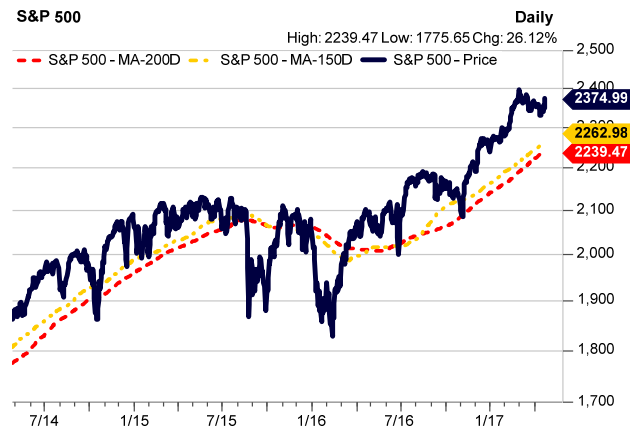


Observation Deck

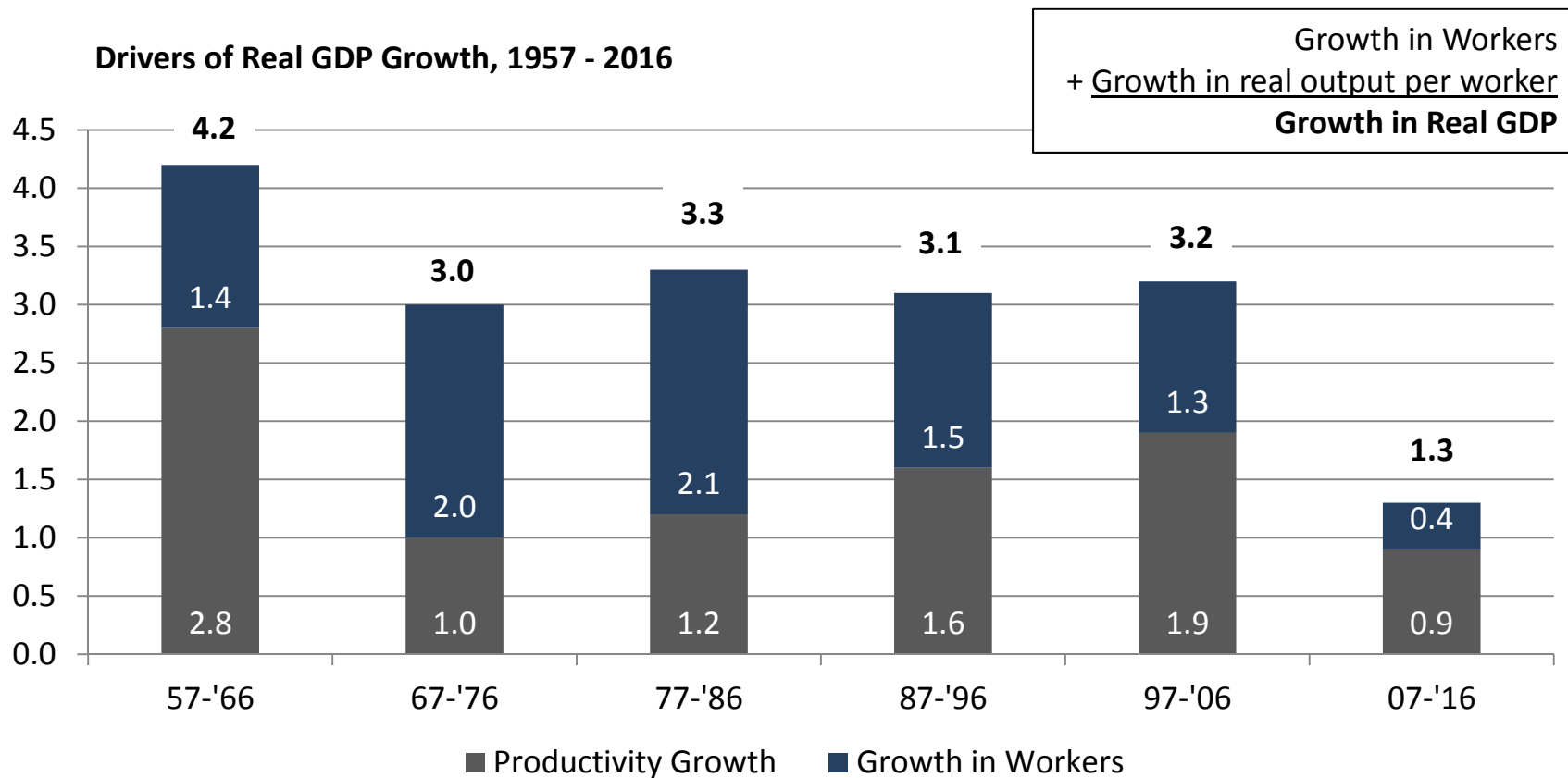
Views from the Investment Policy Committee



April 2017

Real GDP Growth Drivers

- The trajectory of economic expansion is constrained by the growth of the workforce and rate of productivity.
- Monetary and Fiscal Policy direction can influence the rate of growth over the intermediate term, but the long-run drivers of real GDP, growth in labor and productivity, will be the ultimate determinants.



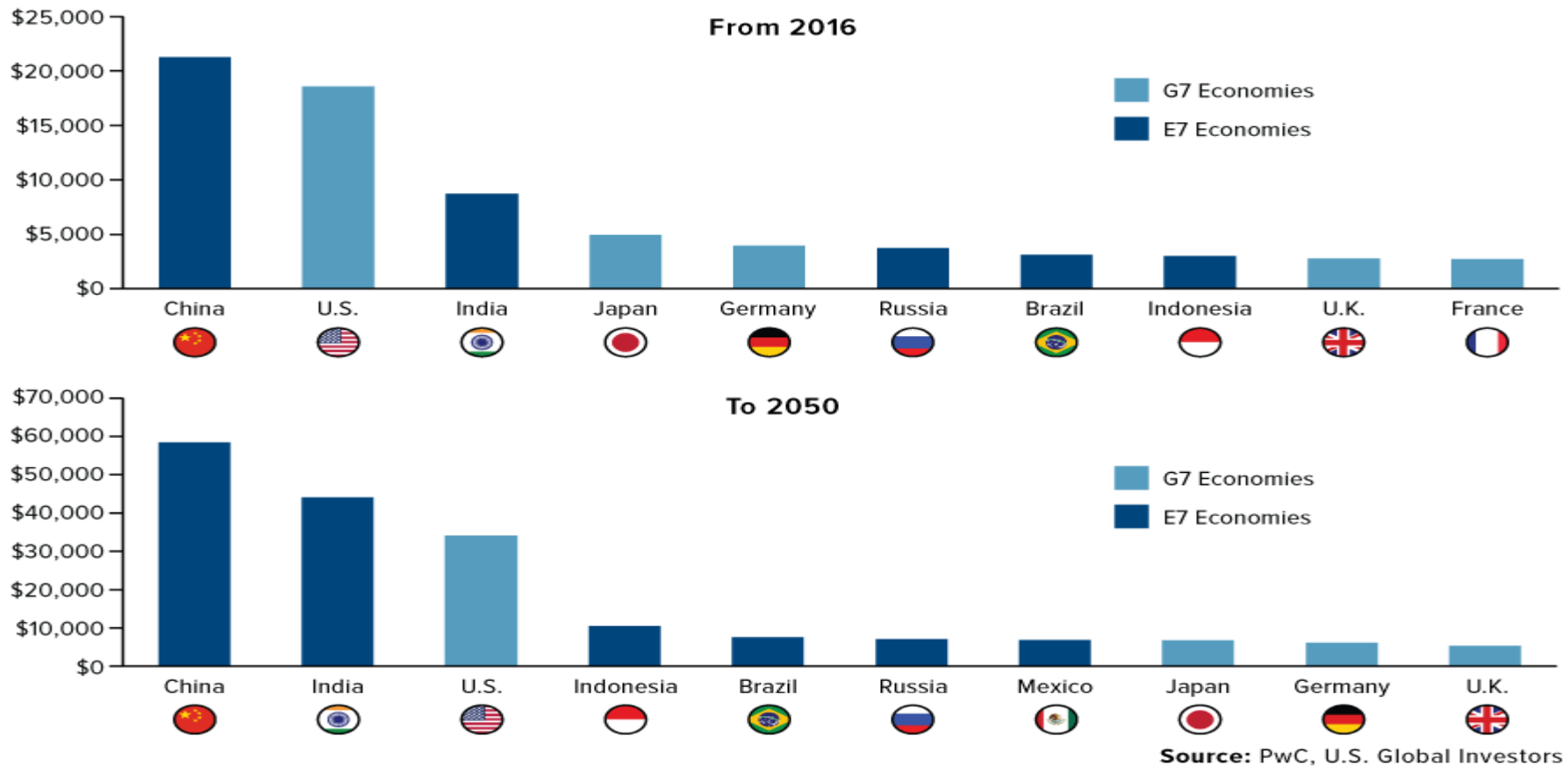
Source: BEA, BLS, Federal Reserve Bank

Finding Faster Economic Growth

- Companies, large and small, that face slower levels of economic growth locally, seek economic environments that offer faster growth trajectories, many of which are found in emerging markets

