

Economic and Market Overview

Fourth Quarter 2017



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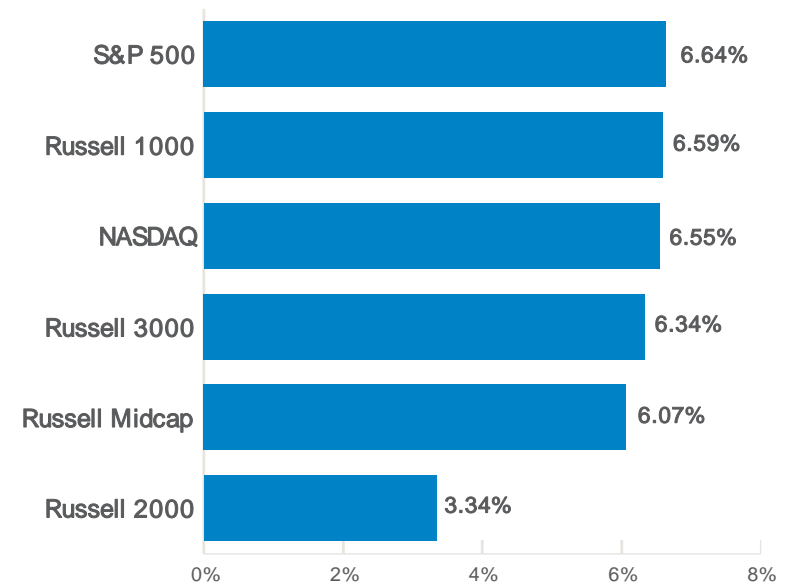
The Economy

The US economy remains quite strong, with its upward trend intact. As various headwinds in the form of political infighting and geopolitical tensions continue to be obstacles, economic data in many segments remains on a solid trajectory. The Bureau of Economic Analysis reported its third estimate of third-quarter 2017 gross domestic product (GDP) of 3.2%, down slightly from the prior estimate, but a notch higher than the second quarter's 3.1% reading. The employment situation also made gains, with an average of approximately 170,000 jobs added each month. At the same time, the unemployment rate remained steady at 4.1%. The Federal Open Market Committee (FOMC) modified its interest rate policy by raising the federal funds rate target by 25 basis points to a range of 1.25% - 1.50%. Most economists expect multiple increases in 2018 as the economy encounters wage pressures.

The global economic environment has benefited from increased demand as well as accommodative monetary policies. The Eurozone economy grew at a 2.6% annual rate in the third quarter, continuing a positive trend begun early in the year. One of the key drivers in the Eurozone was solid domestic demand. Japan is among the Asian economies faring well, posting a seventh consecutive quarterly expansion, its longest streak since 2001. China continues to balance instituting economic reforms with maintaining robust growth, with economists expecting the country's growth to decelerate to about 6.5% in 2018 from 6.8% in 2017.

Broad Market Equity Index Returns

Fourth Quarter 4Q17



Source: Morningstar, Inc.

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Highlights and Perspectives

GROSS DOMESTIC PRODUCT (GDP)

