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QUARTERLY SPOTLIGHT

Third Quarter, 2017

Economic Response & Strategic Insights

In Brief

It appears that unless something fairly dramatic occurs within the next three months, the S&P 500 equity market performance will be positive for the ninth consecutive year since the dramatic decline in 2008. The last day of trading for Q3 ended on a new high for the S&P, closing at 2,519.36, up 4.48% from where it started at the end of Q2. It is a fascinating run so far, as most observable asset classes are moving together in a highly correlative state. Perhaps more interesting is the fact that the equity markets appear relatively unphased by anything that has been thrown at them. There were a few stories worth mentioning during the third quarter, including the Fed's conviction to reduce accommodation and move interest rates higher; the ongoing war of words between North Korea and the US, and actual missile testing; the devastation experienced by a series of late summer hurricanes; and, the ongoing difficulty the current administration is having moving parts of their agenda forward. The term that comes to mind in this particular set of circumstances is "climbing the wall of worry."

US equity markets continue to move higher with little divergence, other than a hiccup in the energy and telecom sectors. This move appears to be bolstered by the strength in the economy's growth and individual company earnings with the potential for new pro-growth policies and deregulation also helping. The economy remains strong, with the most recent revision of second quarter GDP at 3.1%, the strongest since 2Q2015. S&P 500 earnings were strong during Q2 and are expected to keep this trend through the third with an earnings growth rate of 5.5%. The unemployment rate reported in September crept lower to 4.2%, even as the labor participation rate moved higher to 63.1%. An increase in the participation rate can cause the unemployment rate to rise, as more workers come into the job market. Even as higher stock prices are reached, the VIX remains at historically low levels. Looking all the way back to December 2006 was the last time the VIX was even close to 9.51, the reading on September 29, 2017.

While the war of words between the US and North Korea paints a picture of global unrest, the international economic landscape continues to be one of growth and opportunity. Global economies are past the stage of just trying to stabilize, and instead, are looking for ways to increase growth. Progress has been made in the European Union where the European Central Bank President Mario Draghi has allowed talk of eventual withdrawal of some level of accommodation from the system. One of their biggest problems is that the Euro continues to rise against other currencies. The International Monetary Fund recently revised global growth higher in several regions for the remainder of 2017 and going into 2018. The EU, Japan, and China were all on that list of higher expected growth. The US had a slight downward revision as the IMF considered certain proposed economic policies they felt were conflicting and questioned the ability of the US to attain higher growth rates. When these global economic underpinnings are combined with the favorable valuations seen in foreign markets, it's easy to understand why these markets have been on such a good run this year.

Overview

The ProEquities Investment Committee is comprised of highly specialized market strategists with 69 years of combined financial services experience. This team meets regularly to discuss markets, review portfolios, and optimize investment strategies, ultimately developing the analysis and recommendations presented here.

We look forward to feedback and questions at: PESolutions@proequities.com

About ProEquities

ProEquities is a an independent RIA with a broker/dealer helping advisors maximize their effectiveness and optimize business growth. Founded in 1985, this wholly owned subsidiary of Protective Life Insurance Company supports more than 750 independent financial advisors nationwide with headquarters in Birmingham, Ala.

EQUITIES: WALL OF WORRY OR NOT, STOCKS CLIMB

The prospect of a ninth consecutive positive year for the S&P 500 Index moves closer to reality with each trading day. Through the end of the 3Q2017, the index returned 14.24% and continues to overcome a variety of global economic and political issues that might make weaker markets crumble. And the pace of the market does not appear to be slowing with the returns for the past three quarters progressing: +6.07%, +3.09%, and +4.48%. Most other domestic markets show a similar strength, some with even more conviction than the S&P. Technology stocks have been a big driver for the markets overall, showing strength

	Trailing Returns		
	3Q17	YTD	1 Year
Equities			
S&P 500	4.48%	14.24%	18.61%
Dow Jones Industrials	5.58%	15.45%	25.45%
Nasdaq 100	6.17%	23.99%	24.08%
Russell 1000	4.48%	14.17%	18.54%
Russell Mid Cap	3.47%	11.74%	15.32%
Russell 2000	5.67%	10.94%	20.74%
MSCI EAFE	5.47%	20.47%	19.65%
MSCI EM	8.04%	28.14%	22.91%

