

Observation Deck

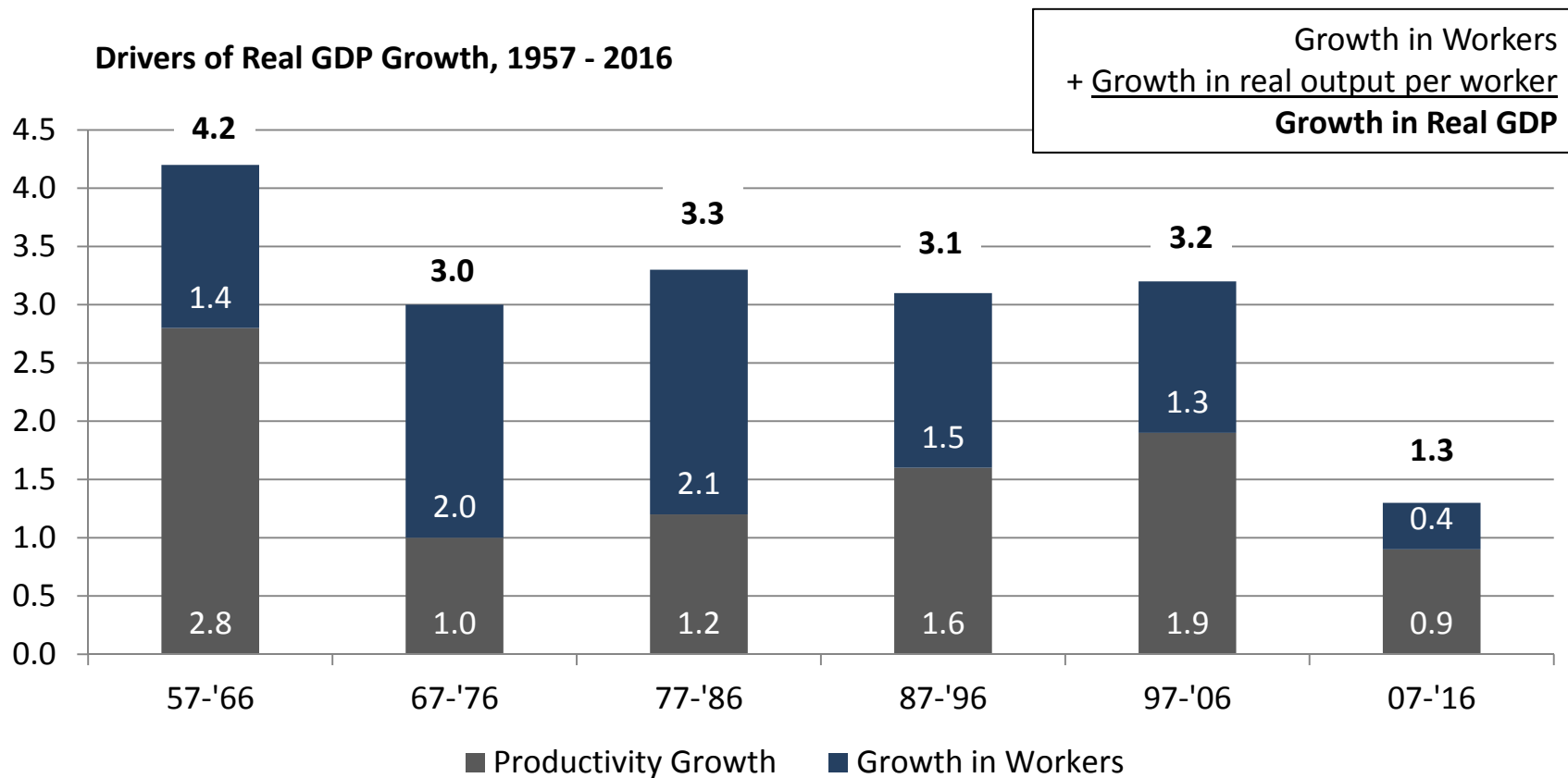
Views from the Investment Policy Committee



3rd Quarter 2017

Real GDP Growth Drivers

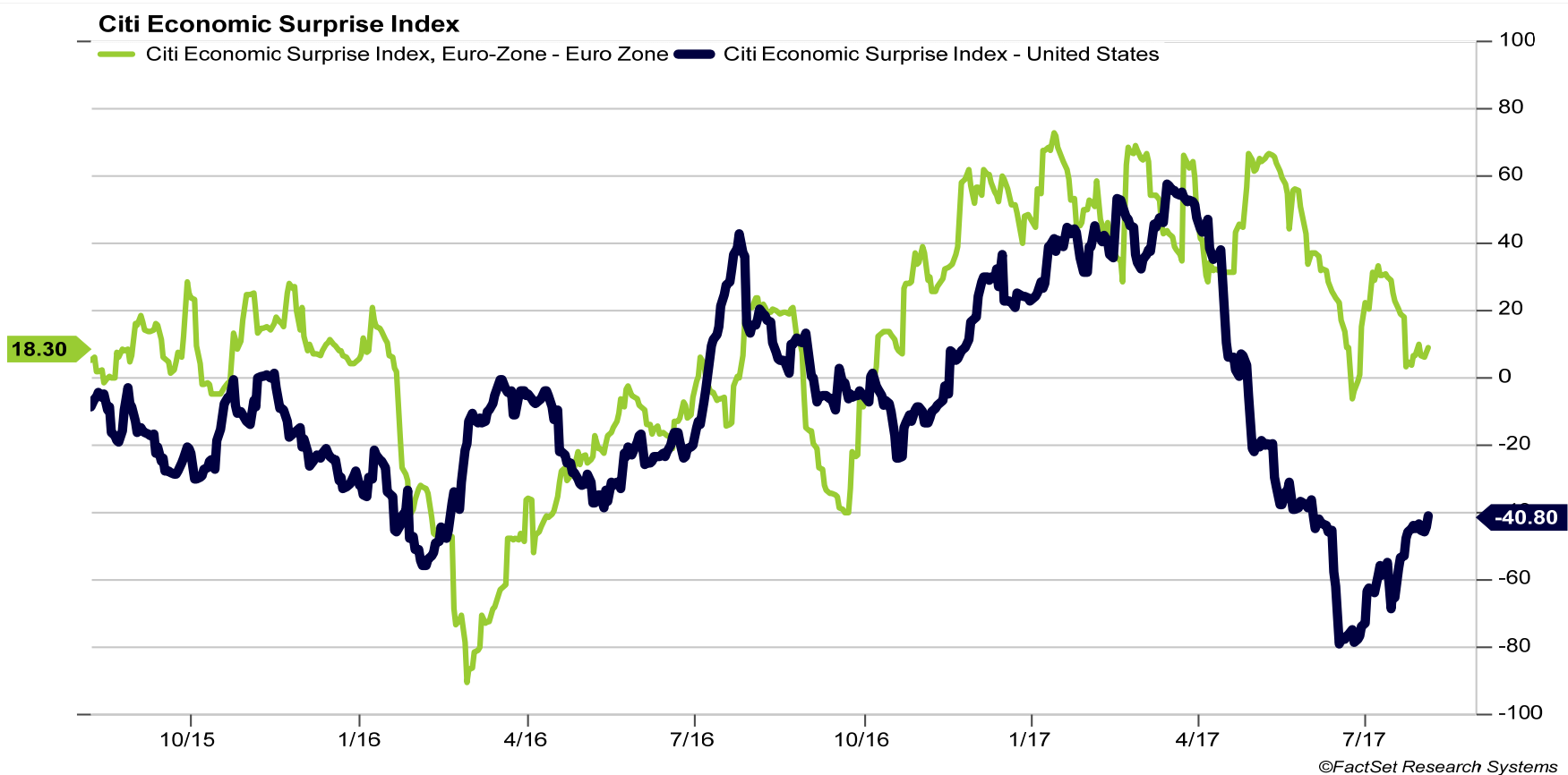
- The potential of economic expansion is constrained by the growth of the workforce and rate of productivity.
- Monetary and Fiscal Policy actions can influence the rate of growth over the intermediate term, but the long-run drivers of real GDP, growth in labor and productivity, will be the ultimate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



