

# Observation Deck

Views from the Investment Policy Committee

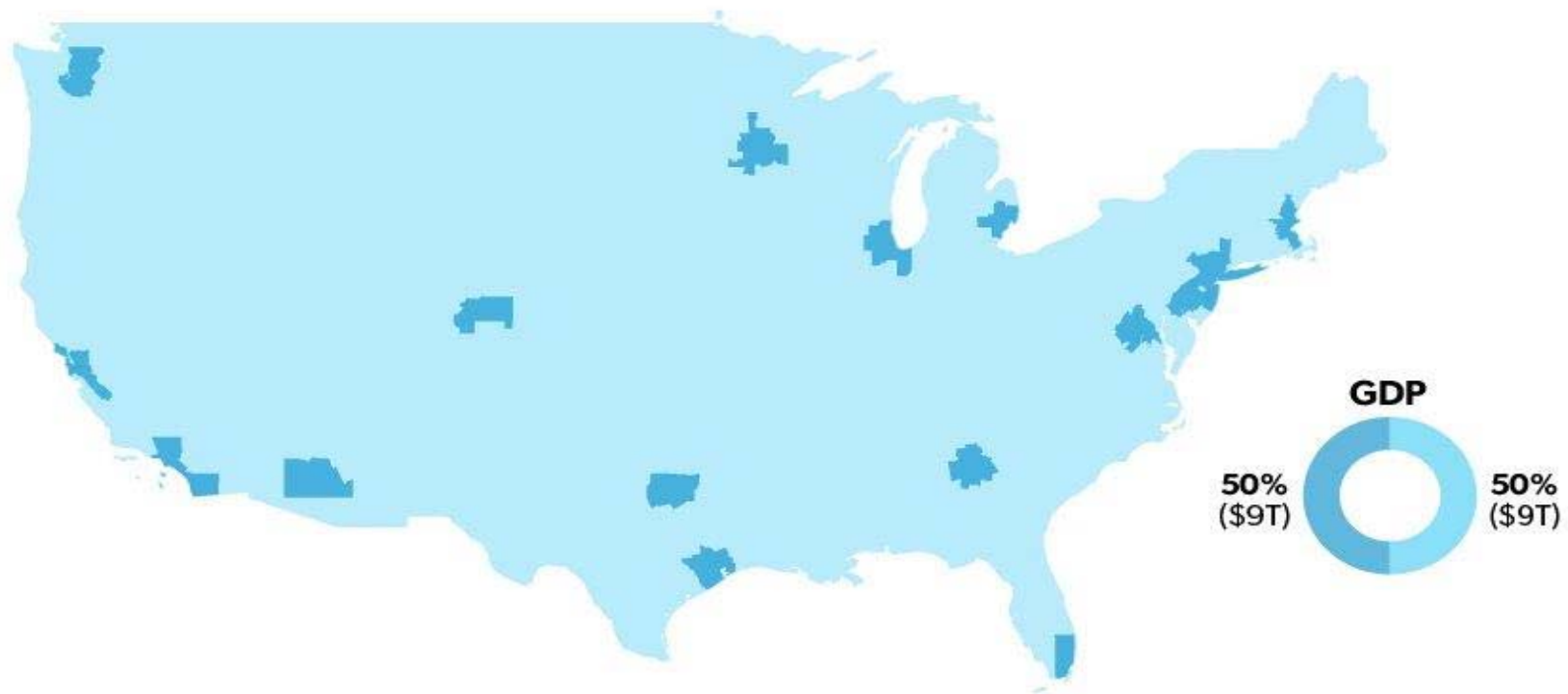


January 2017

# America's Economy

- The composition of urban economies can look a whole lot different than that of more rural areas.