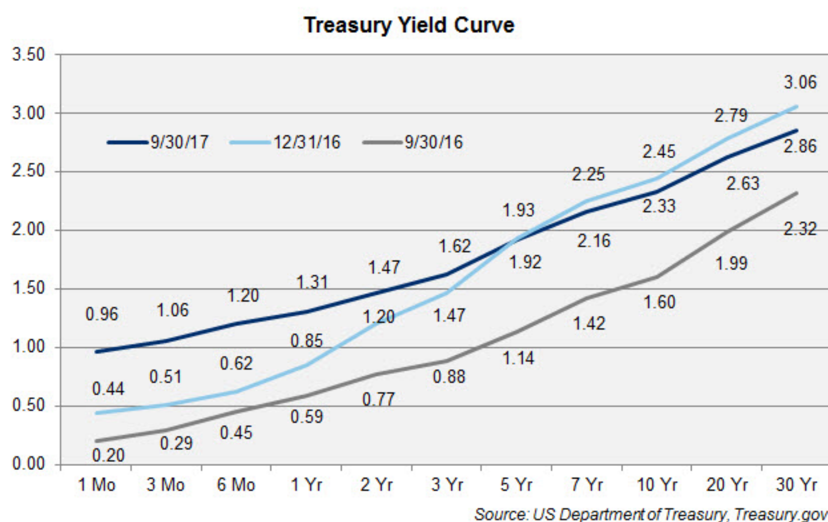
Source: Morningstar Direct, as of 9/30/2017

in the Nasdaq 100's 24% return so far this year. Large cap stocks have generally been stronger this year, but both Mid and Small are right at its heels.

International markets continue to dominate most other domestic equity markets, a trend that has persisted since the beginning of the year. The MSCI Emerging Market index has returned over 28% through the first nine months, with the MSCI EAFE coming in at a strong but relatively distant second at 20.47%. Investors continue to flock to international investments as (1) they see the benefit in the valuation differential with US stocks, (2) international economies are still more accommodative in the current recoveries, and (3) jittery investors are looking for some place to go other than the high flying US markets. The Asset Flow data on page 4 provides additional insight into how investors currently feel about international opportunities, as some of the strongest inflows are directed to the international space.

BONDS: TWO RATE HIKES, ONE MORE TO GO?

Bond markets have moved steadily higher during 2017 with very few retracements. There have been only two occasions of a wide spread decline in bond prices this year, in June and September. The first occasion can be more directly tied to the Federal Reserve Board Committee's actions, as they made the decision to raise the Fed Funds Rate by 25 basis points to the target range of 1.00-1.25% in June. The second is tied to current economic signals, language coming from the Fed, and the prospect of future interest rate hikes.



The Fed Committee met two more times during Q3 and both times decided not to raise the Fed Funds Rate; however, they did take those opportunities to communicate that (1) they are proceeding with their plan to allow approximately $4.5 trillion worth of government and mortgage bonds to begin rolling off their balance sheet, and (2) between the underlying strength of the economy and their desire to stay ahead of inflation, that one more rate hike in 2017 seems prudent.

The move higher that Treasury yields made in September served to pull the whole curve higher for the entire third quarter. The largest move overall was at the shortest part of the curve with the 1-month yield moving 12 basis points to finish at 0.96%. Looking across other parts of the curve, the 2 and 3-year Treasury yields moved 9 and 7 bps higher, and the 10, 20, and 30-year yields all moved higher by 2 bps. These changes continued to flatten the yield curve. Year to date on average, yields on the short end of the curve have risen by 53 basis points, while yields on the long end have fallen 16 bps.

