David W. Griffis, CFA Andrew B. Hartline, CFA Fourth Quarter 2017

VERO BEACH GLOBAL ADVISORS

Registered Investment Advisor

> "Compound interest is the eighth wonder of the world. He who understands it earns it… He who doesn't, pays it." Albert Einstein

2017 proved to be a rare year for investment portfolios, with collective global markets firing on all cylinders. Each of the key segments within our investment spectrum, from lower risk bonds to higher risk emerging market stocks, enjoyed favorable returns, with the riskier equity exposures providing the strongest results:

Market	2017 total return
S&P 500 Index	***21%***
Russell 1000 Value Index	***13%***
MSCI All Country World Index	***27%***
Intermediate Muni-Bond Index	***4%***

Despite the ample number of geopolitical alarms, the global financial markets largely displayed "risk on" sentiment throughout most of 2017. Market behavior was persistently one sided, rallying on favorable economic news, and largely ignoring worrisome events. Volatility, as measured by day to day market gyrations, proved unusually low, with the S&P 500 Index going 71 days without a move greater than 1% in either direction.

Against that backdrop, equity market valuations are now the focus, and yes, they are stretched. Valuations within our core portfolio, in terms of trailing P/E ratio and dividend yield, are at high and low levels, respectively. Yet the positive growth trajectory of corporate earnings and dividends softens the valuation-related apprehensions. *Factset** recently reported that earnings growth for a global pool of 20,000 public companies averaged 19% over the past year. That type of growth pushes a P/E ratio of 20x down to a more historically reasonable 17x. Dividend expansion for S&P 500 Index companies averaged 8% for the 4th quarter of 2017, and more importantly the actual payout ratio (dividend divided by earnings) remained at the long-term average of 38%. These key points lessen the dramatic focus on absolute valuations, in our view, particularly for domestic stocks. Outside the U.S. the valuation snapshot hasn't really been an issue. The Pan-European market region is trading at roughly 16x, while Asia Pacific stocks are trading at an even lower multiple, around 13x forward earnings.

There are other factors that bake into our modest but favorable 2018 market sentiments. Consider for example that American corporations have amassed a record amount of liquidity. According to a recent report from *Moodys**, the liquidity for non-financial companies reached a record level of nearly $2.3 trillion in the 2nd quarter, and offshore cash reached $1.4 trillion. These figures reflect a 60% increase since 2009, and in total represent 12% of assets for the S&P 500 companies, another all-time high. A second example is a new buyout fund from fund manager *Apollo Capital*. *Apollo* was able to raise a record setting $23.5 billion fund in the 3rd quarter of 2017, specifically for merger and acquisition activity. This is the largest single buyout fund ever raised, representing a powerful war chest for future business purchases. Similarly, *Pensions & Investments* magazine reported that Private Equity firms were sitting on $915 billion of deployable capital at the end of the 2nd quarter. These impressive figures are symptomatic of the amount of liquidity created by global central banks during the recent years of easy monetary policies.

Our expectation is that corporate treasurers will continue to reward shareholders with healthy dividends and share buybacks, as well as look for transformative acquisitions. The amassed liquidity may also be directed towards retiring debt (or avoiding future debt), then likely a portion moves toward research, development, and business expansion.

While seemingly a separate paradigm, we recently took notice of a research paper from *Credit Suisse** which indicated that the stock listings in the U.S. markets have dropped by 50% over the past 20 years, shrinking the available pool of publicly traded stocks. Bundling the collection of data together: strong earnings, record amounts of liquidity in the hands of institutional firms, massive amounts of cash in corporate coffers, and a shrinking pool of domestic public securities, our feeling is that elevated valuations (viewed in isolation) should not be imminently detrimental to equity prices.

The real risk to the equity markets, in our estimate, is a pick-up in inflation, coupled with rapidly rising interest rates. The U.S. 10-year note touched 2.4% at year-end, and is now higher than the dividend yield for the S&P 500 Index. Global growth is expected to continue with final indications of about 3.2% for 2017 and a bit higher in 2018 at 3.3%, according to *Fitch Ratings*.* We see the December tax reforms as further bolstering the already tight domestic job market, and overall consumption. Similar economic activity is occurring outside the U.S., in particular within the emerging markets. We are not predicting consecutive rate hikes at this stage, but envision two to four over the coming 12 months. Still, we have seen market tantrums on several occasions with just whispers of rising rates. Subsequently, we have tempered our aggregate bond durations, focusing more on short and intermediate maturities. At some point, higher bond yields will start to seriously compete for investor attention.

As our firm looks out on the evolving investment landscape of the coming quarters, we are quite active in many respects with our planning. The 2018 research travel schedule includes trips to the U.K., Hong Kong, and likely India with the direct goal of building on our team's knowledge base of specific portfolio companies, prospective opportunities, and macro developments. With the aforementioned shrinking U.S. stock universe and valuation trends continuing, we believe strongly that prudent firms should look globally for investment opportunities. Please visit www.VBGlobalAdvisors.com periodically to read our investment, economic and market research.

Finally, we would be remiss if we did not take this opportunity to thank you for joining us in establishing a Registered Investment Advisory firm anchored in integrity and personal service to the client. We are truly humbled and thankful.

Turning the page into 2018, we acknowledge the importance of modest return expectations after such a strong year. Yet we look forward to finding global investment opportunities tailored to each client's objectives and capacity for risk. We remain passionate for our role in shepherding our entrusted capital, truly energized by the investment horizon, and ever so grateful to have you as our clients and friends.

Notes and Sources:

Factset The Wall Street Journal , 12.6.17

Credit Suisse, The Incredible Shrinking Universe of Stocks, 3.22.17, Mauboussin, Callahan, Majd

Fitch Ratings, The Global Economic Outlook, *12.4.2017*

Moody's ,11.20.17