THIRD QUARTER 2017

Matt's Market Update

IN THIS REPORT

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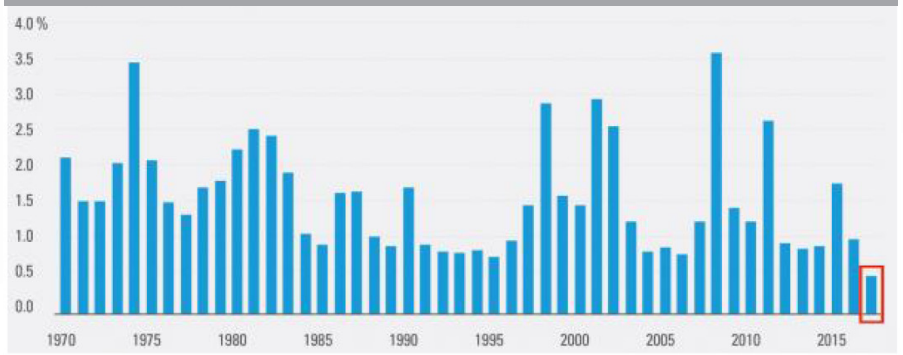
Chief Investment Officer

Market Review

Global equity markets continued their surge higher in the third quarter with many key index benchmarks making new all-time highs. The S&P 500 gained +4.48% in Q3, the 8th straight quarter of gains for the index. This type of winning streak has only occurred four other times since the index was created in 1928. In addition, the S&P 500 hasn't had a single month of negative returns in 2017. This has never happened through a full calendar year according to Hartford Funds. It has now been 318 trading days since the S&P 500 suffered a 5% drawdown, the 4th longest streak since 1928. We are truly witnessing an unprecedented period for U.S. equities. While lagging their large-cap counterparts for most of the year, small-cap stocks as represented by the Russell 2000 index finished the quarter with a gain of +5.67% after posting an incredible +6.24% gain in the month of September. Consider everything we've just described in the context of the major news events of September: three horrific storms (Harvey, Irma and Maria) inflicted major damage on Texas, Florida and Puerto Rico; North Korea continues to test fire missiles (including one over Japan) and the attempt to reform healthcare fails again in Congress. Yet, through it all, it was the least volatile September for stocks in the past 47 years as you can see on the chart below.

Foreign markets continued their strong momentum in Q3 as well with the MSCI ACWI index outperforming the major U.S. indexes with a +6.16% return for the quarter. We continue to overweight foreign equities in our managed portfolios and still feel like investors in general are underinvested in this segment of the market. Consider that the U.S. (33%) and Canada (3%) combined represent only $^{1}/_{3}$ of the investable global market cap. This means $^{2}/_{3}$ of the opportunity, or $50 trillion in market cap, resides outside of North America. It's understandable that many investors would have a "home bias" with the majority (if not all) of their equity exposure to the U.S. Especially in light of how foreign markets have lagged in performance since the crisis ended in 2009. That being said, foreign categories represent the top 6 spots in our YTD ranks of mutual fund performance through 9/30 with funds focused on emerging markets and foreign small-cap stocks leading the way. To generalize broadly, foreign markets have superior valuation metrics, longer runways for growth (as they're earlier in the economic expansion cycle) and have friendlier central banks which are still providing stimulus in support of equity prices.

AVERAGE DAILY RANGE IN SEPTEMBER FOR THE S&P 500
September is now in the books and it's official—it was the least volatile September for stocks in history...



Source: LPLFinancial

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U.S. equity performance in September seemed to get an extra boost from increased talk of a sweeping corporate tax reform plan. This certainly contributed to the very strong month for small-cap stocks, but it was also evident in the fact that companies with the highest tax rates saw their stock prices start to outperform during Q3. How tax reform will shake out (if it happens at all) is anyone's guess at this point. The White House has only released few details at the moment and much more in terms of negotiation is sure to take place ahead of any vote. It would seem the stock market though is discounting a deal that is very friendly to corporate America (and equity prices) as a done deal. Given that we witnessed several failed attempts to reform healthcare, it's a wonder why the market is so sure that tax reform is coming. Perhaps lowering taxes is a more universally agreed upon ideal (no matter your side in the political spectrum), but the devil will be in the details of course. Should efforts to slash taxes fail or if the final version of the bill is less attractive than what is currently hoped for, U.S. equity prices may not react well. Further details and progress on tax reform may finally be what shakes the market out of this very low volatility phase.

