April 17, 2018

Dear Valued Client:

The smooth sailing of 2017 is a distant memory. Through April 10th, the S&P 500 has experienced moves greater than 1% higher or lower 16 times as compared to only 4 moves of this size in all of 2017! Volatility is back.

Historically, equity markets correct about once a year (a correction is traditionally defined as a reversal of the market valuation in the amount of 10% or greater). A correction should not be confused with a bear market. It is actually a healthy, albeit unpleasant, event. We had not experienced a market correction in nearly 2 full years until this February. In fact, the market did not pull back more than 3% in all of 2017.

The pick-up in volatility is normal. Markets are sometimes volatile and in the short-term unpredictable. It is possible that markets will experience further declines, but it is possible they will not. The declines this quarter have been well within historic norms. In the long-term, markets have been more predictable - they tend to go up.

First Quarter Market Review

Global financial markets faced headwinds in the first quarter of 2018, contributing to heightened volatility. The MSCI ACWI Index returned -0.8%, marking the first down quarter for global stocks since 2015.[1] Stocks were weighed down by uncertainty over Federal Reserve moves, with concerns over inflation and a potential trade war with China. Bonds were held back by tighter central bank policy and higher interest rates. The Bloomberg Barclays Global Aggregate Bond Index rose 1.4%, but the dollar-hedged index, which strips out the effect of foreign currency moves, returned -0.1% during the quarter.

The S&P 500® Index of large-cap US stocks recorded a -0.8% return for the first quarter, but there was a wide disparity in performance across market sectors. Growth-oriented stocks led the way, lifted by gains in the Technology (+3.5%) and Consumer Discretionary (+3.1%) sectors. Defensive and higher-dividend sectors lagged as bond yields rose, including Telecommunications (-7.5%), Consumer Staples (-7.1%), and Real Estate (-10.3%). Small cap stocks (-0.1%) outperformed larger caps, with the US-China trade conflict believed to be a greater headwind for larger multinational firms.

The MSCI ACWI ex-US Index of international stocks returned -1.9% for the quarter. Broader Europe was weighed down by Germany (-3.5%) with more protective global trade policies expected to impact exports, while the UK (-3.9%) was hurt by ongoing Brexit concerns. Asian markets were lifted by Japan (+1.0%) with the yen appreciating versus the US dollar. Emerging markets rose with Brazil (+12.5%) and Russia (+9.4%) benefiting from OPEC’s reduced oil production and higher crude oil prices.

