Global Income Strategy

Portfolio and Economic Commentary – 4th Quarter 2017

ALTRIUS
CAPITAL MANAGEMENT
INVEST LIKE AN AARDVARK

GLOBAL INCOME STRATEGY COMMENTARY

Our investment philosophy is predicated on a time-tested, three pronged approach providing solid risk adjusted returns to our investors for over two decades.

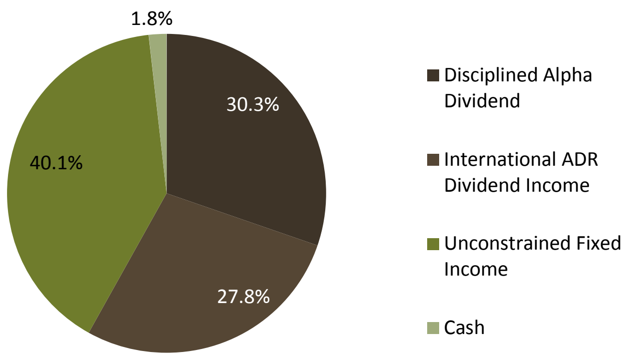
- We believe in the importance of getting paid immediately for the risks which are taken and focus on businesses which compensate our clients with **dividends and above average interest.** We believe this income stream, coupled with capital appreciation, is a vital aspect of total return.
- We dig deep for **value** often viewing crisis as an opportunity. We believe that fundamental research and patience are critical to long term success and that over time, the price of a company will rise to reflect the value of the underlying firm viewing each purchase as if were buying a piece of a business – not simply a stock certificate.
- We believe that **global revenue generation** is a key component to growth and sustainability and invest in companies with global growth opportunities. We are unafraid to take contrarian positions, but remain diligent about the risks of a global economy.

PERFORMANCE COMMENTARY

The Global Income strategy posted sound gains for 2017 garnering a 13.11% return versus a gain of 14.04% for the blended balanced benchmark. The annualized trailing returns for the strategy since our inception on January 1, 2003 are 7.35% versus 7.79% for the blended benchmark and 6.66% for Morningstar's US Fund Allocation – 50% to 70% Equity. The twelve month trailing yield for the Global Income strategy stands at 4.73% versus 1.71% for the Vanguard Balanced index fund (VBINX).

We remain slightly underweight to a traditional 60% stock/40% bond portfolio due to the risks which remain and valuation metrics. That said, our portfolio maintains a reasonable 17.27 P/E (TTM), and 13.92 forward P/E, which is significantly lower than the broader market indices – most of which currently maintain multiples in excess of 20 times trailing earnings. Our focus continues to emphasize the importance of immediate income to our investors particularly in this volatile, low interest rate environment, which we believe will persist for longer than most economists. In the fixed income sector, our emphasis remains on high yield bonds, which we believe more adequately compensate our investors for credit risk, while providing better protection in a potentially rising interest rate environment. The following is an analysis of the independent strategies which comprise our flagship Global Income strategy in percentages indicated above.

Sector Allocation



Top Five Equity Holdings	Weight
Teva	1.25%
Caterpillar	1.20%
AbbVie	1.17%
DineEquity	1.14%
Intel	1.12%

Top Five Fixed Income Holdings	Weight
American Axle & Manufacturing	0.58%
Blue Cube Spinco	0.57%
Tempur Sealy	0.56%
Centurylink	0.56%
Western Digital	0.55%

Disciplined Alpha Dividend Strategy Commentary

As value investors, we constantly focus on our duty to protect the principal of our investments even as we look for ways to grow them over time as well. As economists, we remain alert to trends taking place in the larger global economy. As analysts, we seek to invest in securities priced with a margin of safety in order to account for their near term volatility and our uncertainty about what the future holds. With this in mind, we look for opportunities in three specific categories: classic value, persistent earners, and distressed or contrarian.

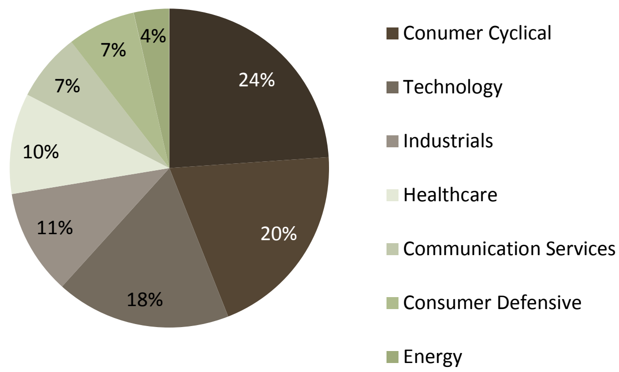
Classic value stocks sell at attractive valuations and provide above-average dividend yields and growth. Persistent earners are companies which have steady and predictable earnings and that are selling below their historic valuation. The distressed/contrarian category refers to stocks that are out of favor due to what we perceive to be temporary factors and are likely to appreciate substantially as the temporarily distressing factor recedes. Typically the distressed category is the smallest in the portfolio.

Performance Commentary

The Disciplined Alpha Dividend strategy gained 16.22% while the Russell 3000 Value index returned 13.19% for the year. The strategy has produced outstanding ten-year risk adjusted returns roundly besting its indices and peer group for the period earning a Morningstar 4-star 10-year rating. The trailing annualized ten year returns were 9.13% for the strategy, 7.19% for the Russell 3000 Value index and 8.84% for the Dow Jones US Select Dividend index. Since inception on January 1, 2003, the strategy has returned 9.42% versus 9.63% for the Russell 3000 Value index and 10.07% for the Dow Jones US Select Dividend index.

