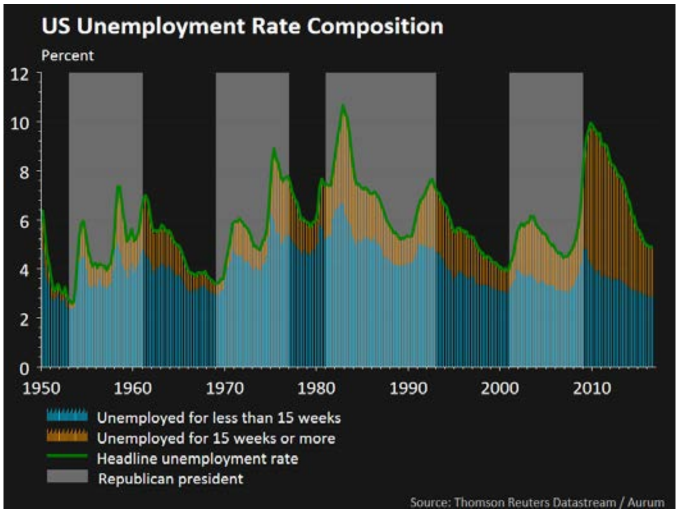
Strategy Newsletter
1st Quarter 2017

- The new administration brings more upside to the U.S. economy with risks to trade.
- Equities performed well post-election with high dispersion among sectors.
- Higher inflation and real growth expectations pushed interest rates sharply higher.
- Hedge funds were up in the fourth quarter with managed futures profitably shorting bonds.

Economy

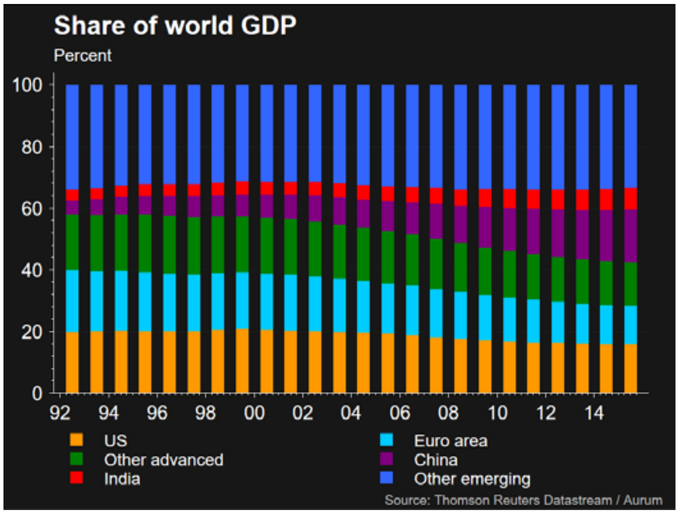
The unemployment rate declined in the years before three of the last four Republican presidents came into office. Eisenhower took over in 1953, near the trough of the employment rate. The same occurred with Nixon in 1969 and George W. Bush in 2000. The unemployment in the green line below shows this trend.



For each of these presidents, timing was not on their side as the business cycle was nearing the end. The cyclical ups and downs of the economy can be effected by policies enacted by the President and Congress, but only to a degree. President-Elect Trump inherits an economy with an unemployment rate that has declined for eight straight years.

The new administration is seeking to provide fiscal stimulus to the economy. It aims to boost through both tax cuts and infrastructure spending programs. With a Republican Congress, plenty should get done. Most likely these changes will go into effect in 2018. With the velocity of money picking up due to these policies, inflation will likely increase. In turn, the Federal Reserve would likely increase the pace of interest rate hikes. Fed Chair Yellen has indicated as much.

Recent data across the global economy looks healthy. This matters considering how many countries make up a significant share of world GDP. The rest of the world has gained ground on developed markets the last 25 years, while the U.S. has only declined modestly. The biggest increase was from China followed by India.