Top 10 Economies Expected to Be Dominated by 7 largest Emerging Markets in 2050

Gross Domestic Product (GDP) Based on Purchasing Power Parity (PPP), in Billions of 2016 Dollars

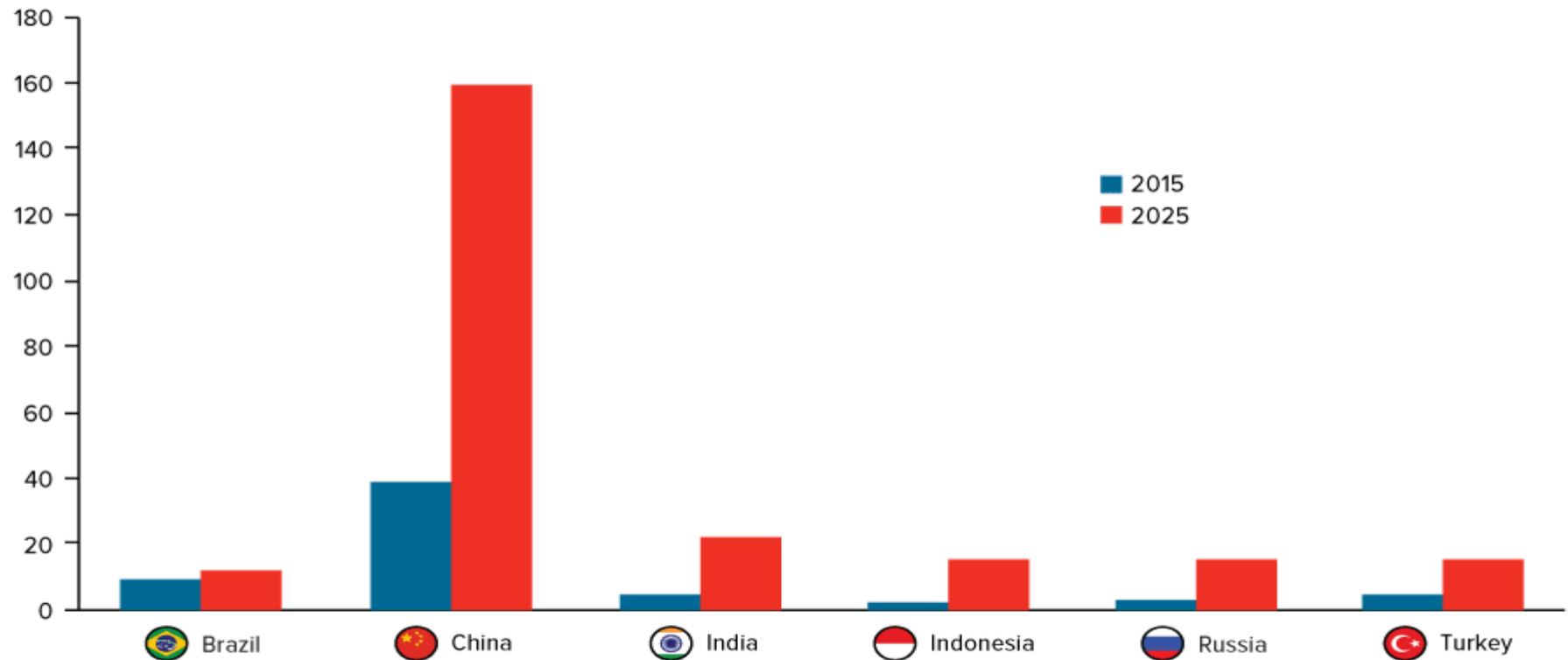


Rising Purchasing Power of Global Consumers

- Despite many challenges within emerging markets, it would be a mistake to overlook the rising purchasing power of consumers within emerging markets
- Companies have elected to locate manufacturing in many emerging markets not simply to reduce cost, but also to be closer to these emerging consumers

China's Surging Middle Class Is a Growth Market for U.S. Businesses

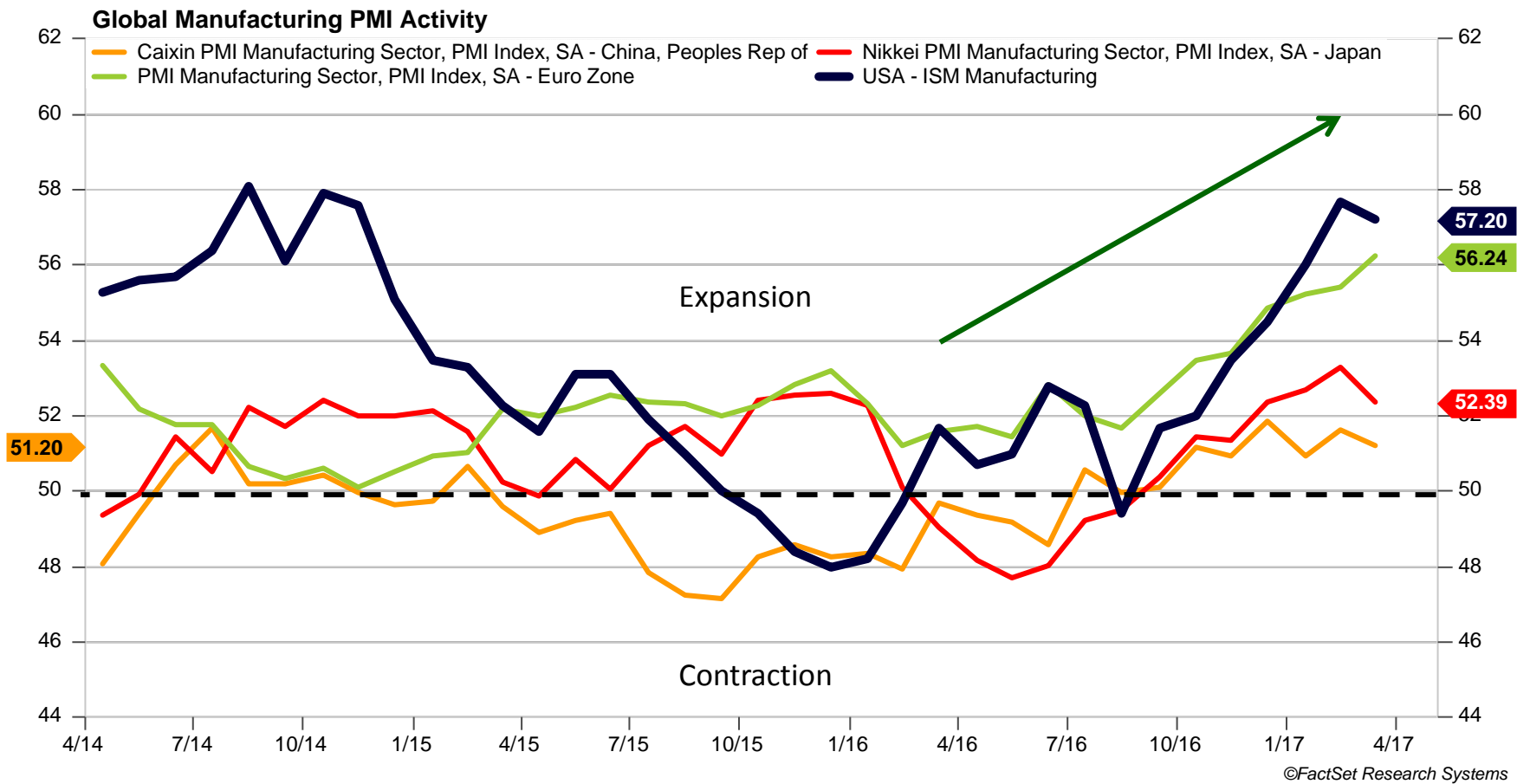
Millions of Households with Incomes over \$35,000



