CORBETT ROAD

MACRO MUSINGS

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2017 MARKET YEAR IN REVIEW

SUMMARY

- Declines in the MACROCAST™ score make sense considering how the market performed in 2017. A deeper analysis reveals the market's strength was the primary driver in pushing MACROCAST™ lower.
- Our annual review of major asset classes reveals that 2017 was the best year for global equities since 2012.

THE MESSAGE FROM MACROCAST™

MACROCAST™ was positive throughout 2017, marking the sixth consecutive year the score did not drop below zero.

MACROCAST™ is Corbett Road's in-house model that measures the attractiveness of risky assets by looking at the **VITALS** of the market—**V**aluation, **I**nflation, **T**echnical Analysis, **A**ggregate Economy, **L**iquidity, and **S**entiment. We use our model to assess the chance of major, protracted bear markets.

Examples of such markets are the declines of 1973-74, 2000-2002, and the financial crisis of 2008. By striving to avoid major losses in these types of markets, we can preserve capital and provide peace of mind to our clients.

Please see important disclosures at the end of this article

The strength in MACROCAST™ continues to come from two categories: the 'Aggregate Economy' and 'Liquidity'. The biggest detractors lie within the 'Valuation' category, where every indicator we follow is flashing negative.

This makes sense intuitively. The S&P 500 returned over 21% last year, which is more than double the average historical gain. The global economy is strong and major central bank policies remain accommodative. In addition, anticipation of corporate tax cuts and regulatory action boosted earnings estimates for corporations. The combination of all of these factors helped push the market above the historical trend, in turn, pushing our valuation metrics into negative territory.

Does that mean we are due for a big pullback soon? No. These types of rallies have historically weakened before turning down, and we are not seeing that in the data yet. MACROCAST™ suggests if the next correction in the market begins soon, it could be a buying opportunity, rather than the beginning of a major decline.

ASSET CLASS REVIEW: INTERNATIONAL MARKETS LEAD THE WAY

2017 represented the best combined performance among international stocks since 2012.

Asset Class Returns

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
EM 56.3%	REIT 31.6%	EM 34.5%	REIT 35.1%	EM 39.8%	HG Bnd 5.2%	EM 79.0%	REIT 28.0%	REIT 8.3%	REIT 19.7%	Sm Cap 38.8%	REIT 28.0%	REIT 2.8%	Sm Cap 21.3%	EM 37.8%
Sm Cap 47.3%	EM 26.0%	Int'l Stk 14.0%	EM 32.6%	Int'l Stk 11.6%	Cash 1.4%	HY Bnd 57.5%	Sm Cap 26.9%	HG Bnd 7.8%	EM 18.6%	Lg Cap 32.4%	Lg Cap 13.7%	Lg Cap 1.4%	HY Bnd 17.5%	Int'l 25.6%
Int'l Stk 39.2%	Int'l Stk 20.7%	REIT 12.2%	Int'l Stk 26.9%	AA 7.6%	AA -22.4%	Int'l Stk 32.5%	EM 19.2%	HY Bnd 4.4%	Int'l Stk 17.9%	Int'l Stk 23.3%	AA 6.9%	HG Bnd 0.6%	Lg Cap 12.0%	Lg Cap 21.8%
REIT 37.1%	Sm Cap 18.3%	AA 8.9%	Sm Cap 18.4%	HG Bnd 7.0%	HY Bnd -26.4%	REIT 28.0%	HY Bnd 15.2%	Lg Cap 2.1%	Sm Cap 16.4%	AA 11.5%	HG Bnd 6.0%	Cash 0.1%	EM 11.6%	Sm Cap 14.7%
Lg Cap 28.7%	AA 14.1%	Lg Cap 4.9%	AA 16.7%	Lg Cap 5.5%	Sm Cap -33.8%	Sm Cap 27.2%	Lg Cap 15.1%	AA 0.3%	Lg Cap 16.0%	HY Bnd 7.4%	Sm Cap 4.9%	Int'l Stk -0.4%	REIT 8.6%	AA 14.6%
HY Bnd 28.2%	Lg Cap 10.9%	Sm Cap 4.6%	Lg Cap 15.8%	Cash 4.4%	Lg Cap -37.0%	Lg Cap 26.5%	AA 13.5%	Cash 0.1%	HY Bnd 15.6%	REIT 2.9%	HY Bnd 2.5%	AA -1.3%	AA 7.2%	REIT 8.7%
AA 25.9%	HY Bnd 10.9%	Cash 3.2%	HY Bnd 11.8%	HY Bnd 2.2%	REIT -37.7%	AA 24.6%	Int'l Stk 8.2%	Sm Cap -4.2%	AA 12.2%	Cash 0.1%	Cash 0.0%	Sm Cap -4.4%	HG Bnd 2.7%	HY Bnd 7.5%
HG Bnd 4.1%	HG Bnd 4.3%	HY Bnd 2.7%	Cash 4.7%	Sm Cap -1.6%	Int'l Stk -43.1%	HG Bnd 5.9%	HG Bnd 6.5%	Int'l Stk -11.7%	HG Bnd 4.2%	HG Bnd -2.0%	EM -1.8%	HY Bnd -4.6%	Int'l Stk 1.5%	HG Bnd 3.5%
Cash 1.0%	Cash 1.4%	HG Bnd 2.4%	HG Bnd 4.3%	REIT -15.7%	EM -53.2%	Cash 0.2%	Cash 0.2%	EM -18.2%	Cash 0.1%	EM -2.3%	Int'l Stk -4.5%	EM -14.6%	Cash 0.3%	Cash 1.0%