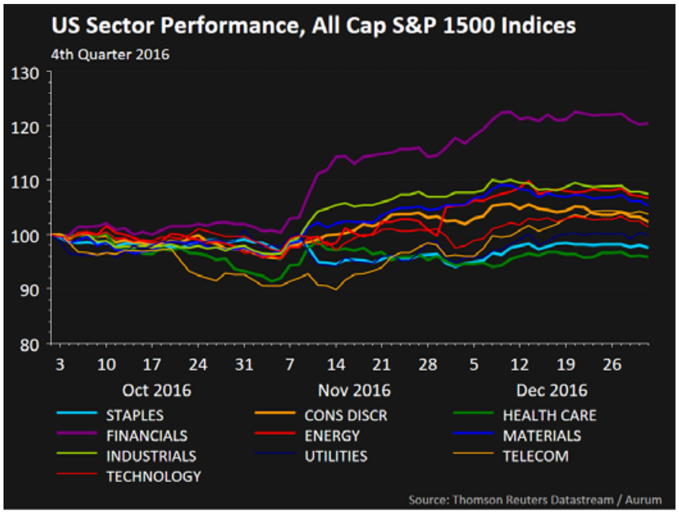
The largest economic risk we see to the "Trumponics" rhetoric is a trade war. Tensions with China or other countries could cause a drop in exports for all. The stated ultimate goal of the administration is growing the U.S. economy at 4% instead of 2%. President-Elect Trump's economic advisors know a trade war is not the path to the growth goal. While the U.S. only makes up about 16% of world GDP, it is still the key driver.

Equity

Equities slid lower during October. As Donald Trump began to take the lead in the vote count on the night of November 8th, stock market futures began to sell-off sharply by 4%. By the open the next day, equities regained footing and were off to the races for the remainder of the year.

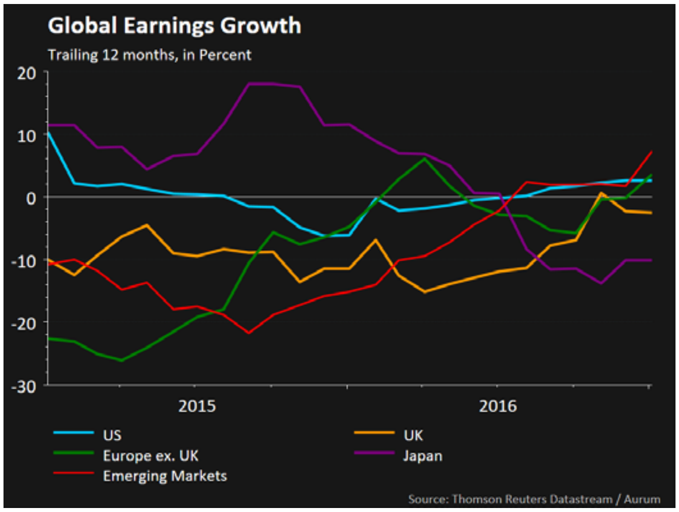
US Equity	4Q 2016
Large Cap Stock	
Dow Jones Industrial Average	8.66%
S&P 500	3.82%
Small & Mid Cap Stock	
Russell Mid Cap	3.21%
Russell 2000	8.83%
Style Indices	
Russell 3000 Value	7.24%
Russell 3000 Growth	1.20%
International Equity	**4Q 2016**
MSCI EAFE	-0.68%
MSCI EAFE Value	4.22%
MSCI EAFE Growth	-5.50%
MSCI Europe	-0.36%
MSCI Japan	-0.14%
MSCI Emerging Markets	-4.08%

There was large sector dispersion during the quarter after the election. Financials were the clear winner while utilities, staples, and health care all dropped.



Since the beginning of 2008, financials were the only sector (besides energy) to not reach a new high in price. The S&P 1500 All Cap Financial Index finally breached this level after the 2016 election. Higher interest rates and the promise of less regulation helped banks and the rest of financials trounce other sectors.