Source: Oxford Economics, U.S. Global Investors

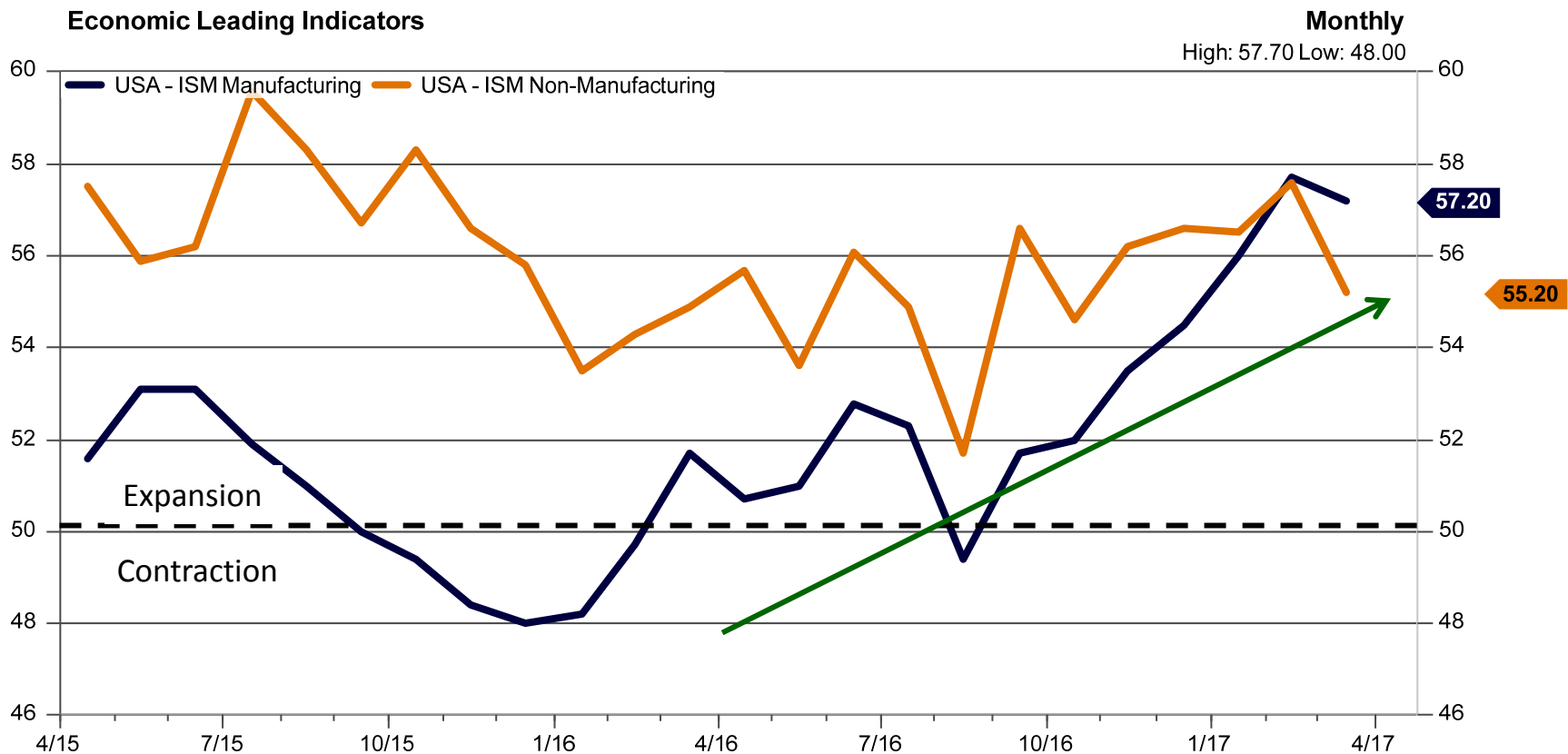
Stronger Global Manufacturing Activity

- Leading indicators of economic activity have been rising nicely in the US and abroad in recent months
- Together, the US, Eurozone, China & Japan represent more than 60% of global GDP



USA – Manufacturing & Services

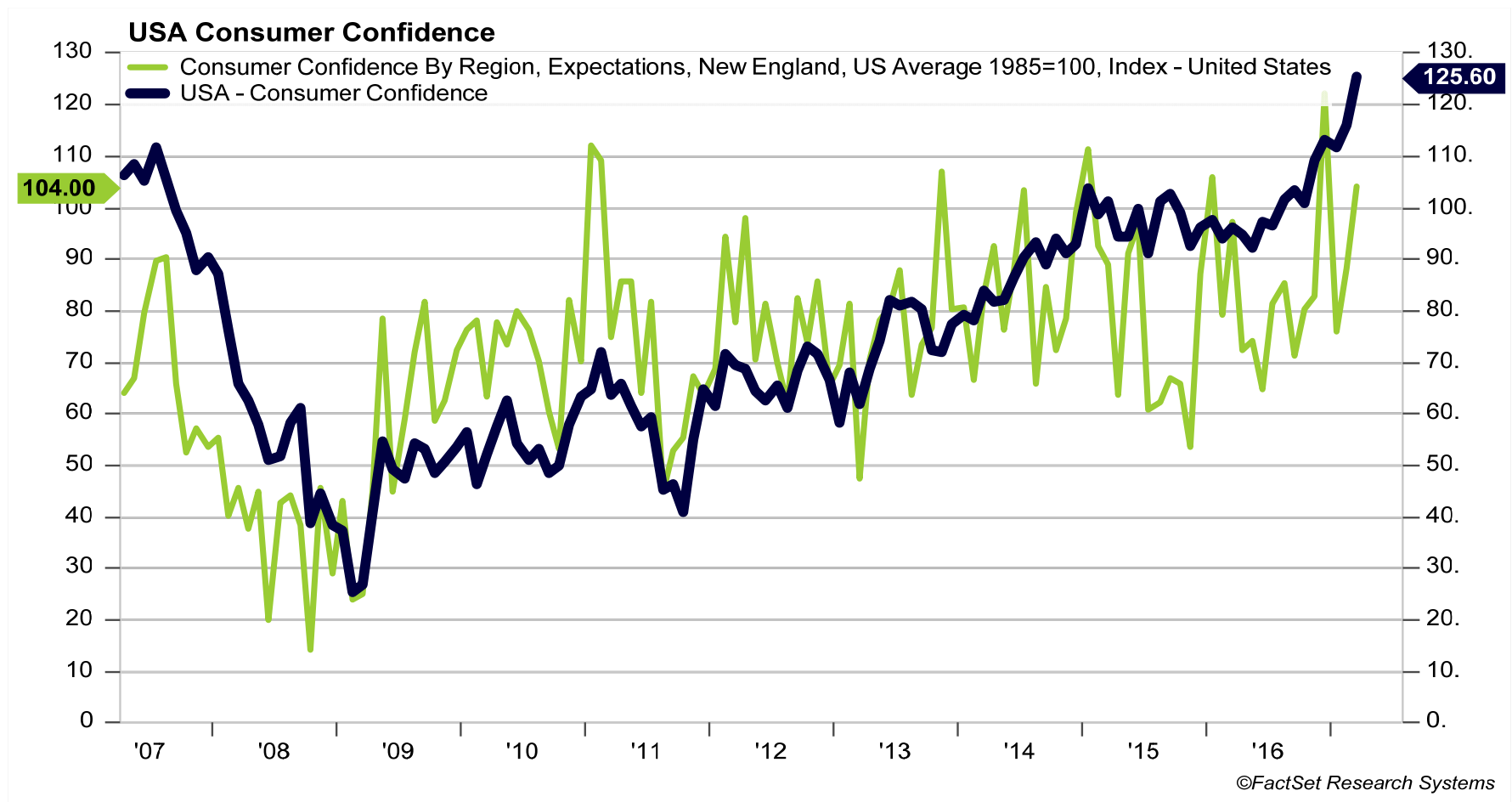
- Leading indicators of USA economic activity have been very constructive over the past 12 months
- Faster economic expansion is expected to lead to profit growth and a normalization of interest rates