Our sector allocation weighting and active return have added to relative performance by just over 3% for the year against the Russell 3000 Value index. The industrials, technology and healthcare sectors have been our largest attributors to active return, while the financial services, consumer cyclical and basic materials sectors were the largest detractors to relative performance. Though maintaining a focus on dividends and above average income generation, we believe the utility and real estate sectors remain overvalued and will perform poorly in a potentially rising interest rate environment. The top performers for the year have been Caterpillar (70.3%), AbbVie (64.5%), Apple (51.0%), KKR & Co. (42.5%) and Norfolk Southern (37.4%). The bottom performers have been Mattel (-38.3%), Western Union (-30.2%), Pitney Bowes (-20.6%), New York Community Bancorp (-11.7%) and B&G Foods (-10.8%).

Sector Allocation (Morningstar)



Top Ten Holdings	Weight
Caterpillar	3.93%
AbbVie	3.82%
DineEquity	3.73%
Intel Corp	3.67%
Norfolk Southern	3.62%
Qualcomm	3.60%
Cisco Systems	3.59%
JPMorgan Chase & Co.	3.56%
Phillips 66	3.56%
Wells Fargo & Co.	3.47%

DISCIPLINED ALPHA DIVIDEND STRATEGY COMMENTARY

As one may recognize from the below chart, our firm has consistently provided a steady stream of income to our clients in the form of dividends. It is our assertion that this income stream has not only reduced the risk of our portfolio, but also provided a large part of the total return thereby leading to our performance success over this past tumultuous decade plus.

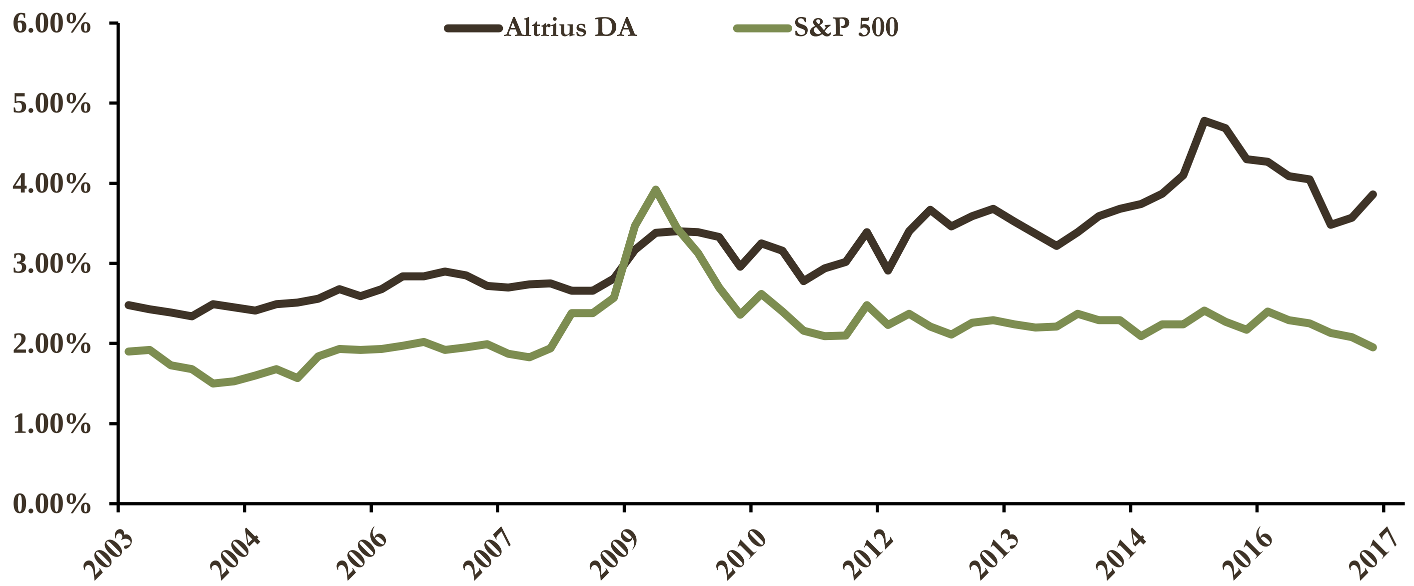
We believe that dividends allow our investors to "get paid to wait" while patiently working through volatile business and market cycles. This strategy provides emotional support during difficult cycles enabling investors to weather turbulent periods utilizing dividend income for personal needs or to reinvest cash at lower valuations. Our strategy is not only grounded in psychological and behavioral finance concepts, but is also supported by empirical evidence outperforming in both negative and full market cycles.

Dividends also act to align the interests of corporations and shareholders in helping to eliminate the agency effect. Corporate boards have recognized the value of dividends in stabilizing their stock price and encouraging investment during both high and lower tax regimes. In supporting and increasing dividends over time, managers are compelled to maintain a reliable stream of cash flows to shareholders rather than waste capital on those expenses adding little to corporate revenue including executive perks, pet projects, and ill-timed, unwise acquisitions. It appears a paradox; however, our experience and academic studies have displayed that sufficient investment for a good business can still occur in conjunction with dividends as managers are forced to invest cash flow more prudently and only in those capital investments in which they have the highest conviction in adding to corporate revenue particularly since stocks buybacks are often ill-timed.

ALTRIUS: A STORY OF CONSISTENT DIVIDENDS OVER THE YEARS

The strategy has consistently delivered an above average dividend yield versus the S&P 500 since its inception.

Altrius Disciplined Alpha Dividend Income vs. S&P 500 Dividend Yield



Source: Morningstar

INTERNATIONAL ADR DIVIDEND INCOME STRATEGY COMMENTARY

As value investors, we constantly focus on our duty to protect the principal of our investments even as we look for ways to grow them over time as well. As economists, we remain alert to trends taking place in the larger global economy. As analysts, we seek to invest in securities priced with a margin of safety in order to account for their near term volatility and our uncertainty about what the future holds. With this in mind, we look for opportunities in three specific categories: classic value, persistent earners, and distressed or contrarian.