[1] Unless otherwise indicated, all index returns are from FactSet

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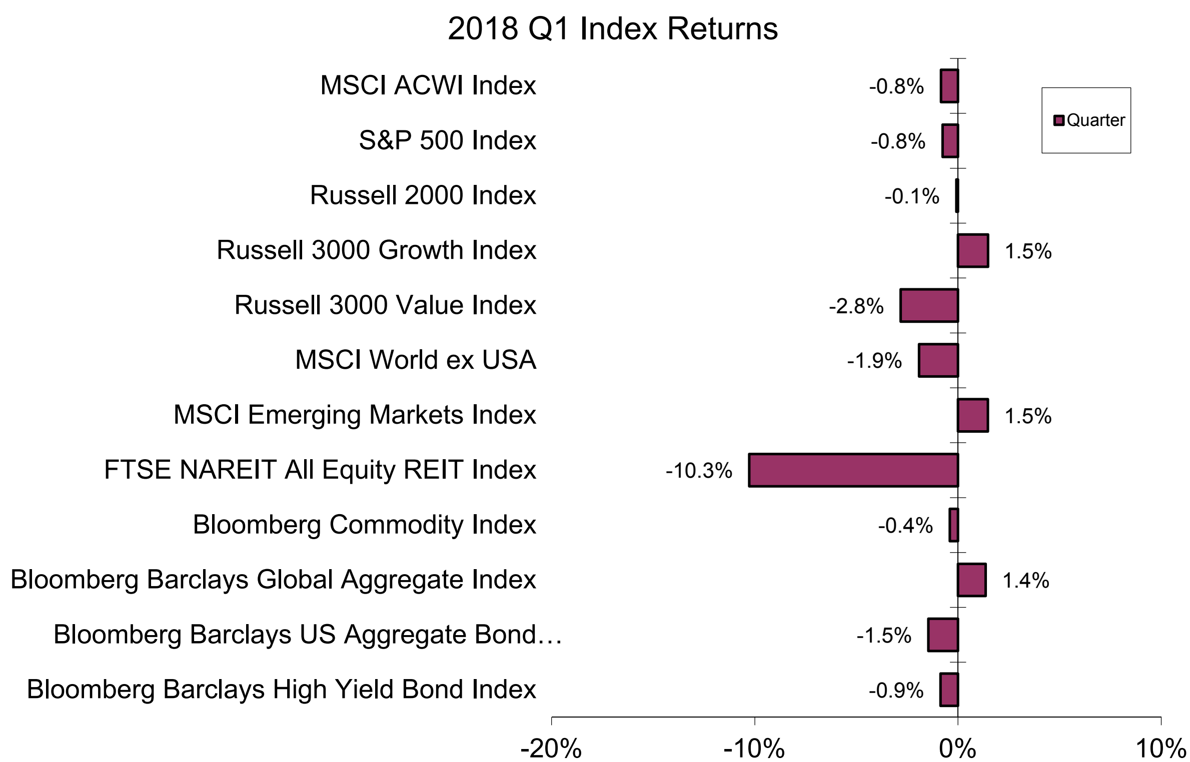
In fixed income, the Bloomberg Barclays US Aggregate Bond Index returned -1.5% for the quarter, as bond yields rose. Long-term bonds were more sensitive to the rise in rates and underperformed shorter-term issues. Corporate bonds (-2.3%) were hurt by their longer maturities and as credit spreads widened. High yield bonds (-0.9%) displayed more resiliency, with their higher coupons countering the rise in rates. International bonds (+3.6%) benefited from foreign currency gains versus the US dollar, while dollar- denominated emerging market bonds (-1.5%) were in-line with the broader US market.



An index is a portfolio of specific securities, the performance of which is often used as a benchmark in judging the relative performance of certain asset classes. Indices are unmanaged, with no associated expenses, and investors cannot invest directly in an index. All index returns shown in the table represent total return figures in US dollars, with dividends reinvested, which means the returns include not only the change in prices for the securities in the index, but any income generated by those securities.
Sources: Bloomberg, Barclays, Dow Jones, Morningstar, MSCI Barra, Russell, Zephyr Associates.

Economic Highlights

US economic growth was 2.9% for Q4 2017, down from the 3.2% gross domestic product (GDP) reading in Q3 2017.[2] Weaker trade numbers detracted from Q4 growth, but GDP still rose 2.3% in 2017 (up from 1.5% in 2016), lifted by higher business investment and consumer spending. The Federal Reserve Bank of Atlanta forecast that GDP rose 2.3% in the first quarter of 2018, although estimates have fluctuated widely, with February projections as high as 5.4%. Corporate earnings rose 11.0% in

[2] Source: Bureau of Economic Analysis

2017, boosted by 15.0% year-over-year growth in the fourth quarter. Analysts estimate earnings will grow 17.3% in the first quarter of 2018, which would be the highest growth rate since 2011.[3]

The Federal Reserve (Fed) increased short-term interest rates by 0.25% at the March FOMC meeting, raising the new target range for federal funds to 1.50%-1.75%. Economic growth continued to drive employment gains with the unemployment rate at 4.1% in February. The Consumer Price Index (CPI) inflation rate rose 2.2% for the 12-month period through February, with higher energy prices continuing to have a measurable impact. Core inflation (excluding food and energy) increased 1.8% over the same period.[4]The Fed expects that inflation will stabilize around its 2% target in the medium-term, with three to four rate increases projected for 2018 and three more in 2019.[4]

Valuation

Each quarter, we evaluate a number of data points to assess market valuation. Below we share a couple of those "barometers". Many forecasters and tacticians will use these measures to influence their asset allocation decisions for short and medium term decisions. We, too, take these into account when thinking about our portfolio model weightings with respect to risk within each model band and may make changes accordingly i.e. adjusting exposures to certain asset classes toward the lower or higher end of our set ranges within each model. As we are not market timers, we do not seek to make demonstrative changes that would impact long-term investment plans as we know that timing markets is a fool's errand.

