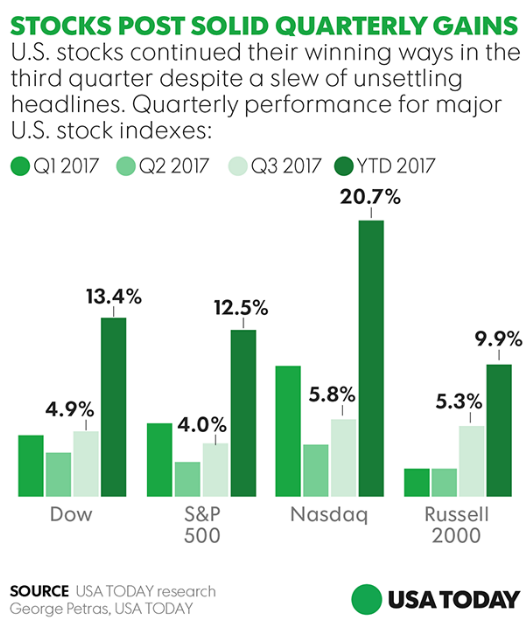
2017 Third Quarter Review & Outlook

Market Review

> *It was a great September and 3rd Quarter for the markets, but it has been a challenging one for the human spirit.* (Recent) *news out of Las Vegas, combined with the devastation from the hurricanes have weighed upon all of our hearts.*
> – Blaine Rollins, CFA, Managing Director, Portfolio Manager; 361 Capital

Equities
The U.S. stock market posted solid third-quarter gains as upbeat news on the global economy overshadowed a steady stream of negative news ranging from catastrophic hurricanes to cyber hacks and war chatter between the Trump administration and North Korea. The S&P 500 Index rose 4% since June 30, notching its eighth consecutive quarterly advance. The Dow Jones Industrial Average added 4.9% in the past three months, posting its longest streak of quarterly advances (also eight) since 1997. This blue-chip index is up 13% this year. Stock market gains also continued to be broad internationally, spanning many regions and sectors.

Stock market volatility remained historically low, which has been correlated to the slow but steady rise in prices. The markets have been so calm that some analysts and investors have expressed concerns that individual investors and professional money managers are growing complacent. The CBOE Volatility Index (VIX), known as Wall Street's "fear gauge," has recently surpassed its record closing low of 9.31 set in December 1993.



Fixed Income
Bond yields soared into the end of 2016 as investors bet that Trump administration policies would spark a surge of economic growth and thus inflation with it. The so-called reflation trade faded in the New Year, however, after consumer prices remained tepid and the administration's legislative agenda stalled. Since then the U.S. Treasury yield posted declines in each of this year's prior quarters.

Nevertheless, now financial analysts are starting to believe in higher inflation again, which typically causes bond yields to rise (and prices to fall). The yield on the benchmark 10-year Treasury note settled at 2.33% at September-end, and posted its first quarterly gain of the year. Treasurys were buoyed by an uptick in consumer prices that lent support to the Federal Reserve's insistence that inflation will soon make a long-anticipated return past the central bank's 2% target. Inflation above 2% usually leads to the Fed raising rates more rapidly.

Global Market Performance

All major U.S. stock indexes ended the quarter at or near record highs. The broad large stock S&P 500 Index advanced by 4.5 % for the third quarter (dividends reinvested). The Russell 2000 Index of small-company stocks gained 5.7% for the past three months, finally outperforming large-cap stocks as investors believed stronger Q3 domestic growth and possible tax reform would cause small company revenues to rise. The tech-heavy Nasdaq Composite rose 5.8% as of September 30.

The sectors posting the biggest gains in the third quarter were the market-leading tech sector, up 8.3%, and a resurgent energy group that rose 6% over the past three months thanks to a nearly 10% jump in September. Financial stocks also roared back in the last month, gaining 5.1%, to finish the quarter up 4.8%. Financials were lifted by hopes for rising rates (good for bank loan and deposit revenues), and also got a boost from renewed hopes for passage of President Trump's latest tax plan, which is also good for bank revenues. All but one of the 11 sectors in the S&P 500 Index ended the quarter higher. Only the consumer staples sector finished in the red.

Economies around the world seem to be heading in the same upward direction as domestically. From Latin America to Europe to Asia, economic indicators are improving and its stock markets are too. Many of these markets have been lagging behind its U.S. counterpart for years, which means analysts and investors see them as more affordable. This, along with a declining dollar relative to foreign currencies, has led to international equity outperformance.

