INVESTMENT REPORT

LYNCH FINANCIAL GROUP LLC
— Retirement Wealth Management —

January, 2018 www.LynchFinancialGroup.com

Investment Review and Outlook

The fourth quarter capped yet another stellar year for U.S. stocks.

The broad driver of the market's rise for the year was rebounding corporate earnings growth, which was supported by solid economic data, synchronized global growth, still-quiescent inflation, and accommodative monetary policy.

By year-end, the S&P 500 Index had rallied for more than 400 days without registering as little as a 3% decline.

Foreign stock returns were even stronger, with developed international markets gaining 26.4% and emerging markets up 31.5% for the year.

We welcome questions or comments regarding this newsletter at jlynch@lynchfinancialgroup.com. Lynch Financial Group provides Retirement Wealth Management Services to individuals within 15 years of retirement, retirees, and surviving spouses. We also provide specialized assistance to professionals, fiduciaries and heirs in wealth transfer situations.

Benchmark and Mutual Fund Performance

The box below contains benchmark (capital market and investment style) performance results. The performance results of our recommended mutual funds and their benchmarks are shown on page 5. For the quarter, client portfolios underperformed their benchmarks.

Fourth Quarter Key Takeaways

The fourth quarter capped yet another stellar year for U.S. stocks. Larger-cap U.S. stocks gained 6.6% for the quarter and ended the year with a 21.7% total return. This was the ninth consecutive year of positive returns for the index—tying the historic 1990s bull market and capping a truly remarkable run from the depths of the 2008 financial crisis. The broad driver of the market's rise for the year was rebounding corporate earnings growth, which was supported by solid economic data, synchronized global growth, still-quiescent inflation, and accommodative monetary policy. U.S. stocks got an additional catalyst in the fourth quarter with the passage of the Republican tax plan, presumably reflecting investors' optimism about its potential to further boost corporate after-tax profits, at least over the shorter term. By year-end, the S&P 500 Index had rallied for more than 400 days without registering as little as a 3% decline. This is the longest such streak in 90 years of market history, according to Ned Davis Research. Foreign stock returns were even stronger, with developed international markets gaining 26.4% and emerging markets up 31.5% for the year. In the fourth quarter, however, these markets couldn't match the S&P 500, gaining 4%–6%.

Benchmark Returns (Periods Ended 12/31/17)

	Quarter	12 Months
Large-Cap Benchmarks		
Vanguard 500 Index	6.6%	21.7%
Russell 1000 Growth iShares	7.8%	30.0%
Russell 1000 Value iShares	5.3%	13.5%
Mid-Cap Benchmarks		
Russell Midcap iShares	6.0%	18.3%
Russell Midcap Growth iShares	6.8%	25.0%
Russell Midcap Value iShares	5.5%	13.1%
Small-Cap Benchmarks		
Russell 2000 iShares	3.3%	14.7%
Russell 2000 Growth iShares	4.6%	22.2%
Russell 2000 Value iShares	2.0%	7.7%
Other Benchmarks		
Vanguard Developed Mkts Idx	4.4%	26.3%
Vanguard Emerging Markets	6.2%	31.2%
Vanguard REIT Index	1.4%	4.8%
Vanguard Total Bond Mkt Index	0.4%	3.5%
Credit Suisse High Yield Index	0.5%	7.0%

Moving on to bonds, the core bond index fund gained 3.5% in 2017. This return was close to the index's yield at the start of the year, as intermediate-term interest rates changed little during the year. Although the Federal Reserve raised short-term rates three times, yields at the long end of the Treasury curve declined and the yield curve flattened. Corporate bonds across all credit qualities and maturities had positive returns. High-yield bonds gained 7.5% and floating-rate loans rose 4.1% for the year. Investment-grade municipal bonds rebounded from a flat 2016, returning 4.5%. Our long-held tactical positions in several flexible and absolute-return-oriented bond funds added value, outperforming core bonds by several percentage points.

