member of
the LANIGAN GROUP of companies

Southeast Asset Advisors, Inc.
Lanigan Wealth Management
Investment Management & Consulting
Thomasville – Atlanta – Tallahassee – Mobile – Charleston

TO: Clients and Friends
FROM: SAA Managing Directors
RE: 4th Quarter 2017 Commentary
DATE: February 2018

Our Long-term Goal:
WE STRIVE TO PROTECT AND GROW OUR CLIENTS' CAPITAL OVER THE LONG TERM BY:

(1) Focusing on individual client goals and objectives.
(2) Having the proper asset allocation to reflect each client's tolerance for volatility (i.e., temperament.)
(3) Stress testing short-term liquidity needs.
(4) Investing with a value orientation and utilizing managers who understand the intrinsic value of a business and margin of safety along with passive strategies as appropriate.
(5) Rebalancing portfolio holding/managers when appropriate to take advantage of underpriced and avoid overpriced assets.

Welcome Back Volatility

As this letter goes to press, concerns over the tightening of monetary policy (increased interest rates) and subsequent program trading created the first real volatility the markets have seen in quite some time. The 6.6% market pull back in the last few days was the first mini-correction (5-10%) since the Brexit sell-off in 2Q 2016. So far, in 2018, the S&P has gone from up ~8% back to even after the sell-off through February 7th. Although unsettling for investors, especially given the exceptionally calm markets we have been accustomed to over the last few years, we view this mini-correction as healthy and in-line with the long-term norms of Mr. Market. We believe the underlying strength in the global economy coupled with the US tax cuts should continue to significantly boost earnings in 2018.

We continue to closely watch the perception of and actual increase in inflation rates. Accordingly, we want to continue to keep all fixed income in very short duration maturities as we think that long maturity bonds are a real "bubble." Of course, we have no idea about where the market goes in the short term, nor do we think anyone else knows. However, we believe volatility is healthy and tempers the "melt up" ("animal spirits") that prevails, especially with many new passive index participants. The massive increase in funds flowing into ETFs and passive index funds and the continued increase in program trading, could cause extreme volatility in the future. In this environment, we strongly prefer "bottom up" fundamental investment managers rather than passive index investing, etc.

2017 Key Takeaways / Market Commentary

The S&P index delivered a return of 21.8% for the year. The supercharged technology sector accounted for ~38% of this return. Specifically, five tech companies (AAPL, AMZN, FB, GOOG, and MSFT) comprised ~24% of the gain while representing only ~13% of the S&P 500 market cap.

Value trailed growth in 2017 as the Russell 1000 Value returned nearly 14% vs. 30% for the Russell 1000 Growth. The Value index has a much lower weighting to technology sector, so the relative performance is understandable. Value has generally underperformed for several years, a condition we believe will reverse in the future.

Many of our value managers had good risk adjusted performance while holding substantial cash balances. Most have been selling into strength as their holdings reached or exceeded fair value and have not found suitable qualifying investments at attractive prices to reinvest the cash. This will change as we are beginning to see the return of volatility to the markets, and thus, opportunity.

Short bonds and money markets continued to offer very low returns. However, as we go to press the 2-year treasury note and 10-year note yields have moved up to 2.12% and 2.82% respectively as inflation worries and corresponding interest rate increases begin to concern traders.

The markets were driven in 2017 and early 2018 by many factors including a continued accommodative interest rate environment, the expectation (and final realization) of a new tax bill, and solid earnings growth (approximately 12% in 2017) in corporate America. Investors were seemingly oblivious to the countless concerns and uncertainties that are always present. Certainly, the economy is strong and getting stronger, companies are more efficient as evidenced by high profit margins, unemployment is low, and consumer confidence is high.

While we are recommending a neutral to overweight allocation to equities in all profiles, we are somewhat cautious because of valuation, which we characterize as fair (relative to the alternatives of fixed income) to overvalued (relative to history). Inflation and corresponding interest rate increases are issues we are watching closely. We have not had much inflation for many years, but we see signs of increases. Inflation can accelerate quickly, and if it does, may cause an increase in interest rates at a quicker pace than currently expected, having an impact on market valuations and create competition for equities by making fixed income yields more attractive.