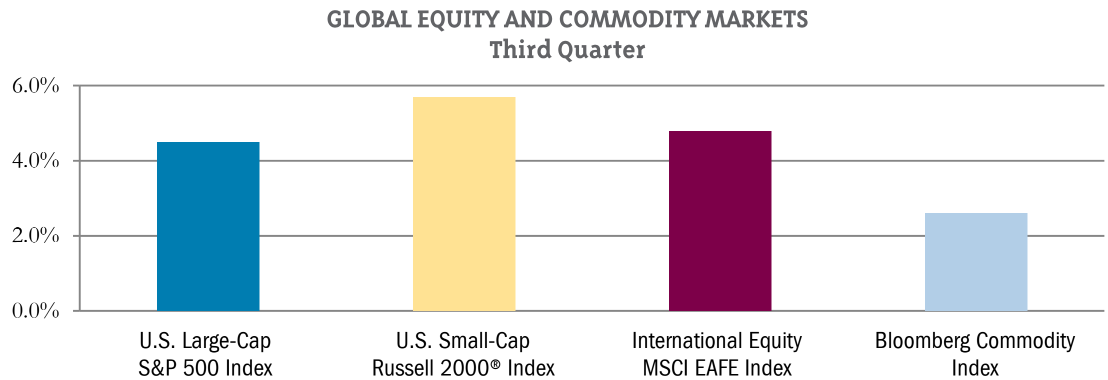
Developed international stocks gained 4.8% in the third quarter as measured by the MSCI EAFE Index (in U.S. dollars), outperforming U.S. stocks again this year as signs of steady economic growth and political stability in Europe and Japan continued to be evident. In Europe, the Stoxx Europe 600 ended the quarter 6.2% higher, as solid earnings growth and a buoyant global economy have drawn in investors. Businesses and households across the Eurozone were more upbeat about their prospects than at any time in more than a decade during September, according to the European Commission.

Key indexes in the Asia-Pacific region finished the quarter higher, with solid earnings and broadly positive risk sentiment continuing to outweigh the region's geopolitical concerns, in particular the escalation of tensions between North Korea and the U.S. In China, the Shanghai Composite Index gained 4.9% during the quarter—its best since 2015—while Hong Kong's Hang Seng added 6.9% over the period. Japan's Nikkei Stock Average also posted gains of 4.7% for the quarter.

Emerging-market stocks are on pace for its best year since 2009. The MSCI Emerging Markets Index rose 6.6% in the third quarter. That brings this year's gains to 25%, which—if the level holds—would be its best annual performance since a 75% return eight years ago. The rally reflects faster earnings growth, a weaker dollar and easy global monetary policies that make these riskier investments more attractive.

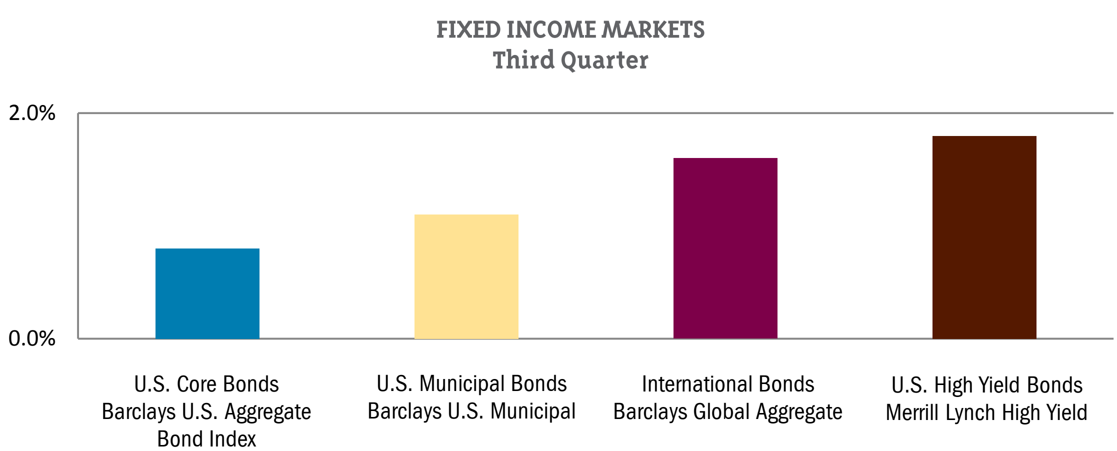
Natural resources and other commodities gained 2.6% for the last three months as measured by the Bloomberg

Commodity Index. A jump in oil prices helped the commodity index price. The index measures the collective returns of a basket of 23 commodity futures contracts representing the energy, precious metals, industrial metals, grains and livestock industries.