The year 2017 was a very good one for most financial markets. While the macro outlook remains positive, unprecedented central bank policy shifts could trigger increased volatility, a stock market correction, or even a recession sometime in this business cycle. During this uncertain time, it is all the more important to stay disciplined and patient. We remain confident in our diversified portfolio positioning looking ahead over our long-term investment horizon.

Looking Ahead: Updates on Our Asset Class Views

U.S. Stocks: As noted above, U.S. stocks were up 22% for the year, driven in part by expectations of a historic corporate tax cut, which the Republican-led Congress duly delivered. We suspect much of the benefit of tax decreases might be priced in based on consensus earnings estimates for the S&P 500.

Foreign Stocks: Political uncertainties notwithstanding, Europe continues its economic recovery within what appears to be a benign fiscal and monetary environment. Europe is matching the United States in terms of economic growth and, according to Capital Economics, is on track to generate its strongest growth since 2007. Earnings have rebounded strongly, with Ned Davis Research analysis showing continental Europe and U.K. local-currency earnings growing over 25% and 35%, respectively, over the past 12 months. (The United States has seen earnings growth of 14% over the same period, according to NDR.) While earnings were up strongly, investor sentiment was relatively depressed (especially during the fourth quarter), leading valuation multiples to compress.

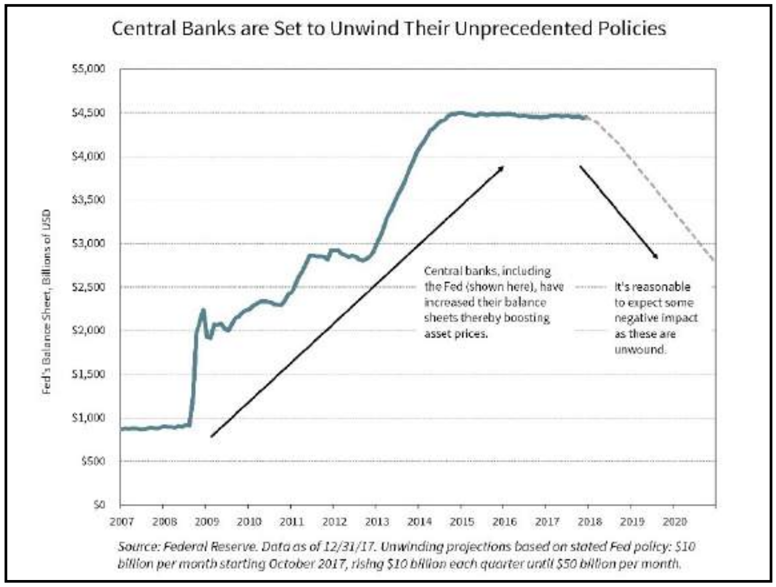
Like European stocks, emerging-market stocks posted strong earnings growth of nearly 20%. Yet after the recent run-up, we still expect emerging-market stocks to generate mid- to upper-single-digit annualized returns over the next five years in our base case scenario. While not attractive in absolute terms (given equities' downside risk), these returns are still better than what we expect from U.S. stocks.

Fixed-Income: Our return expectations for core bonds remain muted looking out over the next five years, in the range of 2.5% to 3.2% (from a current yield of 2.7%). Today, we're faced with taking on elevated levels of interest rate risk for low yield. The yield per unit of duration is near its all-time low. For context, a 50-basis-point yield increase in the Bloomberg Barclays U.S. Aggregate Bond Index would wipe out more than a year of income. This explains our meaningful positioning away from core bonds in favor of flexible credit strategies, which we believe will outperform core bonds in a period of flat or rising rates. That said, we still maintain core bond exposure in our balanced portfolios to serve as ballast in the event of a risk-off environment.

Looking Ahead: A Quick Word on the Macro Outlook

In terms of the near-term macro outlook, the consensus view is that there is little risk of a U.S. or global economic recession in 2018. The market expects the in-sync global growth that we saw in 2017 to continue. Most of the investors and strategists we respect seem to share this view. However, when an outlook becomes the strong consensus view, one should assume it is *already discounted* to a meaningful degree in current market prices. This is where our investment discipline comes in, because we think we have an edge in assessing fundamentals, valuations, expected returns, and risks *across different asset classes* and *over longer-term periods*.

