Atlas BROWN
FAMILY WEALTH MANAGEMENT

1st Quarter 2018

I can't remember the last time I was happy to put a quarter behind us, but like many investors, I am happy to have the 1st quarter of 2018 in the rearview mirror. The market started off the quarter strong, rallying through the month of January, but selling off significantly in early February leading to a 10% decline from peak to trough which officially marks a correction. Not only did we see a "correction" in the quarter, but volatility returned and hasn't subsided since the early part of the quarter. We will highlight these aspects and touch on a few others from the quarter and, like our previous quarterly commentaries, will go back to our traditional format (please try to contain your excitement). Large, mid and small caps ended the quarter down -0.8%, -0.5% and -0.1% respectively. Outside the U.S., developed international lost -1.6% during the quarter with emerging markets up slightly at 0.9%. Fixed income investors were down -1.5% during the quarter, as the 10-year rate added 34 basis points. Turning to alternatives, commodities, real estate and MLP's were all down in the quarter -0.4%, -7.0%, and -12.8% respectively.

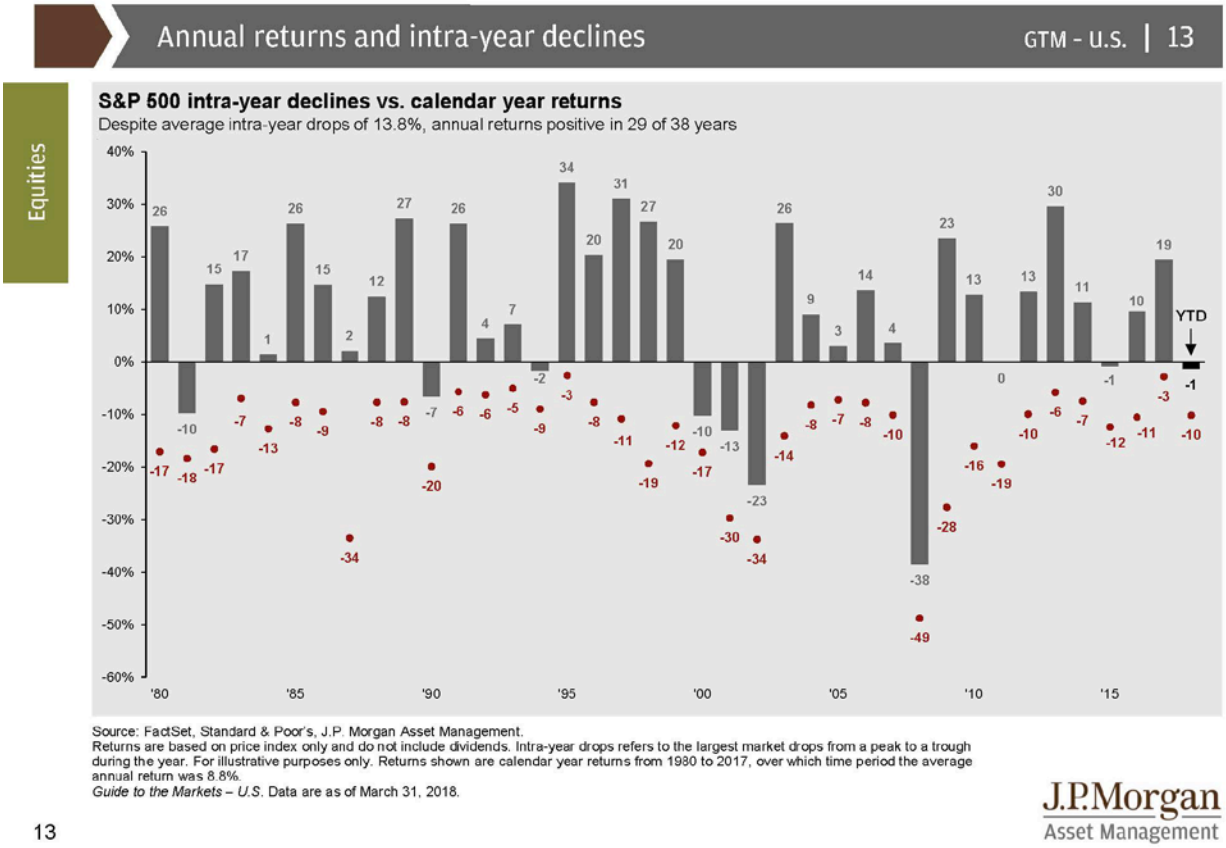
Economy

The economy continues to improve with the recovery now lasting 105 months--the third longest in history. While the economy looks to be on stable footing, the data is mixed. From the cyclical side of things, light vehicles sales are declining along with housing starts, albeit slightly. However, inventories and capital goods orders are improving. The unemployment rate is steady at 4.1% with wages only up 2.5% year over year which is well below the 50 year average of 4.2%. We have previously talked about the length of this recovery and mentioned that this recovery could last a bit longer due to its slow progression. We feel that one of the things investors will have to consider moving forward is that from a structural standpoint, our economy may well grow at a slower rate than we have experienced historically. The main driver of this is the aging population which has led to a declining workforce. GDP is a component of two variables: the number of workers and their productivity. Productivity really accelerated in the 80's and 90's contributing 1.7%-1.8% to GDP in that time period. In addition, we saw strong growth in the labor market which contributed roughly 1.3% to GDP. Moving forward, however, the growth in workers is expected to be just 0.3% looking toward 2026. Unless we see a significant uptick in productivity (it is currently contributing 0.9% to GDP), we feel the level of GDP experienced will be well below where we have been accustomed. Probably more on the top of the minds of most investors is how current and future fiscal and monetary policy will affect their investment outcomes and returns. There are a lot of moving parts here and requires much more of a conversation than this commentary (and the expertise of this author) can provide. However, we think it important for investors to know where we stand now. The fiscal deficit was $666 billion in 2017 and is expected to grow this year and possibly top $1 trillion in 2019. These deficits have caused the debt level to climb to over 100% of GDP and will likely climb higher in the coming years given tax cuts and current entitlement spending. From a monetary policy standpoint, the fed is expected to raise rates 3 times this year (having just raised the rate 25 basis point in late March). Again, there are many more moving parts here but it is important to remember that as interest rates rise, your (and the US government's) cost of debt increases. If you are continuing to take on more debt, while at the same time the cost of that debt is increasing, sooner or later there will be a tipping point. What triggers and when the tipping point occurs is up for much debate, but at the very least it warrants some caution. Most recently, investors are having to digest the president's proposed tariffs on goods imported from China and subsequent

retaliation from China on goods we export to them. The market has reacted negatively to these developments and it remains to be seen whether these tariffs are merely a negotiating tactic or something larger, but until this issue is resolved we expect markets to stay volatile.

Equities

