Second Quarter 2017 Commentary

July 17, 2017

Dear Investor,

Beware of the summer of discontent. With share prices at record highs and cautionary signs of a potential bubble, summer doldrums may start to show signs of a bumpy road ahead. While we do not predict dire doom and gloom, we do not expect a smooth ride either. We have spoken at length about our STAR™ Spectrum strategies' defensive postures which we transitioned to during 2016 and continue to maintain. Should the bumps in the road appear, we stand ready to use the defensive posture to our advantage. Here is a look at what transpired during the Second Quarter.

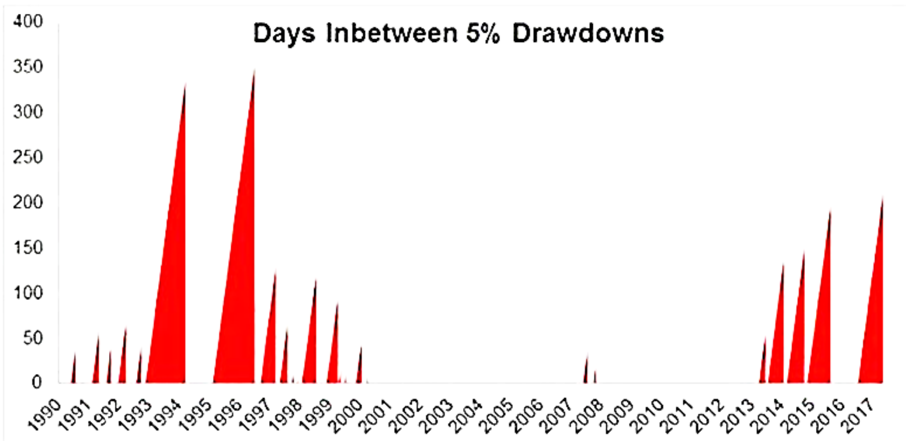
Share prices continued their skyward trajectory in despite the warnings of frothy valuations and reckonings to come. (Pride goeth before a fall, the bigger they are …, etc.). The Federal Reserve Bank raised its estimate for 1Q growth to a respectable clip, though other institutions such as the International Monetary Fund and Bank of America revised their forecasts downward for annualized growth, citing gridlock in Washington and concerns of the Trump agenda. An invigorated Europe, fueled in part by the results of France's presidential elections, provided global investors with an under-bought market even as it overshadowed the dollar. Oil and other commodities slumped, Amazon loomed even larger amid the ashes of America's brick-and-mortar retail sector and the pace of new loan creation continued to dwindle.

Nevertheless, we see no reason why the post-2008 global recovery should not continue at its steady, if languid pace. Uninspired is not recessionary, after all, and barring a geopolitical crisis we are holding fast to our existing course: confident but vigilant.

US Markets: *Still buoyant*

Equity valuations had a Shiller PE ratio of 30x in June, the highest level on record and matched only by those that prevailed on the eve of the tech bubble's collapse. The S&P 500 hasn't had more than a 5% pullback since July 2016, according to Michael Batnick, Director of Research at Ritholtz Wealth Management, the longest such streak since 1996 and the bane of day-traders. If equity markets are due for a pullback, however, it may be shallow in scope.

Writing for *The Fat Pitch*, analyst Urban Carmel noted that, since 1991, similarly meteoric S&P performances resulted in an average annual gain of 2.3% and 5.9%, respectively and an average 12% for the previous year. Conversely, *The Daily Coin* argued that valuations have passed their 2007 peak - prime bubble territory and one of the key milestones Warren Buffett cited when warning about the prospect of a tech-boom bust.