We fully expect to get the opportunity to add back to our U.S. stock exposure at prices that imply (much) better expected returns across our scenarios. One obvious trigger for that would be a meaningful drop in the market. We believe a bear market is likely sometime in the next five years (our tactical time horizon). Again, we can't confidently predict exactly when, but one reasonable scenario would be triggered by ongoing monetary policy tightening, which is already underway in the United States, to be followed by other central banks. Given the boost to asset prices from unprecedented monetary stimulus, it is reasonable to expect some negative impact as central banks stop and then reverse course. On the other hand, should U.S. stocks continue their very strong upward trajectory, we will further reduce our exposure to them. There are a lot of variables involved, but all else equal, one key trigger for U.S. stocks would be if even under our optimistic/bullish scenario, we are seeing low-single-digit five-year expected annualized returns, down from 7%–8% currently.



Source: Federal Reserve. Data as of 12/31/17. Unwinding projections based on stated Fed policy: $10 billion per month starting October 2017, rising $10 billion each quarter until $50 billion per month.

Concluding Comments

The year 2017 was a very good one for most financial markets and particularly global stocks. But there was one small corner of the investment world that did a bit better than stocks: bitcoin gained 1,518%. We don't own bitcoin (or any other crypto currency) in our portfolios. It doesn't fit within our investment discipline or circle of competence. It's a speculative game we *simply don't need to play* to achieve our clients' investment objectives.

However, the exponential rise of bitcoin and the questions, emotions, and behaviors it triggers in many investors offers us an opportunity to restate some of the core principles and practices that underlie our investment approach. First, the path to long-term investment success is simple to describe but not easy to achieve. (As Charlie Munger put it in his characteristically blunt way: "It's not supposed to be easy. Anyone who finds it easy is stupid.") Successful long-term investors are disciplined and patient. They are honest with themselves about what they know, what they don't know, and what they can't know (the unknowable). In making investment decisions they focus both on what's knowable (within a reasonable degree of likelihood) and what's important (in terms of portfolio impact). Yet, they are also cognizant of and try to manage their exposure to risks that are important, but unknowable or unpredictable (e.g., geopolitical shocks).

Successful investors have the humility to know not every decision will turn out to be right and that simply having conviction about something doesn't mean it will actually happen. Their investment process is well defined and repeatable. It requires having a sound basis for each decision, so that if investors consistently implement the process over time they should be right more than wrong and the gains from their winners will more than outweigh their losers.

Successful investors are willing to challenge their own ideas and admit when they are wrong—whether due to new information and changing circumstances, or an error in their original thesis. They keep their eyes on their long-term financial objectives and on the underlying fundamentals that ultimately drive investment returns. They don't get emotionally caught up in the day-to-day noise of the financial news channels or the zigs and zags of the markets. But when the short-term zigs and zags get meaningfully out of whack with the longer-term fundamentals, they use that price volatility to their advantage—buying lower and selling higher. If the market isn't presenting them with compelling investment opportunities, they are content to hold their current positions; in other words, they don't confuse activity with progress. (Munger calls it "sit on your ass investing.")

Successful investors are self-aware about their own risk tolerance and investment temperament. As such, they are invested in a portfolio consistent with those personal attributes, managed by an investment manager aligned with them as well. This enables them to remain disciplined and patient—during the good times as well as the inevitable challenging periods—on the road to achieving their long-term success.

Thank you for your continued confidence and trust. We wish you and yours a very happy, healthy, peaceful, and prosperous New Year.