Random Stats

We come across a great deal of interesting statistics in our reading and meetings with fund managers. So we'll likely make this segment of the update a more regular feature. Here are the latest collection of market tidbits courtesy of AMG Funds and BlackRock.

- 2017 is only the 2nd calendar year in history (since 1926, 92 calendar years) that the first eight months of the year were all positive. The other year in which the first eight months were all positive was 1995, which finished the full calendar year +37.58%. See the chart below.

- Over the last 25 years (1992–2016), the S&P 500 stock index has gained an average of +4.9% (total return) during the final three months of the year. Twenty of the last 25 fourth quarters (80%) have produced a positive total return.

- The S&P 500 is up +14.2% YTD through Friday 9/29/17 on a total return basis. The index has had only one down year (2008) in the last 14 years, i.e., 2003–2016.

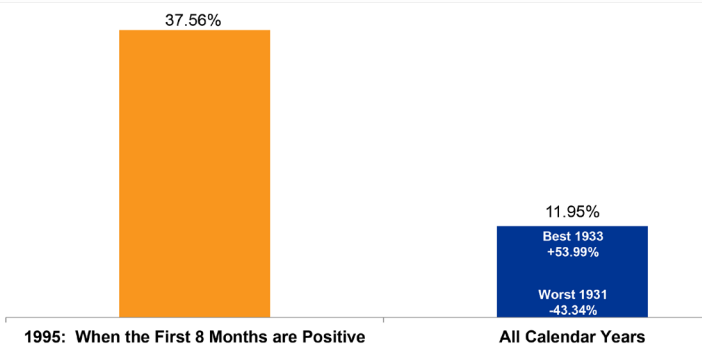
- The S&P 500 has experienced ten drops of at least 5% during its bull market run that reached 103 months in on 10/09/17, but none since 2/11/16 or 19 ½ months ago.

- Since 1926, the month of September has been the worst month by far for stocks -0.72% on average. The median return for September was +0.02% and you lost money in 45 out of 91 Septembers. September 2017 saw the S&P 500 index rise +2.06%..

- Today's bull market is the 2nd longest in history. Starting on 3/09/2009, gain of +302.8% and has lasted 3098 days (thru 8/31/17). Since 1926, the only Bull market that lasted longer was from 12/08/87 to 3/09/00 lasting 4,494 days and cumulatively returned +720%.

- Since 1926, U.S. bonds are up on average +0.622% in October outpacing stocks on average +0.617%. October is the only month bonds outpace stocks. The two months of September and October are the best two-month period for bonds returning on average +1.06% vs. -0.11% for U.S. stocks.
- Over the last five years, ten-year U.S. Treasury Bond yields have had a trading range of a low of 1.37% and a high 3.03% (1.66% difference). The average range in yields for five year windows over the last 40 years is approximately 4.1% (difference).

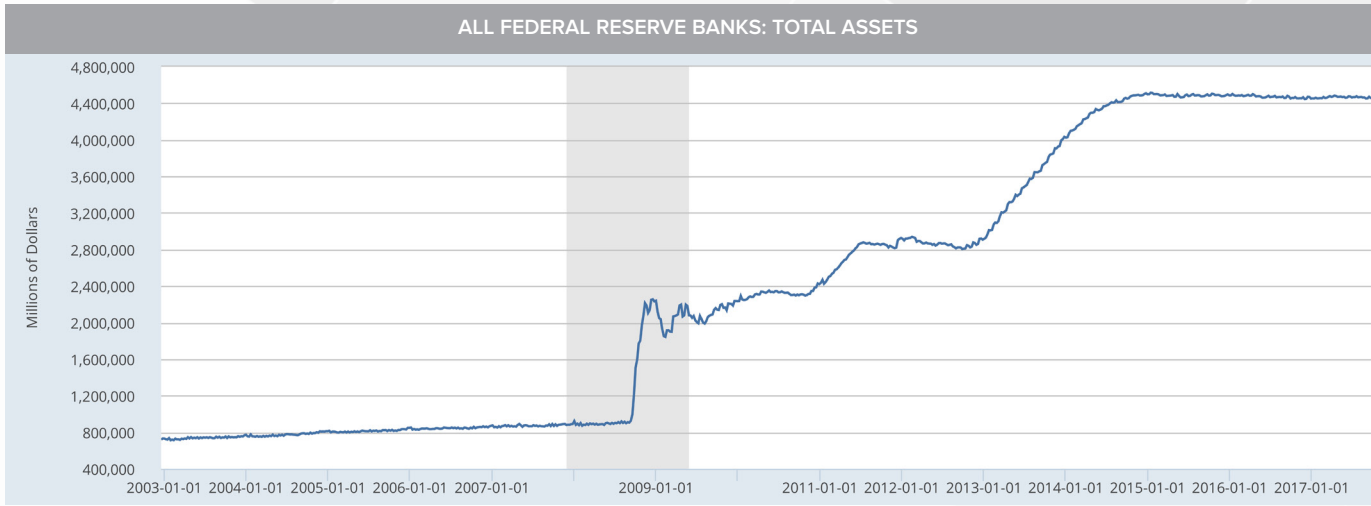
AVERAGE U.S. STOCK CALENDAR YEAR RETURNS (1926-2017)