The proxy measure of the broader bond market, the Bloomberg Barclays Aggregate Bond Index, was higher by 0.85%. The index was actually up 1.33% through the first two months of Q3; however, the sharp move higher in interest rates in September ended that run. Still with longer term interest rates generally lower since the beginning of the year, bond indexes across the entire fixed income landscape have benefited. High Yield bonds continue to be one of the strongest groups, as positive economic factors helped drive that group. Emerging Market bonds had a strong quarter and continue to lead most other global bond markets for the first nine months of the year, with attractive valuations and the perception of less interest rate risk driving investor demand.

Fixed Income Returns

	Trailing Returns		
	3Q17	YTD	1 Year
Fixed Income [1]			
Short Gov't / Credit	0.34%	1.06%	0.66%
U.S. Aggregate Bond	0.85%	3.14%	0.07%
High Yield	1.98%	7.00%	8.88%
Global Aggregate Bond	0.78%	2.22%	(0.17%)
Emerging Markets	2.27%	7.50%	4.70%

Source: Morningstar Direct, as of 9/30/2017

REAL ASSETS: REAL ESTATE IS CONSISTENT, ENERGY NOT SO MUCH

Real estate remains consistent and positive during 2017, though moving higher at a relatively muted pace. Like other interest rate sensitive sectors, real estate is being driven in larger part by what is going to happen with interest rates. The relatively low interest rate environment since 2008 has been advantageous for high dividend yielding groups like real estate. The 1-year performance is almost flat, as this period includes the negative returns of 4Q16, due to a sharp rise in Treasury yields pre- and post-election of President Donald Trump. Real estate had started the third quarter at a pretty decent pace but ultimately finished at 0.93%.

Alternatives Returns

	Trailing Returns		
	3Q17	YTD	1 Year
Real Assets			
MSCI US REIT	0.93%	3.61%	0.54%
S&P NA Natural Res	7.41%	(4.45%)	0.35%
Brent Crude Oil Price	20.08%	1.27%	17.28%
Gold	3.51%	11.03%	(3.08%)

Source: Morningstar Direct, as of 9/30/2017

Commodities have struggled during much of 2017 with oil taking much of the blame. Through August 2017, the S&P North American Natural Resources Index was down by 11.44% which tends to have a very high weighting to energy stocks. This move coincided with a similar decline in the price of oil, as Brent Crude oil was down as much as 21% through June, although has since recovered.

The recovery in the price of oil just during the third quarter has been remarkable. With its price moving higher by approximately 20% in just three months, it has managed to pull a negative year to date return into the positive. Prices during the most recent quarter have been impacted in part by tensions in Iraq and the possibility of a disruption in oil flow out of the country and surrounding regions. Oil traders are also looking to increased world economic demand and a nearer term pick-up in demand from US refiners in the aftermath of Hurricane Harvey.