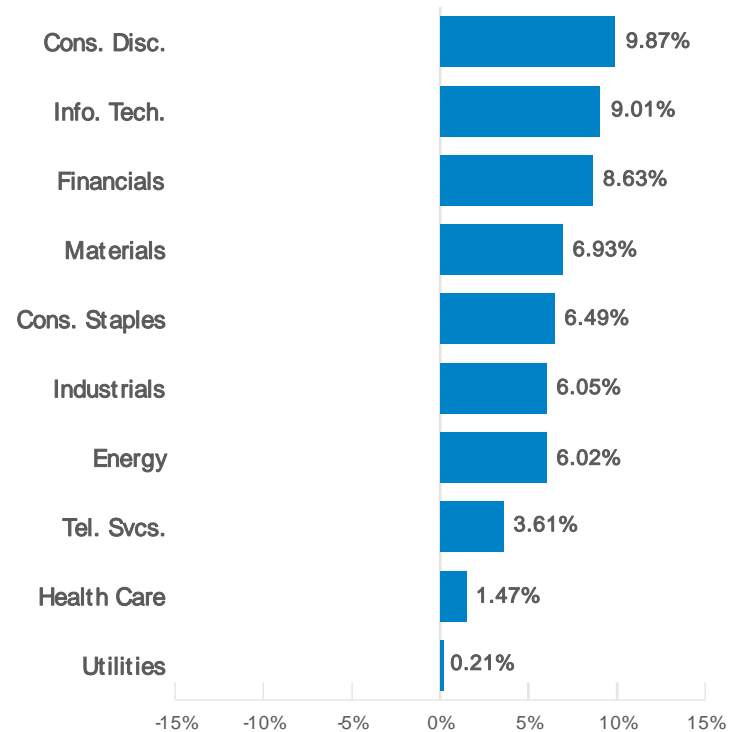
The Bureau of Economic Analysis released the third estimate of the third-quarter 2017 real GDP, a seasonally adjusted annualized rate of 3.2%, up from the second quarter's 3.1% annualized growth, but down slightly from the 3.3% prior estimate. The consensus among economists is that the economy continues to expand, but some of the underlying components suggest that the expansion is nearer to the end than the beginning. Consumer spending slowed during the quarter, but was offset by an increase in inventories. Inflation began to tick higher in the quarter, with the personal consumption expenditures (PCE) index of prices rising 1.5%, following a 0.3% advance in the prior quarter. Corporate profits rose 4.3% (not annualized) during the quarter. Economists are generally of the opinion that with the economy nearing full employment, wage pressure should begin to pick up.

HOUSING

The housing segment continues to deliver results strong enough for analysts to maintain a positive outlook heading into 2018. Existing home sales for November (the latest monthly data available) grew at an annualized rate of 5.8 million units, an increase of about 5.6% from October, and up about 3.6% from a year ago. The inventory of existing homes was slightly more than three months of supply, down from the prior year. Existing home prices in November were up 1.2% from October, and have increased 5.5% from November 2016. In the new-home segment, the NAHB Housing Market Index, a measure of homebuilding activity, ended the quarter at 74, its highest level since 1999. Analysts believe the housing market should remain strong over the coming months.

U.S. Equity Market Returns by Major Sector

(GICS Sectors in S&P 500, Fourth Quarter 4Q17)



Source: Morningstar, Inc.

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EMPLOYMENT

The employment situation remained strong in November. Employers added 228,000 jobs during the month, exceeding the consensus expectations of 199,000 new jobs, but falling short of the prior month's gain of 244,000. The three-month moving average also rose slightly, coming in at 170,000. The unemployment rate in November was 4.1%, unchanged from the prior month. Average hourly earnings increased by a modest 0.2% in the month, and analysts believe earnings will begin to accelerate in coming months.

FEDERAL RESERVE POLICY

The FOMC ended its recent December meeting by announcing an increase in the federal funds rate target of 25 basis points from 1.25% to 1.50%. The most significant change to the statement accompanying the rate increase was acknowledgement that inflation had declined. The incoming Federal Reserve (Fed) chairman, Jay Powell, has stated that it is very important for inflation to achieve its 2% target, and the FOMC is increasingly concerned that it has yet to attain that level this far into the expansion. The FOMC is data dependent, and although the expectation is that one rate increase per quarter will occur in 2018, it's possible that if inflation does not begin to pick up, there will be a pause in the tightening regime.

