



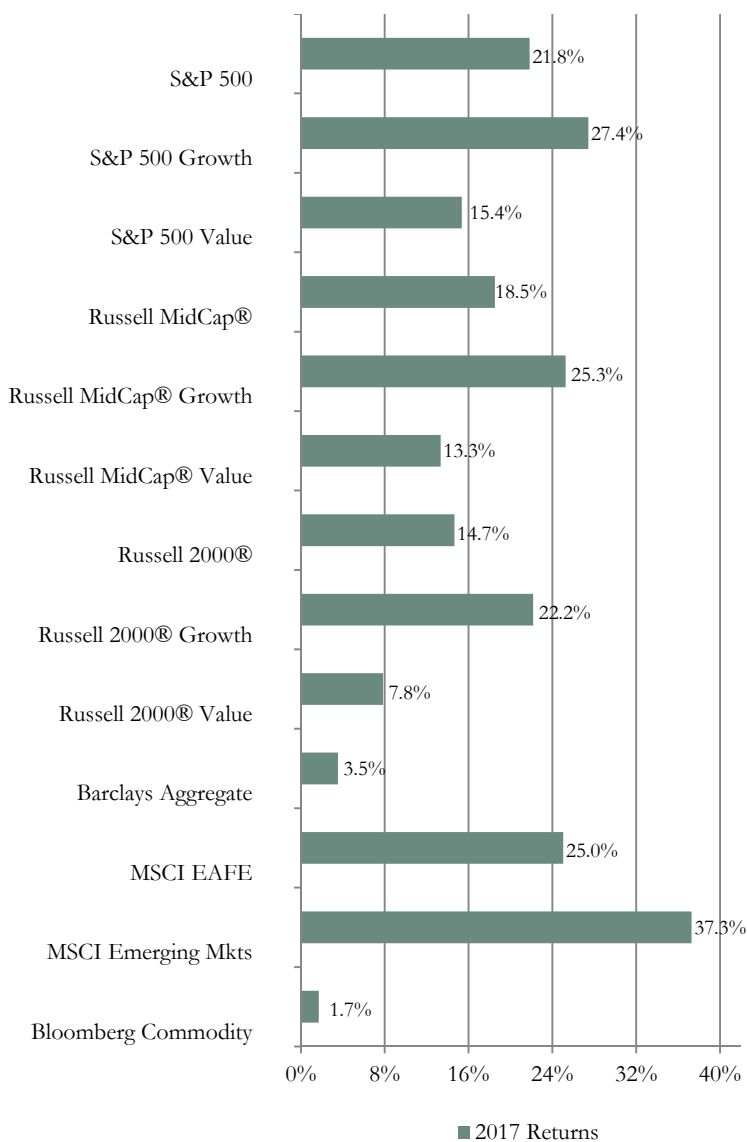
### Market Summary – Year-End 2017

2017 will be remembered for an equity bull market in full force and synchronized global growth.

It was a record setting year for equity markets. In the U.S., the S&P 500 index recorded a positive return in each month of the year for the first time in history. On the way to that historical achievement, the S&P 500 hit 62 record closing highs. That was only one of the major U.S. equity indices to set several record closing highs. The Dow Jones Industrial Average set 71 new highs, the largest number of closing highs in a single year, topping the previous record set in 1995. The technology company heavy Nasdaq Composite had 72 new highs during the year. The Russell 2000 index of small company stocks reached 30 new closing highs during the year. Equity market records were set outside the U.S. as well. The FTSE 100 index in the United Kingdom (U.K.) set a new all-time high on the last trading day of

the year. The STOXX 600 in Europe, Nikkei 225 in Japan, Hang Seng in Hong Kong, Taiex in Taiwan, and S&P /ASX 200 in Australia all set multi-year highs in 2017.

### Market Indices – 2017



Not only did equity markets post strong gains, volatility was unusually low. The largest decline in the S&P 500 during the year was -3%. The 3% decline was well below the average intra-year decline of about 16% and was the smallest since 1995 which also had a maximum intra-year decline of 3%. The CBOE Volatility Index of implied volatility was at an all-time low in 2017. The uptrend in stock prices with low trading volatility was due to improving economic data and corporate profits, low inflation, and supportive monetary policy around the world and occurred despite several natural disasters, geopolitical tensions, key elections, political wrangling, and the U.S. Federal Reserve (Fed) tightening monetary policy.