We continue to emphasize equity exposure for clients appropriate with their risk (volatility) tolerance. Despite lower expected future returns, we believe they will provide better total returns than the fixed income alternatives. However, we do expect much more volatility like we are experiencing as we go to press.

Tax Reform "Tax Cuts and Job Act" Comments

As you all know, a new tax bill was signed into law December 22, 2017. The bill is the largest overhaul of the IRC in over 30 years affecting every taxpayer type (individual and corporate) both within and outside the U.S. It includes reduction in rates and the elimination of many deductions, exclusions, and credits. The taxation of pass-through entities is reformed as are international laws to make the U.S. more competitive. Several of the biggest changes are the reduction of the corporate rate from 35% to 21%, the immediate expensing of capital additions, reduced rates on bringing foreign income back to the U.S., and the total reform of our international tax system, which makes the U.S. more competitive with other countries. We basically signaled "The U.S. is now open for business."

This tax bill is very exciting to us as both investment and tax advisors. We think it will substantially increase many companies' earnings after the initial adjustments (write-offs and adjustments in the 4^{th} quarter of 2017 earnings) – so pay attention to 2018 guidance, not 4^{th} quarter 2017 reported net income.

The impact can be summed up as WEB recently said, "Well it's like most businesses had a government partner and that partner share went from 35% to 21% overnight."

The key will be what businesses do with the tax savings and repatriated funds. Will they buy stock back (even if at high prices) to shrink shares outstanding, pay debts, invest and expand their business, increase wages or buy companies (M&A.) As always, we are sure there will be good decisions made by corporate CEOs and their boards that increase the intrinsic value per share (IVPS) and bad decisions that decrease IVPS. That is why great management and boards and capital allocation decisions are so important in order to increase and grow the intrinsic value per share.

The "animal spirits" will surely be observed. This is a grand experiment, and worth the risk to spark growth and jobs. However, we are not sure of the effect of subsequent growth, interest rates, and inflation on our ballooning deficits. Time will tell, but for now, "let's all stand up and dance" and align our affairs to maximize tax savings from the new bill. This is a time where an advisor (team) with a tax background (like us) who know taxes, valuation, and investments can add a lot of value in multiple ways.

Valuation Musing Continued from Prior Letters

With the new tax bill and the present low interest rates, we see an environment that can cause a market "melt up," so we are continuing to "proceed, but with caution." Also, we see intermediate bonds and surely long bonds as a real bubble. If indeed interest rates rise, long bonds (fixed income) could have a substantial loss on a "mark-to-market" basis. Thus, we continue to avoid intermediate / long bonds and by doing so, give up some current yield in near term to avoid bond value loss. We also find many venture capital and private equity investments in the bubble category; however, it is not fair to generalize. We are saying, "Be extremely cautious of these investments being promoted by promoters."

Closing

As always, we want a client to own as much equities for the long term as possible but within their goals and risk profiles, as it is the only way to get a real return over inflation. However, it is always important to know what you invest in, and who you invest with, and to be a long-term, patient investor. We cannot predict the market movements in the short term, and we really do not try, but we expect volatility to certainly increase from what was experienced in 2017. Of course, for patient, long-term investors and likeminded managers, volatility is an opportunity.

We continue to be very pleased with the progress in our new locations, Charleston, SC and Mobile, AL. Ned Johnson (Charleston) and Mikell Leland (Mobile) have done a terrific job for us in these areas and have proven to be valuable additions to our team. As you know, we grow primarily through referrals of prospective clients and we hope that you will think of us if you have friends in these markets (or anywhere for that matter) who would benefit from our services. Our team is strong, we have a great diversity of skills, and we continue to use a team approach to serve all our clients.

Thank you again for your continued confidence and trust. Please call us if you would like to discuss your asset allocation, etc. We are working hard on your behalf. Deserved trust will always be the most important thing we will ever earn.

Your SAA Investment Team

“First-level thinkers look for simple formulas and easy answers.
Second-level thinkers know that success in investing is the antithesis of simple.”
H. Marks

\---

“Using volatility as a measure of risk is nuts. Risk to us is 1) the risk of permanent loss of capital, or 2) the risk of inadequate return.”
C. Munger

\---

“Asset allocation and time horizons are the key to an investor’s success.
The biggest barrier is one’s personal psychology or how he reacts to the daily noise and clutter.”
B. Lanigan