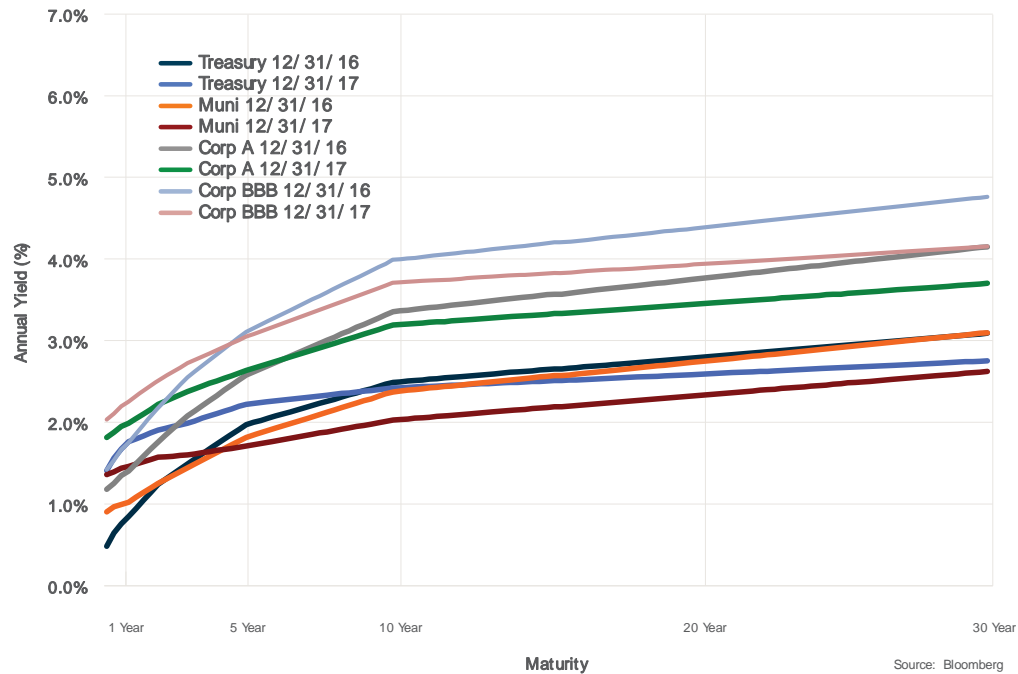
FIXED INCOME

Fixed income securities generated mixed total returns across the various market segments. The Bloomberg Barclays Treasury 5-7 Yr. Index declined 0.5% for the quarter, but was up 1.9% for the year. The Bloomberg Barclays U.S. Corporate 5-10 Yr. Index advanced 0.5% during the three months. High yield securities, which often follow the performance of equities, posted a gain of 0.5%. High yield has advanced 7.5% on a year-to-date basis. Municipals were also positive, as the Bloomberg Barclays Municipal Bond Index rose by 0.8% during the quarter. Prices of non-US fixed income securities also turned in modest gains in the quarter, as the Bloomberg Barclays Global Aggregate ex-U.S. Index advanced 1.6%. Emerging markets bonds continued the positive trends from throughout the year, with the JPM EMBI Global Index rising 0.5%.

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U.S. Treasury, Muni, and Corporate 30-Year Yield Curves



The trend in yields was higher throughout the quarter, but not especially volatile: The yield on the 10-year Treasury Note traded within a 22 basis point range. In addition to the passage of the tax reform package, other factors contributing to the yield changes were the FOMC's decision to raise short-term interest rates, as well as ongoing tensions with North Korea. As mentioned above, yields at the shortest end of the yield curve (up to one year) were generally about 20 to 40 basis points higher than in September, while those on the longer end were lower by about 10 basis points. The yield on the 3-month Treasury Bill settled at 1.38% at the end of the quarter, up about 33 basis points from the end of the previous quarter. The yield on the 5-year Treasury Note ended the quarter at 2.21%, compared to 1.94% on September 30, and as mentioned above, the yield on the 10-year Treasury Note inched up to 2.41% from 2.33% over the same period. At the same time, the yield on the 30-year Treasury Bond was little changed, ending the period at 2.74%, compared to its beginning level of 2.86%. Inflation expectations rose modestly, with the Fed's gauge of five-year forward inflation expectations rising slightly from 1.79% as of September 30.