The 10-year Treasury note yield had spent the past six months locked in a range near 2.25% as the economy maintained a slow and steady pace and as consumer prices (thus inflation) showed few signs of gathering momentum. In September, it hit its lowest close since the presidential election, 2.06%, as investors sought the relative safety of government debt as tension escalated between the U.S. and North Korea, and investors worried about economic damage from recent hurricanes. Then the Treasury note yield rebounded to 2.33% at month-end after the Fed's decision to push ahead with an aggressive schedule for rate increases, penciling in one more this year and three for 2018.

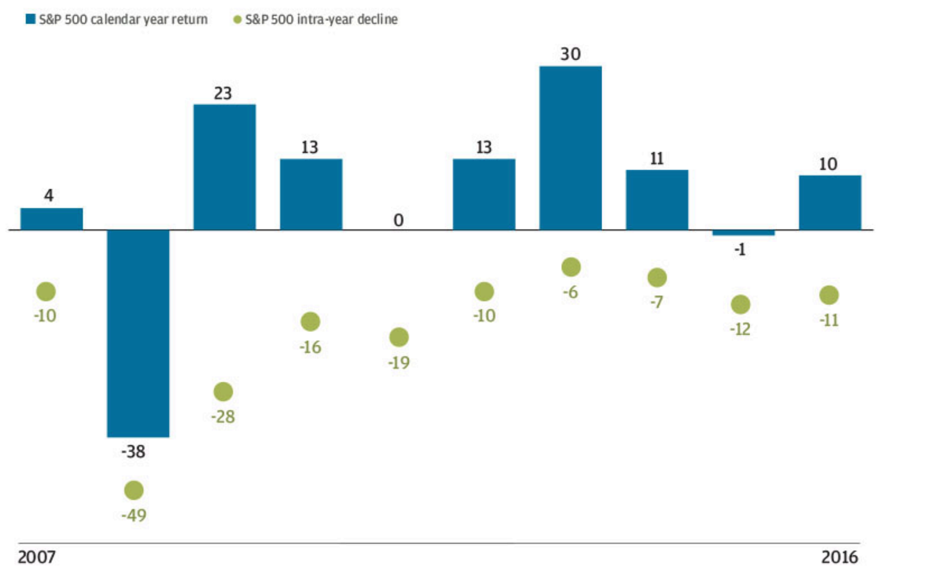
The Barclays U.S. Aggregate Bond Index of high-quality government, mortgage and corporate bonds ended slightly up by 0.8% for the past three months. Non-investment grade (or high-yield bonds) rose 1.8%, as measured by the Bank of America/Merrill Lynch High Yield Master Index. A continued positive economic and stock market outlook kept these high-yield bond's prices rising for the year with "spreads" very low (the difference in yield between investment-grade and high-yield bonds). State government municipal bonds gained 1.1% for the past quarter (as measured by the Barclays Capital Municipal Bond Index), outperforming taxable high-grade bonds for the quarter and year. The Barclays Capital Global Bond Index was up 1.6% for the past three months, due mainly to continuing stable emerging market growth and favorable local currency values versus a weakened U.S. dollar.



Portfolio Review

SFC Tactical Investment Strategies (TIS) portfolios overall registered positive returns for the third quarter and for 2017 so far. Still, our model portfolios have somewhat underperformed the benchmark indexes lately by being conservatively positioned and underweight equities in the midst of a rapidly rising stock market. We do *not* expect to outperform the benchmarks in times when the stock market is "running hot," as it has for eight straight quarters. We do anticipate, nevertheless, that our balanced model portfolios will perform well over the long term—after good and bad stock market periods. SFC TIS's performance track record since the early 2000's in balanced portfolios demonstrates that our tactical decisions and investment selections have worked well for financial advisors and their clients. And, most importantly, with less risk than the benchmarks.*

History indicates that there's likely to be a pullback in the stock market of over five percent in any given calendar year (see the chart below), which has not happened yet in 2017 and may not happen in the last quarter. When the market does decline, we anticipate using our excess portfolio cash to invest mainly in beaten-down stock holdings. So far this year very few trades have been made in portfolios in anticipation of this event. In February of last year, we were fortunate enough to invest a portion of clients' cash near that market bottom. We plan to use the same strategy and remaining excess cash when the market inevitably corrects again.



Source: J.P. Morgan Asset Management, FactSet, Standard & Poor's. Returns are based on price index only and do not include dividends. Intra-year drops refer to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 2007 to 2016, over which time period the average annual return was 16.8%. Guide to the Markets –U.S. Past performance does not guarantee future results.