As noted before, price-to-earnings, or P/E ratios, are a popular financial metric to identify the relative value of stocks. With the correction this past quarter, these ratios are quietly becoming more attractive. In January, the forward price-to-earnings ratio for the S&P 500 peaked at 18.6. However, with analysts expecting almost 19% earnings growth for the approaching first quarter earnings season (per FactSet) coupled with US stocks about 8% off their January highs, the forward P/E of the S&P 500 has quickly shrunk to 16.1. Coincidently, the 5-year P/E average is 16.1 and in 2017 this ratio had an average of 17.7. Therefore, as we enter the Q1 earnings season, stocks appear more fairly valued than they have in some time using this metric.

While forward P/E is a valid measure of value, another measure of value known as the Cyclically Adjusted Price-to Earnings (CAPE) ratio is telling us a different story. Robert Shiller's derived CAPE Ratio is showing a reading of 33X vs a Median CAPE Ratio of 16X dating back to 1881 (http://www.econ.yale.edu/~shiller/data.htm) . The model further looks at expected returns working from a CAPE over 30. As might be expected, at such a high relative valuation, expected returns over the next 10 years, under Shiller's model, come in somewhere in the 3% range.

While valuation analysis is helpful, it is not so clear cut. The two aforementioned valuation methods have as many admirers and detractors. Valuations vary across sectors, across US and International stocks, and are further influenced by interest rate and other expectations. As we have shared before, markets tend to follow earnings with expected volatility driven by geopolitical news, fear, and greed helping to make the ride and correlation a lot more interesting.

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[3] Source: FactSet

[4] Source: Bureau of Labor Statistics

Outlook

Global equity markets entered 2018 on a sustained uptrend that continued into January with several market indices reaching record levels. As noted above, concerns about inflation, interest rates, tariffs and trade wars disrupted this trend in the equity markets. Newly appointed economic adviser Larry Kudlow has sought to calm the markets. Greg Valliere, Global Strategist at Horizon Investments, notes that "Kudlow's biggest role will be as horse whisperer to the markets. He's great on TV and can get messages from Wall Street to the President, and he can get Trump's messages to the markets.[5] We will see how long this honeymoon lasts. We will be watching to see how this trade/tariff situation plays out with China and are hopeful that the recent back and forth will lead to constructive outcomes.

Technology-related stocks were among the hardest hit by the market selloff amid a rash of negative news, including Facebook's privacy scandal, Tesla's and Uber's autonomous car crashes, and government scrutiny over Amazon's business practices. The NYSE FANG+ Index, an index of 10 leading technology stocks based in the US and China, was up 24.5% for the year-to-date period through March 12th, but then declined 11.8% from this point through quarter-end.[6] While the technology sector remained solidly in positive territory for the quarter, this served as a reminder of the potential risks and swings that can come with concentrated exposure to individual stocks and market sectors. We continue to like the sector and it remains an over-weighted tactical position in our portfolios.

On the plus side, U.S. economic fundamentals still look solid. Employment numbers and readings on service and manufacturing sectors have been strong while company balance sheets are mostly healthy. Rates have pulled back from their march towards the feared 3% on the 10-year Treasury and the Fed continues to be open with its intentions. Business-friendly tax and regulatory regimes are also supportive. Consumer confidence for March declined slightly to 127.7 from 130, but the current reading is still quite high relative to historic readings.

Central bank support is fading and the new debt we are assuming may allow us to realize some short-term gains but potentially at the expense of longer-term pain. It will be fascinating to see how it plays out. Near term, policy uncertainty in Washington is making for a difficult planning environment. The uncertainty will likely compound as we head towards the mid-term elections. Sam Stovall, chief investment strategist at CFRA, recently noted that during the second and third quarters of midterm-election years, the S&P 500 has traditionally delivered higher volatility and lower returns. On the plus side, he shared, that when looking at the 12 months after midterms, the S&P 500 was higher in 18 of 18 years by an average of 16.6%.