Source: BEA, BLS, Federal Reserve Bank

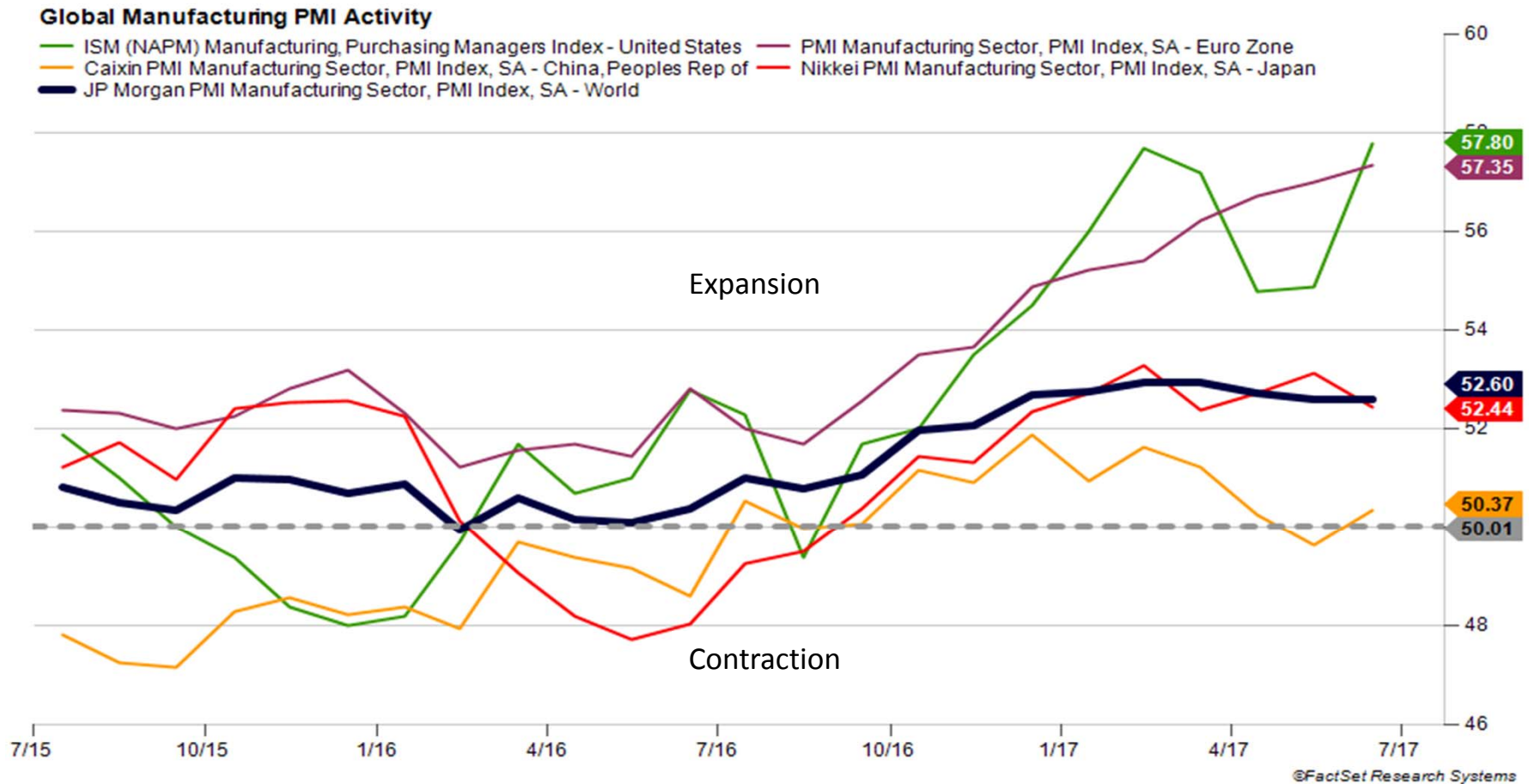
Economic Reality vs. Expectations

- Recent indicators have suggested a healthy pace of economic expansion. However, the data has failed to live up to the lofty expectations that market participants established through the Spring.
- Bond yields have followed the surprise index lower, as would be expected. But stock prices have continued to advance, presumably believing in the longevity of the business cycle and prospects for higher profits.