Source: Morningstar as of 8/31/17. Past performance does not guarantee or indicate future results. U.S. Stocks are represented by the S&P 500 Index.

The Great Unwind

As we've discussed numerous times in prior commentaries, the Fed's influence over the stock market simply cannot be understated. On November 25, 2008 the Fed announced it would begin buying assets for its own account (the start of QE or printing money to purchase financial assets in an attempt to stablilize financial markets and boost economic activity as lowering rates to 0% simply wasn't enough). Fed influence has been the greatest factor in supporting the bull market for equities that started in '09. After three separate phases of QE, the Fed ended its QE3 buying program in October of 2014, but continued to reinvest the proceeds (interest on bonds they purchased) to maintain its $4.5 trillion balance sheet. Last month, Janet Yellen announced the balance sheet will be allowed to normalize, with reinvestments slowed/stopped starting in October. The plan now is for the Fed to reduce bond investments by $10 billion per month and growing to a $50 billion reduction per month by late 2018. Eventually, the balance sheet would shrink by half to $2 trillion five years out, but this is all theoretical at this point. Market watchers are now rightfully wondering how the Fed's gameplan to start selling assets back to the market will impact stock prices and bond yields. If Fed influence was the driving force behind higher stock prices over the last eight years, what will happen as the Fed removes stimulus? This is literally the trillion dollar question.



Source: Board of Governors of the Federal Reserve Systems (US)

It should be noted that the plan to unwind the Fed balance sheet has been widely telegraphed to the market. The Fed in prior meetings has even described this process as "watching paint dry" to describe a tiny $10 billion per month being removed from a $4.5 trillion balance sheet. This might explain in part why the market in general has had no negative reaction to this plan. As we get further down the road and into 2018, the impact of the plan may be more obvious. This is especially true as it relates to the Fed's impact on interest rates. Conventional wisdom would suggest that as the Fed stops purchasing new securities, market supply will increase thus causing interest rates to rise. While the true impact of the Fed's plan to remove stimulus is still to be determined, there is no question that the Fed will continue to be a major influence on equity prices for the foreseeable future.

Looking for Value

One of the great challenges today is finding investment opportunities that are unloved or fairly valued. Obviously, it seems like the rising tide of global equity prices has lifted all boats and the high (by historic standards) equity valuations would seem to bear that out. At the beginning of the year, emerging markets represented (to us at least) an opportunity where the sector was unloved, the valuations were depressed and there was a fundamental case to be made that these economies were turning a corner. That thesis has certainly played out this year. Looking ahead, are there any similar situations to consider as opportunities? Very broadly speaking, value investing may be one such opportunity due to the overwhelming superiority of the growth style of investing since 2009. While the growth style of investing is the darling of the market today, we wonder if the obituary for the value style

