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March 31, 2017 Quarterly Report

We hope you had a great start to the New Year! As always, thank you for your continued support and trust in allowing us to provide you with your investment management solution.

The last six months have been fortuitous for those of us that were able to maintain a disciplined approach to value investing. While it felt like wheels just spinning in the mud throughout 2015 and into 2016, the latter half of last year finally saw the fruits of our labor produce excellent returns.

Going forward we believe that there are some important factors that, if they continue, would provide for continued positive returns for investors. We discuss each of them below.

Legislative Gridlock

While volatility could reign supreme in the US stock market over the next few months, we continue to assess the new Administration's upcoming top priorities: tax reform and infrastructure spending

Despite the denial of the newly proposed health care bill, analysts believe lawmakers will continue to push on their mission to cut taxes and reform the US tax system. Chief US Economist Paul Ashworth at Capital Economics stated "Even complete legislative gridlock wouldn't necessarily be a disaster, however, particularly not when there is evidence of a very strong pick-up in global economic growth." Ashworth continues to anticipate a $2 trillion package of tax cuts to be passed by early 2018.

Even assuming that there can be no agreement reached on any of the big reform or tax proposals, we feel that this "legislative gridlock" does not necessarily portend negative returns.

Jobs Report

With the unemployment rate at a low 4.7%, payroll growth has continued to beat expectations, with employers adding 238,000 in January and 235,000 in February. Expectations for March could potentially show added jobs falling below 200,000. Still, companies are increasing wages by the largest amount in eight years and higher pay could draw more individuals back in to the workforce or keep the baby boomer era from retiring earlier.

There is an argument to be made that there are not enough individuals in the Labor Market to meet the expected increase in jobs necessary to get the overall U.S. economy back to historical growth levels. However, we point out that the number of people that have "quit" looking for work accounts for more than 43% of those unemployed. Additionally, the largest share of those listed as unemployed are 18-29 year olds, individuals that would be most likely to reenter the work force given better employment opportunities.

GDP Reports

The US economy is growing faster than what was initially reported in the fourth quarter of 2016. Currently, at a pace of 2.1%, the US economy is outperforming estimates of 1.9%, and even an adjusted 2% expectancy made last year. Improved spending on insurance, transportation, and recreation is a supporting factor on the advancement of consumer spending. These results were from a stronger than expected increase in consumer spending, which was reported at 3.5%, up 0.5% from its original forecast.

U.S. GDP by Year Since 1929 Compared to Major Events

Year	GDP Growth Rate	Real GDP (trillions)	Nominal GDP (trillions)	Events Affecting GDP
2006	2.7%	$14.614	$13.856	Fed raised rates.
2007	1.8%	$14.874	$14.478	Bank crisis.
2008	-0.3%	$14.830	$14.719	Financial crisis.
2009	-2.8%	$14.419	$14.419	Stimulus Act.
2010	2.5%	$14.784	$14.964	ACA. Dodd-Frar
2011	1.6%	$15.021	$15.518	Japan earthquake.
2012	2.2%	$15.355	$16.155	Fiscal cliff.
2013	1.7%	$15.612	$16.692	Sequestration.
2014	2.4%	$15.982	$17.393	QE ends.
2015	2.6%	$16.397	$18.036	TPP. Iran deal.
2016	1.6%	$16.662	$18.569	

- BEA, National Income and Product Accounts Tables: Table 1.1.5. Nominal GDP, Table 1.1.1. GDP Growth Rate. Table 1.1.6 Real Gross Domestic Product, Adjusted for inflation using 2009 dollars.
- St. Louis Federal Reserve, GDP per Capita by Year, Adjusted for Inflation using 2009 dollars. (Updated November 24, 2015.)

The chart above shows annual GDP Growth Rate over the last 10 years. While the Administration is vowing to return the economy to an annual growth exceeding 4%, which we believe to be quite a lofty expectation, we remain optimistic for continued expansion if the growth rate continues at 2%-3%.

Fed Response

March 15th marked the day that the Fed raised the benchmark interest rate by a quarter percentage point, while remaining committed to their projections for three total hikes for 2017, and three total for 2018. This would only be the 3rd hike in a decade, but the 2nd hike within 3 months.

Many regional bank presidents are making aggressive assumptions that the Fed will consider hiking rates at least four times this year. This perception would be viewed as a positive and somewhat encouraging, however, in hopes to safeguard against the US economy from overheating. While the Fed has made it clear that the pace of future hikes is “data dependent”, current market-implied odds show only a 20% chance that 2017 will end with rates being above 1.5%.

Index Returns

Index	Q1 2017	Q4 2016	Q3 2016	Q2 2016	5 Year Annualized
*MSCI ACWI ex-US	7.21%	-1.61%	6.26%	-1.75%	1.60%
S&P 500	5.66%	3.82%	3.85%	2.46%	14.66%
Russell 2000 Value	-0.13%	14.07%	8.87%	4.31%	12.54%
Barclay's US Agg	0.82%	-2.98%	0.46%	2.21%	2.32%

Data provided by MorningStar Office
*MSCI ACWI ex-USA PR USD is the Price Return of the Morgan Stanley Capital International Index excluding US based companies

Summary

We remain cautiously optimistic that we will see continued positive returns from equities, particularly small cap value stocks, and that the bond market returns will continue to face headwinds as the Fed begins to lift rates.

Thus, we will continue to focus on finding additional investments from the small cap value stock universe, an area that we have had much success with in the past.

Should you have any questions please feel free to call me directly at 314-726-5500 or email at bgrunzinger@chrysalisim.com.

Sincerely,

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President Chrysalis Investment Management, LLC