For the third quarter and for 2017 so far, our bond holdings have outperformed the bond benchmark, but our stock positions have somewhat underperformed the stock benchmark year-to-date. Especially our large-cap global equity funds versus international equity funds. That's because our global stock funds contain U.S. stocks as well as foreign stocks. And U.S. stocks have underperformed international markets this year. Importantly, for the quarter and the year, our alternative investments (specifically long/short equity, hedged emerging market equity, equity options writing and natural resources) have collectively performed well by not only adding to portfolio gains but also lowering volatility, or limiting the "drops" in account values during turbulent stock markets.

It's likely that we'll experience a bear market at some point in the coming years as this bull market cycle is now eight+ years old—the second longest on record according to Bespoke Investment Group—and thus is historically due for a pullback at some point. And although cautiously optimistic, our opinion is that given indicators discussed in the below *Market Outlook* section, it's best to be conservatively positioned with broad diversification in different asset classes (including alternative investments) to lower risk while achieving a reasonable return to help advisors' clients reach long-term goals.

Market Outlook

> *In the last month, the market seems to have completely changed its mind about what's going to happen*.
> —Omar Aguilar, Chief Investment Officer for Equities, Charles Schwab Investment Management

In the short term, at least for the next quarter or two, the stock market could continue to slowly grind higher—although geopolitical or natural disaster risks around the globe may rear its ugly head and shock markets at any time. For one, the "Trump trade" is making a comeback, reflecting investors' renewed belief in the strength of the U.S. economy and fresh hopes for business-boosting policies from Washington D. C. such as tax reform and favorable trade negotiations. In a throwback to the early days after President Trump was elected, shares of U.S. banks and industrial companies are climbing and small-cap stocks are in record territory, while Treasury bonds and its stock-market proxies (such as high-dividend paying investments) have fallen out of favor. The U.S. dollar, beaten down for much of 2017, is now holding steady.

Perhaps most important is the combination of continuing good business fundamentals such as corporate earnings, and positive economic data. And some say such affirmative indicators support a rally regardless of any policy changes from the Trump administration and Congress. These indicators could give investors reasons to believe that even with stocks trading at or near record highs and also despite concerns over historically high stock valuations and rising bond yields, equities can keep rallying.

If some version of tax reform is passed into law, every percentage point reduction in the corporate tax rate could boost the per-share earnings of the S&P 500 companies by a dollar, according to Goldman Sachs Group. Small companies, which tend to have higher tax rates than larger companies, should benefit the most if tax reform is enacted. That fact was not lost to investors as the Russell 2000 Index of small-cap companies climbed 5.7% over the past three months, outpacing large companies.

So although our market outlook for the short term is generally positive, there are still issues that cause us some concern. Issues such as the aforementioned high stock valuations, the long length of this bull market, the unknown "Trump (tweeting) factor" and geopolitical risks. Given our somewhat mixed view on stocks and concerns about bonds, other or "alternative" investment strategies are a higher portion of clients' portfolios than in prior years.

Historically, equity alternative strategies have had similar returns to stocks in periods of positive but lower-than-historical returns, with less than half the volatility (or "downside" risk). During periods when equity market returns are in negative territory, alternative strategies for stocks tend to outperform the S&P 500 Index. Fixed income alternative strategies typically add gains as interest rates rise (and traditional bond prices fall). Since our firm's investment mandate is to protect client portfolios' principal as best as possible while providing favorable long-run returns, our bias is to be somewhat conservative—especially in these times. So in light of high stock valuations and the potential for lower returns, along with rising interest rates and possible declining bond prices, we believe we are in a favorable environment for these alternative strategies in clients' accounts.

Our thoughts and prayers go out to our advisors and clients that were affected by Hurricanes Harvey, Irma, Maria and Nate, and the recent wildfires in California. We hope you are recovering. We appreciate your continued confidence in our services. Your inquiries are welcomed.

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Dedicated to Protecting and Growing Clients' Wealth

* For financial advisors, please contact our firm for performance information on SFC's model portfolios.

Sources: 361 Capital, *Weekly Briefing*, October 2, 2017; Marketfield Asset Management, *The Weekly Speculator* (multiple publications); Janus Capital Group, *Investment Outlook by Bill* Gross, July 2017; JP Morgan Asset Management; *Investment Insights*, Q3 2017; State Street Global Advisors SPDR ETFs Chart Pack, September 2017; USA Today (multiple publications); The Wall Street Journal (multiple publications).

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