THE UNITED COMPANIES

Planning for the Possibilities®

Dear clients and friends,

April 2018

After a strong January, which continued the steady and smooth upward trajectory that was prevalent in 2017, equity markets brought a swift reversal for the last two months of the quarter. With that downturn came the meaningful return of volatility. For some perspective, there have been significantly more 1% moves in the S&P 500 Index through just the first three months of 2018 than there were ALL of 2017! To dive a bit deeper, the average daily movement of the S&P 500 Index has been 0.53% over the past 5 years. Year to date, that has increased to 0.90%, and more recently (since January 31), it has spiked to more than 1% daily. The primary drivers of this increase in volatility are rising interest rates, concerns about inflationary pressures and policy uncertainty (most notably around trade wars).

For the quarter, the S&P 500 Index was down 1.22%, while the Dow Jones Industrial Average declined 2.49%. While bonds typically move up in weaker equity markets, that was not the case in 1Q18, with the municipal bond index down 3.35% and the corporate bond index declining 2.20%. Our clients' portfolios typically held up better than the indices in 1Q, especially for those clients in our actively-managed Growth & Income strategy and those invested in our Value strategy. More details on the various equity strategies are provided on page 2 of this letter. Generally speaking, cash levels increased across most strategies in the quarter, as stop limit orders were triggered and gains were locked in on various positions. Most equity strategies also incorporate some type of hedge, which can help protect on the downside.

On the bond side, our security selection within fixed income still seeks quality. Corporate credit spreads have begun to widen but remain historically low, and we feel they have further to go before they become an attractive opportunity. We like high-quality long-term tax-free municipals, as we feel they present good relative value. Lastly, short-term Treasuries have become more attractive, and a 2% state-tax favored yield can now be achieved using very short bonds, which we feel is a better use of cash than money markets in our bond strategies.

What are the key factors we are monitoring as we assess the various markets?

While we do believe investor concern is warranted given a confluence of risk factors that have emerged, we also see a push/pull against positive factors, such as a solid economic backdrop and strong corporate earnings. After bottoming close to 1.5% in 2016, the 10-year Treasury note yield has increased to more than 2.9% in recent weeks. Going forward, we feel that there is potential for higher long-term interest rates this year, as the Fed may shrink its balance sheet at a faster pace and the ECB is likely to communicate the end of its Quantitative Easing program. The Fed should continue to monitor inflation trends closely, particularly with the unemployment rate at low levels and wage inflation increasing.

In addition to the impact of higher rates, volatility is being driven by policy. Again, there is a tug of war going on, with certain policies acting as tailwinds to markets (such as tax reform) and other policies presenting headwinds (such as trade). On the positive side, the tax-reform package along with the recently passed budget should provide a meaningful fiscal stimulus to the economy in 2018. It is worth recalling that the tax package includes significant corporate tax cuts, individual tax cuts and small business tax cuts and provides for the repatriation of cash held overseas by corporations. When combined with the increase in spending included in the recently signed budget, it is estimated that fiscal policy will provide $800 billion in stimulus to the economy in 2018. By contrast, it is estimated that the tariffs imposed by President Trump, along with the retaliation impact especially from China, will present a $32 billion headwind to the economy.

Importantly, the economy appears to remain on solid footing. The "soft data" indicators we follow point to ongoing confidence in the economy, with consumer sentiment, the small business optimism index and the CEO economic outlook results coming in at recent highs. Looking at the "hard data", US industrial production remains positive, the employment indicators are solid, and the global PMIs (f.k.a. Purchasing Managers Index) are well into expansionary territory. Corporate earnings are expected to increase nearly 19% in 2018, driven in large part by tax reform and healthy revenue trends.

Bottom-line, the economy looks solid, and corporate earnings should be strong as reporting season is set to kick off this month. That being said, we are closely monitoring the emerging risk factors mentioned above, such as inflation, interest rates and policy uncertainty, as we construct portfolios for our clients.