Commodity prices bottomed in early 2016. In turn, earnings in emerging markets turned higher and remain the regional leader over the past twelve months. U.S. earnings only took a modest dip in late 2015 with oil prices falling before bouncing. Japan's earnings turned negative in 2016.



The U.S. equity market was the clear winner post-financial crisis. Left behind have been emerging markets, with returns hurt by falling currencies. However, with cheaper currencies today, this should boost export demand for these countries. In a surprise to many, the returns in 2016 for emerging markets (+11.60%) and the S&P 500 (+11.96%) were quite close. If the earnings trend continues, and we believe there are tailwinds, emerging markets are in a solid position looking ahead.

Our Aurum Asset Allocation Frameworks continue to hold an underweight to developed markets and an overweight to emerging markets. Portfolios are above the strategic equity targets due to the undervalued prices found in emerging markets. Our tactical weights reflect value-based opportunities.

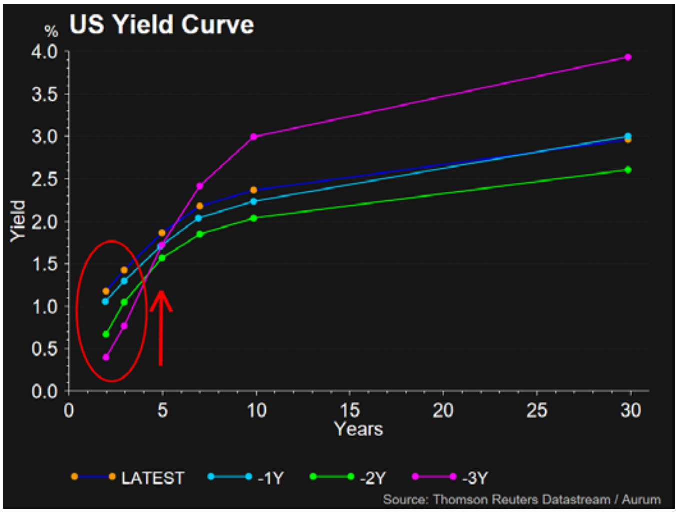
Fixed Income

In just three months, bonds gave up more than half the returns earned during the year. This is as measured by the Barclays U.S. Aggregate Bond Index. The index covers about $17 trillion of the $38 trillion U.S. debt market.

Fixed Income	4Q 2016
Barclays U.S. Aggregate Bond	-2.98%
Barclays Corporate Inv. Grade	-2.83%
Barclays High Yield Bond	1.75%
Barclays Global ex. U.S. Tres.	-11.26%
Barclays Municipal Bond	-3.62%

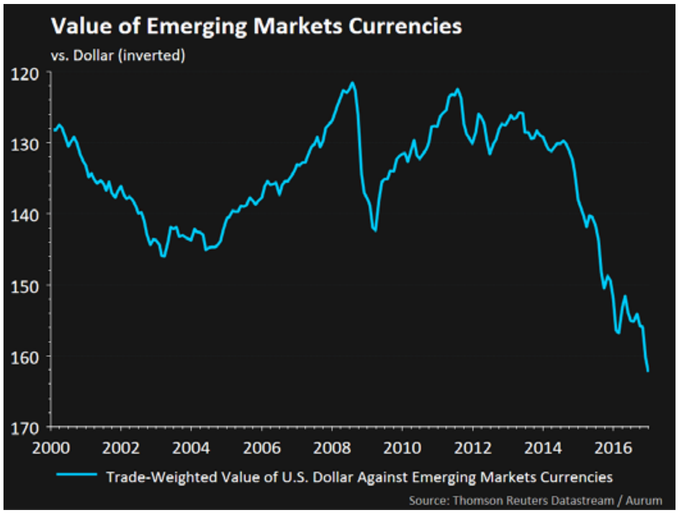
Yields on bonds rose gradually since the summer. Stronger growth prospects around the globe and higher inflation expectations drove this. Just after the election, yields rose over a quarter of a point in just one day and continued the ascent higher to finish the year.