Source: Michael Batnick, CFA: Ritholtz Wealth Management

Meanwhile, the *Wall Street Journal* reported in June that the pace of share buybacks has slowed this year despite record market highs, a trend that may signal apprehension among corporate executives. It noted that S&P companies repurchased $133 billion of their own shares in Q1, down 18% on a year-on-year basis. The article coincided with a Goldman Sachs report that disparaged "hope-driven" share rallies and forecasted the S&P would end the year 6% in the red. Bank of America warned of unstable "internal inconsistencies" between booming stock markets and weak economic data while Bloomberg reported that option contracts that reward stock index declines outnumber those that favor gains by a rate of more than 2-to-1, the most since January 2016. Goldman also cast doubt on the US dollar's recovery, citing stronger-than-expected and increasingly synchronized growth in overseas markets while revising upward its forecast for sterling and the euro.

Crude oil prices slipped below levels sustained before recent OPEC production cuts thanks in part to robust output from Libya. With future production cuts unlikely and with the number of drilled-but-uncompleted wells at their highest level in at least three years, according to Bloomberg, the outlook for oil prices is bleak. Other commodities took a beating as the promise of President Trump's vision for an ambitious infrastructure bill has yet to materialize. Iron ore prices gave back half their gains on the year, for example, while bids for lumber and copper declined dramatically.

Even as BofA announced that central banks continue their stimulative debt-repurchase plan - to the tune of $3.6 trillion this year on an annualized basis - JP Morgan worried that remarks from the Fed about its plan to gradually reduce its debt portfolio was too limited. The Fed's proposed target of depleting its portfolio by $600 billion per quarter from late 2018 - about the same time frame it took to build up its debt in the first place - would be "like watching paint dry." Treasury rates swung back and forth in June on countervailing dovish and hawkish comments from Fed presidents Charles Evans and William C. Dudley. Evans said he anticipated downside risks to the inflation outlook and suggested the current environment demands gradual rate hikes with slow balance sheet reductions. He counseled the Fed to delay the next round of credit-tightening until December so officials would have ample time to consider the market environment before making good on their commitment to three rate hikes by the end of the year.

American corporate bonds are close to their most expensive valuations ever, according to Morgan Stanley, after taking into account their vast quantity, abundance of low ratings and high exposure to shifting interest rates. Thus handicapped, the risk premiums on US corporate debt were at the start of June a mere 0.21 percentage points away from their all-time narrowest levels. Already, according to Bloomberg, tight credit spreads and uncertainty about the Trump agenda have money managers bracing for low returns on their corporate bond portfolios this year. In addition, the default rate for high-yield bonds continued to decline, according to Moody's, to 3.3% in May on a year-on-year basis and is expected to fall further to close 2017 at 2.5%.

Bank regulators, including senior Fed officials, have signaled they would support a roll-back of the Volcker Rule, stress tests and other constraints on Wall Street after the Trump administration issued a long list of proposals for financial deregulation. Fed officials said they were open to a rethink of the trading restrictions and reducing the burden of the annual exams that evaluate banks' ability to weather severe economic shocks.