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Strategy Review

GROWTH & INCOME STRATEGY (GI)

Overview: Growth & Income (GI) is our most utilized strategy and is recommended for clients seeking growth with income while minimizing risk. The goal is to optimize risk-adjusted returns, which has a broad appeal among our clients. This strategy is designed to be less volatile than the overall market, with risk managed through actively managed diversification across all the industry sectors and the use of stop orders on a portion of the portfolio.

Update: Cash was raised over the course of the quarter due to our active strategy, and we locked in meaningful gains in several positions. We put into motion a plan to sell certain positions if key levels of support were violated and those levels were breached, resulting in additional protective sales. The team now has an action plan for both upside and downside moves in the market.

HIGH DIVIDEND EQUITY & HIGH DIVIDEND PLUS STRATEGY (HDIV & HDIV+)

Overview: This strategy is recommended for clients seeking a steady stream of income with a modest amount of trading activity. The portfolio consists primarily of individual stocks and some ETFs, diversified across most of the industry sectors. By seeking positions that are dividend growers, HDIV aims to beat the average yield of stocks within a given sector and to provide for a hedge against rising interest rates. HDIV+ includes a 20% allocation to growth.

Update: Given the goal of generating income, the models tend to be overweight high-yielding sectors, such as utilities, REITs and telecom services. As a result, the average dividend yield is close to 5%. One theme we would highlight is regional banking, which offers a decent dividend but is also a beneficiary of higher interest rates. This helps offset some of the pressure that rising rates have on some of our other positions. In this sector, we recently added BB&T.

VALUE PLUS EQUITY STRATEGY (VAPL)

Overview: This strategy is recommended for clients seeking a value-based equity strategy with a beta below that of the overall market. This strategy seeks to invest in mispriced stocks with attractive fundamentals in a diversified portfolio.

Update: Given its ownership of seemingly undervalued securities, and with hedges in place to protect on the downside, Value Plus was able to generate 1Q returns ahead of the S&P 500 Index and well ahead of the S&P 500 Value Index (which was down 4.2% in 1Q18). Over the past quarter, we added a midstream energy company, reducing the sector underweight as the Energy sector is now trading below fair value.

GROWTH PLUS EQUITY STRATEGY (GP)

Overview: This strategy is recommended for clients seeking a growth-based equity strategy with a beta above that of the overall market. The team uses a two-part screening system to identify stocks that seem likely to outperform and then ranking them by growth prospects. Higher growth names across the various sectors are then selected.

Update: During the quarter, the portfolio manager increased the weight in Financials and International stocks along with cash, while reducing HealthCare, Materials and Technology. The strategy gained exposure to the Staples and REITs sectors in 1Q, while eliminating its small exposure to the Discretionary sector.

EXCHANGE-TRADED FUNDS STRATEGIES (ETF)

United Robo: This strategy utilizes artificial intelligence to select one of the 16 risk-based allocations developed by UASI. During 1Q18, the portfolio manager reduced the weight to equities in most allocations and increased the weight in Gold.

UDAA: This strategy utilizes artificial intelligence to design a portfolio aimed at generating a risk-adjusted return exceeding a 60/40 equity/fixed income portfolio. During the quarter, the portfolio manager increased cash & US Treasuries to 88% and reduced equities to 12%.

Momentum Plus®: This is a dynamic strategy that utilizes technical indicators, such as relative strength and momentum, to make sector selections. This strategy's biggest overweight continues to be in broad Technology.

Risk-Based ETF: This strategy seeks to identify relative value opportunities for investment. Recent increases were made to Emerging Markets, while developed International was reduced.

Sector-Based ETF: This strategy mirrors the sector allocation changes made in the Growth & Income Strategy (see above).

MUTUAL FUND STRATEGIES (MF)

Our mutual fund strategies are available in three primary risk allocations (Aggressive, Moderate, and Conservative), and the team seeks to mirror the sector allocations determined in the Growth & Income Strategy. Specific funds are evaluated quarterly to ensure that they continue to meet our criteria for inclusion. No changes were made to the lineup in 1Q2018.

Respectfully submitted by the Professional Staff at United Asset Strategies, Inc.

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