## America's \$18 Trillion Economy (2015) Divided in Half

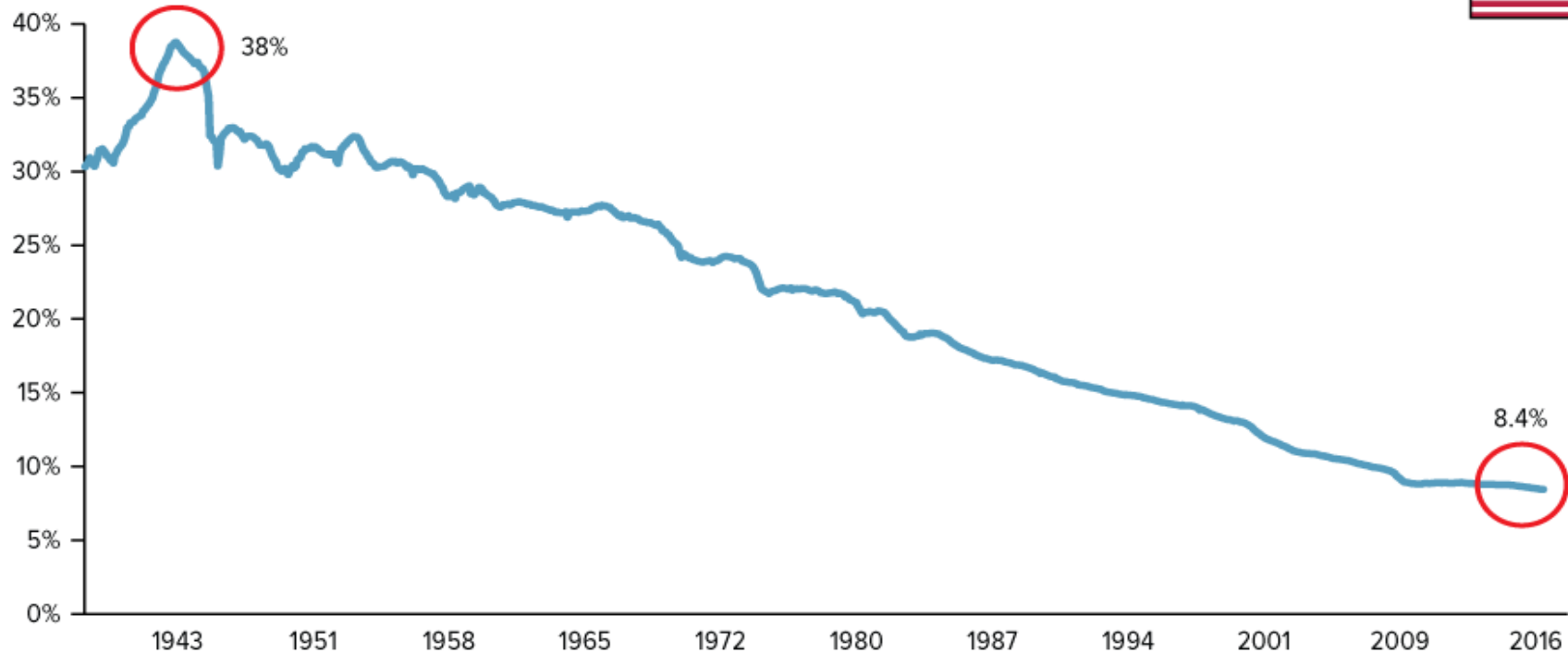


# America's Economy

- Manufacturing jobs have been disappearing in the US for decades, replaced by a services economy, cheaper labor in international markets, technological advance and productivity gains.
- Public policy should be well versed in these long-term trends and fully aware of the unintended economic consequences that can accompany protectionist measures.