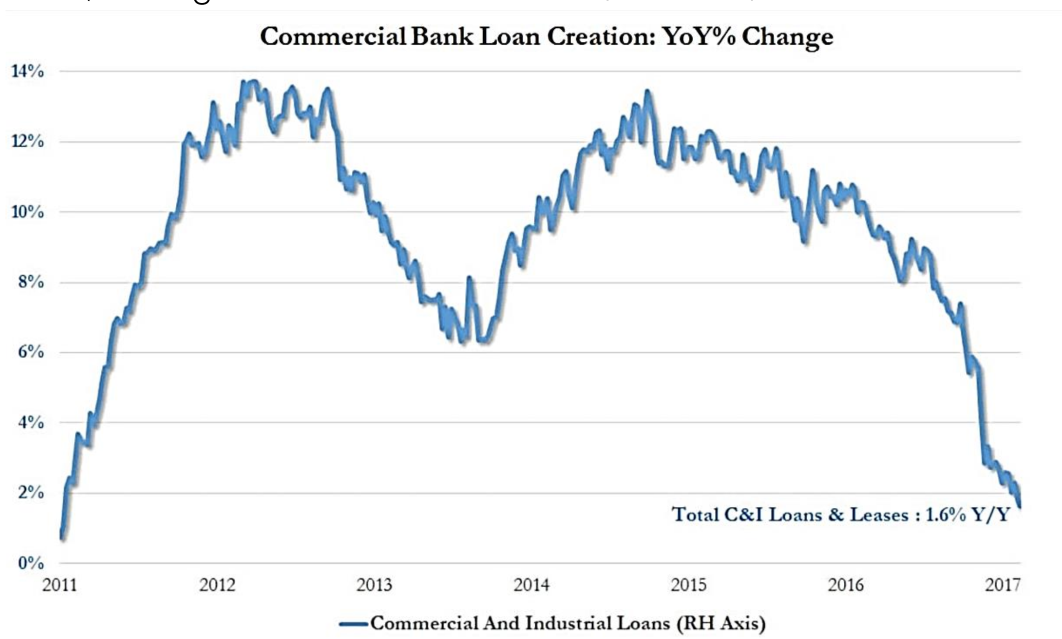
6/30/2017	Economic and Market Review						
		Last Reported	3 Mo. Ago		1 Yr. Ago		
Overall	Indicator Name	Date	% Change		1 Yr. Ago	% Change	
▼	US Core Inflation Rate	5/31/2017	▼	-22.05%	2.24%	▼	-22.64%
▼	ADP Change in Nonfarm Payrolls	6/30/2017	▼	-38.04%	258	▼	-38.81%
▲	US Unemployment Rate	6/30/2017	▼	-2.22%	4.90%	▼	-10.20%
▬	US Producer Price Index: Savings Institutions	5/31/2017	▬	0.00%	94	▬	0.00%
▲	ISM Purchasing Managers Index	6/30/2017	▲	1.05%	53	▲	8.65%
▼	US Housing Starts	5/31/2017	▼	-15.22%	1,119	▼	-2.41%
▼	US 30 Year Mortgage Rate	6/29/2017	▼	-6.28%	3.48%	▲	11.49%
▼	US Consumer Price Index	5/31/2017	▼	-0.25%	239.4	▲	1.87%

Source: yCharts

US Economy:

The Labor Department unveiled a robust employment report of 222,000 new jobs added in June, though wages continued to disappoint. The news followed the Fed's decision to raise its Q2 growth estimate to 3.0%, up from its previous 2.7% forecast, based on strong manufacturing and consumer spending data. The ISM Manufacturing Index rose in June to 57.8 compared with May's 54.9 figure - its fastest pace in nearly three years – all while spending rose 0.1% in May, according to the Commerce Department. The ISM data, however, was at odds with the IHS Markit US Manufacturing PMI report, which concluded that factory production weakened in June “with few signs of growth picking up any time soon.” At the same time, Gallup reported in its monthly household savings report that consumers “pulled back significantly” in June, with daily reports of spending averaging $82, down from the $95 and $93 recorded in April and May respectively. In addition, the University of Michigan said its index of consumer sentiment slipped to 95.1 in June from May’s 97.1 - the lowest level since last November - as consumers expressed growing doubts about future growth prospects. The survey peaked in March with its strongest reading since the end of 2000 before registering modest declines.

The IMF cut its forecast for annual US growth to 2.1% in 2017, down from the previous estimate of 2.3%. The Fund said it could no longer assume the Trump administration will be able to deliver on his promises of tax cuts and infrastructure renewal. Bank of America followed suit, slashing its 2017 GDP forecast to 2.1% from 2.5%.



Source: Federal Reserve, Zero Hedge

The bell continued to toll for the retail sector as sales declined 0.3% in May, the steepest drop since January 2016. Restaurants, department stores, and appliance and electronics retailers led the declines while online orders - read “Amazon,” which dominates e-commerce - reported steady growth. The June purchase of Whole Foods by Amazon triggered a selling frenzy among shares in rival grocers like Kroger - down 19% in a single trading day - as well as related sectors such as pharmacies, drug distributors, and even real estate.