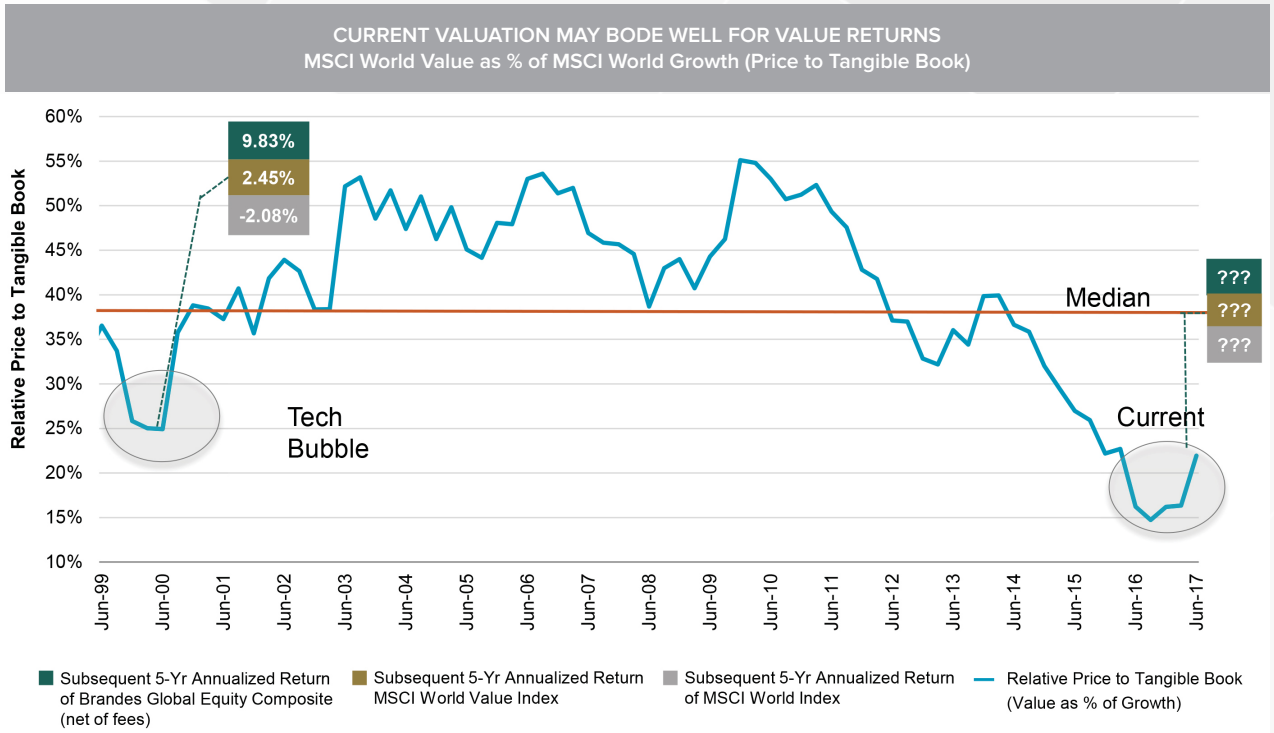
is being prematurely written. Consider the following:

- The Russell 1000 Growth Index outperformed the Russell 1000 Value index by 10 percentage points in the first half of this year, the widest spread over that period since 2009. Over the past decade, the performance of U.S. growth stocks has been almost three times better than that of value stocks. State Street Global Advisors described this as "the longest period of underperformance for value stocks since the late 1940's".

- According to Morningstar as of 6/30, investors pulled $116 billion out of U.S Large-Cap value funds. More than a quarter of this amount came out in just the prior 12 months.

- According to the data analytics firm eVestment, the median value fund in their global database trailed the median growth fund by 7 percentage points in the first half of this year, on pace for the worst relative performance for value since 2007. When looking at actively managed value and growth funds from the U.S., Europe and Asia (representing $8.8 trillion of assets under management), that this is the first year since 2010 where value strategies have lagged growth in each region.

Needless to say, enthusiasm for value based strategies is severely lacking. If you believe in reversion to the mean, an opportunity may be



DECEMBER 31, 1998 TO JUNE 30, 2017: 5 YEAR RETURN DATA JUNE 30, 2000 TO JUNE 30, 2005
Source: Brandes, Bloomberg, MSCI. Price to Tangible Book: Price per share divided by tangible equity per share. Past performance is not a guarantee of future Results. Please note that all indices are unmanaged and are not available for direct investment. Please see the accompanying composite performance page. The hypothetical examples are for illustrative purposes only. They do not represent the performance of any specific investments. Actual results will vary.

starting to form. See the chart on this page. On the basis of price to book value, we've rarely witnessed the MSCI World Value index trading at a steeper discount to the MSCI World Growth index. We believe that a value orientation may not only be an opportunity, but also offer better relative performance (compared to growth) when the next broad-based equity decline takes place.