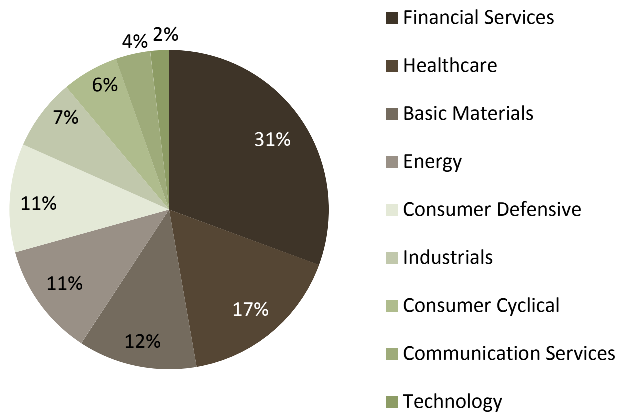
Classic value stocks sell at attractive valuations and provide above-average dividend yields and growth. Persistent earners are companies which have steady and predictable earnings and that are selling below their historic valuation. The distressed/contrarian category refers to stocks that are out of favor due to what we perceive to be temporary factors and are likely to appreciate substantially as the temporarily distressing factor recedes. Typically the distressed category is the smallest in the portfolio.

PERFORMANCE COMMENTARY

The International ADR Dividend Income strategy has had both positive absolute and relative performance returning 23.51% for the year. The MSCI EAFE Value index was higher by 21.44% while the S&P Int'l Dividend Opportunities index gained 20.43%. Since its inception on June 1, 2010, the strategy has produced annualized returns of 6.99% versus 5.37% for the S&P Int'l Dividend Opportunities and 7.55% for the MSCI EAFE Value indices respectively. Since its inception, the strategy has produced alpha against the MSCI EAFE Value index due to its significantly lower beta.

Our sector allocations and stock selection had a positive impact on relative performance during the year versus the EAFE Value index. The consumer defensive, communication services and basic materials sectors attributed the greatest portion to relative outperformance while energy, healthcare and industrials were the largest detractors to active return. Going forward, we believe we will find more value amongst international issues than U.S. companies while expecting the energy and basic materials sectors to be continued benefactors of global economic stabilization. The top performers for the year have been POSCO (55.1%), Rio Tinto (45.8%), Diageo (43.9%), Taiwan Semiconductor (43.9%) and Unilever (43.6%) while the bottom performers have been Teva Pharmaceuticals (-11.7%), Barclays (-4.9%), GlaxoSmithKline (-4.2%), and Roche (-0.9%).

Sector Allocation (Morningstar)



Top Ten Holdings	Weight
Teva Pharmaceutical	4.47%
HSBC Holdings	3.74%
Astrazeneca	3.74%
Lloyds Banking Group	3.70%
Barclays	3.63%
Lazard LTD	2.21%
Rio Tinto	2.03%
Diageo	2.01%
Posco	2.00%
BHP Billiton	1.99%

International ADR Dividend Income Strategy Commentary

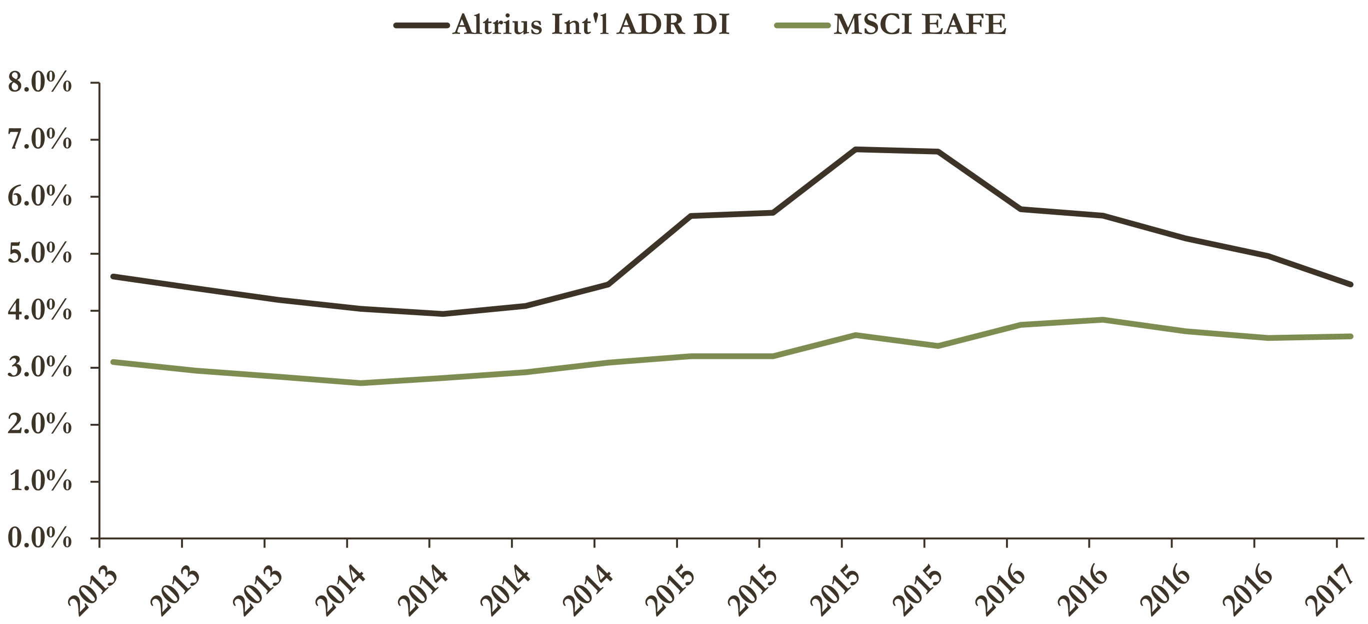
As one may recognize from the below chart, our firm has consistently provided a steady stream of income to our clients in the form of dividends. It is our assertion that this income stream has not only reduced the risk of our portfolio, but also provided a large part of the total return thereby leading to our performance success over this past tumultuous decade plus.

We believe that dividends allow our investors to "get paid to wait" while patiently working through volatile business and market cycles. This strategy provides emotional support during difficult cycles enabling investors to weather turbulent periods utilizing dividend income for personal needs or to reinvest cash at lower valuations. Our strategy is not only grounded in psychological and behavioral finance concepts, but is also supported by empirical evidence outperforming in both negative and full market cycles.

