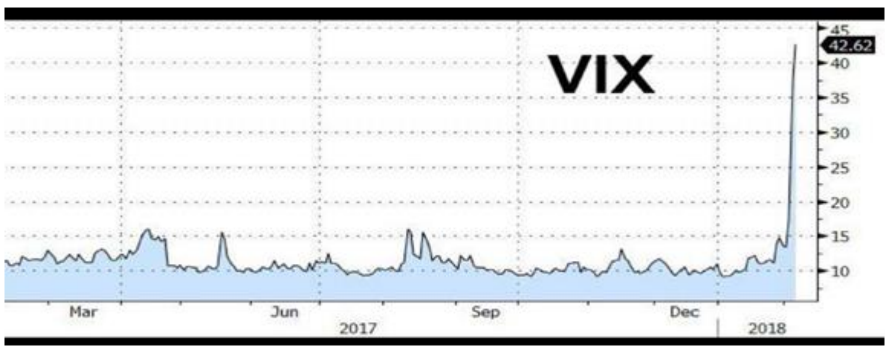
MARKET VOLATILITY UPDATE
FEBRUARY 6, 2018

Dear Investor,

I wanted to update you on the recent market volatility. It's been hard to pinpoint the cause as fundamentals are strong, but after the higher than expected wage increase in last Friday's jobs report, interest rate and inflation fears led to a spike in volatility. Many large financial players were short volatility and scrambled to cover their positions, causing a spike in the VIX that triggered further sell programs within the market (because the VIX is tied to so many market algorithms).



These algorithms drive about 70% of ETF trading and tend to feed off themselves in a circular frenzy to drive markets lower. The net result has been an 8 percent correction in equity markets as of yesterday's close and more like a 12 percent correction based on this morning's implied open. The momentum in volatility-driven ETF's will probably break this morning, and it is our expectation that the dust should settle around midday. I wanted to outline where we go from here:

Fundamentals

The fundamentals are generally positive. So far, Q4 earnings have come in **14 percent higher** than last year which is the strongest quarter we have seen in five years. GDP, consumer and business confidence, and unemployment are all hitting recovery highs. There may be a negative wealth effect on consumption because of this selloff, which we will have to monitor in the next few months.

Valuation

Based on this morning's implied open, the S&P 500 will be selling at **16.9 times** forward earnings versus **19.2X** just 10 days ago, so valuations have improved significantly.

Technicals

The market has had **217** five-percent-plus corrections in the last 50 years. The median drop for those corrections has been **eight percent** and the **average is 13 percent,** so we are right on the averages as of this morning.

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In summary, this high-frequency automated mess needs to work itself out over the next few days. Fundamentals remain strong but volatility should be back with a vengeance as we digest this market drop and process the causes and future implications. It's going to be another black mark for the ETF market which has promoted diversification and liquidity but instead seems to exacerbate volatility given their complex structures and poor liquidity in times of stress. We continue to believe owning individual large cap dividend growth stocks is the best way to invest for the long term.

Please call me with any questions.

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