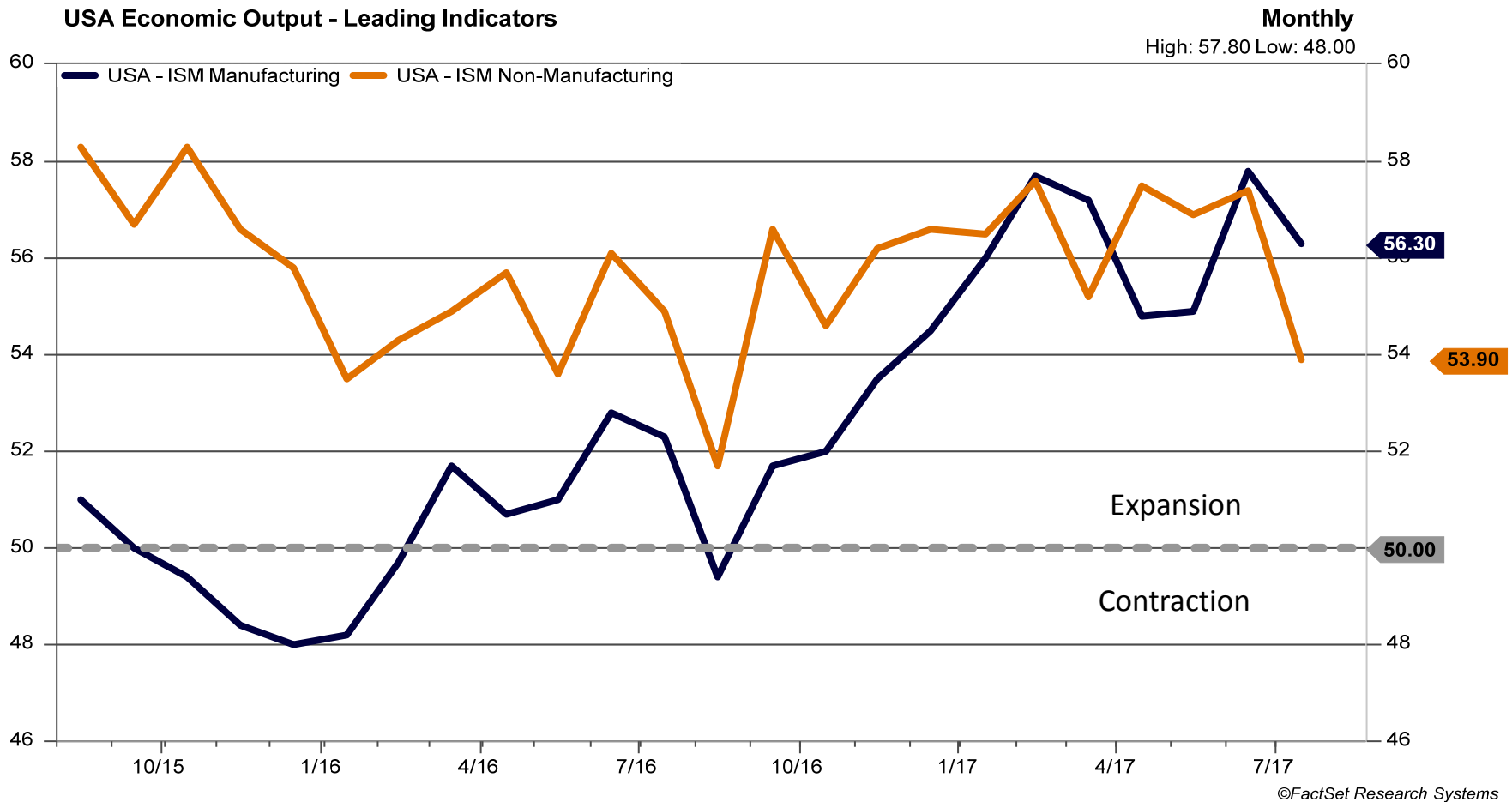
Strong Global Manufacturing Activity

- Leading indicators of economic growth have sustained healthy levels of activity in 2017, and for the first time since the Great Recession, the strength is being experienced across increasing numbers of geographies
- Together, the US, Eurozone, China & Japan represent more than 60% of global GDP