Source: FactSet Research Systems

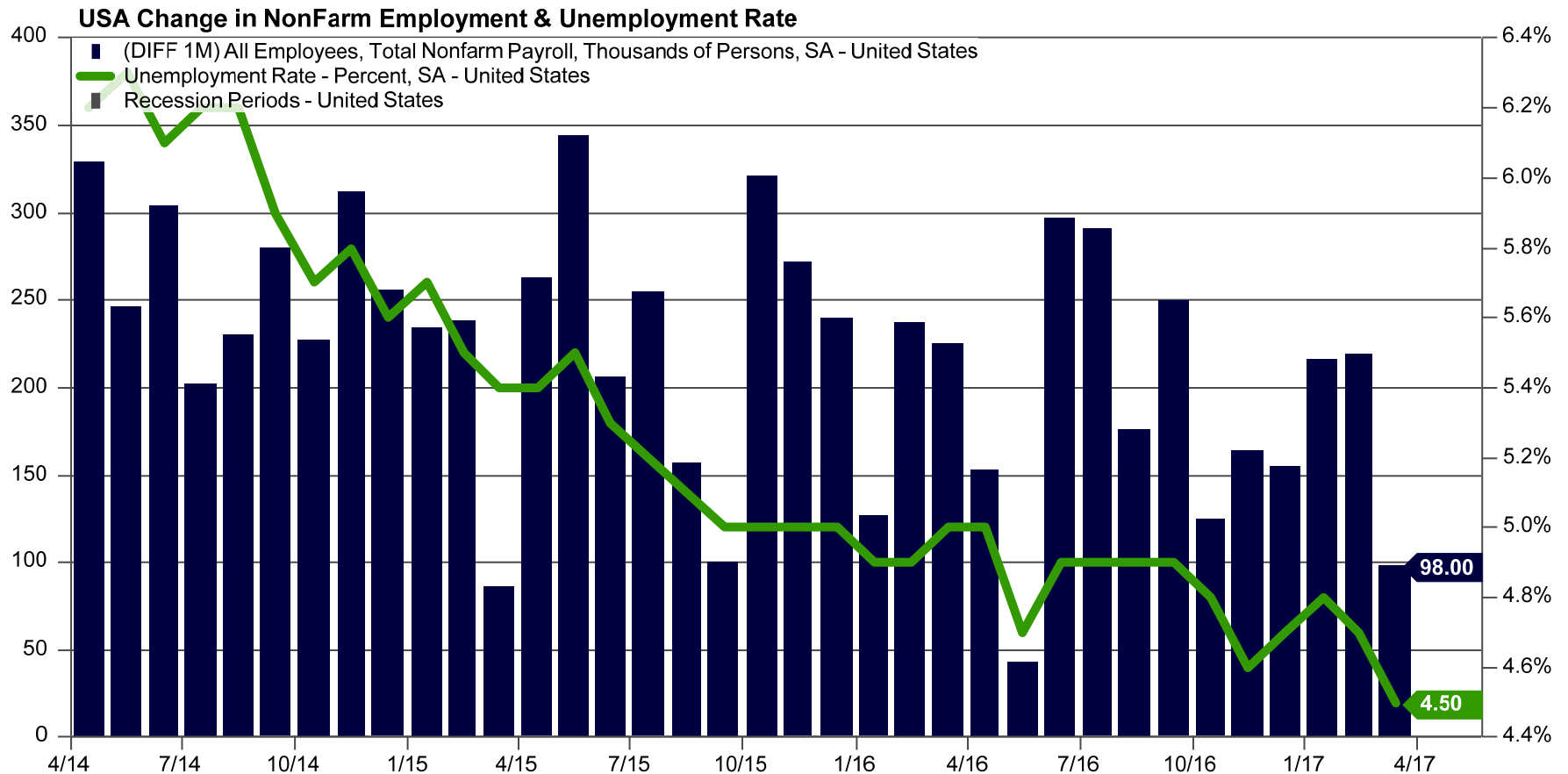
Strong Consumer Confidence

- Consumer Confidence is at new 10 year high, which historically would translate to stronger spending and investment within the economy



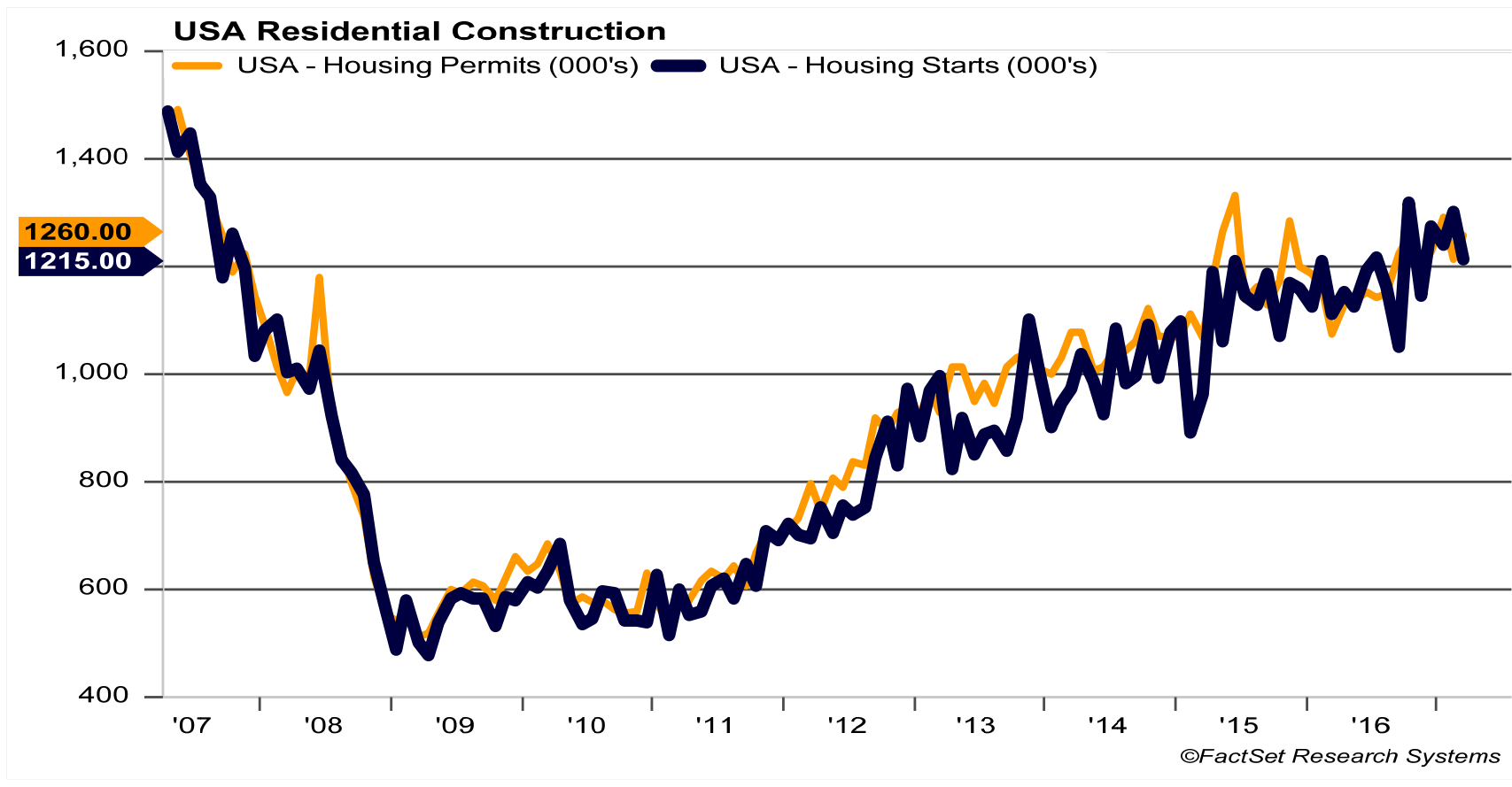
USA Employment Picture

- Consumer Confidence is often influenced by the strength in employment, housing and financial markets
- While segments of the employed population continue to face challenging headwinds, the strength in employment data has become significantly broader over the past two years



