AURUM WEALTH MANAGEMENT
A SKODA MINOTTI FIRM

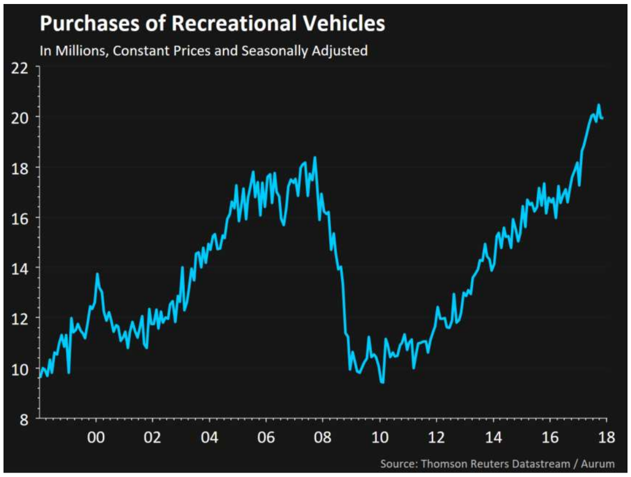
Strategy Newsletter – 1st Quarter 2018

- The U.S. tax plan boosts an already strong global economic backdrop.
- Stocks in emerging markets broke out to new all-time highs.
- The Fed knows inflation is low and is willing to get the data higher.
- Two alternative asset classes look more attractive for investors.

Economy

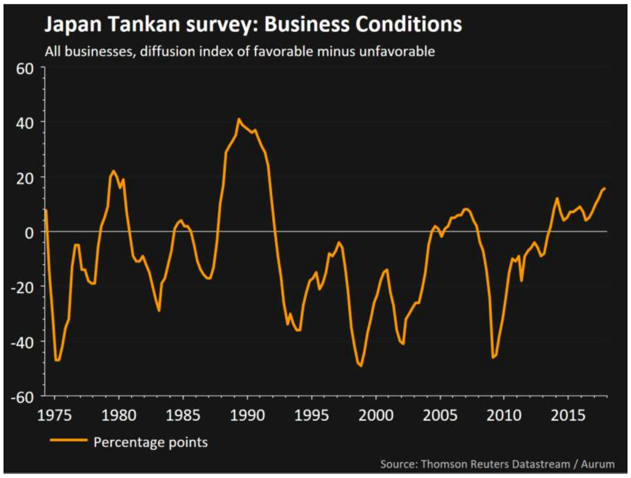
The U.S. economy already had momentum and in December we received a new tax plan. This gives the dose of fiscal stimulus that we have been talking about for years. There is plenty to like and dislike about the bill, but overall it will put more money in motion and into the private sector. Lower tax rates for corporations and individuals make this possible. Immediate expensing of capital purchases for businesses is also a plus. The repatriation of cash from overseas will be great for shareholders, though not as much for the real economy.

A fun demonstration that the economy is in great shape is pictured below. In 2017, there were more sales of recreational vehicles in history than ever before. From 4-wheelers to RVs, people were ready to put down cash (or take out loans) to make a large discretionary purchase.



Around the world, economies are in a synchronized growth period. Surveys across the Eurozone, including the peripheral countries like Italy, Spain, and Portugal show confidence at the highest levels since 2007.

We continue to be particularly excited about Japan. Prime Minister Abe combined positive fiscal and monetary policies to create an environment of growth and confidence. The Japan business survey below measures the difference between favorable and unfavorable conditions. The data shows the measure at the highest levels since 1991. Rising equity prices and strong policies are showing people believe.