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DOMESTIC EQUITIES

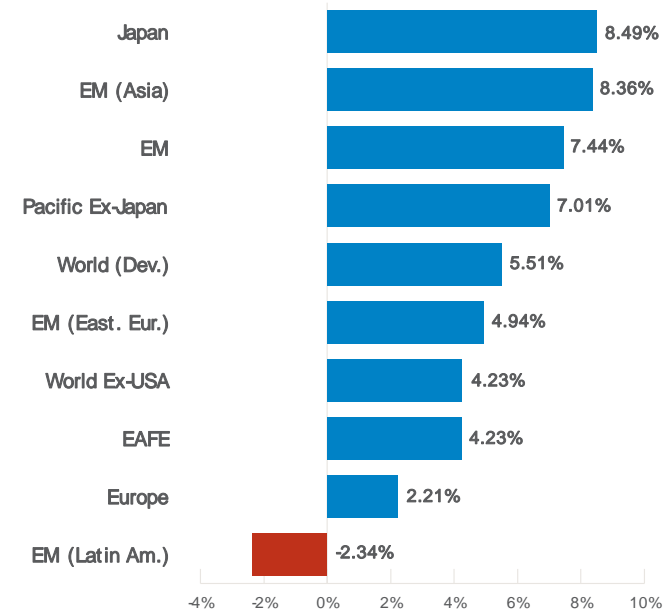
Equity markets racked up another quarter of solid gains, benefiting from anticipation of the tax reform package, an uptick in corporate profitability, and a steadily growing economy. Each of these dimensions was a driver of the continued low volatility financial market environment, with the Chicago Board Options Exchange Volatility Index—better known as VIX—remaining historically low. Against this backdrop, the S&P 500 Index finished the quarter with a gain of 6.6%, and advanced 21.8% for the full year. The S&P 500 has now posted positive returns in every quarter except one in the past five years. The last negative return in a calendar quarter occurred in the third quarter of 2015.

INTERNATIONAL EQUITIES

International stocks performed well on an absolute basis, but generally lagged behind US equities. European economies continue to accelerate, as domestic demand has picked up and monetary policy has remained extremely accommodative. China continues on pace with structural reforms, which will have the effect of lowering GDP growth, but also help deleverage the economy. With that as a backdrop, international stock indices were almost universally higher. The MSCI ACWI Ex-USA Index, which measures performance of world markets outside the US, gained 5.0%. The MSCI EAFE Index of developed markets stocks advanced 4.2%, and was up 25.0% in 2017. Regional performance was mixed for the quarter. Japan was the strongest performer on a relative basis, with the MSCI Japan Index posting a return of 8.5%. China also generated positive returns, gaining 7.6%. Latin America was the poorest performer, declining 2.3%. Emerging markets performance remained robust, as the MSCI Emerging Markets Index gained 7.4%, and finished the year up 37.3%.

Non-U.S. Equity Market Returns

By Region (U.S. Dollars)
Fourth Quarter 4Q17



Source: Morningstar, Inc.

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Outlook

The consensus among economists is that the recently passed tax reform package is likely to provide a short- to intermediate-term boost to the economy. The \$1.5 trillion, 10-year tax cut will likely benefit corporations, which will see a permanent reduction in their tax rate. Individual tax cuts will expire in 10 years (unless Congress eventually makes them permanent), reducing the long-term impact of the changes. Economists expect the tax cuts to act like fiscal stimulus, increasing GDP growth by as much as 0.5% per year. A fear among analysts is that annual growth increasing to 3% at a time when the economy is at or very near full employment may result in overheating. Although wage growth pressure has not been an issue so far, that may change with the impact of the tax changes, and the Fed may be forced to raise rates more quickly than it had previously anticipated. Market analysts have been raising estimates for corporate earnings for 2018, but it is quite possible that the market has already discounted higher earnings. The risks to the generally positive economic outlook continue to include geopolitical tensions with North Korea and Iran, as well as the potential for monetary policy missteps by the Fed. In addition, despite the lack of obvious bubbles, most market watchers expect stock prices to be more volatile in 2018 than in 2017, as valuations are more extended, and volatility remains near multiyear lows.