The value of new loans continued to slow across the board, particularly the all-important Commercial and Industrial space. After growing at 7.0% on a year-to-year basis at the start of the year, C&I loans declined to 3% at the end of March and 2.6% at the end of April, according to the Fed. The report revealed that the annual rate of increase in the C&I sector has declined to 1.6%, its lowest since 2011.

The number of new buildings dropped by 5.5% in May - completing the first trimester of declines since January 2009 - badly missing expectations of a 4.1% increase. Building permits also tumbled by 4.9%, in contrast to an anticipated increase of 1.7%. Additionally, Bloomberg reported that in the 10 most expensive U.S. metropolitan areas median home values have increased by 63% since 2000, after adjusting for inflation, while in the 10 cheapest metros, median values rose by just 3.6%.

6/30/2017 Economic and Market Review Continued....

Overall	Indicator Name	Value	3 Mo. Ago		1 Yr. Ago		
				% Change	1 Yr. Ago		% Change
▲	S&P 500 Total Return	4,678	▲	2.86%	3,968	▲	17.90%
▲	Russell 2000 Total Return Index	6,918	▲	2.73%	5,552	▲	24.60%
▲	MSCI EAFE Total Return	7,397	▲	5.86%	6,122	▲	20.83%
▲	MSCI Emerging Markets Total Return	2,171	▲	5.17%	1,749	▲	24.17%
▲	10 Year Treasury Rate	2.31%	▲	0.87%	1.49%	▲	55.03%
▲	Barclays US Aggregate Total Return	2,021	▲	1.57%	2,028	▼	-0.31%
▼	AMEX Dollar Index	95.64	▼	-4.85%	95.96	▼	-0.33%
▲	Euro to US Dollar Exchange Rate	1.14	▲	4.41%	1.11	▲	2.79%
▼	US Dollar to British Pound Exchange Rate	0.77	▼	-3.52%	0.76	▲	1.9%
▼	US Dollar to Chinese Yuan Exchange Rate	6.78	▼	-1.51%	6.65	▲	2.01%
▲	US Dollar to Japanese Yen Exchange Rate	112.40	▲	0.89%	102.77	▲	9.37%
▼	Gold Price in US Dollars	1,242	▼	-0.21%	1,321	▼	-5.94%
▼	WTI Crude Oil Spot Price	46.02	▼	-6.67%	48.3	▼	-4.66%
▲	VIX	11.18	▲	3.33%	15.63	▼	-28.47%

Source: yCharts

International: *More Europe*

The European Central Bank cut its European Union inflation forecasts - from 1.7%-1.5% this year and 1.6%- 1.3% in 2018 - while enhancing GDP expectations from 1.8%-1.9% and 1.7%-1.8% during the same periods. The recalibration was interpreted by some analysts as proof that the ECB has failed to stimulate inflation.

Nevertheless, Europe continued to lure foreign investors. The Vanguard FTSE Europe exchange-traded fund absorbed $871 million in just five trading days in mid- June, part of a surge of investment in European equity markets on the heels of a deal between Greece and its creditors and French President Emmanuel Macron's successful majority in parliament. In June, hedge funds increased their euro positions to "net long" for the first time in more than three years, according to the Commodity Futures Trading Commission.

On a sober note, the world's economic recovery may encounter headwinds owing to an arcane debt-related instrument. According to UBS, the "global credit impulse" - the second derivative of credit growth and arguably the biggest driver behind economic growth worldwide - has abruptly stalled due to a "sudden collapse" in the ability of

Chinese banks to keep up with "the recent extraordinary pace of credit acceleration." Commenting on the report, ZeroHedge concluded that "absent a new and even more gargantuan credit expansion by Beijing - which is not likely to happen at a time when every single day China warns about cutting back on shadow banking and loan growth - the so-called recovery is now assured of fading."