Dividends also act to align the interests of corporations and shareholders in helping to eliminate the agency effect. Corporate boards have recognized the value of dividends in stabilizing their stock price and encouraging investment during both high and lower tax regimes. In supporting and increasing dividends over time, managers are compelled to maintain a reliable stream of cash flows to shareholders rather than waste capital on those expenses adding little to corporate revenue including executive perks, pet projects, and ill-timed, unwise acquisitions. It appears a paradox; however, our experience and academic studies have displayed that sufficient investment for a good business can still occur in conjunction with dividends as managers are forced to invest cash flow more prudently and only in those capital investments in which they have the highest conviction in adding to corporate revenue particularly since stocks buybacks are often ill-timed.

Altrius: A Story of Consistent Dividends Over the Years

The strategy has consistently delivered a higher dividend yield than the MSCI EAFE index since its inception.



Source: Morningstar

Unconstrained Fixed Income Strategy Commentary

Based on our macroeconomic outlook over a three to five year period and our cyclical views from quarter to quarter, we employ top-down strategies that focus on yield curve positioning, volatility, and sector rotation. We then utilize bottom-up analysis to drive our security selection process and facilitate the identification of undervalued securities with the potential for above average income. We invest in securities that operate across diversified sectors in the fixed income markets of the United States, primarily those in U.S. dollar denominated high yield and investment grade bonds, including government securities, corporate bonds, and mortgage- and asset-backed. Sources of added value:

Credit Analysis - We emphasize independent analysis and do not rely on credit agencies.

Duration Risk - We avoid long, extreme duration shifts generally operating within a moderate duration range typically between two and four years.

High Income - Our research attempts to identify issues paying above average income.

Risk Premium Management - We seek to attain an attractive yield/spread in relation to a five-year treasury within acceptable levels of portfolio risk.

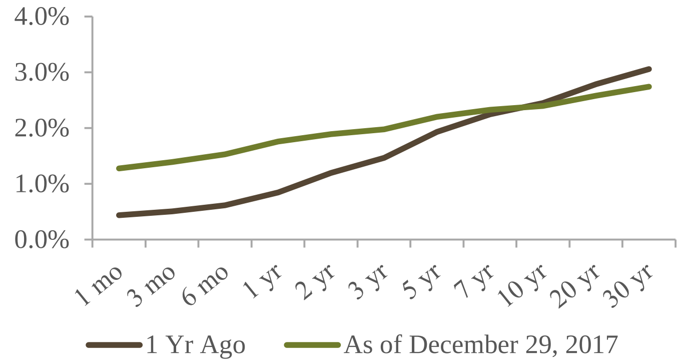
Performance Commentary

Market Overview

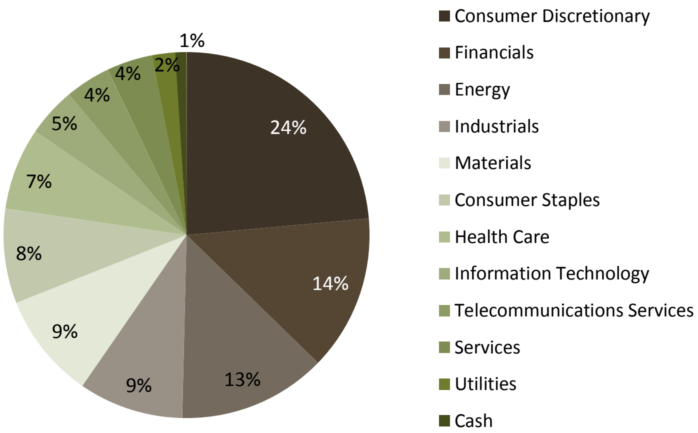
The broad-based US fixed income market produced varied results across sectors in the fourth quarter of 2017, but finished the year up +3.54% as measured by the Barclays US Aggregate Bond index. The 30-year US Treasury was the best performing market segment for the both the quarter and the year as a whole generating returns of +3.00% and +9.14% respectively. Shorter dated treasury notes suffered the most during the quarter, specifically the 2-year and 5-year, with each declining by -0.34% and -0.71% respectively. The aforementioned market dynamics resulting from rising short-term rates led to a pronounced flattening of the yield curve to a degree unseen since 2007.

In the corporate bond market, investment grade issues outperformed high yield bonds returning approximately

US Treasury Yield Curve



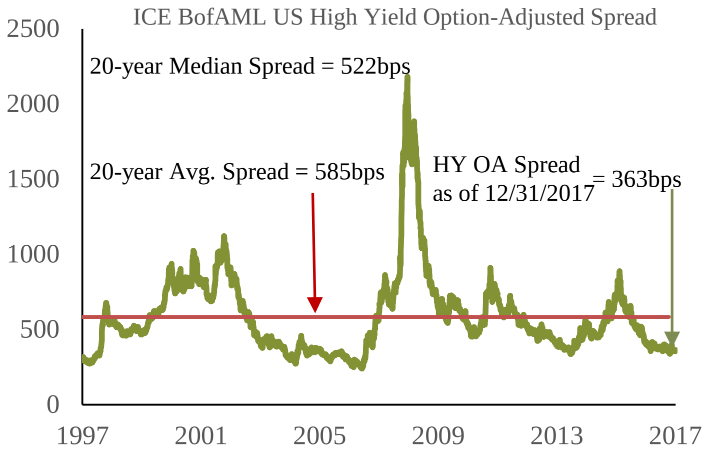
Sector Allocation



Top Ten Holdings	Weight
American Axle & Manufacturing	1.41%
Blue Cube Spinco	1.39%
Tempur Sealy	1.37%
Centurylink	1.36%
Western Digital	1.32%
Avis Budget Car Rental	1.31%
Credit Acceptance Corp	1.31%
The ADT Corporation	1.31%
Signet UK Finance	1.27%
Icahn Enterprises	1.26%

Unconstrained Fixed Income Strategy Commentary

+1.10%, outpacing high yield by roughly 70bps. However, high yield bonds were the second best performing fixed income market segment for the year returning approximately +7.50%. Aggregate credit spreads for both high yield and investment grade corporate bonds exhibited a modest degree of expansion during the first half of the quarter, but tightened over the year as a whole to end 2017 at levels last exhibited in mid 2014.