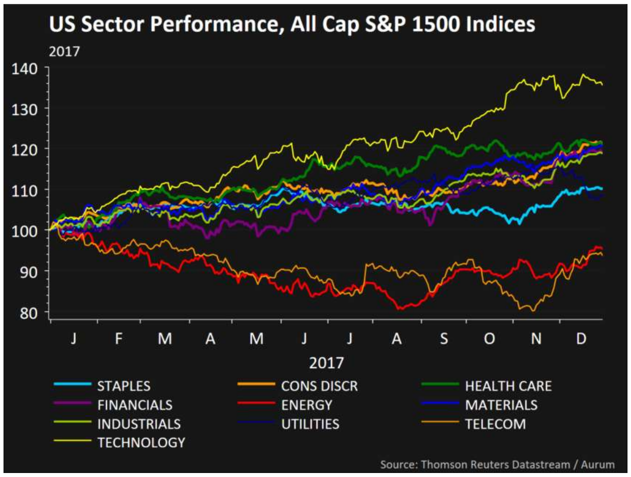
Hopes are high and these feelings tend to happen later in the economic expansion rather than at the beginning. The runway is clear (except for geopolitical shocks, as always). Watching out for a spike in commodity prices and an overzealous Federal Reserve are the two key risks to be mindful of moving forward. Households should continue to see solid wage increases while businesses have strong incentives to reinvest.

Equity

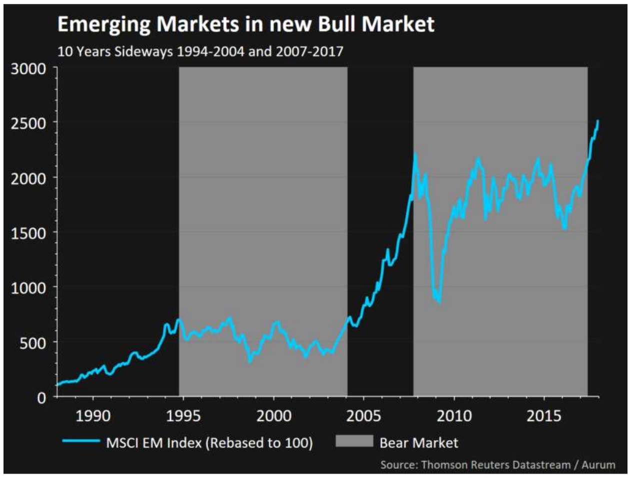
Equities turned in another strong performance for 2017 in the fourth quarter. Emerging markets were the top region while growth tended to beat out value indices.

US Equity	4Q 2017
Large Cap Stock	
S&P 500	6.65%
Small & Mid Cap Stock	
S&P 400 Mid Cap	6.27%
S&P 600 Small Cap	4.02%
All Cap Style Indices	
S&P 1500 Value	6.17%
S&P 1500 Growth	6.74%
International Equity	**4Q 2017**
MSCI EAFE	4.27%
MSCI EAFE Value	3.28%
MSCI EAFE Growth	5.27%
MSCI Europe	2.26%
MSCI Japan	8.52%
MSCI Emerging Markets	7.50%

While global markets were up almost uniformly, there was large dispersion among sectors. Technology increased 37% led by the household technology names like Amazon, Apple, Facebook, and Netflix. On the other end of the spectrum, the two sectors losing on the year were energy and telecom.



The emerging markets equity index published by MSCI comprises 24 countries across five continents. It was a banner year for emerging markets as it outpaced the U.S. for the first time since 2010. During the last year, the emerging markets price index completed another feat. It broke above the highs it originally made ten years earlier in 2007. Back in 2004, it had been ten years since the price index had been above the levels it first hit in 1994. It went on to triple over the next three years.



This is quite a positive development for future inflows. Morgan Stanley, the publisher of the MSCI indices, modifies the countries in the emerging markets index as equity markets grow and mature around the world. Some might point out the different constituents in the index today. Nonetheless, nothing changes people's minds like price. Most institutions use either MSCI or FTSE for benchmark purposes and the direction is clear. Those investors that sold out of emerging markets over the past several years have taken notice of relative outperformance and the price breakouts to new highs.

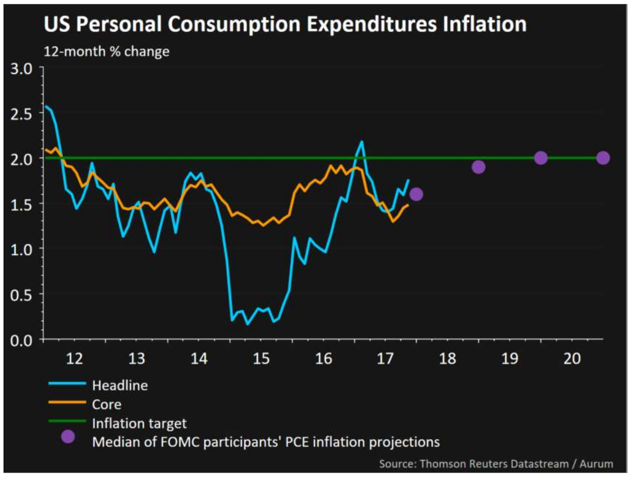
The portfolio weight for equities remains near the long-term strategic target. While we remain underweight U.S. small caps, the domestic large cap brethren continue to reach higher into our valuation composite, now at the 84th percentile. An overweight to emerging markets remains our key tactical allocation at the expense of U.S. small caps.

