THE UNITED COMPANIES

Planning for the Possibilities®

Dear clients and friends,

January 2018

Much like the previous year, equity markets ended 2017 in record territory. However, the two years were very different, as investors experienced meaningful volatility in 2016 leading up to the post-election rally, while 2017 was entirely an upward trajectory with the S&P 500 hitting all-time highs 62 times on low volatility. Specifically, the S&P 500 Index increased by 19.4% in 2017, fueled largely by a positive global economic backdrop and the growing optimism over the passage of a major tax reform bill. International equity markets were also up strongly, with developed international stocks up 22% and the emerging markets index gaining 35%. Meanwhile, bonds lagged with municipals returning 5.7% and corporate bonds generating 6.5% in 2017. While investors could naturally anticipate a pullback for stocks after the strong performance in 2017, it's worth noting that the S&P 500 Index has experienced twenty 18%+ return years since 1961, and the S&P was positive in 75% of the subsequent years. Bottom line, investors are asking whether the stock market can continue to move higher in 2018 and what impact, if any, the tax reform legislation will have on the economy and markets. We will endeavor to provide our view on both of those critical questions in this letter.

Our outlook for 2018 is driven by many of the same fundamentals that fueled the rally in 2017, so we wanted to first dive deeper into last year to determine why equity markets were so strong while bond markets lagged...as these trends are likely to continue into 2018. While multiples did expand in 2017, 61% of the market's return was driven by fundamentals (i.e. earnings, dividends), while 39% could be attributed to higher valuations. Growth was broad with 9 of the 11 sectors comprising the S&P 500 positive for the year and 72% of stocks in the Index currently in an uptrend. This compares with 43% of stocks in an uptrend before the October 2007 downturn and 27% in March 2000. Underpinning the performance of the stock market was solid corporate earnings, with the upside surprise driven by revenue growth. This revenue growth is tied closely to economic conditions, with the PMI Index acting as the best proxy for the health of corporate earnings. To this end, PMIs around the globe remain well into expansive territory, with the most recent survey showing strong manufacturing and service activity in the U.S. For 2018, key factors to watch include:

1. **The Economy:** We believe the economic landscape that prevailed in 2017 is likely to continue into 2018, as several key factors remain at historically high levels. These include consumer confidence, PMI surveys, jobless claims and retail sales. One area of concern is housing, and higher interest rates could be a headwind for this key economic data point. Another risk is an overheated economy, resulting in inflationary pressure and therefore a more aggressive Fed response. We are monitoring this risk closely.
2. **Fiscal Policy:** The Tax Cuts and Jobs Act could have a tangible impact on markets in 2018. While most individuals will benefit from the new tax law (a notable exception are those living in high tax states), the primary economic impact is expected to come from corporate tax changes. The substantial reduction in the corporate tax rate, mandated repatriation, full expensing and bonus depreciation may serve to kickstart net domestic investment by corporations, which has moved sideways in the U.S. for a decade. We will be closely monitoring how management teams address these changes to determine the expected impact on the economy and markets.
3. **Corporate Earnings:** While companies will be facing tough comparisons in 2018 after generating strong earnings growth last year, we do expect corporate earnings to be solid. Key drivers will be a strong underlying economy and benefits from the tax reform bill. We would caution that companies missing expectations will likely be punished.
4. **Monetary Policy/Bond Market:** The Fed's balance sheet unwind is set to continue in 2018, allowing some $20 billion per month to roll off its balance sheet in Q1 (reinvesting remaining matured quantities). At the same time, the ECB is set to end net asset purchases this year as it winds down its own quantitative easing (QE). While other factors will also impact bond prices, these items alone suggest that less support will exist for bonds as the year progresses. We see long-term bonds as vulnerable to reduced central bank support. For this reason, we like "yield steepener" structured products and short-term Treasuries. For longer term bond exposure, high quality municipals look to be the most attractive as the market continues to digest heavy year-end supply.

Based on these factors, we continue to expect bonds to underperform stocks in 2018, with domestic equities likely to outpace international equities.