The global economy had solid growth in 2017 and in many ways has improved to be the healthiest it has been since before the financial crisis. According to the Organisation for Economic Co-operation and Development (OECD), each of the 45 largest economies had positive gross domestic product (GDP) growth for the first time in a decade. The U.S. had back to back quarters

of 3% or higher GDP growth for the first time since 2014 with second and third quarter growth of 3.0% and 3.2% respectively. The GDP growth has come as both consumer and business activity has accelerated. Both the manufacturing and services sectors had robust activity in 2017. For the first time in years, the manufacturing purchasing managers' indices (PMI) were over the 50 mark that divides expansion and contraction for most major developed and emerging markets countries. The eurozone was particularly strong with index readings of over 60 at some points during the year. In November, manufacturing new orders in the eurozone jumped to the highest level since 2000. The manufacturing PMI for both Brazil and Russia went from under 50, indicating contraction, to the mid-50s during the year as those economies recovered from recession. The services sector indices were strong as well. In the U.S., the services PMI was well over 50 throughout the year and reached a high of 56 in August. With accelerating business activity, labor markets improved.

The unemployment rate declined in many key regions to multi-year lows. For example, the unemployment rate in the U.S. declined to a 17-year low of 4.1%. In the eurozone, the rate declined to 8.7%, the lowest since 2009. In Canada, the rate declined to 5.7%, the lowest since 1976. In Japan, the rate declined to 2.7%, the lowest since 1993. In another sign of the strength of the U.S. labor market, the number of job openings reached an all-time high in July at 6.5 million. Also, the ratio of the number of people unemployed to the number of job openings declined to a record low of 1.087. Another important sector of the economy had significant improvement in 2017 in the U.S. New home sales and single family home starts increased to reach the highest levels since 2007. Rounding out the good news on the global economy is the fact that consumer and business confidence were at multi-year highs in the U.S., Europe, Japan, and China during the year. Despite the improvement in economic activity, inflation was moderate in the U.S., Europe, Japan, and other major economies. The main exception was the U.K. where the inflation rate rose to 3.1%, a six-year high, due to the depreciation of the pound and other Brexit related issues. The U.S. consumer price index rate of change for the 12-months ended December 31, 2017 was 2.1%, which is the same rate as in December 2016.

Global monetary policy was accommodative during the year, which supported economic growth and positive returns in financial markets, even though policy is gradually shifting to tightening. In 2017 nine central banks raised interest rates. The Bank of Canada raised its policy rate for the first time in seven years in July and then again in September. The Bank of England raised its policy rate in November which was the first rate increase in 10 years. In the U.S., the Fed raised its federal funds policy rate target by 0.25% three times. The rate target range was raised in March, June, and December and ended the year at 1.25% - 1.50%. In addition, in October, the Fed began its balance sheet reduction program, also known as the unwinding of quantitative easing (QE). The plan gradually reduces the amount of principal payments from Treasury and mortgage-backed securities held by the Fed that will be reinvested until certain monthly limits are reached.

Another significant event during the year was the signing of the U.S. 2017 Tax Cuts and Jobs Act in December. This bill includes many changes and reforms to the tax code for businesses and individuals, including lower tax rates and changes to allowable deductions and exemptions. The corporate tax rate was cut from 35% to 21%, which makes the U.S. more competitive by taking the U.S. from having the highest corporate tax rate in the OECD to having a rate close to the global average. Also, accumulated foreign earnings of U.S. companies are mandatorily repatriated at a one-time rate. The impact of the changes in the new law will vary by taxpayer situation. However, the tax reform has increased confidence that the economic expansion will continue in 2018. Forecasts for the boost to GDP in 2018 from tax reform range from 0.2% to 0.6%.

The U.S. equity market generated strong returns for 2017 with major indices generating double-digit returns. Of the U.S. indices shown above, only the Russell 2000 Value index did not close the year with a double-digit return. Large capitalization (cap) stocks outperformed mid-cap stocks and both outperformed small-cap stocks. Growth stocks outperformed value stocks by a wide margin across the market cap range. One of the main reasons that large-cap and growth stocks outperformed was the significant gains posted by technology and e-commerce stocks. The information

technology sector, with returns of over 37%, was the top performing sector in the large and mid-cap indices. A small group of large-cap stocks known as the FAANG stocks (Facebook, Amazon, Apple, Netflix, and Google parent Alphabet) was one of the main drivers of the advance in the large-cap index. According to S&P, these five stocks accounted for 24% of the S&P 500 index return of 21.8% for 2017. These five stocks had an average gain of over 50% for the year. Healthcare was the top performing sector in the small-cap index. Industrials and materials were also among the better performing sectors reflecting the improving global economy. Sectors that tend to be viewed as more defensive and that tend to pay higher dividends had positive, but lower returns than the higher growth sectors. The energy sector, which had negative returns, was the poorest performing sector in the mid and small-cap indices and had the second lowest return in the large-cap index due to weakness in oil prices until late in the year. The telecommunications sector, with a small negative return due to merger related issues, had the lowest return in the large-cap index.