In a market moved by Tweets and tantrums, our emotional fortitude can often be tested. There are certainly a number of headline issues that could prove to be a detriment to the market should they gain traction and become problematic. Predicting how any event will play out is impossible and we are not going to be reactionary but will be mindful.

During the quarter, we did some portfolio rebalancing after the strong market performance in 2017. We also added a position in our more growth oriented models that seeks to invest in companies pursuing

[5] Source: Federal Reserve

[6] Source: Bloomberg

leading innovative technologies including robotics and artificial intelligence. Finally, we approved a new long/short fund that we are going to be adding to potentially provide additional risk/reward benefits.

PRW Wealth Management News

At the recent gathering of top advisors at our broker/dealer, Lion Street Financial, Principal and Co-Founder Bill Payne along with Estate and Wealth Management Counsel Janice Forgays addressed several topics related to the Tax Cuts and Jobs Act. They presented on the benefits of the higher estate tax exemption and the possible planning opportunities created thereunder. These include numerous gifting opportunities, unwinding of gift and estate tax freeze techniques, and charitable planning strategies. They also pointed out that in states with a state inheritance tax, the value of good planning to minimize this tax remains intact. We encourage you to reach out to us with questions.

Elliot is preparing to moderate a panel discussion at the Private Wealth New England Forum 2018 taking place on April 24th in Boston. The forum brings together thought leaders from around the country to discuss current outlooks, trends, and opportunities in the financial markets.

We look forward to a thaw in the weather here in New England and wish you all a Happy Spring. As always, please contact us if there have been any changes to your financial situation, your investment objectives, or your instructions concerning your account(s).

Sincerely,

William A. Payne | Richard A. Renwick | Elliot B. Herman

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Index Definitions

Bloomberg Barclays Global Aggregate: An index of global investment grade debt from twenty-four local currency markets including treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers. The index also includes Eurodollar, Euro-Yen, and 144A Index-eligible securities, and debt from five local currency markets.

Bloomberg Barclays High Yield Bond: An index measuring the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. The index excludes emerging market debt.

Bloomberg Barclays US Aggregate Bond: An index covering the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The index includes bonds from the Treasury, Government-Related, Corporate, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS sectors. US Agency Hybrid Adjustable Rate Mortgage (ARM) securities were added to this index on April 1, 2007.

Bloomberg Commodity: A broadly diversified index that allows investors to track futures contracts of physical commodities traded on US exchanges. The component weightings are determined by several rules designed to ensure diversified commodity exposure.

FTSE NAREIT All Equity REIT: A broad measure of the performance of publicly traded real estate securities, such as real estate investment trusts (REITs) and real estate operating companies.

MSCI ACWI (All Country World Index): A free float-adjusted capitalization weighted index that is designed to measure the equity performance of countries considered to represent both developed and emerging markets.

MSCI Emerging Markets: A free float-adjusted, market capitalization index that is designed to measure the equity market performance of countries considered to represent emerging markets.

MSCI World ex USA: An index that captures large and mid-cap representation across 22 of 23 Developed Markets (DM) countries – excluding the United States. With 1,020 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

Russell 2000: An unmanaged index that measures the performance of the small cap segment of the US equity universe. It is a subset of the Russell 3000 Index based on market capitalization.

Russell 3000 Growth: An index that measures the performance of the growth segment of the US equity universe. It includes those Russell 3000 companies with higher price-to-book ratios and higher forecasted growth rates.

Russell 3000 Value: An index that measures the performance of the value segment of the US equity universe. It includes those Russell 3000 companies with lower price-to-book ratios and lower expected growth rates.

S&P 500®: An unmanaged index that is generally considered representative of the US equity market, consisting of 500 leading companies in leading industries of the US economy (typically large cap companies) representing approximately 75% of the investable US equity market.