Our Portfolio Strategy & Allocation Outlook

We made very few changes to our managed portfolios in Q3. At the start of the quarter we did establish new positions in emerging market funds for Moderate portfolios (those at the most conservative end of our risk spectrum) as this continues to be one of our highest conviction ideas. Those portfolios with established positions in emerging markets saw small additions as well. The small segment of our portfolio devoted to "alternative" strategies continues to struggle during this environment where long equity strategies seem to be the only source of returns. Managers

emphasizing risk control and hedging techniques to protect against equity pullbacks have understandably failed to produce positive returns in 2017.

Last quarter we shared a number of concerns for the broad equity markets. But what are the counter arguments in support of the strong performance we've witnessed year-to-date? And will these factors support further strong performance as we head into 2018? In no particular order, here are some of the positive dynamics helping to drive global equity markets higher in 2017.

1. Momentum. For right or for wrong, the market's upward momentum has been very strong in 2017. While it's easy to point to high valuations or investor complacency, the facts are that strong inflows of capital are coming into equity markets and pushing prices higher.

2. Corporate fundamentals are supportive. Stronger global growth is driving earnings for the largest multinational firms (which dominate the major equity indexes). Steady U.S. growth is being aided by increased momentum from overseas economic growth. Since February 2016, the S&P 500 has marched steadily higher with the recovery in earnings.

3. Monetary policy normalizing. The Fed has begun its campaign to raise interest rates and equity market reaction has been muted. The slow and steady approach to normalizing interest rates is market friendly and the hope is that the market can begin to trade more on corporate fundamentals and less based on expected Fed policy decisions.

4. Foreign equity markets are leading. As we documented many times in these pages, foreign equity investments have severely lagged the U.S. since coming out of the '08-'09 crisis. This has changed in 2017 with growth in earnings and strengthening currencies powering equities to superior gains vs. U.S. stocks. The gains are widespread as well across developed, emerging and all market-caps.

5. Superior relative valuations for foreign equity markets. The top five countries (Japan, United Kingdom, France, Switzerland and Germany) by market cap weight in the MSCI EAFE index of foreign large-cap equities each have a lower P/E ratio on expected earnings and higher dividend yield than the United States. Expected EPS growth for the MSCI EAFE index in 2017 is 21.5%.

Finally, as Q3 has ended, it's time for our 11th annual recommended reading list. This year we present two books written by very seasoned portfolio managers. Each shares their process and lessons learned over decades of managing money for their investors.

1. Brandes on Value: The Independent Investor. By Charles Brandes. Mr. Brandes started his firm over 40 years ago after encouragement from the father of value investing (and Warren Buffet's teacher) Benjamin Graham. The book is part history lesson and part practical rules to follow when implementing a value based framework for investment.

2. Big Money Thinks Small: Biases, Blind Spots and Smarter Investing. By Joel Tillinghast. Hot off the press in September, Mr. Tillinghast is one of the most tenured and respected investors in the mutual fund community having run the Fidelity Low Priced Stock fund for over 25 years. This easy to read book does a great job in describing his process for success with a special emphasis on avoiding common mistakes we all make as investors.

Please let us know if you'd like to discuss your personal investing goals and financial planning needs.

Matthew H. McPhail, CFA
Chief Investment Officer

Market Scoreboard

Index Returns (%)	Q3 2017	YTD	1 Year	3 Year	5 Year	10 Year
S&P 500	4.48	14.24	18.61	14.23	7.44	
DJIA	5.58	15.45	25.45	10.81	13.57	7.72
NASDAQ	5.79	20.67	22.29	12.34	15.83	9.17
Russell 2000	5.67	10.94	20.74	13.07	13.79	7.85
MSCI ACWI Ex USA	6.16	21.13	19.61	12.17	6.97	1.28
Barclays Aggregate Bond	0.85	3.14	0.07	4.70	2.06	4.27
Bloomberg Commodity TR	2.52	-2.87	-0.29	2.71	-10.47	-6.82