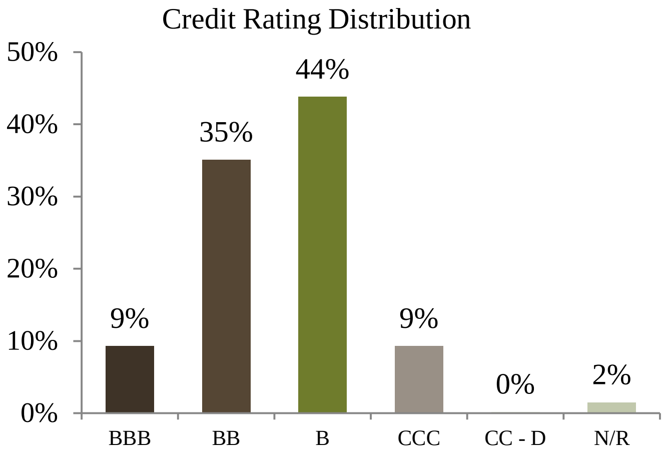
Performance Summary

The Unconstrained Fixed Income strategy generated a gross return of +0.73% for the fourth quarter of 2017, outpacing both the Barclays US Aggregate Bond and the ICE Bank of America Merrill Lynch High Yield Total Return indices, which each produced returns of +0.38 and +0.41 respectively. For the year as a whole, the Unconstrained Fixed Income strategy finished 2017 up +5.51% (gross of fees), outpacing the Barclays US Aggregate Bond index by 197bps, but trailing the ICE Bank of America Merrill Lynch High Yield Total Return index by the same margin of 197bps.

Strategy Characteristics

The strategy is heavily invested in the consumer discretionary, financial services, and energy sectors, with each accounting for approximately 23.7%, 13.8%, and 13.2% respectively of total strategy assets as measured by aggregate market value as of 12/31/2017. Exposure to the materials, industrials, and consumer staples sectors is also robust with each accounting for 9.4%, 9.3%, and 8.4% respectively. Despite the seemingly high degree of investment exposure to the aforementioned sectors, the strategy is always invested in an array of unaffiliated companies within each sector in order to provide broad diversification and help mitigate against issue specific credit risk.

Both the aggregate maturity and overall duration of the strategy remained largely unchanged over Q3 levels, finishing 2017 at 3.57 years and 3.05 respectively.



The strategy's overall credit quality remained unchanged over the prior the quarter, and currently stands at 'B +'.

Strategy Outlook

Despite the elevated valuations in the corporate bond market, it is our view that the high yield segment is primed to generate returns in the low to mid single digits for 2018 based on our outlook that economic growth will continue to persist at or above current levels, and inflation pressures will remain low. As oil prices have appeared to recover and stabilize over the prior year, the energy sector will most likely be an area of keen interest for us in 2018. The upper end of the high yield market (issues rated B+ to BB+) proved to be the best value in 2017, a theme we anticipate will persist in 2018. By our assessment, default risk within the strategy is low relative to recent years, and we believe the strategy is well positioned to perform in a rising rate environment.

Market and Economic Outlook

The fourth quarter capped yet another stellar year for U.S. stocks. Larger-cap U.S. stocks (S&P 500) gained 6.6% for the quarter and ended the year with a 21.8% total return. This was the ninth consecutive year of positive returns for the index—tying the historic 1990s bull market and capping a truly remarkable run from the depths of the 2008 financial crisis. The broad driver of the market's rise for the year was rebounding corporate earnings growth, supported by solid economic data, synchronized global growth, still-quiescent inflation and accommodative monetary policy. U.S. stocks got an additional catalyst in the fourth quarter with the passage of the Republican tax plan, presumably reflecting investors' optimism about its potential to further boost corporate after-tax profits, at least over the shorter term.

We're running out of superlatives to describe the U.S. stock market, but we'll throw out a couple more factoids that reflect just how unprecedentedly steady its recent performance run has been. The market's 1.1% gain in December crowned 2017 as the first year *ever* that stocks rose in each and every month. By year-end, the S&P 500 Index had rallied for more than 400 days without registering as little as a 3% decline. This is the longest such streak in *90 years* of market history.

Foreign stock returns were even stronger during 2017, with developed international markets gaining 25.0% (MSCI EAFE Index) though lagging U.S. stocks some during the fourth quarter with 4.2% returns. Moving on to bonds, the core bond index (Bloomberg Barclays US Aggregate Bond Index) gained 3.5% in 2017. This return was close to the index's yield at the start of the year, as intermediate-term interest rates changed little during the year with the benchmark 10-year Treasury yield ending at 2.4%. Although the Federal Reserve raised short-term rates three times (75 basis points total), yields at the long end of the Treasury curve declined and the yield curve flattened. Corporate bonds across all credit qualities and maturities had positive returns. High-yield bonds gained 7.5% (ICE BofA Merrill Lynch U.S. High Yield Index) and floating-rate loans rose 4.1% for the year (S&P/LSTA Leveraged Loan Index).

Looking Back: Key Drivers of Our 2017 Portfolio Performance

- Our strategies generated very strong absolute returns for the year.
- Our positions in international stocks were highly beneficial.
- Our unconstrained fixed income strategy added value over core investment-grade bonds.
- Our equities lagged broader indices as growth and momentum stocks strongly outpaced value for the year though we soundly outpaced our value-oriented peer managers.