Fixed Income

Interest rates drifted higher during the quarter, except for the longest tenor out to 30 years, which fell modestly. Corporate borrowing spreads came down, boosting returns for bonds.

Fixed Income	4Q 2017
Barclays U.S. Aggregate Bond	0.41%
Barclays Corporate Inv. Grade	1.21%
Barclays High Yield Bond	0.57%
Barclays Global ex. U.S. Tres.	1.81%
Barclays Municipal Bond	0.82%

For the third time this year, the Federal Reserve raised interest rates 0.25% to put the Fed Funds rate at 1.50%. The low inflation level has confused economists during this cycle. The target for inflation is the green line below at 2%. Even given low interest rates, quantitative easing, and positive Fed member speeches, inflation cannot seem to reach the goal.



While low interest rates are nice, households are already so indebted that the price for credit (interest rates) simply does not matter, no matter how low it is. We have been writing that the missing ingredient is fiscal stimulus. The tax plan, while not perfect, will likely increase real final demand to a certain degree, which in turn should increase inflation closer to the Fed's projection of 2% over time. There are some Fed members who believe that since inflation has been below 2% for so long, the allowance for it to run "hot" above 2% for a period of time should be allowed. Either way, we believe the risk is to the upside for prices.

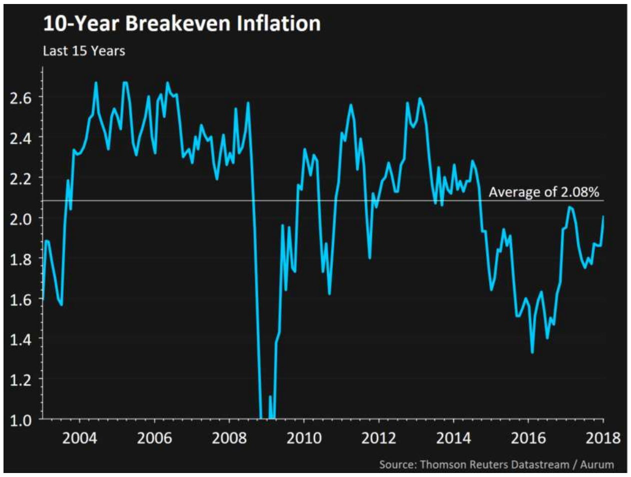
In the last quarter, we lowered our weight to structured credit and corporate credit by selling a fund that became overly popular and offered a less compelling risk/reward scenario. We maintained our allocation to global fixed income markets, particularly through a manager with unique currency and sovereign bond exposure. We remain equal weight fixed income overall in the Asset Allocation Frameworks.

Alternative Investments

Hedge funds turned in a mixed quarter across strategies. Foreign REITs outperformed U.S. REITs, with both turning in positive results. TIPS also jumped higher in the quarter.

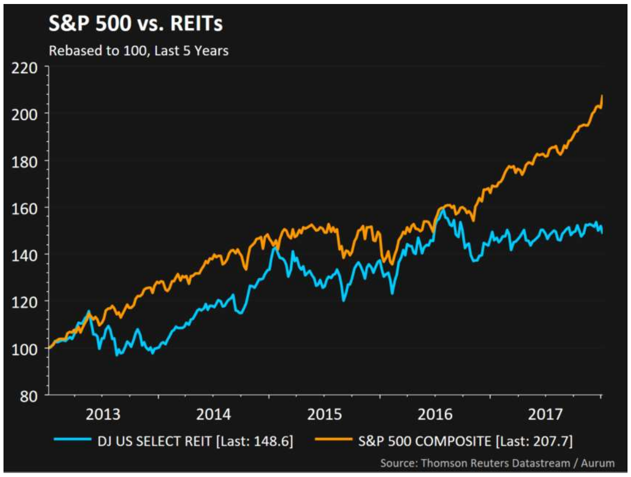
Alternative Assets	4Q 2017
HFRI Fund of Funds Index	2.02%
S&P Global REIT	3.02%
Barclays U.S. TIPS	1.92%

With low inflation data for many years in a row comes low expectations from the market. Breakeven inflation is a market-based forecast of the level of inflation, which has been well below the average since 2014 as the chart below shows.