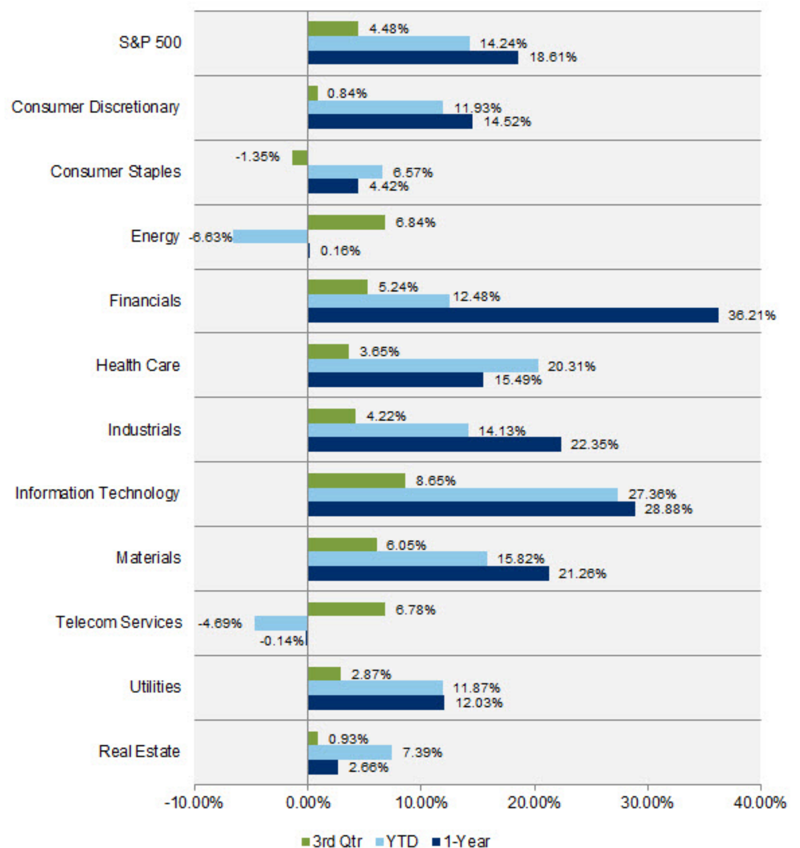
SECTOR PERFORMANCE: TECHNOLOGY CONTINUES TO DOMINATE

The 2Q17 Spotlight opened with sector performance commentary about the difference a couple of quarters can make for the health of a sector. But this quarter demonstrates just how significant one quarter, the fourth quarter of 2016, was for **Financials**. Considering this group has the sixth highest return year to date amongst the other S&P 500 sectors at 12.48%, yet has an eye-popping 36.21% return for the 1-year period, it is clear just how significant that fourth quarter Trump rally was for the sector. The initial move was based on the market's reaction to the possibility of lighter regulation on the financial services industry, but was also driven by the prospect of better lending / borrowing margins due to higher interest rates. More recently many financial institutions have been able to increase dividends and buybacks, because they successfully passed the Federal Reserve's balance sheet stress tests, adding further value to owning financials in this low interest rate environment.

Every sector was higher during the third quarter except for **Consumer Staples** which fell 1.35%. Top performers for the quarter were **Technology** at 8.65%, **Energy** with 6.84%, and **Materials** producing 6.05%. By far the strongest sector so far in 2017 has been **Technology**, as that group outpaces the next closest sector by 7.05% and has put up a blistering 27.36% return through the first nine months of the year. The current market rally has relied heavily on the momentum in the technology group, getting much of its strength from the large cap growth names, which have actually been moving higher on solid earnings and prospects for future growth.

Energy stocks have struggled for the majority of 2017 due to the influence of oil prices. Brent Crude Oil prices through the end of August had dropped approximately 7%, although it was down as much as 20% during June. Strong volume flows from US fracking operations coupled with OPEC's inability to get members to stick to volume quotas has helped prices move steadily lower in 2017. But with Brent Oil prices up 20% for the quarter, there was a positive follow through with energy stocks which helped propel the group to the second highest performing sector for the quarter.

Health Care has proven to be the other 2017 sector star, up 20.31% year to date. This group's good fortune started at the beginning of the year, as they were both the worst performing group during 2016 and the only negative sector. More favorable valuations coming into 2017, and the prospect of significant modifications to both the Affordable Care Act and the industry, have helped spur stocks higher. Potential reforms aside, health care stocks have also offered reasonably valued opportunities, decent dividend yields, and the prospect for future growth.



Source[2]: Morningstar Direct, as of 9/30/2017

STYLE PERFORMANCE: VALUE MAKES A SURPRISE APPEARANCE

The overarching story for 2017 is Large Growth's domination with the style group returning 20.72% year to date versus Mid Growth's 17.29%, and Small Growth's 16.81%. Looking at the trailing 12 months, Small Value is actually right on Large Growth's heels with returns of 21.0% and 21.9%, respectively.

As a reminder, 2016 ended in spectacular fashion for Small Value, as the fourth quarter's 14.07% took the sector to a total one year return of 31.74%. That trend changed almost immediately the first trading day of 2017, as both large capitalization and growth oriented stocks started their own strong move higher. This new trend has persisted throughout 2017, allowing large growth to climb 20.72% higher, generally outperforming all other market cap and style groups.