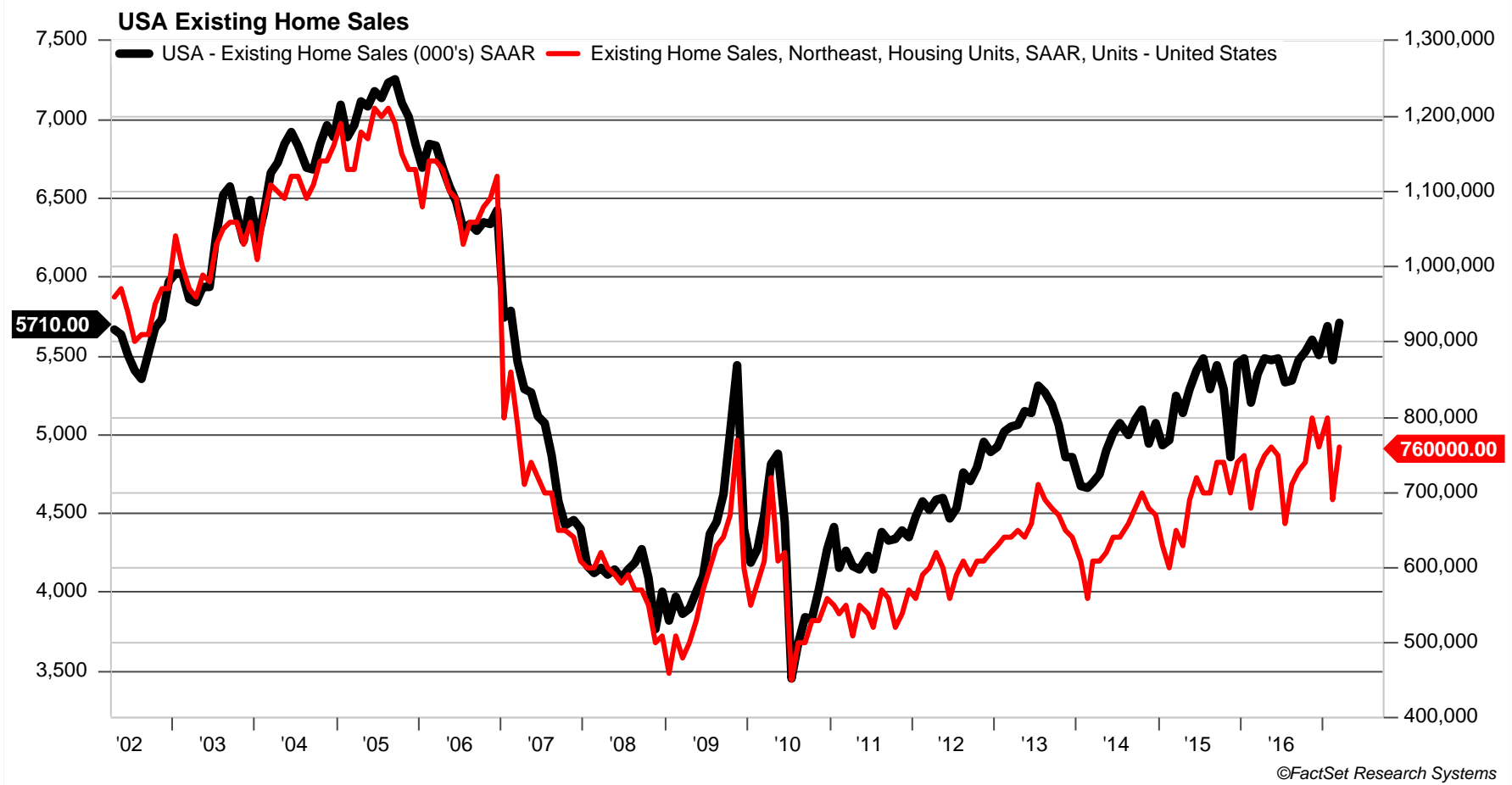
Residential Construction

- New home construction is back to a strong level and the millennial generation is beginning to participate in a more meaningful way to home ownership
- Residential construction contributes nearly 5% directly to GDP, where the full indirect benefit of housing is estimated to influence nearly 15% of GDP



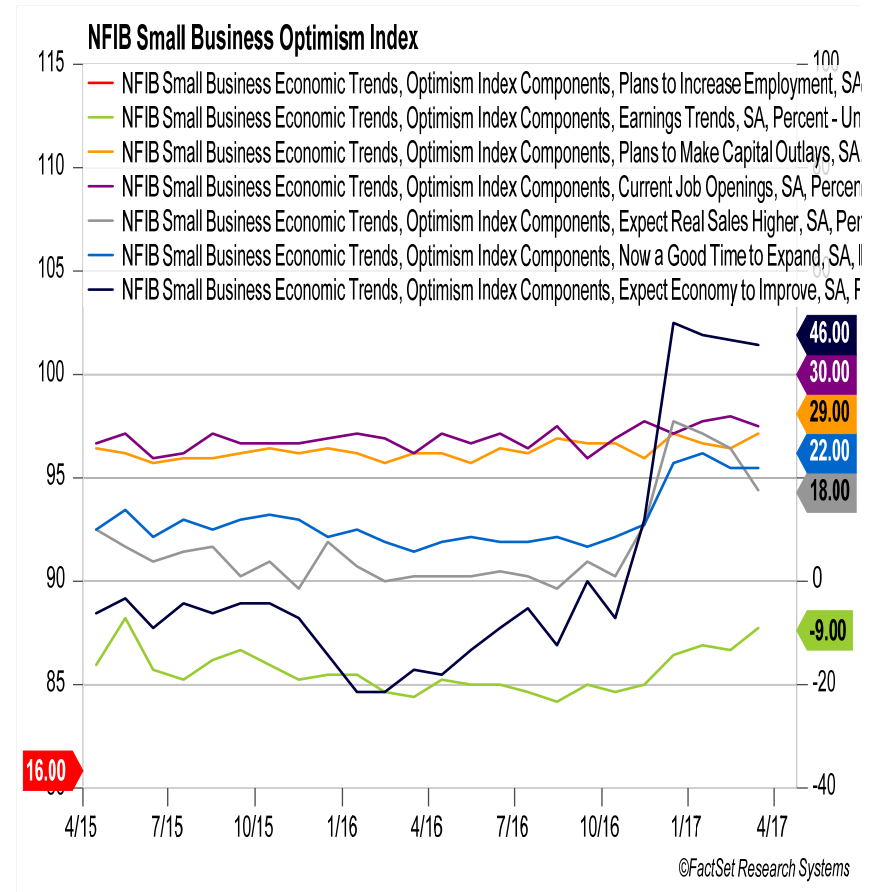
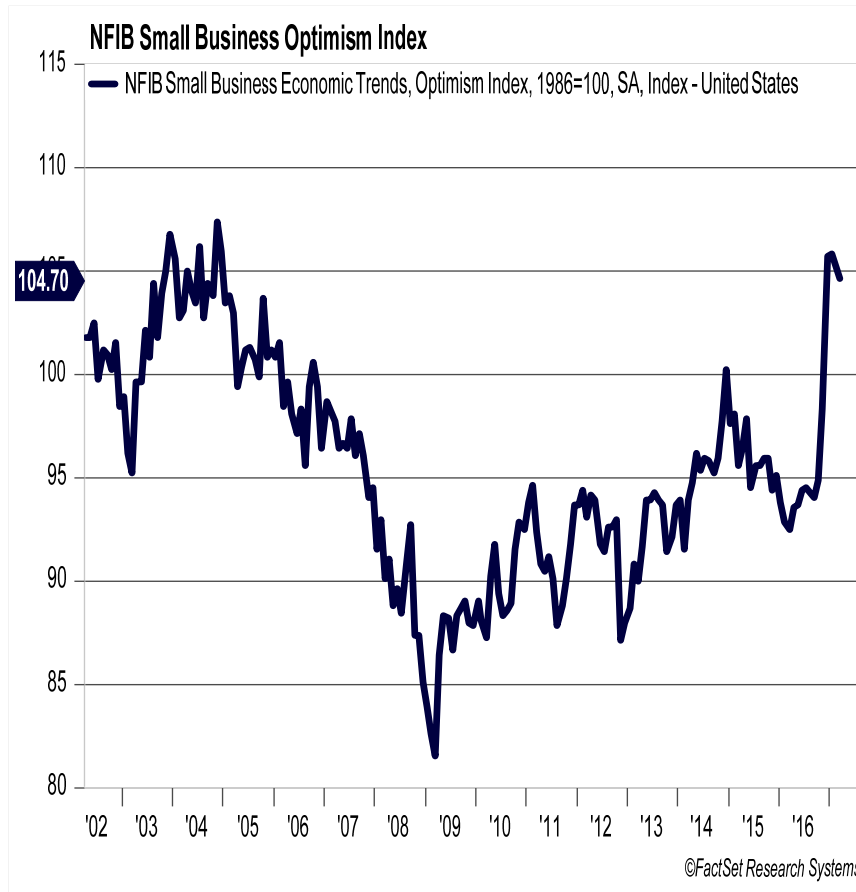
Existing Home Sales