LFG Recommended Mutual Funds
Performance Results for Funds and Benchmarks

		% Returns For The Periods Ended December 31, 2017							
		3 Months		12 Months		3 Yrs Annlzd		5 Yrs Annlzd	
Fund Name[1]	**Benchmark (BM)**[2]	**Fund**	**BM**	**Fund**	**BM**	**Fund**	**BM**	**Fund**	**BM**
Baron Emerging Markets[3]	Vanguard Emerging Markets Index	+6.2	+6.2	+40.6	+31.2	+9.2	+7.3	+9.2	+3.3
Parametric Emerging Markets[3]	Vanguard Emerging Markets Index	+5.0	+6.2	+27.4	+31.2	+6.1	+7.3	+3.0	+3.3
Schwab Fundamental Emerg Mkts[3]	Vanguard Emerging Markets Index	+6.1	+6.2	+26.2	+31.2	+10.5	+7.3	NA	NA
Tweedy Browne Global Value	Vanguard Developed Markets Index	+2.9	+4.4	+15.4	+26.3	+6.3	+8.8	+7.8	+8.2
Artisan International	Vanguard Developed Markets Index	+4.0	+4.4	+31.0	+26.3	+4.4	+8.8	+7.1	+8.2
Litman Gregory Masters Select International	Vanguard Developed Markets Index	+2.7	+4.4	+23.6	+26.3	+3.7	+8.8	+5.7	+8.2
Harbor Capital Appreciation	Russell 1000 Growth iShares	+7.2	+7.8	+36.6	+30.0	+14.5	+13.6	+17.8	+17.1
Jensen[3]	Russell 1000 Growth iShares	+7.8	+7.8	+23.6	+30.0	+12.2	+13.6	+16.0	+17.1
BBH Core Select[3]	Vanguard 500 Index	+6.1	+6.6	+19.9	+21.7	+8.0	+11.3	+11.6	+15.6
Schwab Fundamental US Large Co[3]	Vanguard 500 Index	+7.0	+6.6	+17.1	+21.7	+9.8	+11.3	NA	NA
Dodge & Cox Stock	Russell 1000 Value iShares	+5.8	+5.3	+18.3	+13.5	+11.1	+8.5	+16.3	+13.8
Vanguard Windsor II	Russell 1000 Value iShares	+5.9	+5.3	+16.8	+13.5	+8.6	+8.5	+13.2	+13.8
FPA Crescent[3]	60% Russell 2500 Index; 40% Vang Tot Bd	+2.9	+3.3	+10.4	+11.5	+6.0	+6.9	+9.2	+9.4
PIMCO All Asset	Barclays TIPS Bond iShares	+3.1	+1.2	+14.0	+2.9	+5.7	+1.9	+3.7	+0.0
PIMCO All Asset All Authority[3]	50% S&P 500/50% Barclays TIPS Bond iShares	+2.1	+3.9	+12.0	+12.3	+4.0	+6.6	+0.8	+7.8
Westwood Income Opportunity[3]	25% S&P 500, 25% NAREIT All Equity, 25% Citigroup Treasury Bill 3 mo., 25% Citigroup Treasury 10 Yr	+3.4	+2.4	+11.0	+8.4	+4.9	+5.1	+7.6	+7.0
Osterweis Strategic Income[3]	Vanguard Total Bond Index	+1.1	+0.4	+6.0	+3.5	+5.2	+2.1	+4.7	+1.9
Doubleline Total Return[3]	Vanguard Total Bond Index	+0.2	+0.4	+3.8	+3.5	+2.8	+2.1	+3.0	+1.9
PIMCO Total Return	Vanguard Total Bond Index	+0.1	+0.4	+5.1	+3.5	+2.8	+2.1	+2.2	+1.9
Vanguard Intermed Tax-Exempt	Vanguard Total Bond Index	+0.3	+0.4	+4.5	+3.5	+2.5	+2.1	+2.6	+1.9
Loomis Sayles Bond	1/3 CSFB HY, 2/3 Vang Tot Bond	+0.1	+0.4	+7.5	+4.6	+2.8	+3.5	+3.8	+3.2

[1]Funds were selected using the LFG Proprietary Mutual Fund Rating System℠. This system is based on extensive research using both quantitative and qualitative factors. The system seeks to identify top funds in each asset class and investment style. LFG typically combines 8 to 10 funds in client investment portfolios.

[2]iShares exchange traded funds were used where available and respective Russell indices were used for the other periods.

[3]Funds which were not recommended for entire 5 year period.

The above table reflects past performance and should not be considered indicative of future results. The results contained in this schedule were obtained from sources we believe to be reliable. We cannot, however, guarantee the accuracy of this information.