With a cyclical upswing in the economy, fiscal stimulus in place, and low expectation in place, we see an opportunity for Treasury Inflation Protected Securities (TIPS) to perform. In addition, the risk factors that TIPS add to a diversified, multiple asset class portfolio is strong with its longer duration and inflation component. We purchased TIPS across client portfolios during the fourth quarter.

Another asset class sensitive to inflation underperformed for the last several years. Real Estate Investment Trusts unperformed the broader US Equity market by nearly 60% over the past five years.

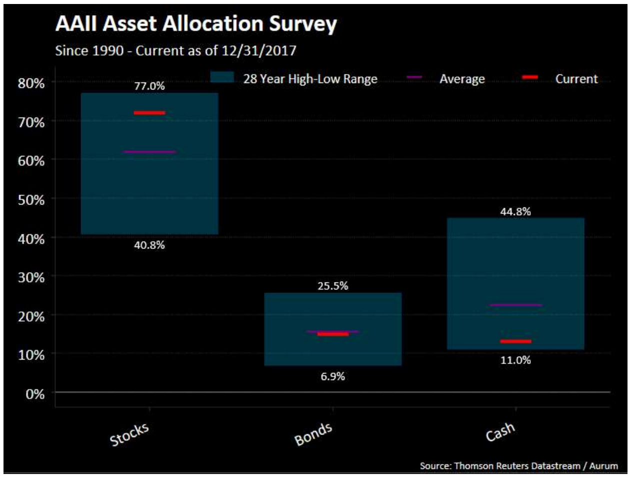


On a relative basis, REITs look the most attractive since 2009. Given commercial and residential real estate prices are sensitive to economic growth, we believe a risk-managed solution is more appropriate at this latter stage of the cycle.

Portfolios own non-correlated alternative strategies and TIPS within the alternative bucket. The percentage weight to alternatives is currently below the strategic target.

Conclusion

"As good as it gets" is the phrase that comes to mind given all of the positive tailwinds the economy has today. Yet studies show the correlation between economic growth and equity returns is nil. Investors today own the most stocks since 1999. That was a time clearly marked by excess in the technology sector. If everyone is already in the equity pool and cash is low, who is jumping in to keep prices higher?



In certain regions, the answer is central banks with purchases of exchange traded funds. We will not bank on that here. The trend over time may be for higher exposure for households, but we think long-term return expectations should be tempered. Opportunities still exist, for those willing to be different, which is a prerequisite for outperforming.

Aurum Asset Allocation Frameworks

	Income		Conservative		Balanced		Moderate		Growth	
	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical
Equity	0%	0%	20%	24%	35%	40%	50%	56%	70%	76%
U.S. Equity	0%	0%	12%	10%	20%	16%	30%	24%	42%	36%
Int'l - Develop. Markets	0%	0%	6%	8%	12%	15%	16%	20%	21%	24%
Int'l - Emerg. Markets	0%	0%	2%	6%	3%	9%	4%	12%	7%	16%
Fixed Income	65%	64%	45%	44%	30%	28%	17%	17%	10%	10%
U.S. Fixed Income	56%	56%	39%	37%	26%	23%	15%	12%	7%	9%
Global Fixed Income	9%	8%	6%	7%	4%	5%	2%	5%	3%	1%
Alternative Invest.	25%	29%	28%	25%	30%	25%	30%	25%	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%	6%	4%	6%	3%	6%	3%	6%	0%	0%
Cash/Equivalents	10%	7%	7%	7%	5%	7%	3%	2%	1%	1%
U.S. Dollar	10%	7%	7%	7%	5%	7%	3%	2%	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.

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