- Existing Home Sales have recovered to a long-term average SAAR that suggests a healthy residential market and should support prices for both buyers and sellers and increase the indirect benefit to the economy



Small Business Optimism

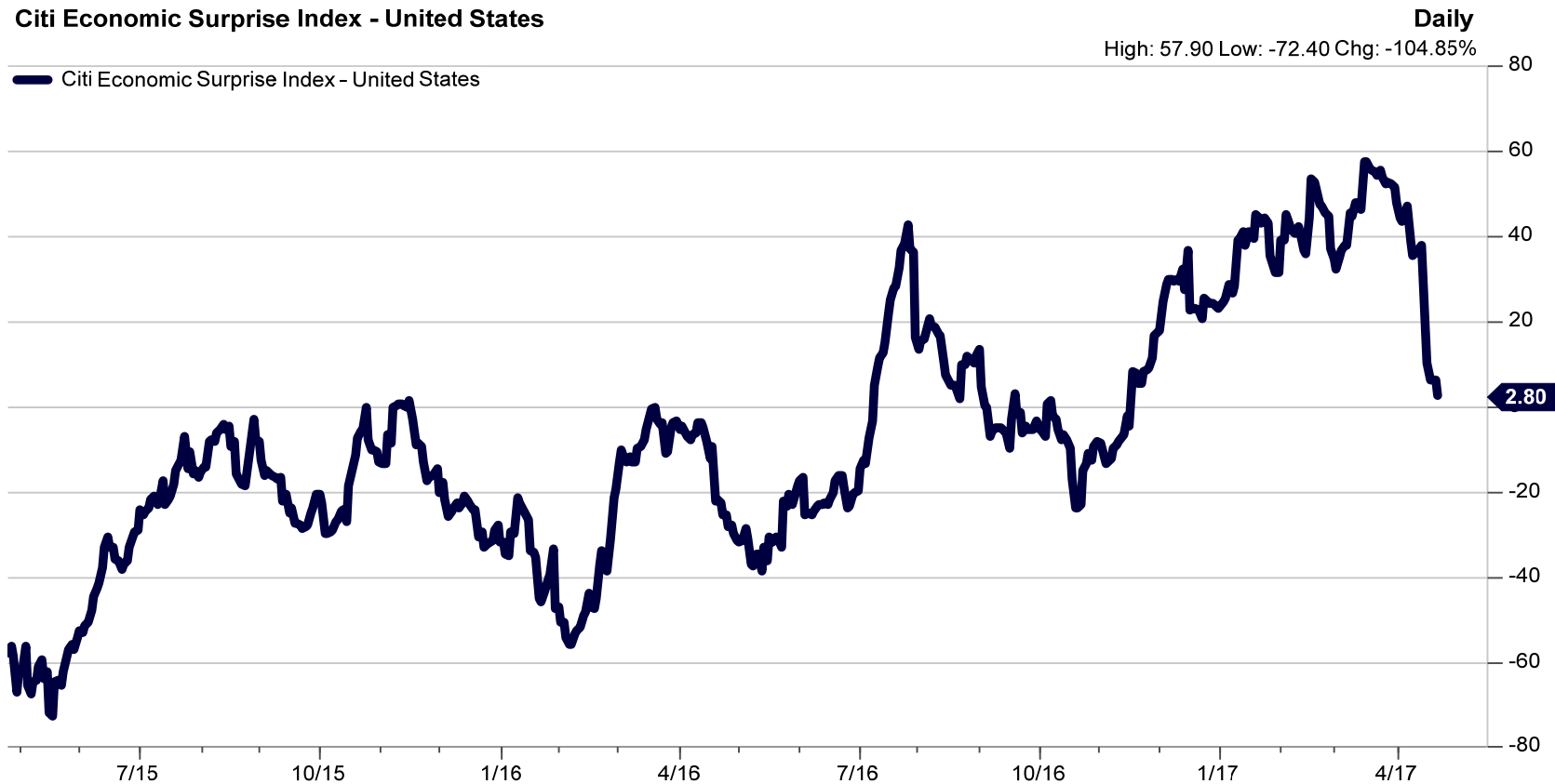
- Small business optimism has surged and many of the key components of optimism are rising
- The US economy is extremely dependent on the health and optimism of small business



Economic – Relative Performance

- Economic indicators have been surprising to the upside in recent months, causing market participants to reassess their expectations for interest rates and bond yields, profit growth and stock prices
- A rising surprise index typically results in higher yields and higher stock prices while trends in the opposite direction often result in declining yields and lower stock prices

Citi Economic Surprise Index - United States

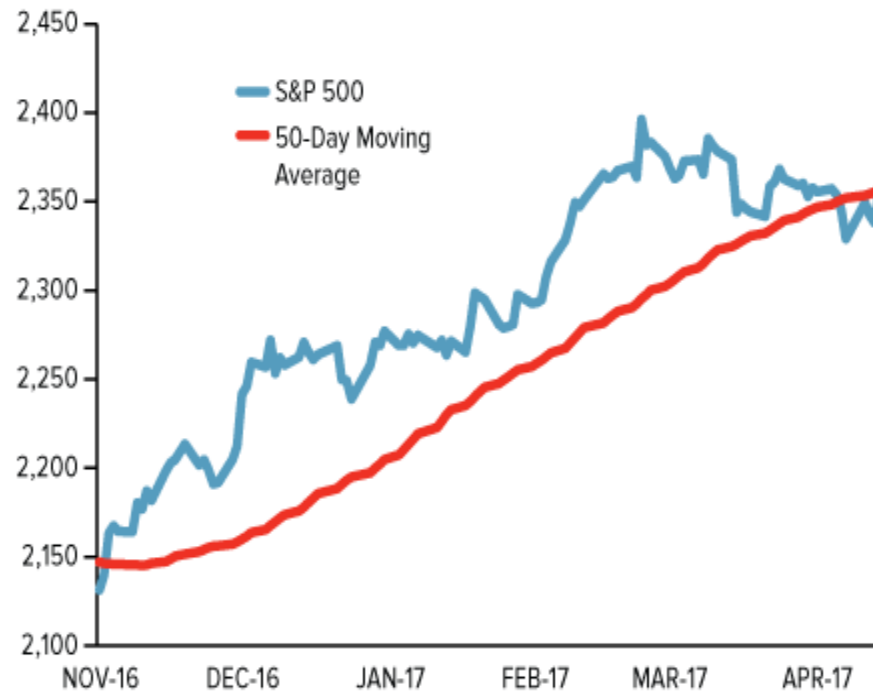


Fiscal Policy – Rising Skepticism

- Positive economic data has been raising the expectations for higher interest rates and rising profits, but the expectation for fiscal policy action to boost economic growth has contributed to financial market optimism
- As optimism wanes toward skepticism, financial markets are likely to pause and re-assess

Are Markets Pricing In a Longer-Than-Expected Delay in Tax Reform?