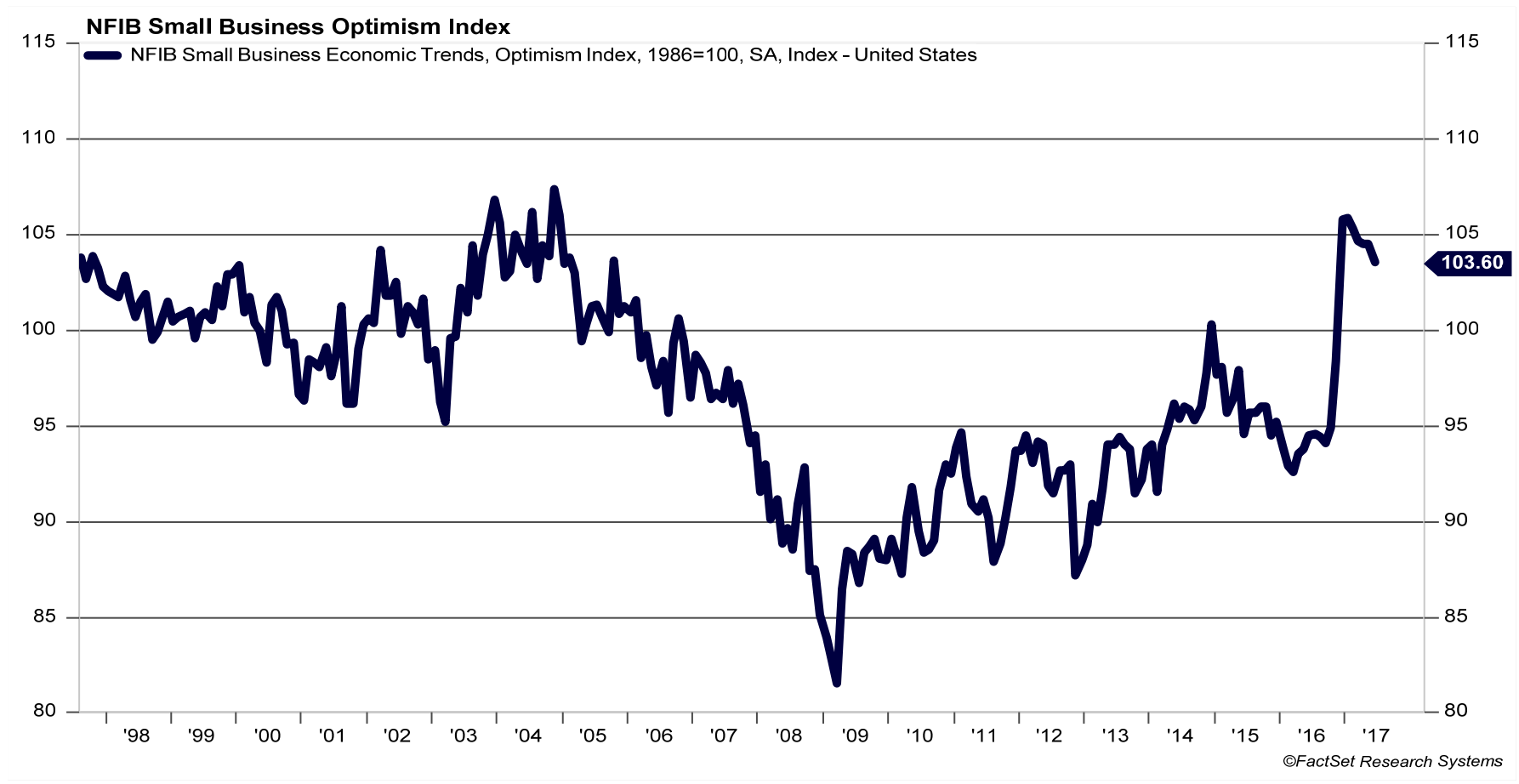
USA Economic Output – ISM Surveys

- 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



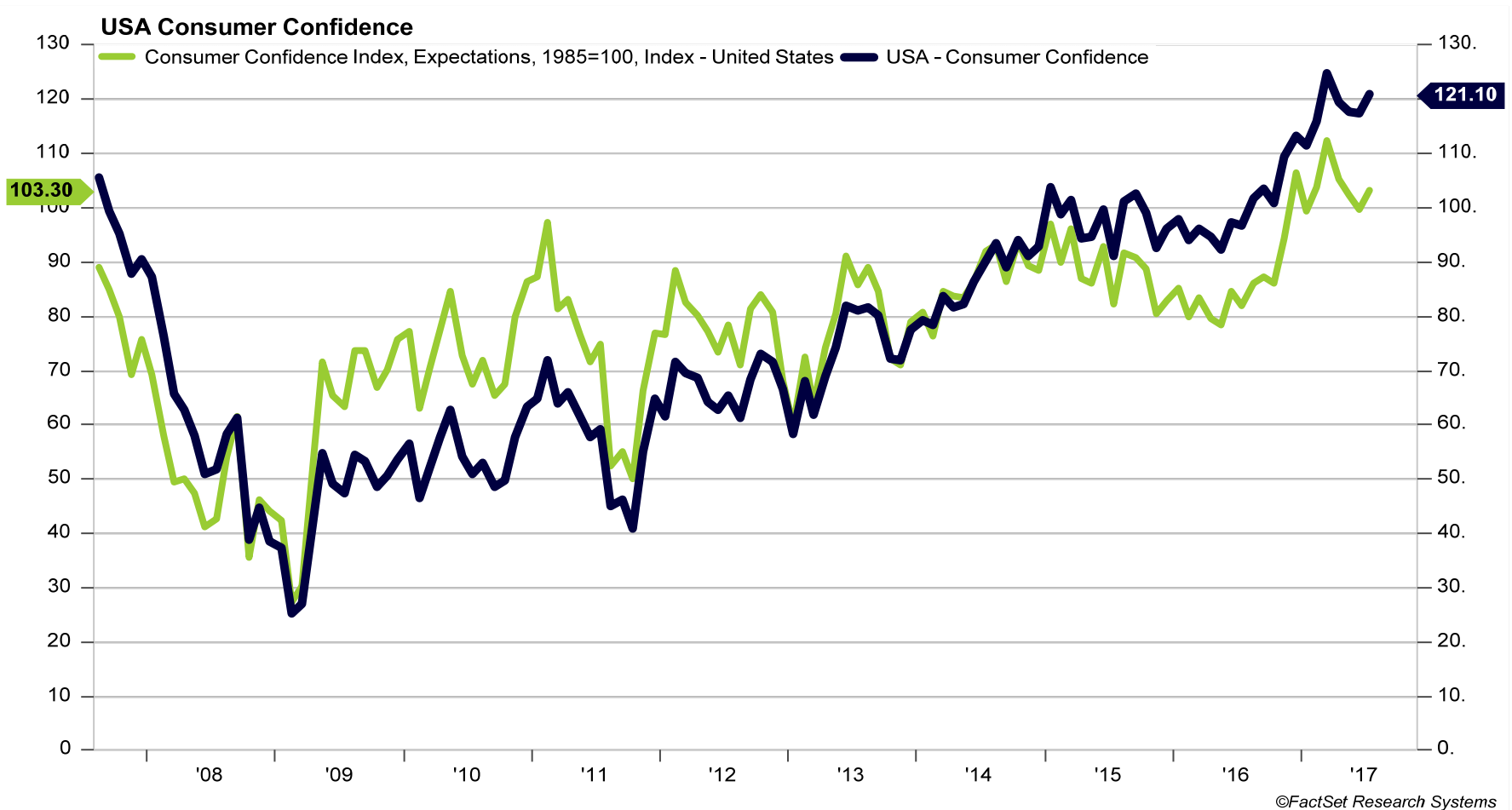
USA Small Business Sentiment

- 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 for increasing the opportunities for labor and capital spending



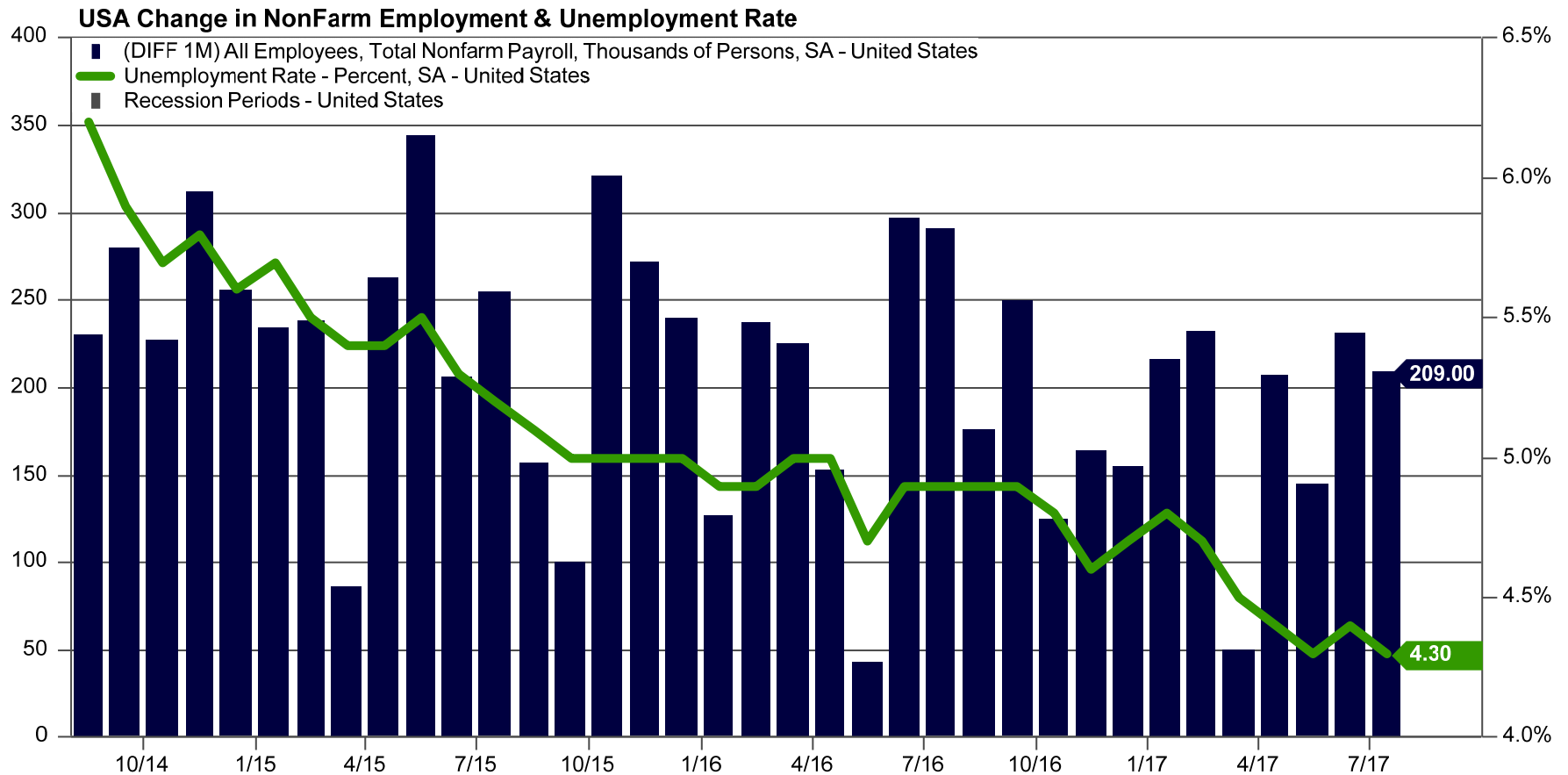
USA Consumer Confidence

- Consumer Confidence is near the 10 year high, which historically would translate to stronger consumer spending and lead to greater business investment toward inventory stocking and capital expenditure