The S&P 500 lost -0.8% in the 1st quarter, breaking the index's streak of 9 consecutive positive quarters. The loss was just the 2nd down quarter in the last 5 years. One of the things missing from these commentaries in the past few quarters has been the mentioning of volatility (ok, I just re-read my previous commentaries and did mention the lack of volatility on several occasions). Having said that, we would envision that volatility will take a prominent space in these commentaries in the quarters ahead. The explosion we saw in volatility in February was not unprecedented, though we hadn't seen something like it since 2015. We don't know what exactly caused the spike in volatility, but it was likely long overdue given how many investors had bet against ever seeing volatility creep back into the market. One important thing we want to state about the volatility is that just because we are experiencing volatility doesn't mean that we will see lower stock prices or the recovery is coming to an end. There is a great chart from JPMorgan below that shows the average peak to trough decline in the S&P 500 each year going back to 1980 along with the calendar year return for each given year.



As you can see from the chart, the average peak to trough decline we have seen is almost -14.0% since 1980. And you can also tell from the chart that we haven't experienced a -14.0% decline since 2011. The chart also shows that by and large the market usually provides an investor with a positive return (approximately 76% of the time). So while we are seeing volatility and did experience a decline of 10%

from peak to trough, that doesn't mean that we can't end the year with a positive return (nor does it mean that we can't go a bit lower). One of the positives resulting from the decline in stock prices during the quarter is that valuations have gotten a bit more attractive on a relative basis. We began the year with the S&P 500 trading at 18.2 times forward earnings and ended the 1st quarter with the S&P 500 trading at roughly 16 times forward earnings. Some of this is due to the positive earnings revisions given the corporate tax cut; regardless, valuations have gotten a bit more attractive. It will be interesting to see how companies comment on the impact of the tax cut during the 1st quarter earnings calls, but we would expect most to be positive and could stabilize the market in the short term.

Fixed Income

Fixed income investors experienced a negative return in the quarter with the Barclays aggregate declining -1.5% in the quarter. We saw rates increase in the quarter with the 10 year moving from 2.40% to 2.74%. We have been calling for a move like this for several years and would expect the gradual increase in rates to continue. One thing we are watching closely is the flattening of the yield curve. We have seen the spread between the 10 year and 2 year government bond yields compress to levels we haven't seen since 2007. We watch this closely as an inverted yield curve is typically a precursor to a recession. We are not at those levels yet, but it is something that should be watched closely.

Alternatives

The traditional alterative bucket consisting of commodities, real estate and MLP's were all negative in the quarter. We will call commodities roughly flat, but real estate and MLP's were off fairly significantly primarily from the rise in interest rates which makes assets that have been predominately used to generate yield less attractive. We have seen some yield compression in some of our private credit strategies but are still finding attractive niche alternative investments that generate non-correlated returns.

As usual, there are more topics we could have touched on, but hopefully we have provided you some insight into our thoughts about the current environment and provided some color on potential risks and opportunities. We haven't changed our previous views and feel the current environment continues with a slower and longer recovery and lower than average equity and fixed income returns. We encourage investors to consider alternatives in their overall asset allocation and favor niche strategies that offer attractive risk adjusted returns. As always, we would like to thank you for the trust and confidence you place in us. We look forward to speaking with you in the coming weeks.

Tim Corley

Scott Robinson