Source: Morningstar

BRANDES INVESTMENT PARTNERS, L.P.
Global Equity Annual Performance Presentation
As of December 31 Period End
Reporting Currency: USD

	Annual Performance %			Composite Characteristics					Annualized 3 Year Standard Deviation % (2)	
Period	Composite Gross*	Composite Net*	Benchmark (a)	Assets $Millions	Number of Accounts	Internal Dispersion (1)	Non-Fee Paying Accounts (%)	Total Firm Assets $ Millions	Composite Gross	Benchmark (a)
2016	8.18	7.62	7.51	2,941	347	0.52	<1	22,971	11.34	10.92
2015	-2.33	-2.84	-0.87	3,040	408	0.68	1	20,666	11.46	10.80
2014	2.65	2.04	4.94	3,670	492	0.40	4	20,722	11.26	10.23
2013	32.99	32.21	26.68	4,031	528	0.65	4	21,464	13.84	13.54
2012	12.58	11.92	15.83	4,278	599	0.40	3	22,171	16.46	16.74
2011	-4.77	-5.32	-5.54	6,532	803	0.39	2	26,658	20.47	20.15
2010	9.71	9.06	11.76	7,871	978	1.05	2	38,659	26.08	23.72
2009	20.01	19.29	29.99	9,114	1345	2.02	2	42,152	24.15	21.40
2008	-44.00	-44.33	-40.71	9,274	1708	1.03	1	40,591	19.86	17.02
2007	2.55	1.96	9.04	19,257	2010	0.78	<1	83,242	8.99	8.10

(1) The measure of dispersion is the asset-weighted standard deviation for annual period gross returns in USD of all portfoliosin the composite for the full reporting period. Measurements displayed when there are five or fewer portfolios in the composite for an entire annual period may not be meaningful.

(2) The three-year annualized ex-post standard deviation measures the variability of the monthly gross composite returns and the benchmark returns over the preceding 36-month period. It is not presented for periods with less than 36 monthly composite returns.

* The net and gross annual returns, calculated in USD, presented for the Brandes Global Equity composite were calculated on a time-weighted and asset-weighted, total return basis, including reinvestment of all dividends, interest and income, realized and unrealized gains or losses and are net of brokerage commissions, execution costs, and any applicable foreign withholding taxes, without provisionfor federal and state income taxes, if any. Securities transactions are accounted for on the trade date. Dividend and interest income is accounted for on an accrual basis. Cash and cash equivalents are included in performance returns. Returns prior to 4/1/06 reflect the deduction of administrative fees. Returns for some accounts in the composite reflect the deduction of a broker fee thatincludes transaction costs and may include advisory, custody, and other administrative fees.

As of 9/30/2013, Brandes Investment Partners includes the non-SMA Division of Brandes Investment Partners L.P., Brandes Investment Partners (Europe) Limited, Brandes Investment Partners (Asia) Pte Ltd and the Brandes Investment Partners & Co. assets sub-advised by Brandes Investment Partners, L.P.The firm was redefined to reflect the expansion of the organization. As of 1/1/2006, Brandes Investment Partners was divided into two separate divisions: the SMA Division of Brandes Investment Partners, which acts as a discretionary manager to SMA or "wrap fee" program clients, including those who may invest in an SMA product; and the non-SMA Division of Brandes Investment Partners (Brandes), which acts as a discretionary manager for all other types of clients which may include pooled investment vehicles, institutional accounts and high net worth clients outside of wrap fee programs. Although the divisions may share portfolio management and other personnel, each division serves a particular target market, may trade in a different manner and may offer investment advice which differs from the other depending upon the individualized needs of the clients served.The performance data presented does not contain any SMA Division accounts.