Below we plot how yields changed over the last three years. Yields on the 10-year and 30-year bond peaked in early 2014 and shifted downwards since. On the front end of the curve, for maturities of 2, 3, and 5-years, the curve shifted higher. The anticipation of, and actual interest rate hikes (in December of both 2015 and 2016), drove the shifts.



High yield bonds held up well during the quarter and were one of the top performing asset classes in 2016. We continue to favor structured credit, such as mortgages and airplane leases. Bonds with contractual cash flows paid to our investors backed by tangible assets are attractive. Many of these securities have interest rates that float, so the prices hold up better in a rising interest rate environment.

During the quarter, we added a position to global bonds. The portfolio owns many developed government bonds while hedging currencies using the Euro and Yen. Given the selloff in many emerging market currencies the last three years, we found value in this region of the world. Also, the fund manager is historically one of the top performers in the category. He was dealing with a period of short-term underperformance, which is often an ideal entry point for strategy selection.



We maintain a slight overweight to fixed income within the asset allocation frameworks. Despite this, the sensitivity to interest rates of bond portfolios is below that of conventional benchmarks, such as the Barclays U.S. Aggregate Index.

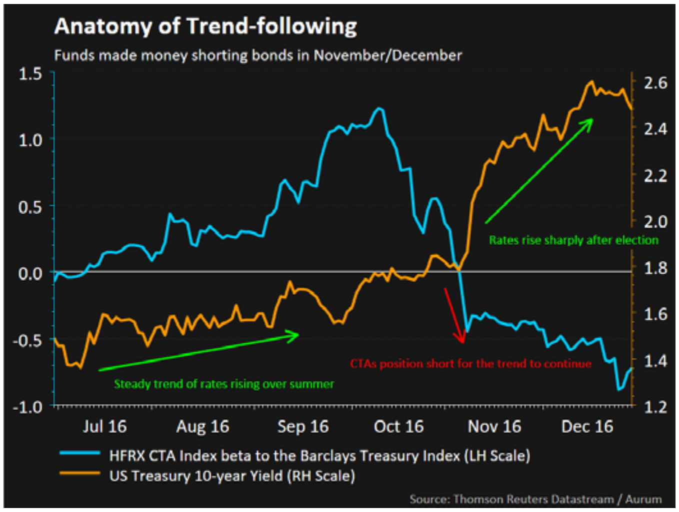
Alternative Investments

Hedge funds topped the interest rate sensitive asset classes of REITs and TIPS during the fourth quarter.

Alternative Assets	4Q 2016
HFRI Fund of Funds Index	0.77%
Dow Jones Global Select REIT	-4.26%
Barclays U.S. TIPS	-2.41%

One of the top performers in the quarter were hedge funds using a trend-following strategy. This means buying when a trend is up or shorting when a trend is down. Sharp price reversals are the achilles heel of this strategy. Steady rising or falling trends are what these managers seek.

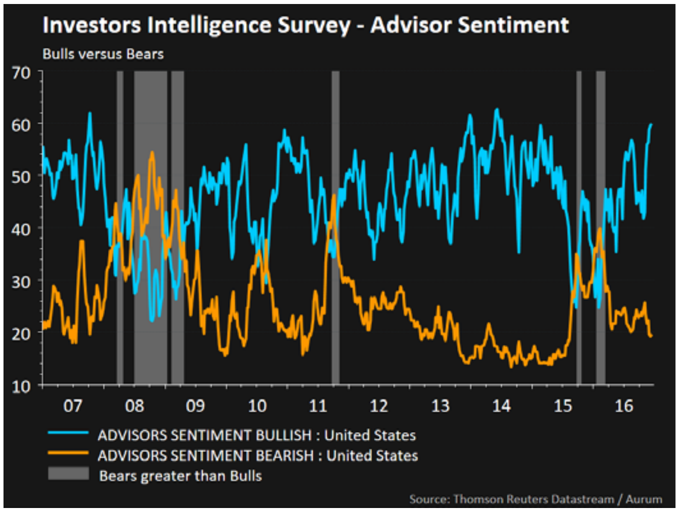
Often known as managed futures, trend-following strategies had a great set up for bonds in the second half of 2016. Bond yields were rising over the summer. This prompted managers to take down the beta, or sensitivity to price moves in bonds. Using trend-following systems, this eventually led the managers to short positions. The pop higher in yields following the election proved profitable for these positions.



