3rd Quarter 2017

MARKET COMMENTARY

Markets in Review

Devastating hurricanes, floods, earthquakes, escalating tensions with North Korea, continuing dysfunction in Washington – stock markets seemed to shrug it all off this quarter. Tragedy on Main Street didn't stir up much of a storm on Wall Street, as major U.S. equity indices posted solidly positive returns. For the quarter, the Dow Jones Industrial Average (DJIA) added 4.94%, the S&P 500 Index gained 3.96% (4.48% including dividends), and the NASDAQ rose by 5.79%. September has historically offered up the weakest stock market returns of any month, but that was not the case this year. A relatively quiet August was followed up by solid equity index returns in September – especially for small company stocks as represented by the Russell 2000. It gained 6.09% as summer turned to autumn, which turned its two-month loss of -0.81% into a three month gain of 5.33%. (See table below for selected index results.)

International equity markets, as measured by the EAFE, had uneven returns over the last three months, but also posted solid gains by the end of the quarter. The Japanese Nikkei was down slightly in July and August, but rallied in September to finish the quarter in positive territory.

The CRB Commodity Index followed an up and down pattern similar to that of U.S. and international equity indices, and finished the quarter with a gain of 4.76%. Oil prices climbed from $46.02 per barrel to $51.67 (West Texas Intermediate), a gain of 12.23%. Gold spiked from $1,241.61/oz. to $1,349.22/oz. before sliding back to $1,279.75/oz. for a quarterly gain of 3.07%.

The monthly returns in the bond markets were almost the exact opposite of those in equity and commodity markets. A soft July was followed by a strong rally in August which was almost completely offset by a slide in September. The Federal Reserve clarified its plans to begin reducing its balance sheet, gradually withdrawing the cash it had pumped into the economy during three rounds of Quantitative Easing, or QE. QE was intended to help stimulate the economy and prevent the Great Recession from becoming something even worse.

The Federal Reserve had never performed an operation like QE before, and there are a wide range of opinions about the program's effectiveness. Some believe all QE accomplished was to artificially boost stock and bond prices. Others are convinced it saved us all from an economic apocalypse.

Whatever positive effects Quantitative Easing may have had, the Fed's decision to gradually unload many of the bonds it bought introduces uncertainty about the negative effects this Quantitative Tightening may have. The longer-term effect of the "QT" program on bond prices and yields remains to be seen, but the past quarter's gyrations in 10-year U.S. Government note prices left their yield at 2.33%, which is essentially the same as the 2.31% yield they had at the start of the quarter – and down from their 2.45% yield at the start of the year.

Something may come along that's disturbing enough to roil the markets before the year is over, but given the calm we've seen in the face of all the storms, conflict and dysfunction we've already seen, it's hard to imagine what that would have to be. Hopefully, we won't have the misfortune of finding out.

					One Month Change				
	Selected Indices	2016	Q1 2017	Q2 2017	**July**	**Aug**	**Sept**	**Q3 2017**	YTD 2017
US Equities	DJIA	13.42%	**4.56%**	**3.32%**	2.54%	0.26%	2.08%	**4.94%**	13.37%
	S&P 500	9.54%	**5.53%**	**2.57%**	1.93%	0.05%	1.93%	**3.96%**	12.53%
	S&P 500 Total Return	11.96%	**6.07%**	**3.09%**	2.06%	0.31%	2.06%	**4.48%**	14.24%
	NASDAQ	7.50%	**9.82%**	**3.87%**	3.38%	1.27%	1.05%	**5.79%**	20.67%
	Russell 2000	19.48%	**2.12%**	**2.12%**	0.69%	-1.39%	6.09%	**5.33%**	9.85%
Global Equities	EAFE (International)	-1.88%	**6.47%**	**5.03%**	2.85%	-0.31%	2.23%	**4.81%**	17.21%
	DAX (Germany)	6.87%	**7.25%**	**0.10%**	-1.68%	-0.52%	6.41%	**4.09%**	11.74%
	Hang Seng (Hong Kong)	0.39%	**9.60%**	**6.86%**	6.05%	2.37%	-1.49%	**6.95%**	25.24%
	Nikkei (Japan)	0.42%	**-1.07%**	**5.95%**	-0.54%	-1.40%	3.61%	**1.61%**	6.50%
Bonds	DJ Equal Wt US Corp Bond	5.84%	**0.86%**	**2.63%**	0.77%	0.66%	0.00%	**1.43%**	5.00%
	Barclays US Treas 20+ Yr	1.43%	**1.41%**	**4.18%**	-0.69%	3.57%	-2.22%	**0.58%**	6.26%
Currency	US $	3.63%	**-1.82%**	**-4.71%**	-2.89%	-0.21%	0.44%	**-2.67%**	-8.94%
Commodity	CRB (Commodities)	9.29%	**-3.44%**	**-5.98%**	4.50%	-0.98%	1.23%	**4.76%**	-4.89%
Inflation	CPI (Inflation)	2.07%	**0.98%**	**0.47%**	-0.07%	0.30%	0.53%	**0.76%**	2.23%

Red Flags, White Flags, and Checkered Flags

As major U.S. stock market indices hit new records day after day, investors who follow market news have almost certainly read and heard a lot lately about valuation. Admittedly, not all investors follow investment news with the same level of enthusiasm, but those who do have heard many commentators express the view that stocks are very expensive at current prices. Other observers point to mitigating conditions, such as low interest rates, to argue that stocks are still fairly valued. Some commentators feel stocks may even be undervalued, often justifying that view by pointing to other investment alternatives that by comparison are even more expensive than stocks. Still others pin their hopes on future developments such as changes in tax laws or regulation to explain why stocks may not be as expensive as they seem.