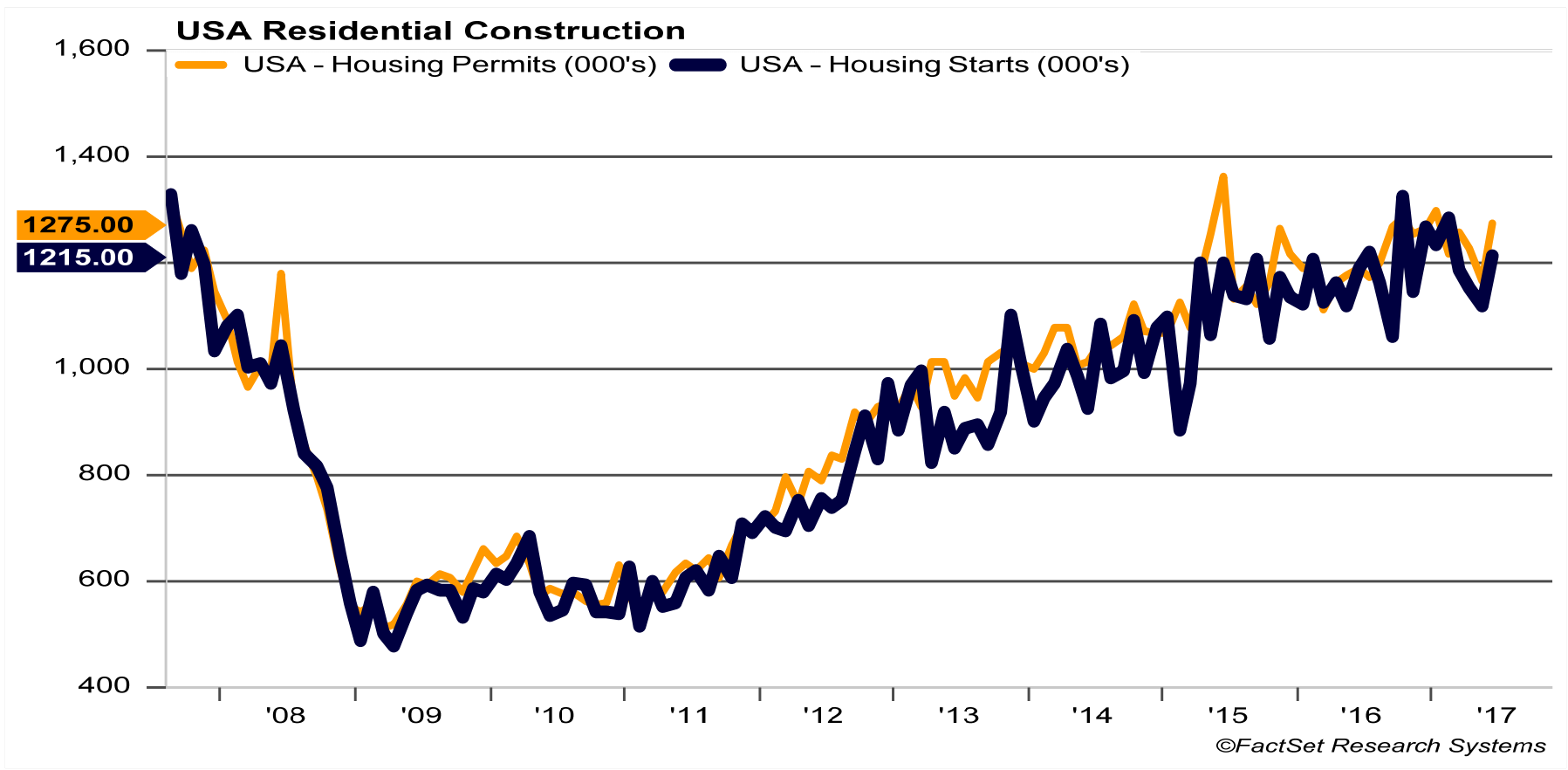
USA Employment Picture

- 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



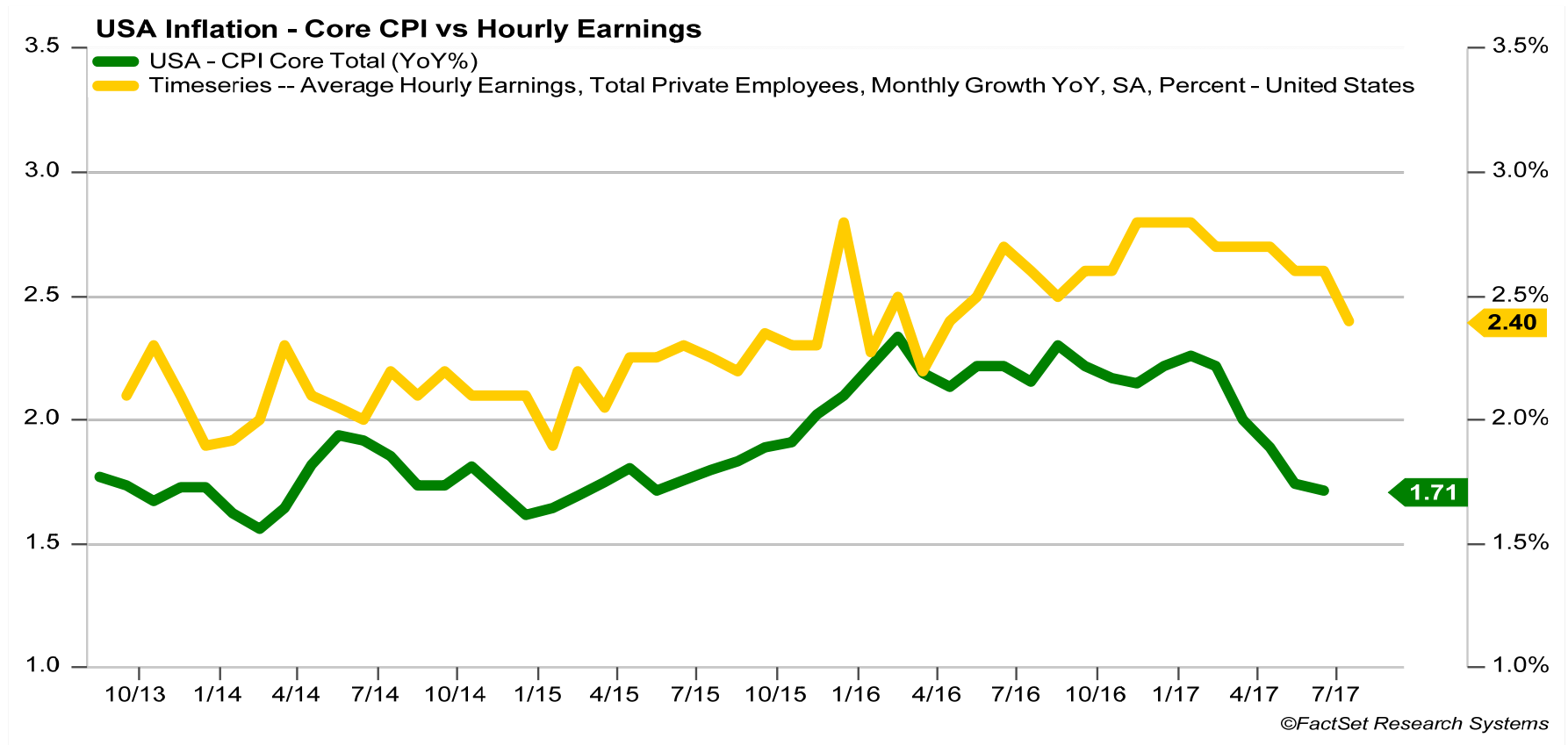
Residential Construction

- 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



Headline Inflation Remains Elusive

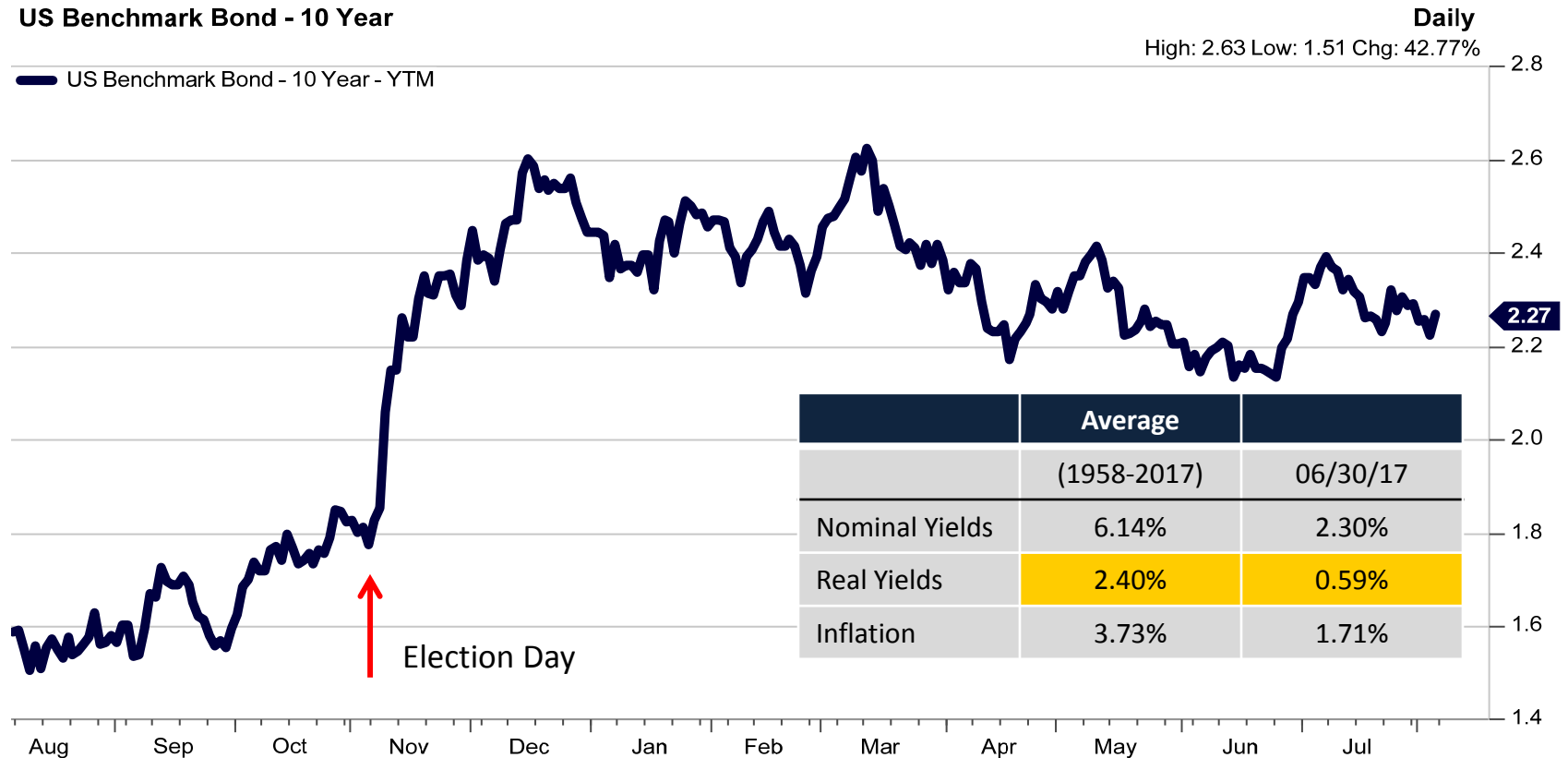
- Monetary policy considers the strength of economic conditions and will raise interest rates if inflationary pressures begin to counter the benefits of faster economic growth
- The structure of the global economy and the pace of growth have not generated inflationary trends that would alarm policy makers (Green Line)
- Hourly earnings can be a leading indicator of looming inflationary pressures (Yellow Line)



Bond Yields Suggest Moderate Growth