We believe TIPS are beginning to look more attractive, now that the real yield is positive again. We continue to be underweight alternatives as a whole and within each of the three sleeves (diversified, REITs, and TIPS).

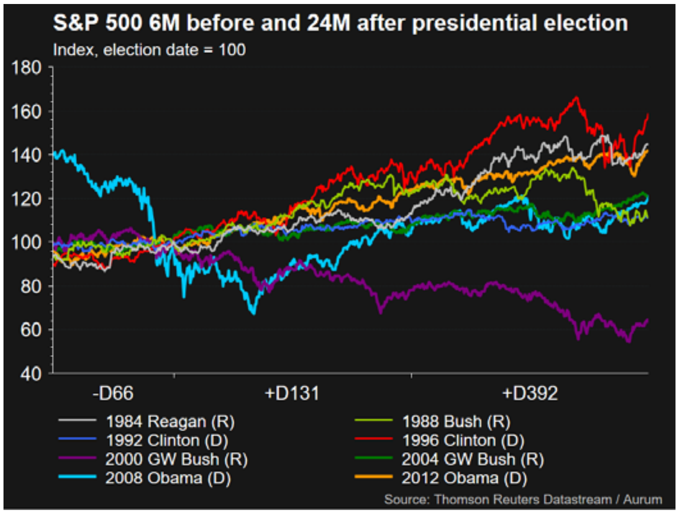
Conclusion

The positive sentiment towards stocks has not been this high since December 2013 and June 2014. One might think that this would be a good contrarian indicator, providing a warning to investors. Yet in both instances, equities were higher six months later.



Bearish sentiment from advisors came way down from the heights in early 2016 (orange line). Yet, it is not at the levels from 2014 or 2015.

In seven of the last eight presidential terms, stocks were higher 24 months after the election. See the graphic below. Again, this is luck-based for the majority, or the lack there of (for George W. Bush coming in at the height of the technology stock bubble in 2000).



Data driven analysis is not always right, just ask the pollsters for the last presidential election.

AURUM

Aurum Asset Allocation Frameworks

	Income		Conservative Balanced		Moderate Balanced		Aggressive Balanced		Aggressive Growth	
	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical
Equity	0%	0%	20%	23%	35%	40%	50%	55%	70%	76%
U.S. Equity	0%	0%	12%	12%	20%	20%	30%	28%	42%	40%
Int'l - Develop. Markets	0%	0%	6%	5%	12%	11%	16%	15%	21%	20%
Int'l - Emerg. Markets	0%	0%	2%	6%	3%	9%	4%	12%	7%	16%
Fixed Income	65%	65%	45%	47%	30%	33%	17%	22%	10%	10%
U.S. Fixed Income	56%	62%	39%	41%	26%	29%	15%	18%	7%	9%
Global Fixed Income	9%	7%	6%	6%	4%	4%	2%	4%	3%	1%
Alternative Invest.	25%	23%	28%	19%	30%	19%	30%	19%	19%	13%
Diversified Strategies	19%	23%	22%	19%	24%	19%	24%	19%	15%	13%
Real Estate & REITs	2%	0%	2%	0%	3%	0%	3%	0%	4%	0%
Inflation-Indexed Sec.	4%	0%	4%	0%	3%	0%	3%	0%	0%	0%
Cash/Equivalents	10%	12%	7%	11%	5%	8%	3%	4%	1%	1%
U.S. Dollar	10%	12%	7%	11%	5%	8%	3%	4%	1%	1%

The risk designations are relative only to the five Strategic Allocation targets and do not represent comparisons with any other investment or risk of the overall strategies.