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MARKET REVIEW

ULRICH INVESTMENT CONSULTANTS
505-224-9100 ulrichcg.com

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MARKET ENVIRONMENT 4Q17

GLOBAL ECONOMY

In the U.S., third quarter real GDP growth was 3.2% (annualized), the fastest pace since the first quarter of 2015 and following similarly robust second quarter growth (+3.1%). As expected, the Fed hiked the Fed Funds target by 25 bps in December. Outside the U.S., developed economies continued to gain momentum.

- The Fed raised its Fed Fund target by 25 bps to a range of 1.25% - 1.50%
 - This marked as the third increase of 25 bps in 2017
 - Markets are pricing in an additional three hikes in 2018, though Fed projections are for rates to year end between 2.0% and 2.25%
 - President Trump nominated Jerome Powell to become the next Fed Chair, replacing Janet Yellen, whose term expires in February
- Inflation remained benign
 - Headline CPI +2.2% y-o-y fueled by a 16.5% increase in gasoline
 - Core CPI (ex-food and energy) +1.7% y-o-y as prices of goods fell 0.9% y-o-y with declines broad-based
 - Fed's favored measure, the PCE price deflator, gained 1.5% year-over-year, remaining below the 2% target
- Labor markets remain tight: unemployment rate at 4.1%
 - Lowest unemployment rate since 2000
 - However, average hourly earnings growth continued to languish at 2.5% for the trailing year (as of November)
- Strong retail sales during holidays
 - Fueled by high consumer confidence and a robust job market, U.S. retail sales in the holiday period rose at their best pace since 2011
- Manufacturing continued to show strength
 - ISM Index exceeded 50 (indicating expansion) for 15 consecutive months through November
- Euro zone 3rd quarter GDP growth +2.6% (y-o-y)
 - Inflation remained low (1.5% y-o-y as of November)
- ECB upgraded its 2018 forecast for growth from 1.8% to 2.3%
 - ECB kept its interest rates unchanged in the fourth quarter, but confirmed the plan to reduce asset purchases to €30bn from €60bn a month in January 2018
- Euro zone unemployment rate fell to 8.8%
 - Below 9% for the first time since 2009
 - Unemployment in Germany fell to a record low of 3.6%
- Japan's economy continued to grow
 - Unemployment reached a 24-year low at 2.7%
 - Core CPI +0.9% y-o-y in November
 - Bank of Japan is expected to continue its stimulus measures in an effort to stimulate inflation.

MARKET ENVIRONMENT 4Q17

FIXED INCOME

The U.S. yield curve continued its flattening trend in the fourth quarter. The 2-year U.S. Treasury yield climbed 42 bps to close at 1.89%. The 30-year U.S. Treasury yield fell 12 bps during the quarter, ending the year at 2.74%. This trend reflects the Fed's tightening bias as well as benign inflation. The municipal bond market performed well in 2017 and demand remained strong even in the face of uncertainty around tax changes. Outside the U.S., quarterly returns were mostly flat in both developed and emerging markets.

- Longer-term bonds sharply outperformed short-term and intermediate-maturity bonds for the quarter and the year
 - Blmbg Barc Long U.S. Treasury Index: Q4: +2.4%; 2017: +8.5%
 - Blmbg Barc Intermediate Treasury Index: Q4: -0.4%; 2017: +1.1%
- U.S. Treasury 10-year traded in a narrow 60 bps band for the year, lowest since 2000
- U.S. Aggregate Bond Index was roughly flat (+0.4%) for the quarter
 - Annual return (+3.5%) was generated largely from its coupon
 - Corporate bonds outperformed for the quarter and the year
 - Yield spreads reached a post-crisis tight of 93 bps over Treasuries
- High yield corporates continue to outperform investment grade
 - Blmbg Barc High Yield Corporate Index: Q4: +0.5%; 2017: +7.5%
- TIPS outperformed nominal Treasuries
 - Blmbg Barc U.S TIPS Index: Q4: +1.3%; 2017: +3.0%
 - 10-year breakeven spread (the difference between nominal and real yields) rose to 1.96% as of year-end
- What may tax reform mean for municipal market?
 - Little market impact by change in personal income rates
 - Decrease in corporate tax rates will reduce demand from corporations such as banks and insurance companies
 - Limiting state and local tax deductions could increase demand for in-state munis in high tax states
 - Elimination of advance refunding bonds (a small part of the market) will modestly reduce supply over time
 - Issuance spiked at year-end in anticipation of changing regulations, setting a record \$62.5 billion for December supply, but the market absorbed it well
 - Blmbg Barc Municipal Bond Index: Q4: +0.7%; 2017: +5.4%
- Quarterly returns were flat in developed markets
 - Blmbg Barc Global Aggregate ex-US (unhedged): Q4: +1.6%; 2017: +10.5%
 - Blmbg Barc Global Aggregate ex-US (hedged): Q4: +1.1%; 2017: +2.5%
- Emerging markets debt delivered muted returns
 - Dollar-denominated JPM EMBI Global Diversified Index: Q4: +1.2%; 2017: +10.3%
 - Local currency-denominated JPM GBI-EM Global Diversified Index: Q4: +0.8%; 2017: +15.2%.