Our globally diversified balanced (stocks/bonds) portfolio generated strong returns for the year, consistent with the positive overall return environment for most financial markets and asset classes. Altrius' flagship Global Income strategy, which consists of individual stocks and bonds yielding approximately 5% in dividend and interest income, returned 13.2% for 2017. Our portfolios benefited from meaningful exposure to international stocks which had very strong absolute returns and also beat U.S. stocks for the year. In the fixed-income portion of our portfolios, our long-held tactical positions in high yield bonds added value, outperforming core bonds by several percentage points.

Market and Economic Outlook Cont.

After a strong rebound in 2016, value stocks struggled to keep up with the surging market. The Russell 3000 Value index returned 13.2% with the small cap Russell 2000 Value returning 7.8% offering very attractive, above-average absolute returns. However, in *relative* performance terms, value trailed far behind momentum and growth stock indexes as the Russell 3000 Growth index gained a whopping 29.6%. As value managers, we have certainly faced relative-performance headwinds versus the broader market indices over the past two decades and certainly during periods of the post-financial-crisis. Though growth and momentum stocks will have periods of outperformance against value stocks, our confidence never waivers in the ability of our disciplined, value-based, dividend focused process to at the least provide sound risk-adjusted returns (along with steady dividends) for our investors and clients while also potentially outperforming broader market indices over longer periods of time.

Looking Ahead: Updates on Our Asset Class Views

U.S. STOCKS

As noted above, U.S. stocks were up almost 22% for the year, driven in part by expectations of a historic corporate tax cut, which the Republican-led Congress duly delivered. We suspect much of the benefit of tax decreases might be priced in based on consensus earnings estimates for the S&P 500. Regardless of what might be priced in, one question we are pondering is what do lower corporate tax rates mean for our long-term earnings assumptions for the United States? The answer is not straightforward as there are many variables to consider.

The tax reform may provide an incentive for companies to repatriate profits from overseas, increase hiring, boost pay and raise spending potentially leading to a virtuous economic circle. As it relates to earnings, specifically, we are evaluating whether the boost in after-tax corporate earnings will be temporary or permanent. Earnings should certainly see a boost in the short term at approximately 10% in aggregate. Larger companies may benefit less than smaller companies given that the former's actual effective tax rates were already well below the 35% statutory federal rate.

Over the long term, we'd expect the incremental profit margin benefit from lower taxes to be competed away in the form of lower prices to consumers (in many cases). Ultimately capitalism charges companies to pursue activities that generate higher profits and returns to shareholders—which will lead most companies to return much of the excess cash flow from tax savings to capital owners potentially leading to higher dividend payouts and yields. However, we also expect corporate spending discipline, exemplified since the financial crisis, to remain in place thereby keeping profit margins at its higher than long-term historical averages.

In the new tax plan, there's an additional tax incentive for companies to pursue capital expenditures which could increase economic activity, boosting overall profits. However, this would come at a time when we could be in the later stages of the business cycle, when the economy arguably is running close to full employment. This may create inflationary pressures and/or cause the Fed to raise rates faster, both of which may counteract the benefit from rising profits.

MARKET AND ECONOMIC OUTLOOK CONT.

EUROPEAN STOCKS

Politically, it was an eventful year for Europe. The uncertainties stemming from the 2016 surprise Brexit vote flowed into 2017. Markets then heaved a sigh of relief after French elections suggested that populist forces might be receding. However, investors were constantly reminded of prevalent political risks in Europe, with the general rise of Eurosceptic parties and the more recent Catalan vote in which the pro-independence parties in favor of breaking away from Spain secured a renewed albeit narrow majority.

Political uncertainties notwithstanding, Europe continues its economic recovery within what appears to be a benign fiscal and monetary environment. Europe is matching the United States in terms of economic growth and is on track to generate its strongest growth since 2007. Earnings have rebounded strongly with continental Europe and U.K. local-currency earnings growing over 25% and 35%, respectively, over the past 12 months. (The United States has seen earnings growth of 14% over the same period.) While earnings were up strongly, investor sentiment was relatively depressed (especially during the fourth quarter), leading valuation multiples to compress. In U.S. dollar terms, Europe generated strong performance in 2017, up 27%, and outperformed U.S. stocks, although this includes a hefty contribution from currency, with the Euro appreciating about 11% versus the dollar.

CORE BONDS

Our return expectations for core bonds remain muted looking out over the next five years, in the range of 2.5% to 3.2% (from a current yield of 2.7%). Since the financial crisis, government policy and direct issuance of Treasury securities has not only suppressed yields but has also lengthened duration. Today, investors in investment grade bonds are faced with taking on elevated levels of interest-rate risk for low yield. The yield per unit of duration is near its all-time low. For context, a 50-basis-point yield increase in the Bloomberg Barclays U.S. Aggregate Bond Index would wipe out more than a year of income. This explains our meaningful positioning away from core bonds in favor of high yield issues which we believe will outperform investment grade bonds in a period of flat or rising rates.

MUNICIPAL BONDS

A generally healthy economic backdrop in the form of rising GDP, low unemployment, and rising home values should support municipal debt. However, we expect a low-single-digit return and continue to find the asset class uncompelling.

HIGH-YIELD BONDS

As noted previously, high-yield bonds had solid absolute returns in 2017 driven by signs of a firming macroeconomic backdrop (domestic and abroad), the Fed’s measured and largely anticipated rate hikes, low stock market and interest rate volatility, relatively attractive yields, and overall healthy fundamentals. The fundamental backdrop includes a benign maturity calendar (i.e., issuers of high-yield bonds have very little debt maturing over the next two years), EBITDA margins hitting their second-highest level on record, and leverage ratios that have declined for five sequential quarters. As a result, default rates remained at historically low levels for high-yield bonds.

MARKET AND ECONOMIC OUTLOOK CONT.

Looking Ahead: A Quick Word on the Macro Outlook

- The global economy remains in a synchronized recovery—the strongest since the financial crisis—and it seems almost no one expects a U.S. recession during 2018.
- U.S. stock market prices already reflect this sanguine consensus and few investors will accurately predict the timing of the next recession.
- However, unprecedented central bank policy shifts from stimulus to tightening could be a trigger.