3Q17	Value	Blend	Growth
Large	3.1%	4.5%	5.9%
Mid	2.1%	3.5%	5.3%
Small	5.1%	5.7%	6.2%

1 Year	Value	Blend	Growth
Large	15.1%	18.5%	21.9%
Mid	13.4%	15.3%	17.8%
Small	20.6%	20.7%	21.0%

Source: Morningstar Direct, as of 9/30/2017

The 1-year numbers are considerably different than year to date 2017, because the 1-year numbers still have the results of 4Q16 which was a banner quarter for both small and value oriented stocks. Those 1-year numbers will change quite a bit as we end 2017. Another item worth noting is the sharp move higher small cap stocks made during September. Large caps stocks have dominated for the entire year through August, with the Russell 1000 Index outpacing the Russell 2000 Index by 7.36%! In September, that trend changed rapidly, as Small Value ran up 7.08% versus Large Growth's 1.30%. The question now is whether this demonstrates a one month reversion to the mean or a foreshadowing of the market's mood going into the final quarter of 2017.

MUTUAL FUND INFLOWS REMAIN POSITIVE BUT ETFs STILL OUTPACE

Asset flow trends remained consistent during 3Q17 with investors continuing to pull assets out of US Equity, Sector Equity, and Allocation categories within the mutual fund space, while ETFs continue to experience positive inflows across all major investment categories. At the same time, large inflows continue to be directed into International Equity and Taxable Bonds categories in both the ETF and mutual fund groups. The flow out of US Equity mutual funds actually accelerated during the third quarter with the $46.1 billion outflow making up almost 80% of the entire outflow for all of 2017. That being said, the rate of outflow within this group is much slower than 2016.

Asset Flows (in billions)	3 Months		YTD		2016	
	ETF	MF	ETF	MF	ETF	MF
US Equity	$16.0	($46.1)	$73.2	($58.3)	$143.1	($143.8)
Sector Equity	$5.3	($4.5)	$19.3	($11.2)	$27.1	($27.2)
International Equity	$36.6	$32.3	$107.5	$69.8	$11.1	($0.3)
Allocation	$0.6	($8.1)	$1.2	($16.0)	$1.0	($49.9)
Taxable Bond	$33.7	$59.0	$88.1	$176.9	$86.4	$114.1
Municipal Bond	$1.5	$9.6	$3.2	$22.9	$6.3	$27.3
Alternative	$2.3	$0.7	$4.9	$0.3	$3.4	($2.8)
Commodities	($0.1)	$0.1	$1.0	$0.9	$10.4	$3.8
Totals	**$95.9**	**$42.9**	**$298.3**	**$185.3**	**$288.9**	**($78.9)**

Source: Morningstar Direct, as of 8/31//2017

Another important difference between this and last year's flow trends is that overall mutual fund flows are very much to the positive side at $185.3 billion through September 30. In 2016, however, total mutual fund flows were actually a negative $78.9 billion. ETFs year to date have had positive inflows within every tracked category with flows totaling $298.3 billion. This total puts the group almost $10 billion over total inflows of $288.9 billion in 2016.

Positive flow trends continue in International Equity, Taxable, and Municipal Bonds — a fascinating phenomenon as investors currently flocking to international equities see both valuation opportunities and are seeking beta and higher equity prices, not exactly a low risk strategy. At the same time, investors are dumping massive amounts of money into bonds, as ever higher equity prices and the many uncertainties in the geopolitical landscape drove this demand. Both ETFs and mutual funds are enjoying healthy inflows within each of these areas with totals for all inflows year to date at $177.3 billion, $265 billion, and $26.1 billion. For international equity this is quite a remarkable shift, as there was almost no growth in assets during 2016. The $200 billion addition to the taxable bond space in 2016 has been easily eclipsed through three quarters and is on pace to break the $300 billion level by end of year.

LOOK AHEAD: GLOBAL ECONOMIES ON THE MOVE, WILL THE US STAY IN THE GAME?

There are three quarters now to observe how the current US Administration operates and what the implications might be for not only the future of the US economy but also for portions of the world economy. In many ways, things have not changed considerably since Quarterly Spotlight in first quarter, 2017. The Investment Committee is still talking about a

very strong set of financial market returns, about how the proposed pro-growth policies are having difficulty making it through the legislative process, and about how any future delays might eventually impact rising asset prices.