Abbr.	Asset Class – Index	Annual	Best	Worst
Lg Cap	Large Caps Stocks – S&P 500 Index	10.15%	32.4%	-37.0%
Sm Cap	Small Cap Stocks – Russell 2000 Index	11.17%	47.3%	-33.8%
Int'l Stk	International Developed Stocks – MSCI EAFE Index	8.60%	39.2%	-43.1%
EM	Emerging Market Stocks – MSCI Emerging Markets Index	12.68%	79.0%	-53.2%
REIT	REITs – FTSE NAREIT All Equity Index	11.13%	37.1%	-37.7%
HG Bnd	High Grade Bonds – Barclay's U.S. Aggregate Bond Index	4.14%	7.84%	-2.0%
HY Bnd	High Yield Bonds – BofAML US High Yield Master II Index	9.08%	57.5%	-26.4%
Cash	Cash – 3 Month Treasury Bill Rate	1.18%	4.7%	0.0%
AA	Asset Allocation Portfolio*	8.74%	25.9%	-22.4%

Past performance does not guarantee future returns. The historical performance shows changes in market trends across several asset classes over the past fifteen years. Returns represent total annual returns (reinvestment of all distributions) and does not include fees and expenses. The investments you choose should reflect your financial goals and risk tolerance. For assistance, talk to a financial professional. All data are as of 12/31/17.

*Asset Allocation Portfolio is made up of 15% large cap stocks, 15% international stocks, 10% small cap stocks, 10% emerging market stocks, 10% REITs, 40% high-grade bonds, and annual rebalancing.

Source: Novel Investor

Some additional insights:

1. ***Emerging markets led the way for the first time since 2009.*** Emerging markets began their rebound in January 2016, but really took off last year. Thanks to strong global growth and a weaker US dollar, EM put in its best performance since the end of the global financial crisis.

2. ***Large cap stocks, represented by the S&P 500 had another excellent year. They have now outperformed Novel's Asset Allocation strategy for nine consecutive years.*** Novel Investor outlines a basic asset allocation portfolio, which they include in the above table under AA. We first highlighted the recent weakness of the Asset Allocation portfolio in 2015. In 2017, the S&P once again outperformed the AA portfolio. Part of the reason for this is the asset allocation model consists of 40% bonds. Despite the large allocation to bonds, the asset allocation model often outperformed from 2000-2008.

3. ***REITs muddled along.*** From 2010-2015, Real Estate Investment Trusts (REITs) were the top performing asset class in five out of six years. Returns over the past two years, while respectable, lagged other major assets classes. Thus far, 2018 is not off to a good start. Although many factors drive performance, we believe as long as interest rates are rising, REITs will likely underperform.

4. ***Small cap stocks took a breather.*** After leading all major asset classes in 2016, the stocks of smaller publicly traded companies lagged their larger cousins by seven percentage points. Small caps are considered riskier due to higher volatility and bigger drawdowns, but that does not always translate into higher returns during a bull market (as we saw last year).

5. ***Cash was a lousy investment. Again.*** Cash was the worst performing asset class for the second consecutive year. Proponents for cash like to argue that it is a good asset class because it provides investors the flexibility or "dry powder" to take advantage of lower prices when markets decline. In practice, we find that investors who insist on holding significant amounts of cash, rarely pull the trigger, even after a significant decline in the market. The asset class table above shows that cash has been a poor performing asset class for over a decade.

   By focusing on the bigger picture at hand and cancelling out the noise and misinformation that exists in our markets, MACROCAST™ continues to be an effective forecaster of risk and potential return for each of our respective tactical strategies. We appreciate your confidence in our firm and look forward to a prosperous 2018.

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