- 10 Year Treasury Yields reflect the expectations that global investors have for the pace of economic growth and how that will influence inflation and therefore interest rate policy
- The post-election expectations for fiscal policy change accelerated the reflation trade across markets, but that sentiment has been waning of late and has placed downward pressure on “real” yields once again

US Benchmark Bond - 10 Year



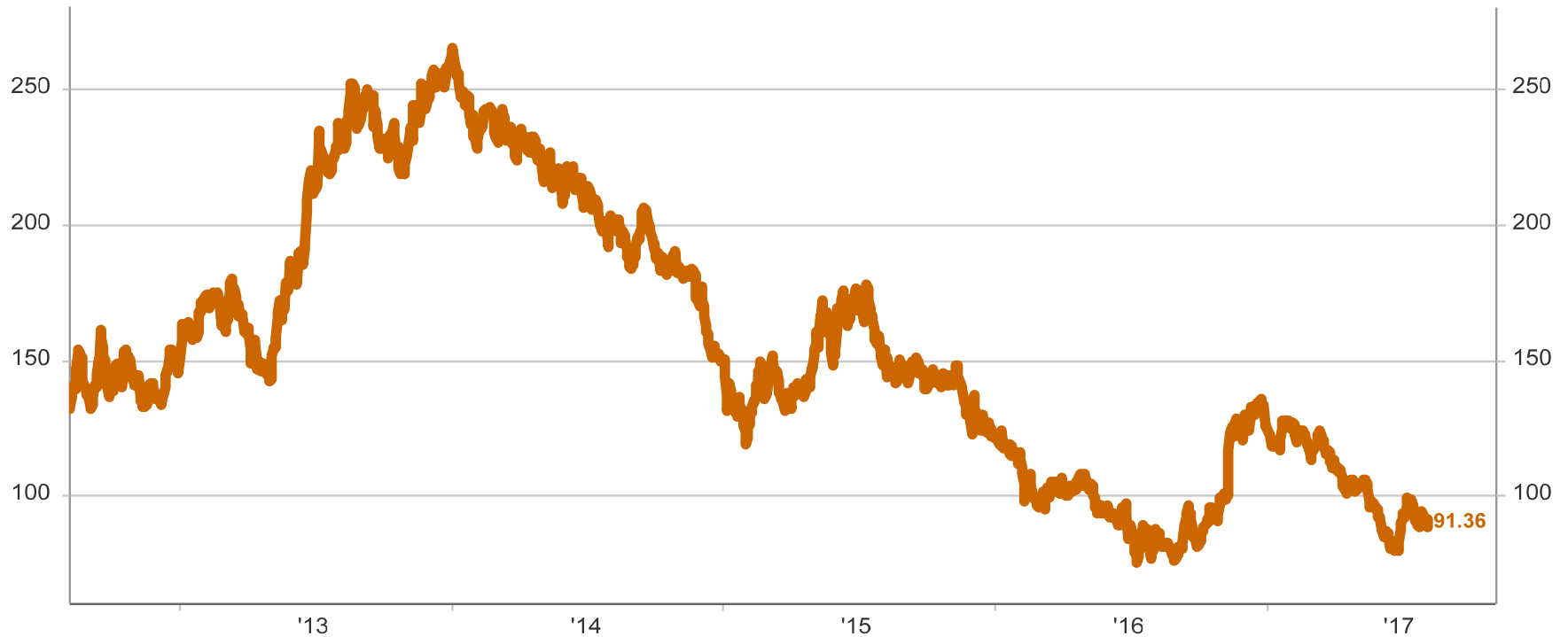
Source: FactSet Research Systems

Yield Curve - 10 Yr / 2 Yr Spread

- Inverted yield curves are great indicators of looming recession. Each of the last 7 USA recessions have been preceded by witnessing 10 Year Treasury yields that fall below 2 Year Treasury yields.
- While the spread has narrowed with the unwind of the reflation trade, it remains positive, albeit near the lows of the current business cycle