S&P 500 Index



U.S. Dollar

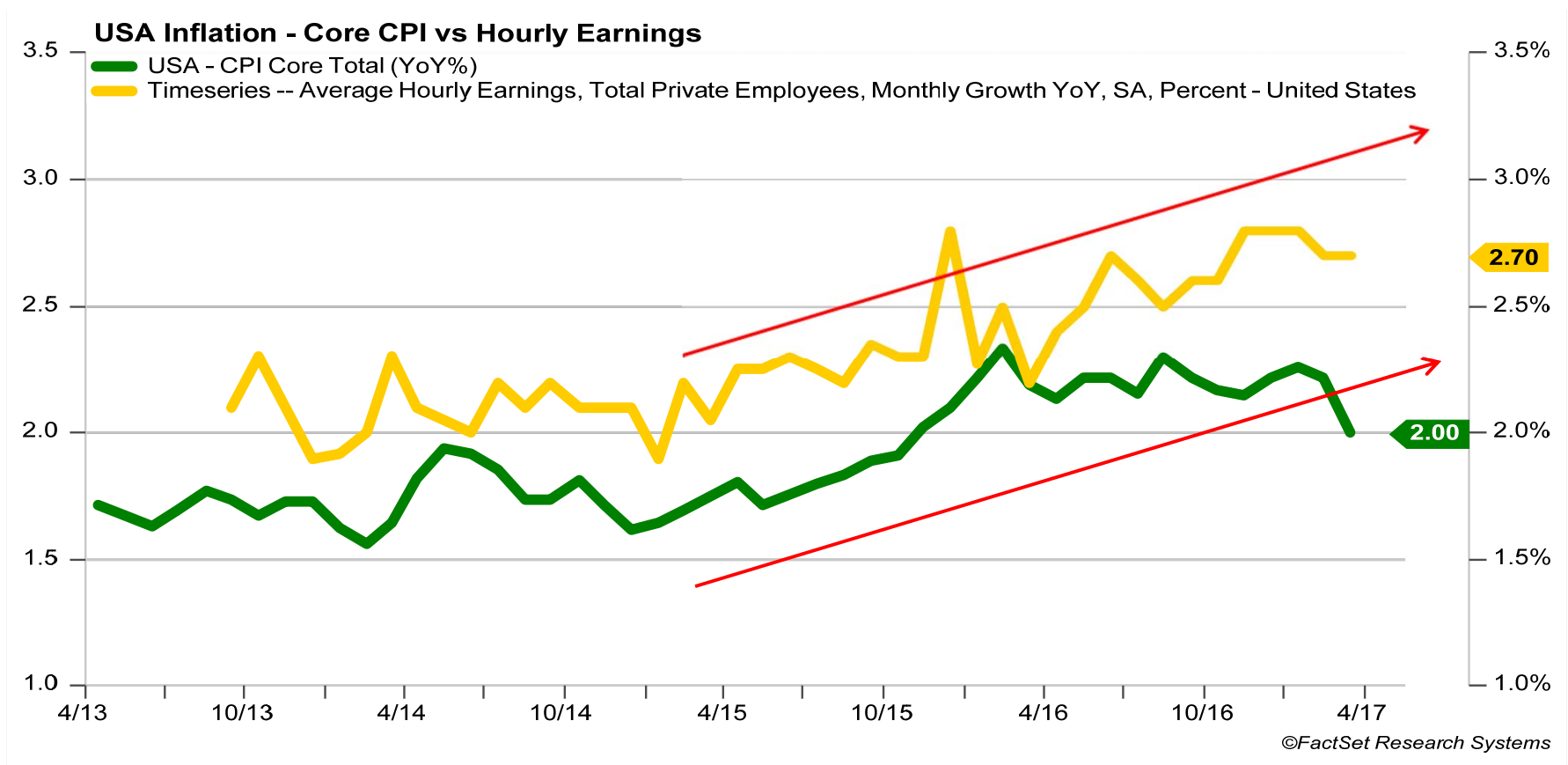


Past performance does not guarantee future results.

Source: Bloomberg, U.S. Global Investors

Inflation

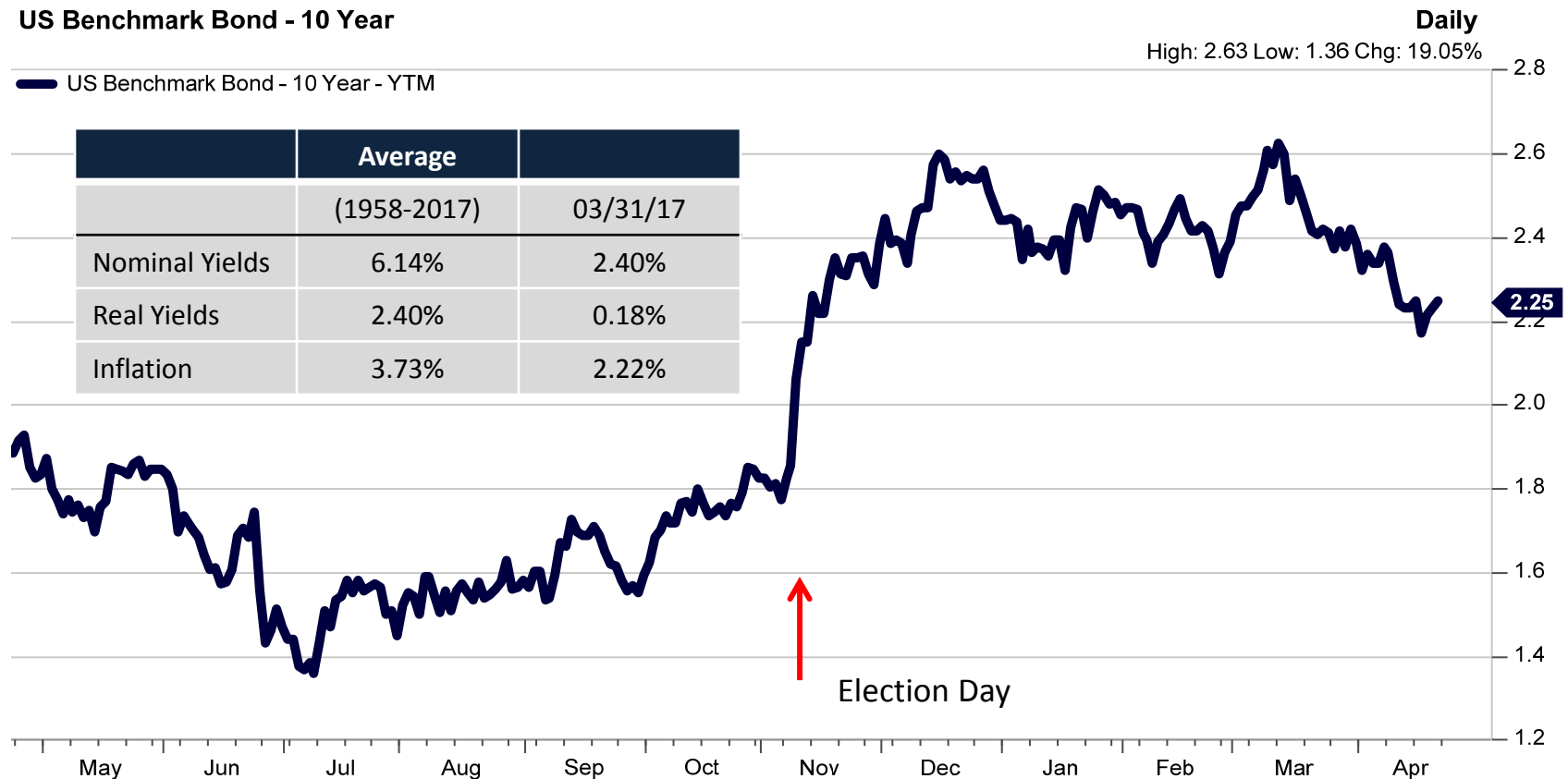
- Monetary policy considers the strength of economic conditions and will raise interest rates if inflationary pressures begin to counter the benefits of faster economic growth
- The Fed monitors many data points and Core CPI and Hourly Earnings are among those that are considered



Stronger Growth – Higher Yields

- Stronger economic growth should lead to a faster normalization of interest rates and higher bond yields
- The post-election expectations for fiscal policy change accelerated the reflation trade across markets, but that sentiment has been waning of late and have placed downward pressure on “real” yields

US Benchmark Bond - 10 Year



Source: FactSet Research Systems

10 Yr / 2 Yr Spread

- Inverted yield curves are great indicators of looming recession
- While the spread has narrowed with the unwind of the reflation trade, it remains firmly positive