MARKET ENVIRONMENT 4Q17

GLOBAL EQUITY

The S&P 500 Index gained 6.6% in the fourth quarter and its 21.8% gain for the year was its best since 2013. The Index hit 62 record highs during the year and had only eight days of 1% or more fluctuations, the lowest number since 1964. Markets were fanned by strong corporate earnings, expectations for tax cuts and deregulation, and share buybacks. Non-US equity annual gains were broad-based and further bolstered by a weakening U.S. dollar.

U.S. Equity

- Large caps outperformed small caps across styles for the quarter and the year
 - S&P 500: Q4: +6.6%; 2017: 21.8%
 - Russell 2000: Q4: +3.3%; 2017: 14.6%
- Growth outperformed value for the quarter and the year
 - Growth: Q4: +7.9%; 2017: +30.2% vs. Russell 1000 Value: Q4: +5.3%; 2017: +13.7%
 - Growth: Q4: +4.6%; 2017: +22.2% vs. Russell 2000 Value: Q4: +2.0%; 2017: +7.8%
- Tech sector was a clear leader for the year in S&P
 - Best performing sector was Technology for the year (+38.8%); sector now makes up 24% of S&P 500 and 38% of the Russell 1000 Growth
 - High flying tech stocks “FAAMG” continue to perform well:

| | Q4 | 2017 |
|-----------------------|-----|------|
| Facebook | 3% | 53% |
| Apple | 10% | 48% |
| Amazon | 22% | 56% |
| Microsoft | 15% | 41% |
| Google (Alphabet A&C) | 9% | 36% |

- Consumer Discretionary (+9.9%) outperformed Technology (+9.0%) for the quarter
- Energy (-1.0%) and Telecom (-1.3%) lost ground for the year

International Equity

- Bolstered by a weakening dollar, non-US equity performed well
- Strong results for developed markets
 - MSCI EAFE: Q4: +4.2%; 2017: +25.0%
 - Annual gains were broad-based with several countries posting double-digit returns (U.K. +22.3%; ex-U.K. +26.8%; Japan +24.0%)
 - For the quarter, Energy (+7%) and Materials (+8%) were the best performers; Health Care and Telecommunications were laggards with results of just over 1%
 - For the year, Technology was the clear leader at +51%
- Emerging markets outperformed developed markets in the quarter and for the year
 - MSCI EM USD: Q4: +7.4%; 2017: +37.3%
 - Latin America was the only weak spot in the quarter (-2.3%) but was up a robust 23.7% for the year
 - Emerging Asia performed the best for the quarter and the year (+8.4%; +42.8%) . China (+7.6%, +54.1%) and Korea (+11.4%, +47.3%) are the top two contributors

MARKET ENVIRONMENT 4Q17

LIQUID REAL ASSETS & HEDGE FUNDS

Most liquid real assets turned in positive performance in the 4th quarter as global economic growth continued and expectations for future inflation rose. Energy infrastructure MLPs were the exception, as the sector evolves in the wake of heightened oil price sensitivity and investors' concern over the impact of tax reform.

- Brent crude oil prices closed the year at \$64/barrel, the highest since 2014 and up roughly 12% for the year.
 - Global growth, improving supply/demand dynamics and OPEC agreements contributed to its rise
- Commodities indices gained
 - The energy-heavy S&P GSCI Commodity Index + 9.9%
 - More diversified Bloomberg Commodity Index +4.7%
- Gold: Q4: +1.9%; 2017: +13.7%
- The Alerian MLP Index continued to decline in spite of rising oil prices
 - Alerian MLP: Q4: -0.9%; 2017: -6.5%
 - Index was hurt due to dividend cuts by some of its constituents
 - Concerns over the impact of tax reform also weighed on MLPs
 - Fundamentals have improved as MLPs have better distribution coverage and stronger balance sheets, a response to heightened oil price sensitivity.
- REITs up modestly for the quarter and the year
 - MSCI: US REIT: Q4: +1.4%; 2017: +5.1%
 - Industrial REITs posted large gains, +20.6% for the year.
 - Retail lagged, with Shopping Centers declining 11% in 2017.
 - Global REITs gained 15%, bolstered by strengthening economies and currencies in international markets.
- TIPS outperformed nominal Treasuries
 - Bloomberg Barclays U.S. TIPS Index: Q4: +1.3%; 2017: +3.0%
- Global Infrastructure up as well
 - DJB Global Infrastructure Index: Q4: +0.5%; 2017: +15.8%
 - With 57% of the index comprised of non-US infrastructure companies, returns were aided by the relatively weak US dollar.

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Ulrich Investment Consultants may be notified by mail:

Ulrich Investment Consultants
1805 Rio Grande Blvd, N.W. Suite 1
Albuquerque, NM 87104
Compliance@ulrichcg.com