Our own view, which we have shared in many of our commentaries, is that stocks are expensive today. It's true that interest rates are still low, but the Federal Reserve has been clear about its intention to gradually send them higher. There is a lot of talk coming out of Washington about cutting taxes, but recent experience suggests that converting talk into legislation is anything but a sure thing. The future brings all sorts of uncertainty with it, so positive developments are possible, but based on many traditional measures of value, stocks are expensive right now.

One of the more popular measures of stock value is the Price/Earnings Ratio, or P/E. Dividing price by earnings shows how long it would take for earnings to cover the current price. If a stock has a P/E of 10, it would take 10 years of earnings at that level to pay for one share of its stock at today's price. At the end of September, as measured by the S&P 500 Index, stocks sported a P/E of more than 20.

Why are high valuations considered a problem? Historically, high stock valuations have often been precursors to huge market declines:

- Valuations were high in 1929 before the infamous stock market crash and Great Depression that lasted until 1939.
- Valuations were high in 1987 before the Black Monday crash that wiped out more than 20% of the S&P 500's value in a single day.
- Valuations were high in 2000 before the bursting of the "Dot com" bubble that caused the NASDAQ Composite stock index to lose more than 67% of its value over the next three years.
- Valuations were high in 2007 before the housing crisis led to the near collapse of the global financial system, launched the Great Recession, and lopped nearly 57% off the value of the S&P 500 Index over a 17-month period.

With such a tragic history, it's little wonder today's stock valuations are such a widespread topic of concern. Given our concerns about overvaluation, why haven't we parked all the assets in our equity oriented portfolios in cash or cash equivalents? Isn't there a "magic number" for P/E that reliably raises a red flag, cautioning investors that a particular level of overvaluation is finally too overvalued?

Unfortunately, it's just not that simple. While P/E ratios have been very good at predicting trouble down the road, they have not been reliable signposts for market turning points:

- On March 30, 1971, the P/E of the S&P 500 Index hit 20.15. The S&P 500 continued to climb – gaining 13.6% over the next twenty months, while the P/E held at 19.12. Over the next two years, however the S&P 500 plunged -41.9%.
- On March 17, 1987, the P/E of the S&P 500 Index again crossed 20. Getting out on that day could have caused a lot of back seat drivers to question the decision over the next five months, as the index soared 15.1% by August 25th. The decision would have looked a whole lot smarter less than two months later after the S&P 500 had plunged by -33.2%.
- If a P/E of 20 seemed too low a hurdle, an investor may have waited until the S&P 500's P/E crossed 25 on March 20, 1998 to steer clear of stocks. For anyone who sold then, the next two years could have felt like an eternity, as they watched the S&P 500 zoom ahead by another 38.4% while its P/E climbed past 30. Of course, eighteen months after that market peak, the S&P 500 had skidded -36.8%.
- Waiting for the S&P 500 to hit a P/E of just 20 hasn't always worked out so well either. The market peak in 2007 came on October 9th with the index sporting a P/E of just 17.58. From there it plunged -56.8% in 17 months.

Clearly, high market valuations have raised a red flag many times in the past, but how many investors are prepared to sit idly on the sidelines watching gains go by month after month – especially when overvaluation seems to be such a moving target?

For some investors, the solution is to raise the white flag of surrender and avoid committing their serious money to stocks. An increasing number have apparently concluded that attempting to distinguish good stocks from bad, cheap from expensive isn't worth the effort. That road leads to passive index investing, accepting whatever the market index offers at any price. These investors have raised the white flag in a different way, surrendering to passive index strategies that don't attempt to respond to changing conditions. They are choosing to hop in for the ride and hold on for whatever comes down the pike –

whether good or bad. For the past 8 ½ years that ride has been a lot of fun, as the S&P 500 has raced ahead – with only a few bumps along the way – to a gain of more than 270%. Who cares if the P/E has gone from 11.06 to 21.31 during that time?