In terms of the near-term macro outlook, the consensus view is that there is little risk of a U.S. or global economic recession in 2018. The market expects the in-sync global growth that we saw in 2017 to continue. Without a recession, a bear market in stocks is unlikely—although a run-of-the-mill 5% to 10% "correction" can happen at any time and an unexpected macro/geopolitical shock could cause a larger drop.

Given this optimistic near-term macro backdrop, one might ask why we aren't more heavily invested in U.S. stocks or stocks in general. The simplest answer is that we have little confidence in our (or anyone's) ability to forecast the timing/onset of recessions. We also think most investors are overconfident in their ability to do so, believing they can successfully time the market and are able to "get out" before everyone else and before prices take a meaningful hit. Of course, that is logically impossible - just as everyone can't be an above-average driver. Investors may also be underestimating the potential for a surprise negative shock, leading to a stampede for the exits.

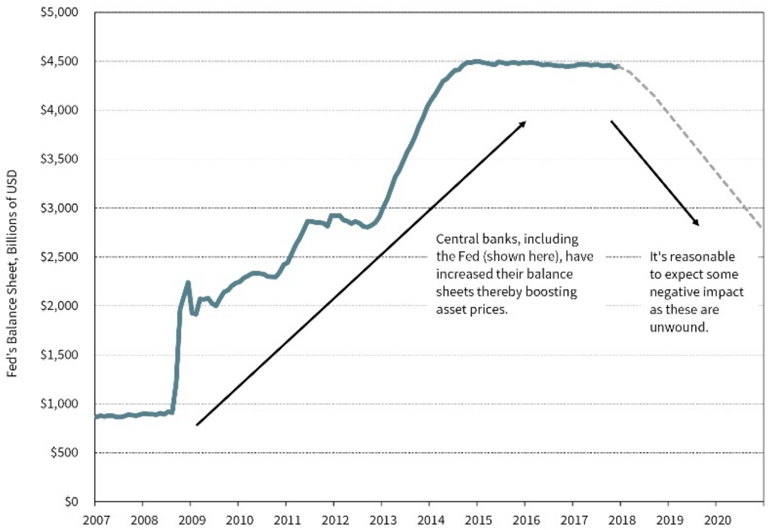
Moreover, when an outlook becomes the strong consensus view, one should assume it is *already discounted* to a meaningful degree in current market prices. This is where our investment discipline comes in, because we *do* think we have expertise and an edge in assessing fundamentals, valuations, expected returns, and risks *across different asset classes and securities* and *over longer-term periods*. Current market prices are a key input into that assessment: high valuations (high prices relative to underlying fundamentals) imply lower future returns. When the market is excessively bullish or optimistic, our analysis should reflect that in lower/low expected returns. That is where we find ourselves today with the broader U.S. stock market driven in particular by a relatively small number of pricey growth/momentum stocks.

We fully expect to get the opportunity to add back to sectors and industries we believe to be currently overvalued (i.e. utilities, REITs, municipal bonds, etc.). One obvious trigger for that would be a meaningful drop in the market (i.e., a bear market). We believe one is likely sometime in the next five years (our tactical time horizon). Again, we can't confidently predict exactly when, but one reasonable scenario would be triggered by ongoing Fed monetary policy tightening, which is already underway, followed by other central banks, such as the European Central Bank, Bank of Japan, and/or the People's Bank of China. Economic and market history would argue for that eventual outcome.

MARKET AND ECONOMIC OUTLOOK CONT.

This market cycle has the added "feature" of an unparalleled unwinding of unprecedented monetary policies put in place after the financial crisis: trillions in central bank asset purchases and negative interest rates that have yet to be normalized. Given the boost to asset prices from these policies, it is reasonable to expect some negative impact as they stop and then reverse course (i.e., "quantitative tightening"). To date, the Fed's gradualist and well-telegraphed steps have proceeded nicely. However, there is a long road ahead of us. There will also be a new Fed chair and several new voting FOMC members in 2018, creating more potential for a market surprise.

Central Banks are Set to Unwind Their Unprecedented Policies



Source: Federal Reserve. Data as of 12/31/17. Unwinding projections based on stated Fed policy: $10 billion per month starting October 2017, rising $10 billion each quarter until $50 billion per month.

Markets have certainly become used to easy monetary policies. With an expectation of only two to three Fed rate hikes in 2018, a more aggressive shift in tightening of global central bank policies poses risks to markets and economies, particularly as the new and still-evolving Fed leadership is untested. At the very least, it raises the potential for increased market volatility.

On the other hand (there's always an "other hand" in economics), should U.S. stocks continue their very strong upward trajectory, we will further reduce our exposure to them. There are multiple variables and moving parts that go into our determination of portfolio allocations. However, all else equal, one key trigger for U.S. stocks would be if even under our optimistic/bullish scenario, we are seeing low-single-digit five-year expected annualized returns. Currently, our optimistic scenario shows expected annualized returns of around 7%–8%.

Putting it All Together: Our Portfolio Positioning

Our portfolio construction and management are based on several factors:

- Our medium-to-longer-term (five-plus year) return outlook for the asset classes we cover,
- Our assessment of the shorter-term downside risk for each asset class,
- Our assessment of the diversification and risk-management benefits from each asset class,
- Our assessment of the broader macroeconomic environment and attendant risks and opportunities.

MARKET AND ECONOMIC OUTLOOK

Currently, our base case scenario implies very low expected returns for both the U.S. stock and core bond market indices looking out the next five years. As such, we remain defensively positioned in U.S. stocks and tilted toward international stocks, where, as noted previously, our return expectations are materially higher than for U.S. stocks.

We believe the range of outcomes covered across our bear and optimistic scenarios adequately captures the recent U.S. corporate tax cut's potential benefits for U.S. equities, and, therefore, we are not contemplating any portfolio-level changes. If we ultimately conclude that U.S. corporations' *normalized* (i.e. longer-term) earnings have improved, we'd likely increase our five-year earnings number slightly across our base case and optimistic scenarios, and maybe even in our bear case. The magnitude of such a shift would not be material (i.e. a 10% increase in our normalized-earnings estimate) and would likely not lead us to increase our exposure to U.S. stocks as we believe U.S. stocks are somewhat overvalued and our return expectations are sufficiently low.