10Y / 2Y US Treasury Spread

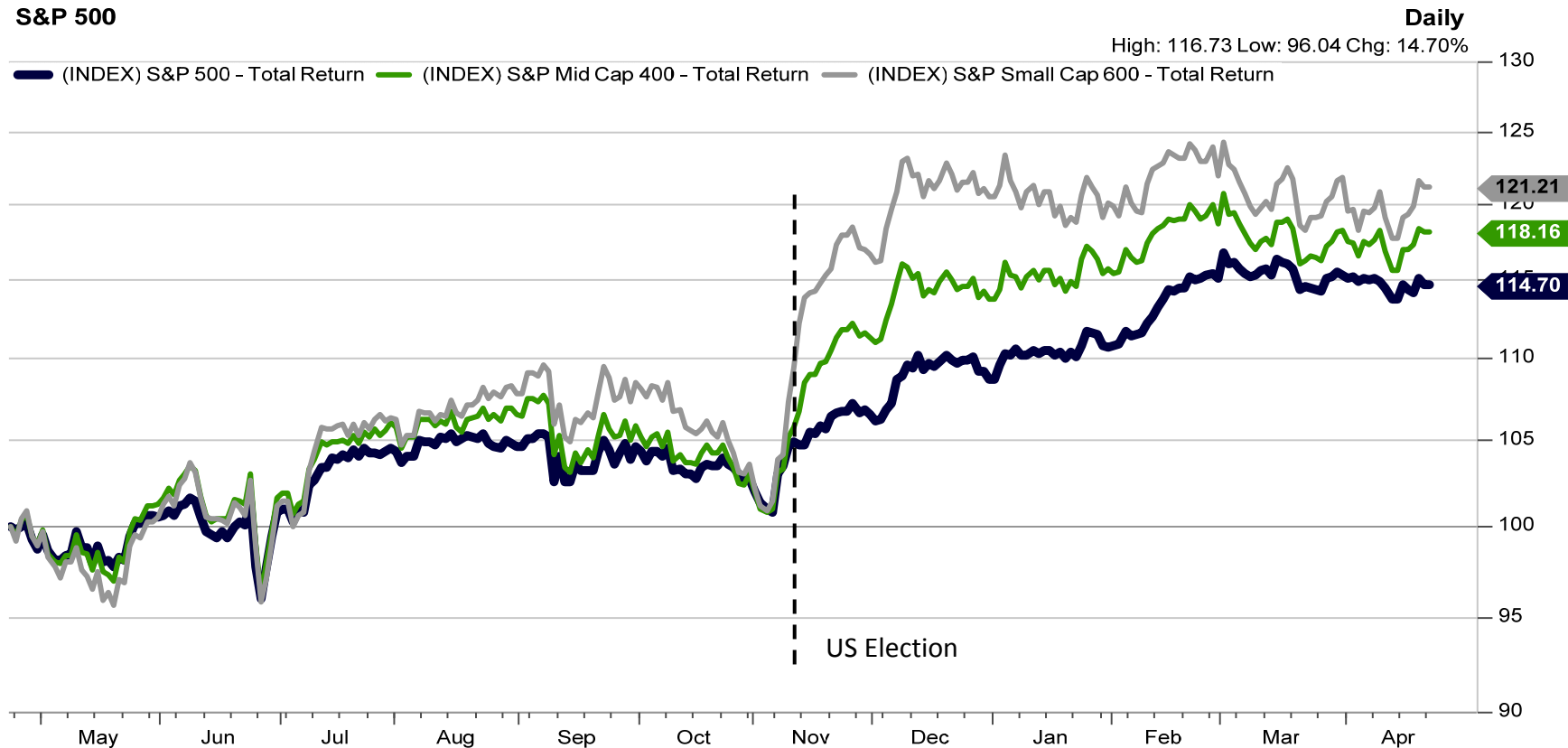


Policy Expectations Fuel Stocks

1 Year

- Smaller companies are expected to capture greater benefit from faster domestic growth, an easing regulatory environment, and lower taxes.
- Markets were pricing in accelerating economic expansion and rising profits, a view that is waning as fiscal policy expectations fade and geopolitical risks increase

S&P 500



PE & Earnings - NTM

10 Year

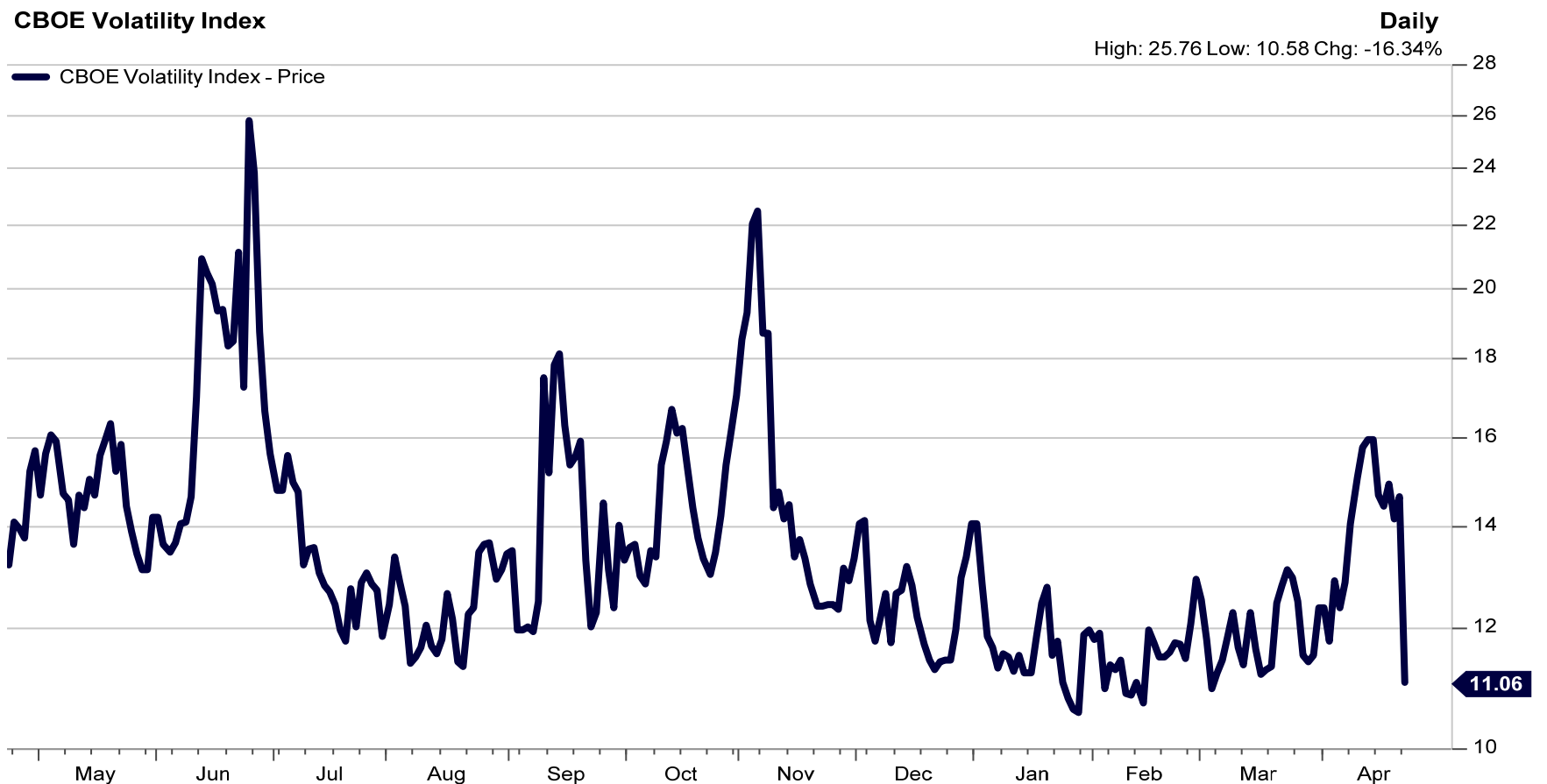
- After four quarters of declining earnings, profit growth has returned and is expected to be near 8% in 2017
- Investors have embraced better economic conditions, feel more certain about earnings growth, and have been willing to pay higher multiples to own stocks



Investor Complacency

1 Year

- Investor confidence about the future has led to higher stock prices and a dangerous level of complacency
- Volatility levels this low are usually a precursor to retreating stock prices, at least temporarily



Disclosure

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