MARKET REPORT
SECOND QUARTER 2017

During the quarter, U.S. equity markets shrugged off the impact of delayed pro-business legislation, as well as increased tension with North Korea and potential trade wars. At the same time, corporate earnings grew and equity market volatility remained quite low. The Federal Reserve increased short-term interest rates again, for the third time since December. Chairwoman Yellen telegraphed plans to soon begin shrinking the Fed's securities portfolio on its balance sheet (more than $4 trillion) by not reinvesting maturing Treasuries and Mortgage Backed Securities. Each steps toward a less accommodating monetary policy. The Fed hopes to methodically drain the monetary punch bowl without disappointing party goers (economies and markets). Some foreign central banks have expressed a similar intent as global economies strengthen. Yet U.S. equities remained priced, relative to earnings, above long-term averages. Are equity market participants becoming complacent? To be determined.

As disciplined, value-oriented investors, we begin our analysis at the company level and construct portfolios from the bottom up – investing in one business at a time. Macro-economic factors are ancillary information. With that in mind, our investment opportunity set remains more limited than usual – as investment candidates sporting a margin of safety are scarce. However, we are searching for such candidates (gems) with fastidiousness and enthusiasm in our effort to grow investment returns.

Total Return as of June 30, 2017						
			Annualized			
	QTD	**YTD**	**1 Yr.**	**3 Yr.**	**5 Yr.**	**10 Yr.**
S&P 500	3.1%	9.3%	17.9%	9.6%	14.6%	7.2%
NASDAQ	4.2%	14.8%	28.4%	13.1%	17.5%	10.2%
Russell 3000						
Index	3.0%	8.9%	18.5%	9.1%	14.6%	7.3%
Value	1.3%	4.3%	16.2%	7.3%	13.9%	5.6%
Growth	4.7%	13.7%	20.7%	10.8%	15.2%	8.8%
Russell Mid Cap						
Index	2.7%	8.0%	16.5%	7.7%	14.7%	7.7%
Value	1.4%	5.2%	15.9%	7.5%	15.1%	7.2%
Growth	4.2%	11.4%	17.1%	7.8%	14.2%	7.9%
Russell 2000 (Small Cap)						
Index	2.5%	5.0%	24.6%	7.4%	13.7%	6.9%
Value	0.7%	0.5%	24.9%	7.0%	13.4%	5.9%
Growth	4.4%	10.0%	24.4%	7.6%	14.0%	7.8%

Regarding asset values and risks, we find the following Federal Reserve leaders' recent comments interesting:

- Chairwoman Yellen commented, "Asset valuations are somewhat rich if you use some traditional metrics like price earnings ratios, but I wouldn't try to comment on appropriate valuations, and those ratios ought to depend on long-term interest rates."

- Vice Chairman Fischer had the following to say, "The general rise in valuation pressures may be partly explained by a generally brighter economic outlook, but there are signs that risk appetite increased as well."

- San Francisco Federal Reserve Bank President Williams chimed in, saying "The stock market seems to be running pretty much on fumes."

Like interest rates and buying government securities, jawboning, such as the quotes referenced above, is another tool in the Fed's toolbox which it often uses to guide markets.

Famed bond manager Bill Gross, always good for a little color, recently was more direct when assessing the current environment: "Instead of buying low and selling high, you're buying high and crossing your fingers."

Even Warren Buffett seems to be struggling to find attractive investments with an adequate margin of safety, as recently evidenced by Berkshire Hathaway's roughly $95 billion hoard of cash and cash equivalents.

We believe rough patches will occur in the future, like in the past – we just don't know when. Our portfolio posture is defensive in our view, and we believe we are positioned well to capitalize on downside volatility should it occur.

Equities – Another Broad Based Rise

The S&P 500 rose 3.1% during the quarter (including dividends), bringing the year-to-date total up to 9.3%. Healthcare was the strongest performing sector for the quarter, likely benefiting from the delay in new healthcare legislation which could cut into profits. Healthcare joined Technology as the best performing sectors for the year thus far. Many technology companies continued to grow, and we view many of these companies' valuations as expensive (or at least providing little margin of safety for investors).

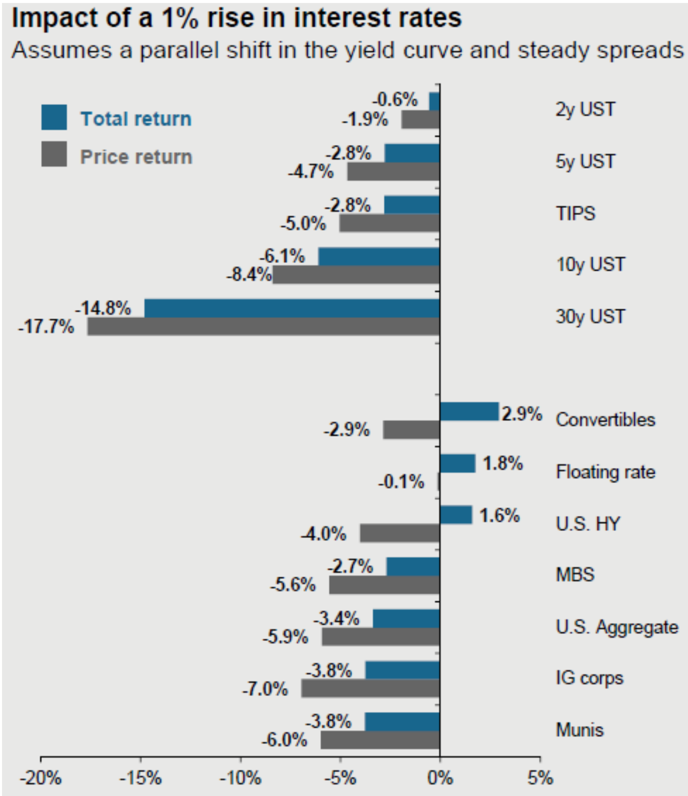
Telecommunications and Energy Sectors declined the most for the quarter and year-to-date. Telecommunications companies seem to be suffering from significant competition from traditional and new foes. Weak energy prices were a drag on energy companies' financials and share prices.