This composite was created in 1978. Prior to April 2014 accounts were removed from the composite when an account's market value falls below US$50,000 due to capitalwithdrawals.The Brandes Global Equity Composite seeks to achieve long-term capital appreciation by investing in the equity securities of U.S. and non-U.S. issuers whose equity market capitalizations exceed $5 billion at the time of purchase. Generally, no more than 30% of the composite total assets, measured at the time of purchase, may be invested in securities of companies located in emerging and frontier countries throughout the world. The Brandes Global Equity composite results include all actual, fee-paying and non-fee-paying, fully discretionary Global Equityaccounts under management by Brandes Investment Partners after one full calendar month beginning 12/31/1977 (except for the Brandes Global Equity pooled account which was fully invested at its inception), that have substantially the same investment objectives,policies, techniques and restrictions. Beginning in 2007 the composite performance after management fee returns are determined by reducing the gross of fee returns monthly by the highest applicable fee schedule per account. Prior to 2007 composite performance after management fee returns were calculated using actual fees. Standard fee schedule -From $100,000 but less than $10 million: First $5 million 1.00%; Next $5 million 0.90%; From $10 millionand over: First $25 million 0.75%; Next $25 million 0.60%; Next $50 million 0.50%; Next $50 million 0.45%; Amounts over $150 million 0.40%. Brandes' investment advisory fees are detailed in Part 2A of its Form ADV. Brandes claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this reportincompliance with the GIPS standards. Brandes has been independently verified for the annual periods 1995 through 2016.Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-widebasis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards.The Global Equity composite has been examined for the periods 1985 through year end 2016.The verification and performance examination reports are available upon request.The complete list and description of Brandes' composites and additional information regarding policies for valuing portfolios, calculating performance and preparing compliant presentations are available upon request. Contact client service at 800-237-7119 or write 11988 El Camino Real, Suite 600, P.O. Box 919048, San Diego, California 92191-9048 or email ClientService@Brandes.com. Investors should not rely on prior performance results as a reliable indication of future results.

(a) The MSCI World Index with net dividends captures large and mid cap representation of developed markets. MSCI has not approved, reviewed or produced this report, makes no express or implied warranties or representations and is not liable whatsoever forany data in the report.You may not redistribute the MSCI data or use it as a basis for other indices or investment products.The benchmark returns are not covered by the report of independent verifiers.

S&P 500 TR: A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the large-cap segment of stock market.

Russell 2000 TR: Consists of the smallest 2000 companies in the Russell 3000 Index, representing approximately 7% of the Russell 3000 total market capitalization often used as a proxy for the small-cap segment of the stock market.

Barcap Aggregate Bond TR: The Barclays Capital Aggregate Bond Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most U.S. traded investment grade bonds are represented.The index includes Treasury securities, Government agency bonds, Mortgage-backed bonds, Corporate bonds, and a small amount of foreign bonds traded in U.S.

MSCI EAFE NR USD: Widely accepted as a benchmark for international stock performance, the EAFE Index is an aggregate of 21 individual country indexes that collectively represent many of the major markets of the world.

DJ US Industrials TR USD: Computed by summing the prices of the stocks of 30 U.S. companies and then dividing that total by an adjusted value--one which has been adjusted over the years to account for the effects of stock splits on the prices of the 30 companies.

NASDAQ: Measures the performance of all issues listed in the Nasdaq Stock Market and is often used as a proxy for the large-cap technology segment of the U.S. stock market.

DJ/UBS Commodity: The DJ-UBSCI is composed of futures contracts on physical commodities and is often used as a proxy for broad-based exposure to the commodity markets.

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*Past performance is no guarantee of future results. It is not possible to invest directly in an index. See appendix for important index information. Assets represented by: Commodities – Bloomberg Commodity Index; Emerging-Market Bonds – JP Morgan EMBI Global Index; Emerging-Market Stocks – MSCI EM Index; Gold – Gold Bullion, LBMA PM Fix; High Yield Bonds – Bank of America Merrill Lynch (BofA ML) High Yield Bond Index; Investment-Grade Bonds – Bloomberg Barclays U.S. Aggregate Bond Index; Non-U.S. Developed-Country Stocks – MSCI EAFE Index; Non-U.S. Small-Cap Stocks – MSCI EAFE Small Cap Index; Real Estate Stocks – FTSE NAREIT Equity Index; U.S. Corporate Bonds – Barclays U.S. Credit Index; U.S. Large-Cap Stocks – S&P 500 Index; U.S. Mid-Cap Stocks – Russell Midcap Index; U.S. Small-Cap Stocks – Russell 2000 Index; U.S. Treasury Bonds – Bloomberg Barclays U.S. Treasury Index. Sources: Bloomberg Finance L.P., Haver Analytics, Fidelity Investments (AART), as of 12/31/16.

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