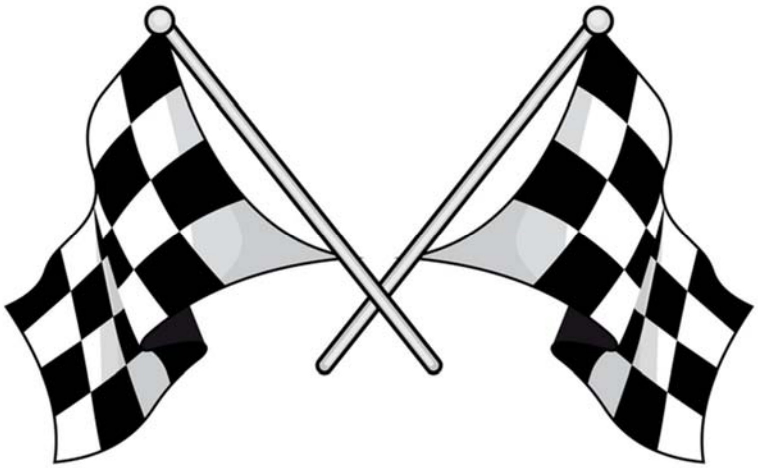
Unfortunately, history has shown that valuation doesn't matter – until it does. Just because something hasn't happened in a while doesn't mean it can never happen again. When the market tanked in 2000, it took more than 7 years to recover to its previous level. It took nearly 5 ½ years for the S&P 500 to get back to the level it reached before the crash that started in 2007.

It may be hard to imagine watching 30%, 40% or 50% of your savings roll away, but it has happened before. For investors nearing the finish line to their important life goals, it can be a lot more than simply inconvenient to have to wait 5 to 7 years just to get back to the starting line. Retiring at 72 instead of 65, or postponing a college education while waiting for accounts to recover, is probably not a risk many passive index investors are prepared to run into.

The stock market runs like a complicated machine with many moving parts. Valuation is an important part, but it's not the only part. Monetary policy, interest rates, economic activity, earnings growth rates, political and geopolitical events, investor behavior, and many other factors help drive the direction of market prices. That's why we monitor them all. We're aware of the risks posed by high stock market values, but we're also aware that overvaluation alone may not be enough to slow down the market's advance. The S&P 500 may run right through cautionary valuation red flags to a P/E of 30 or more – it has happened before.

Rather than raising the white flag and sitting out the race, we believe the best course is to participate – as long as we participate prudently, using the disciplined investment approach we've used for clients for more than 25 years. Through good markets and bad, we have relied on a process designed to manage risk, seek value, and respond to changing conditions. Today, as always, our goal is to help investors take the winner's checkered flag as they cross the finish line to their important financial goals.

- Gary E. Stroik



NOTES

Past performance does not guarantee future results.

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WBI managed accounts may own assets and follow investment strategies which cause them to differ materially from the composition and performance of the indices or benchmarks shown on performance or other reports. Because the strategies used in the accounts or portfolios involve active management of a potentially wide range of assets, no widely recognized benchmark is likely to be representative of the performance of any managed account. Widely known indices and/or market indices are shown simply as a reference to familiar investment benchmarks, not because they are, or are likely to become, representative of past or expected managed account performance.

Additional risk is associated with international investing, such as currency fluctuation, political and economic uncertainty.

Annualized Rate of Return is the return on an investment over a period other than one year (such as one quarter or two years) multiplied or divided to give a comparable one-year return.

Index Definitions

- *The Dow Jones Industrial Average* (DJIA or "The Dow") is a price-weighted average of 30 of the largest blue chip issues traded on the New York Stock Exchange.
- *The S&P 500 Index* includes a representative sample of large-cap U.S. companies in leading industries. The *S&P 500 Total Return Index* includes the performance effect of the dividends paid by the stocks in the index.
- *The NASDAQ Composite Index* (NASDAQ) is a market-value weighted index of all common stocks listed on NASDAQ.
- *The Russell 2000 Index* includes the smallest 2,000 stocks in the Russell 3000 Index (approximately 8% of the total market capitalization of the Russell 3000 Index) of the Russell data series.
- *The MSCI EAFE Index* (EAFE) is an unmanaged index based on share prices of approximately 1,470 companies listed on stock exchanges around the world. The stocks of twenty countries are included in the index.
- *The Hang Seng Index* is a capitalization-weighted index of 33 companies that represent approximately 70% of the total market capitalization of the Stock Exchange of Hong Kong.
- *Nikkei-225 Stock Average* (Nikkei) is a price-weighted index of 225 blue chip Japanese companies listed in the First Section of the Tokyo Stock Exchange.
- *The Dow Jones Equal Weight U.S. Issued Corporate Bond Index* is an index of 96 bonds issued by leading U.S. companies designed to represent the market performance, on a total-return basis, of investment-grade bonds.
- *The Barclays Treasury Bond Index* is an unmanaged index that includes public obligations of the U.S. Treasury that have remaining maturities greater than 1 year.
- *The U.S. Dollar Index* is computed using a trade-weighted geometric average of six currencies. The six currencies and their trade weights are: Euro 57.6%; Japanese Yen 13.6%; UK Pound 11.9%; Canadian Dollar 9.1%; Swedish Krona 4.2%; Swiss Franc 3.6%. These specifications are subject to change.
- *The Commodity Research Bureau Index* (CRB) provides a broad measure of commodity price trends by averaging prices of seventeen commodities from energy, grain, industrial material, livestock, and precious metal groups.
- *The Consumer Price Index* (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.