Statistically expensive stocks outperformed statistically cheap (hunting grounds for value-oriented investors) stocks for the quarter and year-to-date. Additionally, large-caps led small-caps.

Fixed Income & Commodities

Corporate bonds, as measured by the BofA ML 1-10 year index, increased 1.5%, which pushed returns for the year up to 2.8%. U.S. Treasuries and Agencies, as measured by a similar index, increased 0.6% for the quarter and 1.1% year-to-date.

Although interest rates remain very low, significant money continued to flow into U.S. bonds during the quarter. Likely reasons include: chasing positive bond returns in recent periods, relative attractiveness when compared to lower or negative yielding foreign debt and some investors' view that bonds have limited risk. Some bonds, however, can have significant risk. As you can see in JPMorgan's example with basic assumptions below, those bonds with longer maturities are subject to more interest rate risk than those with shorter maturities.



J.P. Morgan Asset Management, June 30, 2017

We maintain a defensive posture in our bond strategies, in our view – keeping maturities reasonably short on average.

Commodities (as measured by the Bloomberg Commodity Index) decreased 3.0% during the quarter. Oil prices weighed on the index in the second quarter as they did in the first quarter. Even though a large number of influential global oil suppliers agreed to continue limiting oil supplies through March 2018, some members of this group (Libya and Nigeria) continued to increase their production (they are exempt from making supply cuts) while U.S. shale oil production continued to increase. Livestock was a standout to the upside for the quarter and year-to-date as the U.S. recently banned fresh beef imports from Brazil and China is eliminating its 14 year ban to import U.S. beef.

Unwinding Accommodative Central Bank Policies

As you know, the Federal Reserve provided extraordinarily accommodative monetary policy after the Great Recession by lowering short-term interest rates and buying Treasuries & Mortgage Backed Securities (Quantitative Easing or QE) as previously mentioned, among other things and is now in the early stages of becoming less accommodating. Some foreign central banks even one-upped the Fed by not only purchasing their government-related bonds, but also corporate bonds (European Central Bank) and equities (Bank of Japan).

We believe these actions have contributed to the low interest rate environment and have helped economies and markets recover from the financial crisis. However, as central banks are likely to reduce or remove these policies in the future if their economies recover (as the Federal Reserve is currently doing), they can potentially harm economies and markets. Potential scenarios of how "unwinding" these policies could inflict economic pain include the following:

- If central banks reduce these policies too *slowly* (e.g., if they raise short-term interest rates too slowly and/or do not sell enough of the significant securities they have accumulated fast enough), excess liquidity may stay in the system and the economy may overheat causing inflation more than desired.

- If central banks reduce these policies too *fast* (e.g., if they raise short-term interest rates too fast and/or sell the securities they have accumulated too fast), they may put significant downside pressure on the securities they are selling (resulting in securities prices falling), and unintentionally subtract needed liquidity from the economic and financial systems (risking a recession).

Of course, central banks are wary of these types of risks. However well-intentioned central banks may be, we do not believe they precisely know the ultimate effects of the medicine they have provided markets and economies. The reality is nobody knows how reducing accommodative monetary policy is going to play out. It's on our minds though as we construct portfolios.

We believe JPMorgan Chase CEO Jamie Dimon's comments after quarter end capture this issue well (per Bloomberg) and we would concur:

> "We've never have had QE like this before, we've never had unwinding like this before," Dimon said at a conference in Paris Tuesday. "Obviously that should say something to you about the risk that might mean, because we've never lived with it before."…"When that happens of size or substance, it could be a little more disruptive than people think," Dimon said. "We act like we know exactly how it's going to happen and we don't."…Central banks would like to provide certainty but "you cannot make things certain that are uncertain," Dimon said.

Summary

- Markets continued moving upward and our portfolios are defensively positioned.

- We believe extremely accommodative policies by the Federal Reserve and global central banks have contributed toward low interest rates and higher asset valuations, and we do not believe anybody knows with certainty how reducing these policies over time is going to affect markets and economies.

- Regardless of the environment, our time-tested value-oriented investment process, now more than 30 years in its evolution, will guide us. At the end of the day, it's our view that the best investments are those that are most business-like, not necessarily the most fashionable.