10Y / 2Y US Treasury Spread

Basis Points

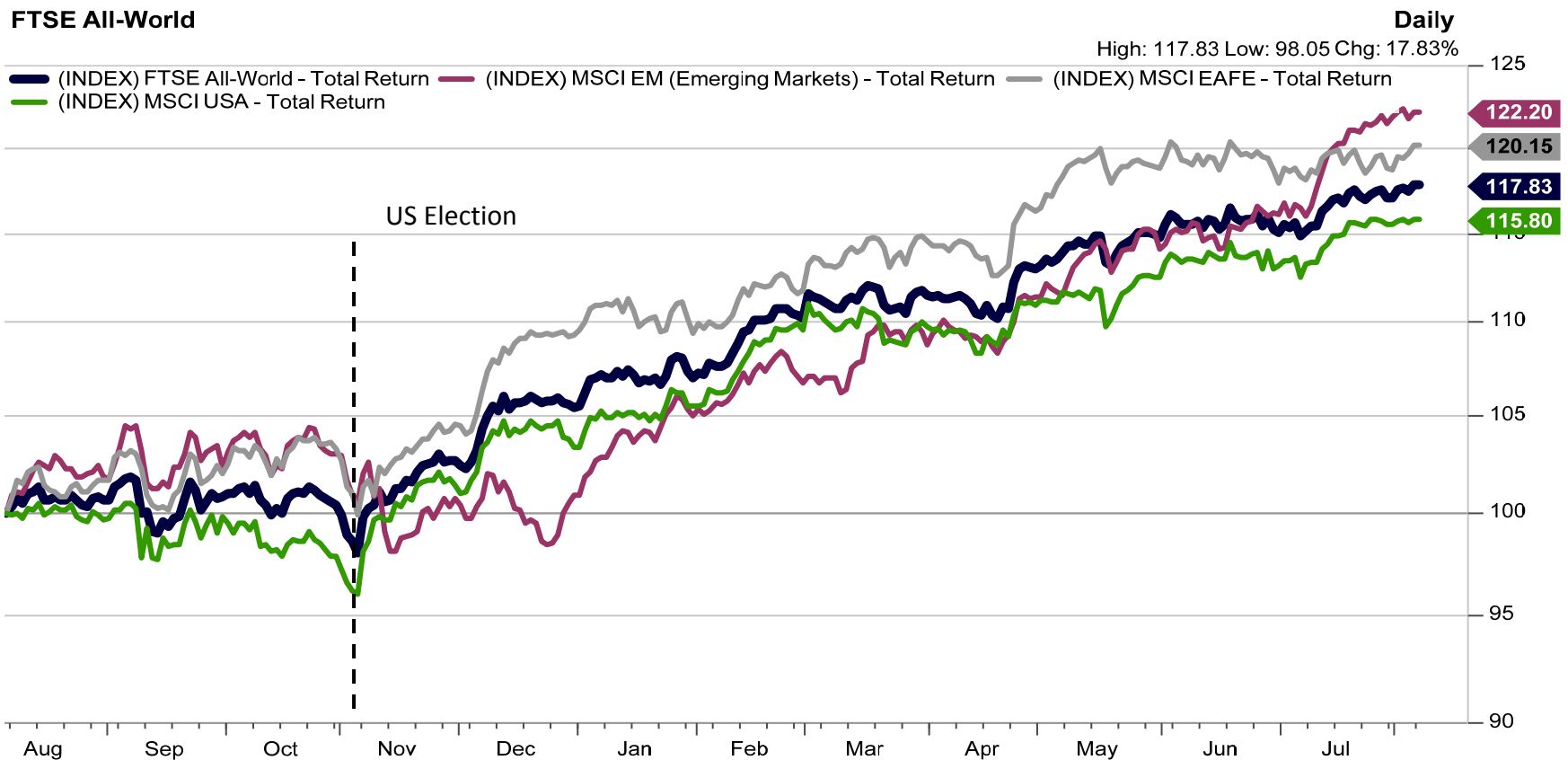


©FactSet Research Systems

Total Return - By Geography

1 Year

- The Global economic growth story has fueled stock prices higher across many geographies and has reversed the multi year trend of USA stocks leading the way. Over the past 12 months, emerging markets stocks have advanced the most with international developed markets following and USA markets lagging.

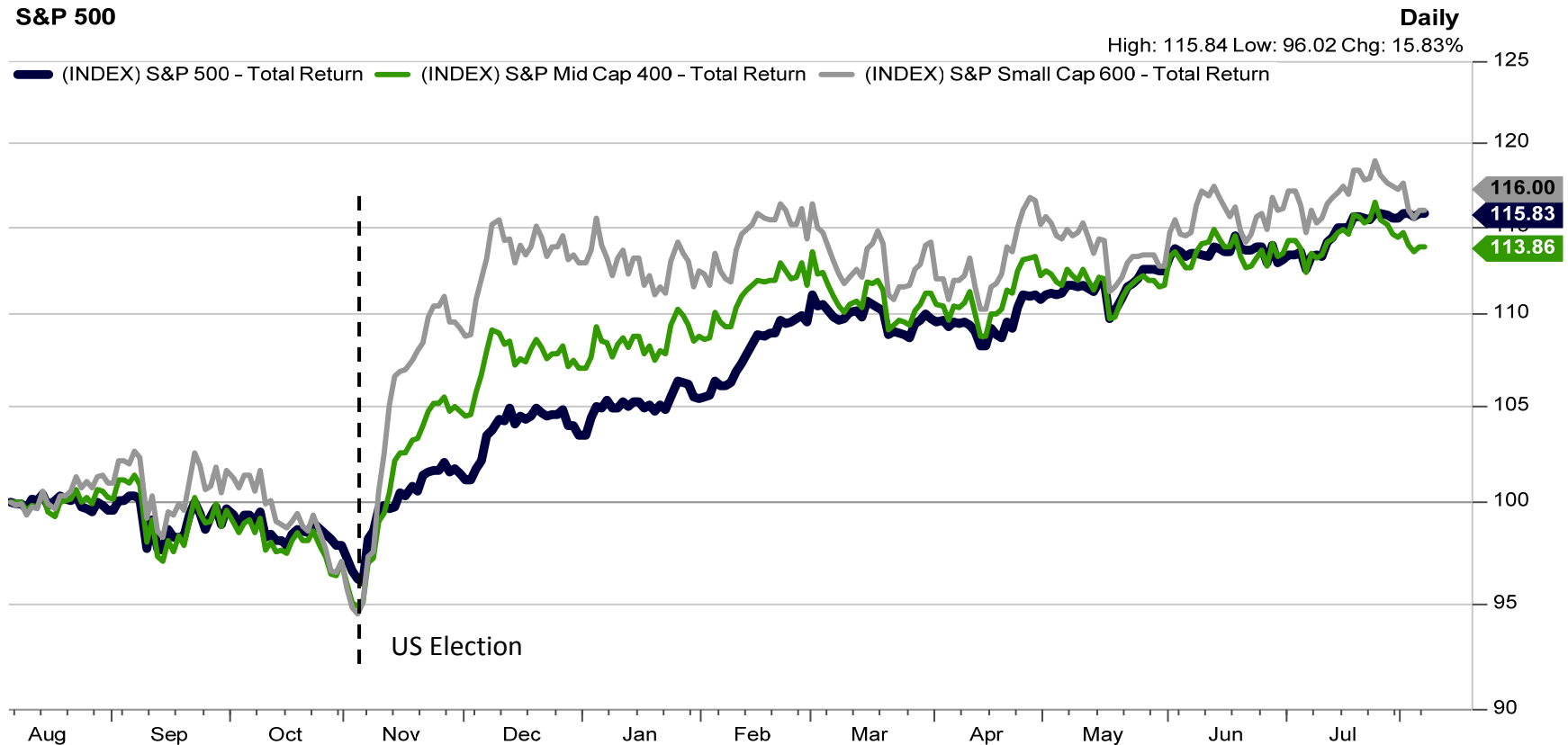


Policy Expectations & Stock Prices

1 Year

- Smaller companies are expected to capture greater benefit from faster domestic growth, an easing regulatory environment, and lower taxes. Small company stocks advanced the most after the election (Gray Line)
- As the prospect of fiscal policy actions that would stimulate economic growth and drive accelerating profits has waned, stocks have paused and will be looking for confirmation that growth will continue to materialize.

