INVESTMENT STRATEGY UPDATE - APRIL 2018

Allocation: Our overall allocation strategy is defensive because of high valuations of both stocks and bonds. High valuations imply low returns over an extended time period and/or large declines. Thus, we are generally maintaining an under-weighting of stocks. We have lowered bond allocations or reducing duration by an equivalent amount because of rising inflation and the reversal of Federal Reserve policies that lowered interest rates. Finally, higher cash yields make cash a more viable alternative to bonds, if rates rise.

Stock Market Gauge: Our stock market gauge is composed of 5 measures: valuation, liquidity or financial conditions, trend or momentum, earnings, and sentiment. High valuation and optimistic sentiment have been negative for some time. Earnings are expected to be quite strong, which is positive. However, with the 1st quarter correction, the trend faltered and financial conditions deteriorated. Thus, our model began April close to a sell level. To review, stocks are subject to much larger declines when the model signals a sell condition. However, at times a sell condition has been in place for a relatively short period of a month or two. Thus, a sell signal does not always forecast a large and prolonged downturn. Therefore, we will wait for a meaningful confirmation of a sell signal before taking action. Furthermore, we anticipate shifting at least 5 percentage points from stocks to cash upon confirmation of a sell signal. See the next page for three charts: 1) the current dashboard reading, which is 2.4 out of 5.0; 2) a historical look at the monthly gauge since 1990; and 3) the same historical gauge compared to the S&P 500 stock market index.

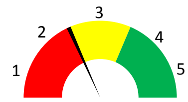
Value Stocks: The reflation narrative, a focus on the acceleration of growth as well as an increase in interest rates, should benefit value stocks that are concentrated in financials, energy, and more economically sensitive companies. Financials and energy companies should benefit the most from the new tax act, since they have high corporate tax rates. Financials also benefit from higher interest rates and stock market values. Finally, our analysis of past periods suggests that value stocks can out-perform growth stocks because of the extreme valuation difference.

Quality Stocks: Quality stocks represent ballast in the stock portfolio. They probably will not out-perform unless stocks correct, although they out-performed in the 4th quarter. After two years of double digit gains, a slowing earnings growth cycle, and a period of unusually low volatility, the chances of a correction have increased.

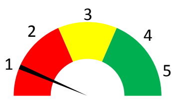
International Stocks: International stocks have under-performed U.S. stocks for an extended period, resulting in a large valuation gap, as we have illustrated in the past. The U.S. stock market recovered earlier than foreign markets because the U.S. undertook stimulus efforts before the rest of the developed world. Also, more successful economic policies tended to support a higher Dollar. Prospectively, higher relative growth overseas should support foreign currencies.

Bonds: Strong growth, no recession in sight, and above expectation inflation imply a hostile environment for bonds. The 1st quarter represented a significant change in bond market sentiment. What had been seen as significant resistance to rising rates, for example, the 2.6% level for the U.S. Government 10-year Treasury, was convincingly broken. Now these levels represent support; in other words, rates will not go below these levels without convincing economic weakness. We are targeting a duration of 5 years, more defensive than benchmarks.

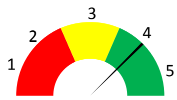
STOCK MARKET DASHBOARD - MARCH 31, 2018



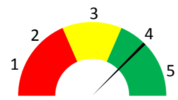
Overall Market Gauge
2.4



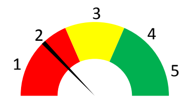
Valuation



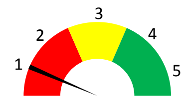
Earnings



Momentum

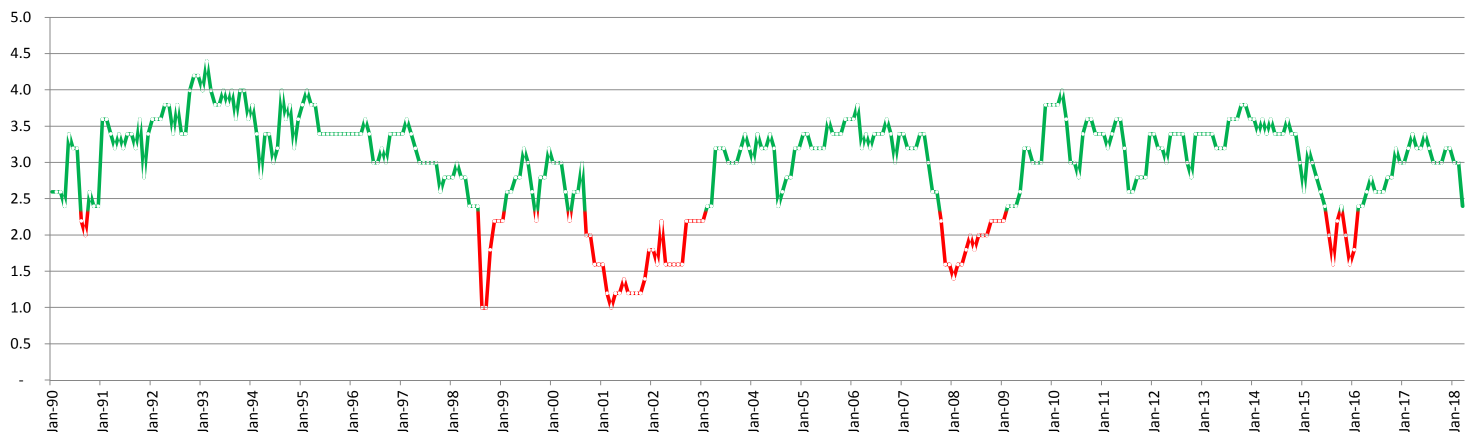


Liquidity



Sentiment

Stock Market Dashboard - 1990 to March 31, 2018



Stock Market Dashboard vs. S&P 500: thru March 31, 2018