Series has met expectations since its launch in February. This fund of various quantitative equity strategies has captured a significant portion of positive equity returns, while also exhibiting risk mitigating characteristics relative to traditional equity investments. We use both the tactical and quantitative strategies to diversify sources of portfolio risk. In the current market environment, we have been focused on increasing portfolio diversification and blending defensive alternative strategies with bonds for appropriate risk mitigation.

2018 Outlook

Going into 2018, Keel Point has a positive outlook for equities, however we are bearish on U.S. bonds. As previously mentioned, current economic data is supportive of continued growth, and U.S. tax cuts should bolster consumer demand, as well as corporate earnings and capital investment. We are often asked, "when will the bull market in equities end?". No doubt equities are expensive by historical standards, as judged by various metrics. We believe we have entered the last phase of the current economic cycle, but note that our research indicates this period typically last for 1 – 3 years. For example, historically equity markets continue to generate positive returns for 3 years on average after the Fed embarks on a tightening cycle, which it did in 2017.

Based on historical data, we are looking for the following market conditions to signal the end of the current growth cycle:

- an inverted U.S. yield curve (i.e. short-term interest rates are higher than long-term interest rates)
- sustained negative trends in corporate earnings, capital investment and unemployment claims
- strong negative signals from Keel Point's economic indicators and tactical model

While we believe equities will come through 2018 with positive returns, bonds do not look attractive. Corporate bonds have historically tight credit spreads, and we think U.S. rates will move higher in 2018. Equity volatility will inevitably increase at some point, which should benefit active and quantitative trading strategies. We will continue to digest incoming economic and capital market data and adjust our market view as warranted.

We appreciate your continued trust in Keel Point. Happy New Year.

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