The economy continues to move along slowly but surely, averaging about 2.2% over the three-year period ending December 31, 2016. Corporate earnings have continued to grow in this environment as companies are running leaner and healthier than they have in a very long time. Where new project opportunities may not be available, astute management teams are returning capital to investors through higher dividends and share buybacks. Things are good, but many feel they could be better.

There is a tremendous amount of potential energy stored up in the US economy, considering the amount of cash reserves sitting on company balance sheets, the reluctance of companies to hire new or full time workers, and the choice by many firms to pay out earnings in the form of dividends rather than deploy into some new project. The key question is, “What will be the catalyst to help unleash this potential energy and transform into kinetic?”

The first quarter this year led to an annualized GDP of 1.2% followed by 3.1% in 2Q17, a pattern not unlike the past three years. The second quarter number was positive, but will it fall into the same pattern as those three previous years? So far this year, nothing overtly legislative has been passed to directly help the US economy, like a tax cut or major change to existing legislation, as both are potential catalysts to spur the economy. On the other hand, some of the less obvious, slightly more opaque pro-growth influencers might be working their way through the system. Specifically we refer to both the systematic “roll back” of some of the Obama-era regulations by the Trump administration and the proposed “one-in, two-out” regulation policy. If one acknowledges that increased regulation and control of the different components of an economy can slow and even stifle economic growth and prosperity, then it is a reasonable argument to say by reducing some of these regulatory hurdles that growth will improve. Understanding exactly how the reduction of these hurdles will impact the economy in terms of size and timeline is unknown, but it seems to have helped improve attitudes and confidence of the companies and individuals directly impacted by these rules.

Global economies are growing across most geographic regions, and it appears that growth is strengthening. It is amazing to think it has taken almost nine years to get comfortable reducing the level of liquidity available to investors, to raise the Federal Funds Rate towards normalization (albeit at the earth shattering rate of 25 basis point increments), for most major US financial services firms to fully pass the Federal Reserve’s balance sheet stress test, to get to the point where the European Central Bank would even consider moving interest rates away from essentially 0%, and that it has been since 2005 that the US has experienced a one year GDP growth rate over 3%.

It is apparent that investors are nervous, whether it’s because valuations are too high or the rally has gone on too long. But looking at overall growth in the global economy, there are reasons to feel pretty good. A core, fundamental strength is driving world growth today, one that has been formed through the fire of what has been our world economy over the past nine years. The one recurring question remains, “What might happen to take that fundamental strength to a second level and when might that happen?”

HAVE QUESTIONS OR FEEDBACK?

Email the ProEquities Investment Committee at PESolutions@proequities.com.

DISCLOSURES

*Benchmark performance statistics for the time periods referenced are pulled from Morningstar Direct, a robust investment research and analysis tool used widely by investment professionals. The tool focuses on providing comprehensive and timely financial, statistical, and operational information on a wide range of investment products and indices.

[1]The fixed income sectors referenced in this table correspond to the following benchmarks: Short Gov't/Credit = Barclays US Government / Credit 1-3 YR Index / U.S. Aggregate Bond = Barclays U.S. Aggregate Bond Index / High Yield = Barclays High Yield Corporate Bond Index/ Global Aggregate Bond = Barclays Capital Global Aggregate Bond Index / Emerging Markets = Barclays Emerging Markets Hard Currency Aggregate Index

[2]The sector performance numbers pulled from Morningstar Direct are from the **S&P 500 Sector** performance series