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INDEX OVERVIEW

The **Dow or DJIA** (Dow Jones Industrial Average) is an unmanaged index of 30 common stocks comprising 30 actively traded blue chip stocks, primarily industrials, and assumes reinvestment of dividends. The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **S&P 500 Index** is an unmanaged index comprising 500 widely held securities considered to be representative of the stock market in general. The **DJ U.S. Select REIT Index** is a subset of the Dow Jones Americas Select RESI and includes only REITs and REIT-like securities (the Dow Jones U.S. Select Real Estate Securities Index (RESI) represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the US). The **Bloomberg Commodity Index** is a broadly diversified commodity price index that tracks prices of futures contracts on physical commodities on the commodity market, and is designed to minimize concentration in any one commodity or sector. The **MSCI EAFE Index** is recognized as the pre-eminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia, and the Far East. The **MSCI Emerging Markets Index** is a free float-adjusted market-capitalization-index that is designed to measure equity market performance in the global emerging markets. The **MSCI ACWI Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 46 country indices comprising 23 developed and 23 emerging markets country indexes. The **MSCI Emerging Markets (EM) Eastern Europe Index** captures large and mid cap representation across four emerging markets (the Czech Republic, Hungary, Poland, and Russia) countries in Eastern Europe. With 52 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in each country. The **MSCI EM (Emerging Markets) Latin America Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of emerging markets in Latin America. The **MSCI ACWI Ex-U.S. Index** is a market-capitalization-weighted index maintained and designed to provide a broad measure of stock performance throughout the world, with the exception of US-based companies. The **MSCI China Index** captures large and mid cap representation across China H shares, B shares, Red chips, and P chips covering about 85% of this China equity universe. The **Bloomberg Barclays Municipal Bond Index** is an unmanaged index comprising investment-grade, fixed-rate municipal securities representative of the tax-exempt bond market in general. The **Bloomberg Barclays Global Aggregate ex-U.S. Index** is a market-capitalization-weighted index, meaning the securities in the Index are weighted according to the market size of each bond type. Most US-traded investment-grade bonds are represented. Municipal bonds and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The Index includes Treasury securities, government agency bonds, mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in the US. The **Bloomberg Barclays U.S. 5-10 Year Corporate Bond Index** measures the investment return of US dollar-denominated, investment-grade, fixed-rate, taxable securities issued by industrial, utility, and financial companies, with maturities between five and ten years. Treasury securities, mortgage-backed securities (MBS), foreign bonds, government agency bonds, and corporate bonds are some of the categories included in the Index. The **Bloomberg Barclays Capital US 5-7 Year Treasury Bond Index** is a market-capitalization-weighted index and includes Treasury bonds issued by the US with a time to maturity of at least five years, but no more than seven years. The **Russell 1000 Index** is a market-capitalization-weighted benchmark index made up of the 1,000 largest US companies in the Russell 3000 Index (which comprises the 3,000 largest U.S. companies). The **Russell 2000 Index** is an unmanaged index considered representative of small cap stocks. The **Russell 3000 Index** is an unmanaged index considered representative of the US stock market, and measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market. The **Russell Midcap Index** is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities, based on a combination of their market cap and current index membership. The **Housing Market Index (HMI)** is based on a monthly survey of **NAHB** members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months, as well as the traffic of prospective buyers of new homes. The **JPMorgan Emerging Market Bond Index (EMBI Global)** tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the JPMorgan EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least \$500 million. The **Chicago Board Options Exchange Volatility Index (VIX)** is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. The **MSCI Japan Index** is designed to measure the performance of the large and mid cap segments of the Japanese market. With 321 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

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DEFINITIONS

The **Federal Open Market Committee** (FOMC) is the monetary policymaking body of the Federal Reserve System. The **Federal Funds Rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The **European Central Bank** (ECB) is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power and thus price stability in the euro area. The euro area comprises the 19 European Union countries that have introduced the euro since 1999. The **Gross Domestic Product** (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. The **Bureau of Labor Statistics** (BLS) is a unit of the United States Department of Labor. It is the principal fact-finding agency for the US government in the broad field of labor economics and statistics, and serves as a principal agency of the US Federal Statistical System. The **Bureau of Economic Analysis** (BEA) is an agency in the US Department of Commerce that provides important economic statistics, including the gross domestic product of the US. It is a governmental statistical agency that collects, processes, analyzes, and disseminates essential statistical data to the American public, the US Congress, other federal agencies, state and local governments, business, and labor representatives. The **PCE (Personal Consumption Expenditure) Index of Prices** is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data, including US Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures, and is essentially a measurement of goods and services targeted towards individuals and consumed by individuals. Sector performance is represented by the **Global Industry Classification Standard (GICS)** sectors, developed by Standard & Poor's and MSCI Barra.