International equity indices also posted double-digit returns for 2017. Not only did international equities perform strongly, U.S. dollar weakness increased returns for U.S. investors. The MSCI EAFE index of developed international stocks had a return of 25.0% and the MSCI Emerging Markets (EM) index had a return of 37.3% on a U.S. dollar basis. The EAFE and EM returns on a local currency basis were 15.2% and 30.6% respectively. Just as in the U.S., growth stocks outperformed value stocks by a wide margin in both the EAFE and EM indices also driven by the significant returns for the information technology sector. The information technology sector had a return of 60% in the EM index. Chinese internet stocks along with semi-conductor and smartphone suppliers led the sector higher as demand for their products and services accelerated. Also, similar to in the U.S., the more defensive and income oriented sectors had the lowest returns, but the returns were still positive double-digit returns. On a geographic basis, there was little difference between the returns of the major developed international regions. For example, the euro area index had a return of 26.5% and the Far East index had a return of 25.9%. The U.K. equity index posted a strong return of 22% for the year even though Brexit negotiations have proceeded slowly. The Brexit uncertainty caused the pound to decline, which made U.K. products more cost competitive and provided a boost to U.K. exporters. Among emerging market countries, Poland, China, and technology heavy economy countries had the best returns. Russia had one of the lowest, but still positive, returns as that economy was hurt by weakness in the energy sector.

The main stories in the fixed income market for the year were the flattening of the Treasury yield curve and the tightening of yield spreads. The benchmark 10-year Treasury bond yield traded in a tight range throughout 2017. The yield began the year at 2.45% then rose in March to 2.50% but dropped to the low for the year of 2.00% in September as uncertainty over the ability of Congress to pass a tax reform bill grew. The 10-year Treasury bond yield briefly rose to 2.50% after the tax bill passed in December, but declined again to end the year at 2.40%, almost unchanged from the start of 2017. The bigger news was the movement in short-term yields reflecting stronger economic growth as well as the Fed rate hikes in 2017 and expectations for additional hikes in 2018. The 2-year Treasury bond yield began the year at 1.21% and climbed to 1.89% by the end of December. Yields on 20 and 30-year maturity bonds declined during the year due to strong demand from investors seeking the higher income compared to that available from short-term bonds or from bonds in other developed countries. Because of the various moves, the Treasury yield curve flattened. The difference between the yield on the 10-year Treasury bond and the 2-year bond (spread) fell to the lowest level in a decade. Strong investor demand for the higher yields available on corporate bonds drove corporate bond prices higher and pushed the spread (additional yield on corporate bonds over Treasury bonds) to multi-year lows. All sectors of the bond market posted positive returns for the year. Longer maturity bonds and the high yield bonds had the best returns.

The commodity sector was a mixed bag for the year resulting in a small positive return of 1.7% for the Bloomberg Commodity index. The industrial metals sub-index had the highest return for the year among the sectors we track with a gain of 29.4%. Prices for metals such as copper and nickel soared on higher demand from China and other

countries as manufacturing, construction, capital expenditures, and consumer spending accelerated. West Texas Intermediate crude oil (WTI) traded in a range around \$50 per barrel for most of the year with a brief dip to \$42 mid-year, but rose sharply during the fourth quarter to close the year above \$60 per barrel. Oil has not been priced above \$60 since mid-2015. The price of WTI rose 12% for the year supported by lower supply due mainly to compliance with the production limit agreement by members of the Organization of Petroleum Exporting Countries (OPEC) and other countries including Russia. Earthquakes in Mexico, floods in South Asia, hurricanes in the U.S., and infrastructure vandalism problems in Africa also limited supply. Price gains were also supported by strong demand, particularly from China. The price of gold advanced over 13% in 2017 driven by a weaker dollar and rising bond yields. In the agriculture sector, the livestock sub-index had a modest increase of 6% for the year. However, the grains sub-index declined over 11% on high levels of supply. Prices for other agriculture commodities, such as cotton, sugar, and coffee also fell sharply during the year.

After a year of strong equity returns, positive returns in other sectors of the financial markets, unusually low volatility, and synchronized economic growth, the question for market participants is can the good news continue. We have a cautiously optimistic view for 2018. The outlook for corporate earnings growth continues to be positive due to global economic growth momentum since most economic data continues to be solidly in expansionary territory and inflation remains muted. The tax reform bill will likely also have at least a modest positive impact on consumer and business spending and on corporate profits. However, after the improvements that have been seen in various economic data in the U.S. and other developed economy countries, we expect that the rate of future improvement may be lower. In contrast, various emerging markets regions appear to still be earlier in the economic cycle. Continued macroeconomic and profit growth is likely to be supportive of at least modest equity market gains. However, with valuations stretched in various asset classes, a change in central bank policy, an unexpected pick-up in inflation, or a change in sentiment are risks to asset prices. Therefore, an adequately diversified portfolio including growth and risk reduction focused investments continues to be a prudent strategy. We also recommend using periods of market strength to raise any cash needed to support spending needs over the coming 12-24 months.

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