In terms of international markets, we were heartened to see our investment thesis of a European earnings rebound coming through strongly last year. However, we don't believe our portfolios have been fully rewarded for this yet given that European stocks lagged the U.S. market in local-currency terms. The longer European corporate earnings growth is not reflected in stock prices, the cheaper European equity valuations become on metrics such as trailing price-to-earnings, price-to-cash flow, etc. Ultimately, we expect there to be a hand-off in terms of drivers of European stock market outperformance versus U.S. stocks. As such, we're maintaining our tactical overweight to Europe.

In light of the particularly low expected returns for core bonds, along with the risk of rising interest rates (which correspond to lower core bond *prices),* we maintain meaningful exposure to high yield bonds. While our base case five-year expected returns for high yield bonds are several percentage points above that of core bonds, they do carry more credit risk than core bonds. Therefore, we assume they have more downside in the event of a recession or other macro shock (providing it's not an *inflationary* shock, which would likely be worse for core bonds as high yield issues are generally not as interest rate sensitive).

Concluding Comments

The year 2017 was a very good one for most financial markets and particularly global stocks. However, there was one small corner of the investment world that did a bit better than stocks: bitcoin gained 1,518%. As mentioned in our recent blog, we don't own bitcoin (or any other crypto currency) as it doesn't fit within our investment discipline circle of competence. It's a speculative game we *simply don't need to play* to achieve our clients' investment objectives.

However, the exponential rise of bitcoin and the questions, emotions, and behaviors it triggers in many investors offers us an opportunity to restate some of the core principles and practices that underlie our investment approach. First, the path to long-term investment success is simple to describe, but not easy to achieve. As Charlie Munger put it in his characteristically blunt way: "It's not supposed to be easy. Anyone who finds it easy is stupid." Successful long-term investors are disciplined and patient. They are honest with themselves about what they know, what they don't know, and what they can't know (the unknowable). In making investment decisions, they focus both on what's knowable (within a reasonable degree of likelihood) and what's important (in terms of portfolio impact). Yet, they are also cognizant of and try to manage their exposure to risks that are important, but unknowable or unpredictable (i.e. geopolitical shocks).

Successful investors have the humility to know not every decision will turn out to be right and that simply having conviction about something doesn't mean it will actually happen. Their investment process is well defined and repeatable. It requires having a sound basis for each decision, so that if investors consistently implement the process over time they should be right more than wrong and the gains from their winners will more than outweigh their losers.

Successful investors are willing to challenge their own ideas and admit when they are wrong—whether due to new information and changing circumstances, or an error in their original thesis. They keep their eyes on their long-term financial objectives and on the underlying fundamentals that ultimately drive investment returns. They don't get emotionally caught up in the day-to-day noise of the financial news channels or the zigs and zags of the markets. However, when the short-term zigs and zags get meaningfully out of whack with the longer-term fundamentals, they use that price volatility to their advantage—buying lower and selling higher. If the market isn't presenting them with compelling investment opportunities, they are content to hold their current positions; in other words, they don't confuse activity with progress. (Munger calls it "sit on your ass investing.")

Successful investors are self-aware about their own risk tolerance and investment temperament. As such, they are invested in a portfolio consistent with those personal attributes, managed by an investment manager aligned with them as well. This enables them to remain disciplined and patient—during the good times as well as the inevitable challenging periods—on the road to achieving their long-term success.

Thank you for your continued confidence and trust. All of us at Altrius Capital wish you and yours a very happy, healthy, peaceful, and prosperous New Year.

Disclosures

This report includes candid statements and observations regarding investment strategies, individual securities, and economic and market conditions; however, there is no guarantee that these statements, opinions or forecasts will prove to be correct. These comments may also include the expression of opinions that are speculative in nature and should not be relied on as statements of fact. Altrius is committed to communicating with our investment partners as candidly as possible because we believe our investors benefit from understanding our investment philosophy and approach. Our views and opinions include “forward-looking statements” which may or may not be accurate over the long term. Forward-looking statements can be identified by words like “believe,” “expect,” “anticipate,” or similar expressions. You should not place undue reliance on forward-looking statements, which are current as of the date of this report. We disclaim any obligation to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise. While we believe we have a reasonable basis for our appraisals and we have confidence in our opinions, actual results may differ materially from those we anticipate.

The information provided in this material should not be considered a recommendation to buy, sell or hold any particular security. The S&P 500® Index is an unmanaged index of 500 selected common stocks, most of which are listed on the New York Stock Exchange. The Index is adjusted for dividends, weighted towards stocks with large market capitalizations and represents approximately two-thirds of the total market value of all domestic common stocks. The Russell 3000 Value Index is an unmanaged index commonly used as a benchmark to measure value manager performance and characteristics. The Dow Jones U.S. Select Dividend Index is an unmanaged index commonly used as a benchmark to measure dividend manager performance and characteristics. The Russell 2000 Index, the Russell 2000 Growth Index, and the Russell 2000 Value Index are unmanaged indices commonly used as benchmarks to measure small cap manager performance and characteristics. The MSCI EAFE® Index is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the U.S. & Canada. The Bloomberg Barclays U.S. Aggregate Bond Index and Bank of America Merrill Lynch US High Yield Master II Total Return Index are unmanaged indices that are commonly used as benchmarks to measure fixed income performance and characteristics. Index performance returns do not reflect any management fees, transaction costs or expenses. Investments cannot be made directly in an index. **Investments made with Altrius Capital Management, Inc. are not deposits or obligations of any bank, are not guaranteed by any bank, are not insured by the FDIC or any other agency, and involve investment risks, including possible loss of the principal amount invested. Past performance is not a guarantee of future returns.**