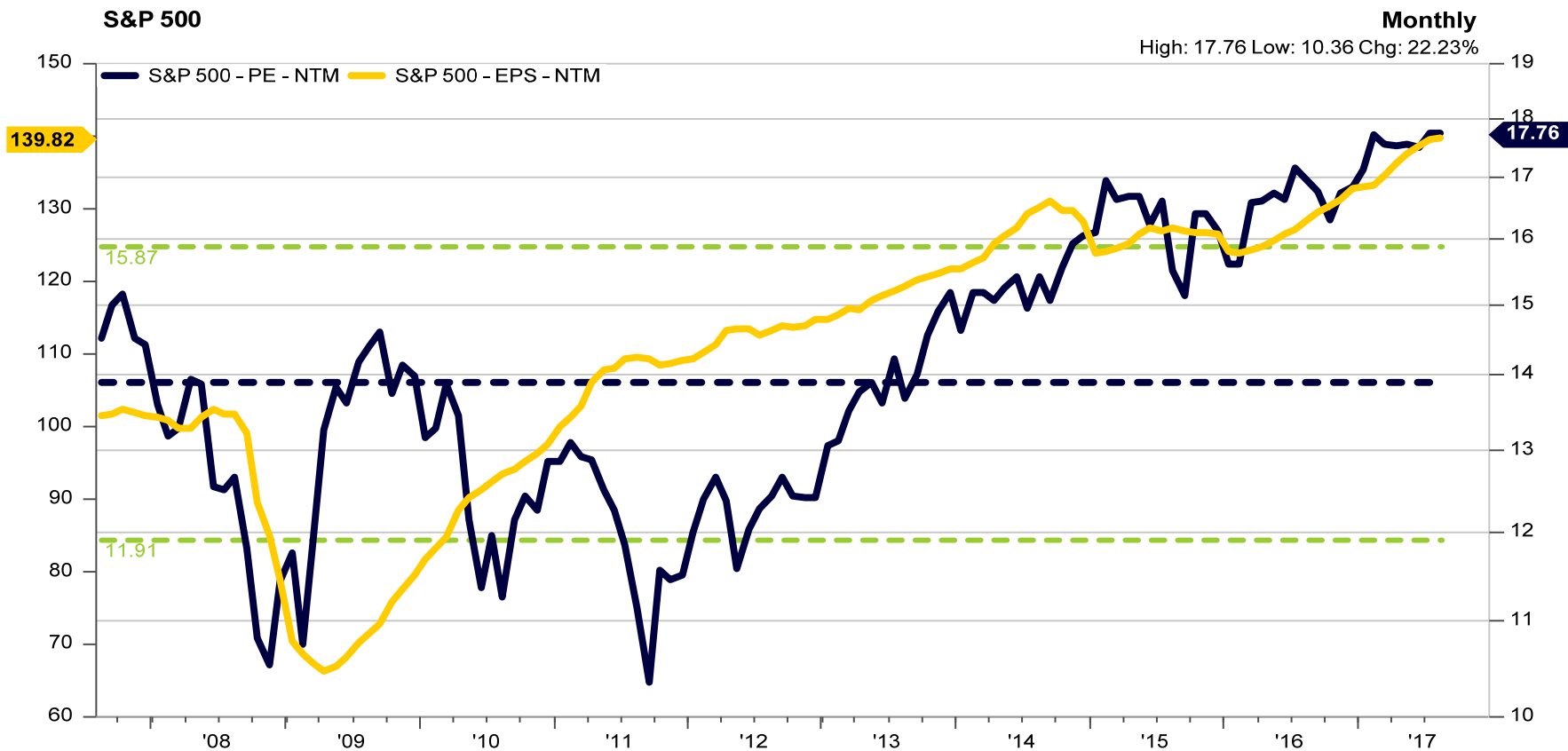
S&P 500



PE & Earnings - NTM

10 Year

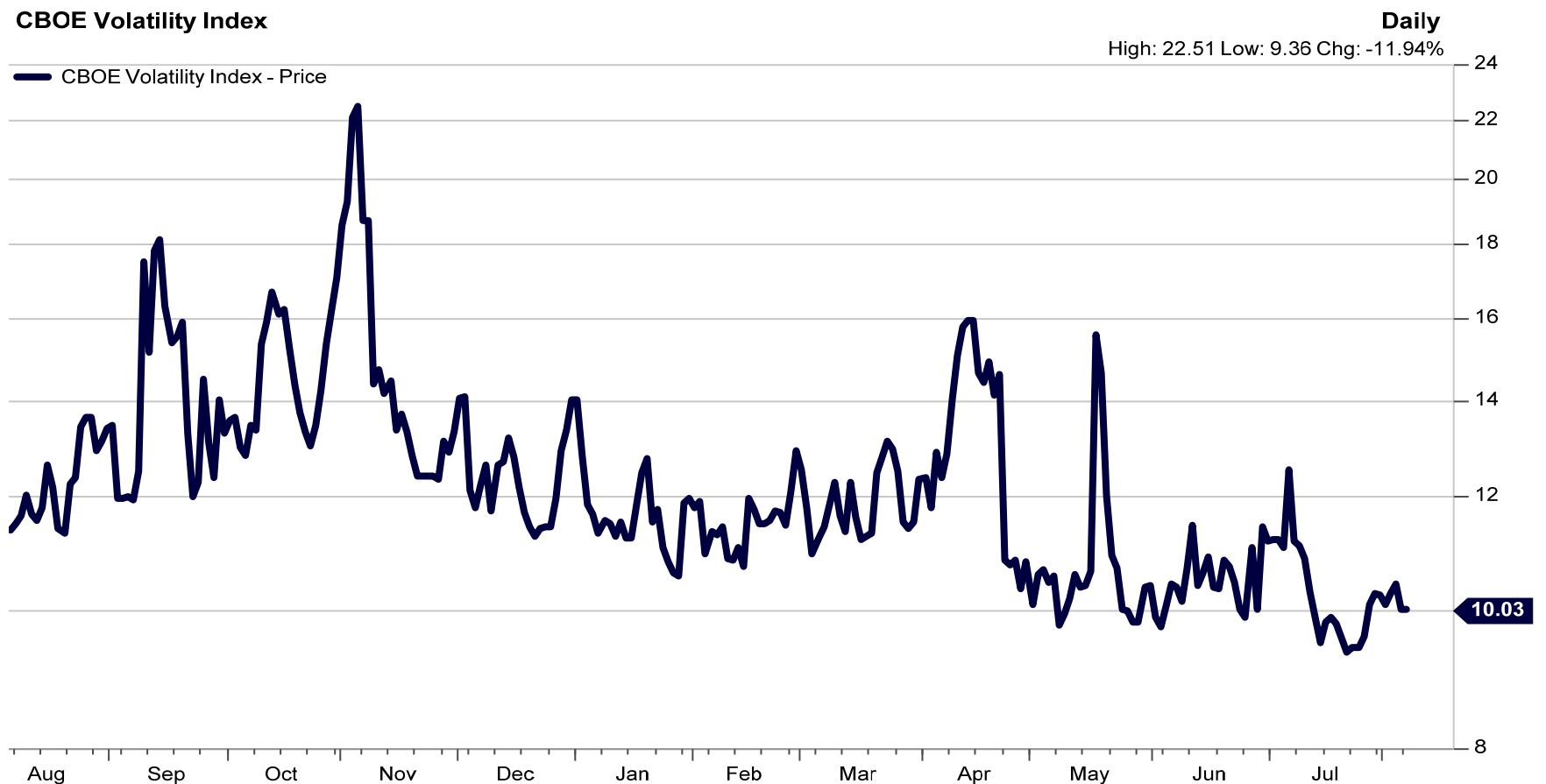
- After a four quarter period of declining earnings per share outlook, profit growth has returned and is expected to be near 8% in 2017 (Yellow Line)
- Investors have embraced better economic conditions, feel more certain about earnings growth, and have been willing to pay higher Price/Earnings ratios to own stocks (Blue Line)



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



Expectations

- **Economy**
 - We expect “Goldilocks” economy to continue through 2017 and into early 2018 with moderate growth and low inflation that increases slightly from current levels
- **Bond Market**
 - Low inflation is likely to keep interest rates anchored despite the Fed’s desire to “normalize” rates
 - Fed decisions related to shrinking the balance sheet have important implications for the shape of the yield curve
- **Stock Market**
 - Moderate growth leads to mid/high single digit earnings growth
 - Stock prices drift higher with earnings growth but PE multiples are unlikely to expand further

Disclosure

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