Benchmark Descriptions

The **S&P 500 Index** is a market capitalization-weighted index of 500 widely held stocks often used as a proxy for the stock market. Members are selected based on market size, liquidity, and industry group representation. The **Dow Jones Industrial Average** is calculated by summing the prices of the stocks of 30 companies and then dividing that total by an adjusted value (due to the effect of stock splits throughout the history of the index). The **Nasdaq 100 Index** includes 100 of the largest domestic and international on-financial companies listed on the Nasdaq based on market capitalization. The **Russell 1000 Index** is an index of approximately 1,000 of the largest companies in the U.S. Equity markets. It is market cap weighted meaning that the largest companies constitute the largest percentages in the index. **The Russell Mid-Cap Index** measures the performance of the mid-cap segment of the U.S. equity universe. The index is a subset of the Russell 1000 Index and is reconstituted annually. The **Russell 2500 Index** is a broad index featuring 2,500 stocks that cover the small and mid-cap market capitalization. It is market cap weighted meaning that the largest companies constitute the largest percentages in the index. The **Russell 2000 Index** is an unmanaged index consisting of approximately 2000 US small capitalization common stocks. The **MSCI EAFE Index** is an unmanaged market capitulation-weighted index that monitors the performance of stocks from Europe, Australia, and the Far East. The **MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. The **MSCI US REIT Index** is a free float-adjusted market capitalization weighted index that is comprised of equity REITs that are included in the MSCI US Investable Market 2500 Index, with the exception of specialty equity REITs that do not generate a majority of their revenue and income from real estate rental and leasing operations. The index represents approximately 85% of the US REIT universe. The **S&P Developed BMI Property Index** is an index consisting of companies from developed markets whose floats are larger than $100 million and derive more than half of their revenue from property-related activities. The MSCI EAFE Index is an unmanaged market capitalization-weighted equity index comprising 20 of the 48 countries in the MSCI universe and representing the developed world outside of North America. The **S&P North American Natural Resources Index** is a capitalization weighted index considered representative of the natural resource industry. The **Barclays Capital Global Aggregate Bond Index (Unhedged)** provides a broad-based measure of the global investment-grade fixed-rate debt markets. It consists of three major components: the US Aggregate Index, the Pan-European Aggregate Index, and the Asian-Pacific Aggregate Index. The **Barclays US Government / Credit 1-3 YR Index** includes all medium and larger issues of US Government, investment-grade corporate, and investment-grade international dollar-denominated bonds that have maturities of between 1 and 3 years and are publicly issued. The **Barclays U.S. Government / Credit Intermediate Index** is an unmanaged index based on all publicly issued intermediate government and corporate debt securities with maturities of 1-10 years. This index represents assets types which are subject to risk, including loss of principal. The **Barclays High Yield Corporate Bond Index** includes all fixed income securities having a maximum quality rating from Moody's Investor Service of Ba1, a minimum amount outstanding of $100 million, and at least one year to maturity. The **Barclays U.S. Aggregate Bond Index** is an unmanaged index composed of securities from the **Barclays Government/Corporate Bond Index**, Mortgage-Backed Securities Index and the Asset-Backed Securities Index. Total return comprises price appreciation / depreciation and income as a percentage of the original investment. Indices are rebalanced monthly by market capitalization. The **Barclays Capital Global Aggregate Bond Index (Unhedged)** provides a broad-based measure of the global investment-grade fixed-rate debt markets. It consists of three major components: the U.S. Aggregate Index, the Pan-European Aggregate Index, and the Asian-Pacific Aggregate Index. Bonds are denominated in local currency and subject to exchange rate risk. The **Citi World Government Bond Index** is a market capitalization weighted bond index consisting of the government bond markets of multiple countries. The index includes all fixed-rate bonds with a remaining maturity of one year or longer and with amounts outstanding of at least the equivalent of US$25 million. Government securities typically exclude floating or variable rate bonds, US/Canadian savings bonds and private placements. The listed portfolio allocations are not adjusted to reflect a 3% allocation to cash as represented by the Barclays US Treasury 1-3 month index. The **Barclays Emerging Markets Hard Currency Aggregate Index** is a debt benchmark that includes USD-denominated debt from sovereign, quasi-sovereign, and corporate EM issuers. The Barclays Emerging Market Aggregate Index **Barclays US Treasury 1-3 Month Index** is the 1-3 month component of the US Treasury Bill Index and includes US Treasury Bills with a maturity from one up to twelve months.

The historical performance results of the above listed indexes do not reflect the deduction of transaction and custodial charges, or the deduction of an investment management fee, the incurrence of which would have the effect of decreasing indicated historical performance results. The aforementioned indexes are not indexes into which an investor can directly invest. An investor cannot invest directly in an index.