Speaking of China, the *Financial Times* reports that regulatory agencies have cracked down on Chinese corporations that have invested massively in highly leveraged mergers and acquisitions overseas. Largely as a result, Chinese foreign M&A activity came to a screeching halt earlier this year. On the other hand, Bloomberg reported that the Chinese government is prepared to increase its holdings of U.S. Treasuries as officials judge the assets are becoming more attractive than other sovereign debt as the yuan stabilizes.

STAR™ Spectrum Portfolios: *Performance Summary*

Fixed Income:

Despite the Fed hiking rates in the second quarter, returns for Core Fixed Income, which many of our Fixed Income allocations are based on, were modestly positive as were the broader bond market indices. Our defensive duration posture has helped the portfolio remain steadfast in the face of volatile markets. More specifically performance was mostly aided by our allocations to Mortgage Holdings (DPFNX) and High Yield (PHB). We anticipate more opportunities in the fixed income markets during the second half of the year as the Fed continues to take action evaluating their balance sheet and raising rates.

Equity:

Equities were positive during Q2 with Emerging Markets returning over 5% and once again outperforming all other equity asset classes. Overall our equity positions were positive for the quarter Our Emerging Market and US Small Cap allocations led the way for our portfolio, with US Large Cap stocks also positive. On net, our approximately 8% cash buffer and the softer results from the Non-US Developed allocation account for some dampened performance.

Alternatives:

Our alternatives allocation was strong for the quarter, contributing 3.33%. The main contributors included Private Equity/BDCs along with Frontier Markets. The allocation to REITs and Multi-Asset also added to positive performance, but not as strong as other sectors.

Summary of STAR™ Spectrum Strategy Performance and Attribution

	Portfolio Weight (Equity Based & Income-Derived Models)	Q2 2017 (%)
Equity	100%	Positive (+)
Large Cap	62%	Positive (+)
Small Cap	24%	Positive (+)
Non US Developed	11%	Positive (+)
EM Market	3%	Positive (+)
Fixed Income	100%	Positive (+)
Investment Grade	73%	Positive (+)
EM Market Bond	7%	Positive (+)
Mortgage	9%	Positive (+)
US High Yield	11%	Positive (+)
Alternative	100%	Positive (+)
REITS	22%	Positive (+)
Convertibles/Preferreds	30%	Negative (-)
Multi-Asset	16%	Positive (+)
Private Equity	32%	Positive (+)
Cash*	8%	Positive (+)

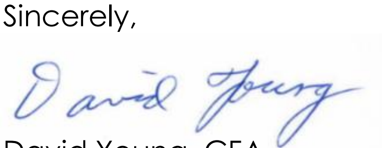
*Cash holdings added modestly to absolute results and kept pace with the broad fixed income markets – Cash was held as part of a set of defensive strategies.

Portfolio Update: *Multi-Asset Portfolios*

- There were no changes to the strategy holdings during Q2 2017.
- The Investment Committee continues to scrutinize our modest holdings to international and emerging market equities as those sectors have rallied strongly during the 1st half of 2017. We remain confident that additional purchases in the space would not be prudent at this time.
- Since the inception of our allocation to XLF, performance has been lackluster compared to our expectations. However, we reviewed and reaffirmed our commitment to Banks and Financials as a thematic position, and have already been rewarded with a strong performance bounce.

As we move into the second part of 2017 there are several factors we continue to watch; key among them are: Fed Action, Tax Code Reform, Entitlement Reforms, Trade Policy, Infrastructure Spending, and Financial Reforms. Our next tactical move will depend on the directionality and magnitude of each of the factors. When the time comes to make changes, we will keep you abreast of our thoughts and outlooks. Thank you for your support

Sincerely,



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