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Strategy Review

We are adding a new feature to our quarterly letter – an overview of our growing suite of equity strategies. We hope you find this additional detailed information helpful.

GROWTH & INCOME STRATEGY (GI)

Overview: Growth & Income (GI) is our most utilized strategy and is recommended for clients seeking growth with income while minimizing risk. The goal is to optimize risk-adjusted returns, which has a broad appeal among our clients. This strategy is designed to be less volatile than the overall market, with risk managed through actively managed diversification across all the industry sectors and the use of stop orders on a portion of the portfolio.

Update: We remain fully invested in the GI strategy, given our positive view of the equity markets. Over the past quarter, the team closed out a number of the "hurricane" trades, realizing solid returns, while adding to industrials and defense stocks. The strategy is now overweight commodity-based sectors, such as materials and energy, as we believe the strong global economic environment could be an inflationary driver this year.

HIGH DIVIDEND EQUITY & HIGH DIVIDEND PLUS STRATEGY (HDIV & HDIV+)

Overview: This strategy is recommended for clients seeking a steady stream of income with a modest amount of trading activity. The portfolio consists primarily of individual stocks and some ETFs, diversified across most of the industry sectors. By seeking positions that are dividend growers, HDIV aims to beat the average yield of stocks within a given sector and to provide for a hedge against rising interest rates. HDIV+ includes a 20% allocation to growth.

Update: Given the goal of generating income, the models tend to be overweight high-yielding sectors, such as utilities, REITs and telecom services. As a result, the average dividend yield is close to 5%. Recent additions include a REIT as well as a chemical company with a solid and growing dividend yield.

VALUE PLUS EQUITY STRATEGY (VAPL)

Overview: This strategy is recommended for clients seeking a value-based equity strategy with a beta below that of the overall market. This strategy seeks to invest in mispriced stocks with attractive fundamentals. It is a diversified portfolio of roughly 25 to 30 individual stocks and ETFs across various sectors.

Update: Launched at year-end 2016, VAPL enjoyed a very strong inaugural campaign, with returns ahead of the S&P 500 Index and well ahead of the S&P 500 Value Index. Over the past quarter, we realized profits in a few stocks based solely on valuation, swapping into stocks in the same sector that appeared relatively cheap.

GROWTH PLUS EQUITY STRATEGY (GP)

Overview: This strategy is recommended for clients seeking a growth-based equity strategy with a beta above that of the overall market. The team uses a two-part screening system to identify stocks that are likely to outperform and then ranking them by growth prospects. Higher growth names across the various sectors are then selected.

Update: Launched in 2017, the strategy is achieving its goal of generating market-like returns in the current strong market. Given its orientation toward growth stocks, the strategy is currently underweighted the consumer discretionary sector and has no exposure to staples, telecom services or utilities.

EXCHANGE-TRADED FUNDS STRATEGIES (ETF)

United Robo: This strategy utilizes artificial intelligence to select one of the 16 risk-based allocations developed by UASI. There were no changes to any allocations in the recent quarter.

Momentum Plus®: This is a dynamic strategy which utilizes technical indicators, such as relative strength and momentum, to make sector selections. This strategy's biggest overweight is to technology, specifically software and semiconductors.

Risk-Based ETF: This strategy seeks to identify relative value opportunities for investment. Recent increases were made to emerging markets and U.S. large cap, while developed international and U.S. mid-cap were reduced.

Sector-Based ETF: This strategy mirrors the sector allocation changes made in the Growth & Income Strategy (see above).

MUTUAL FUND STRATEGIES (MF)

Our mutual fund strategies are available in three primary risk allocations (Aggressive, Moderate, and Conservative), and the team seeks to mirror the sector allocations determined in the Growth & Income Strategy. Specific funds are evaluated quarterly to ensure that they continue to meet our criteria for inclusion. No changes were made to the lineup in 4Q2017.

Respectfully submitted by the Professional Staff at United Asset Strategies, Inc.