## Manufacturing Jobs as a Percentage of Total U.S. Workforce

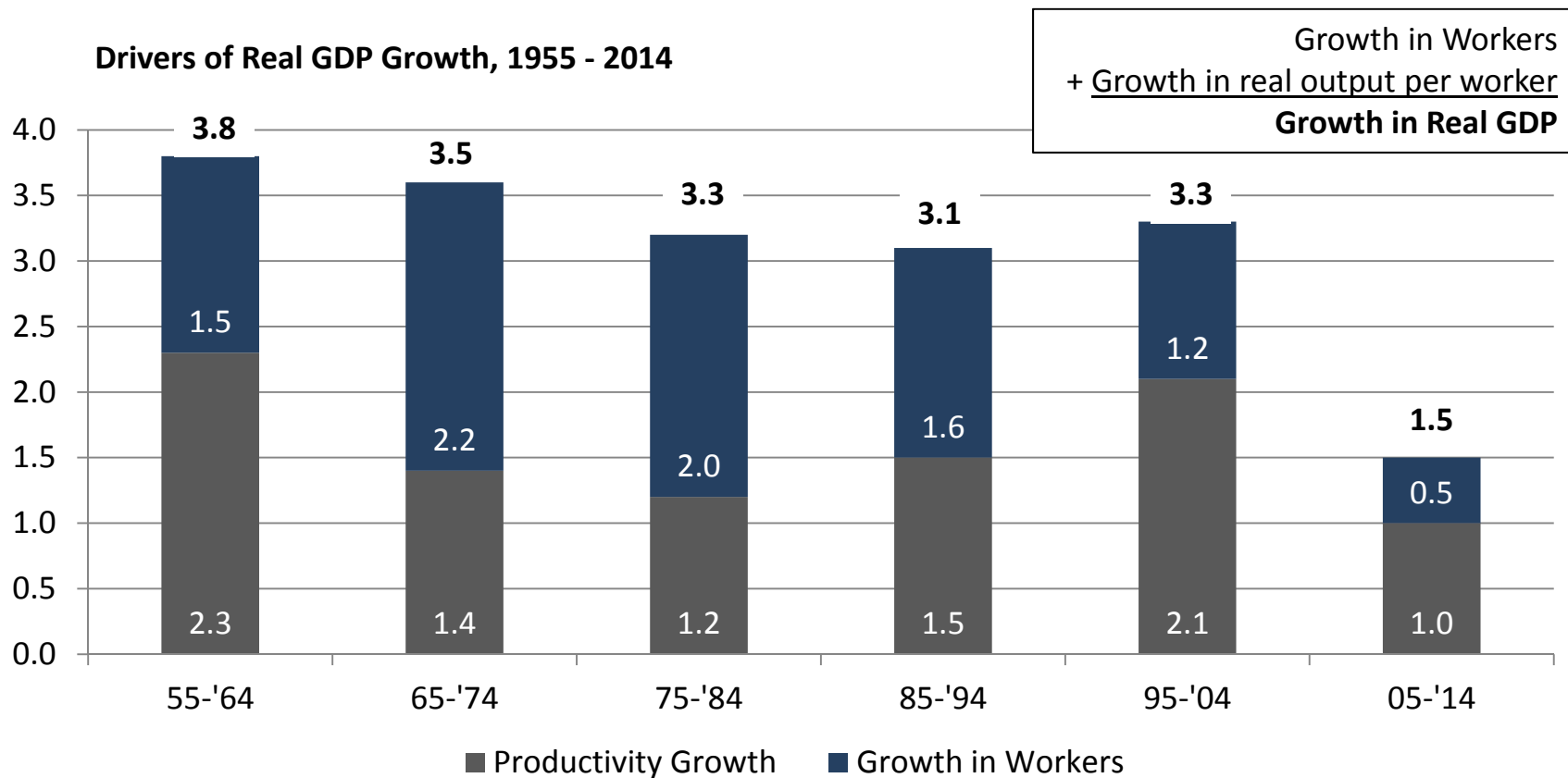
1939 – 2016



Source: Bureau of Labor Statistics, U.S. Global Investors

# 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

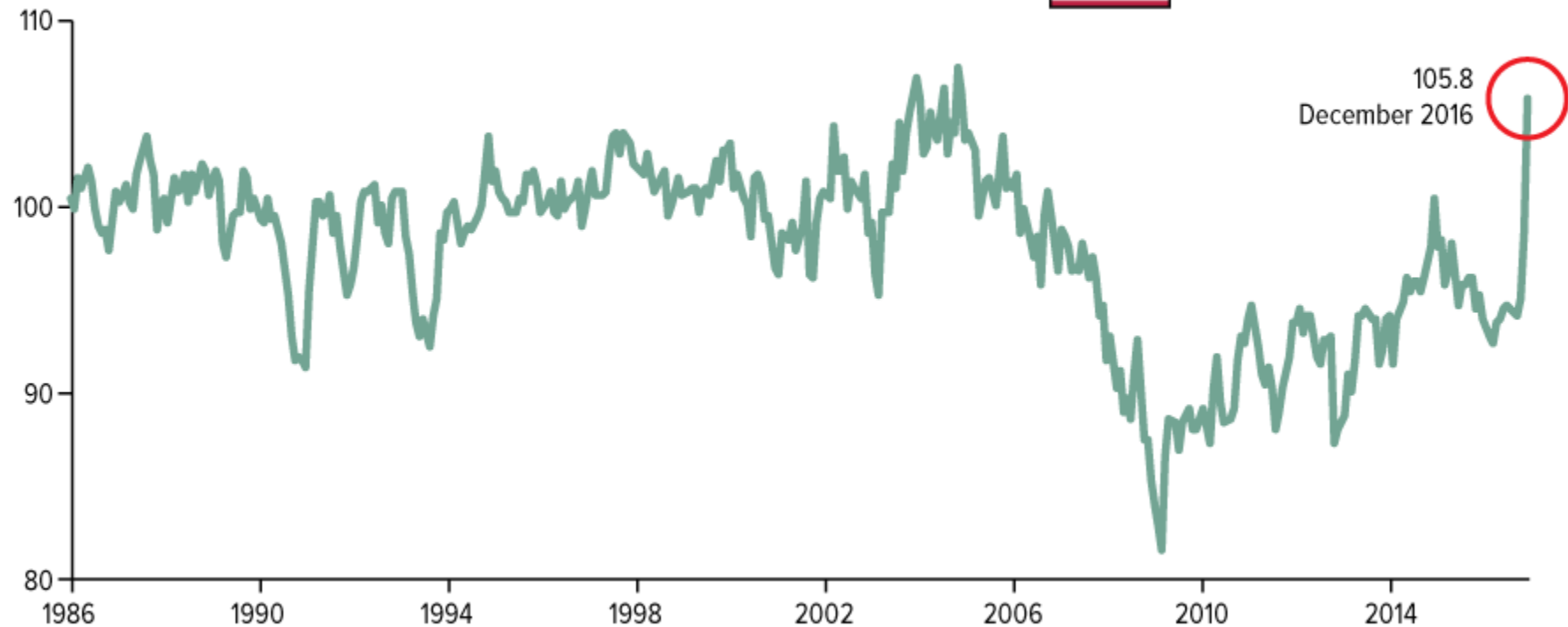
# Small Business Confidence

- Small business is the life blood of the US economy and has carried a disproportionate share of the burdens associated with slower economic growth, greater regulation, restrictions on bank lending and heavy taxes.
- The increase in small business optimism is a reflection of more business friendly policy expectations

## Small Business Optimism Posts Highest Reading in 12 Years



Index Value (1986=100)

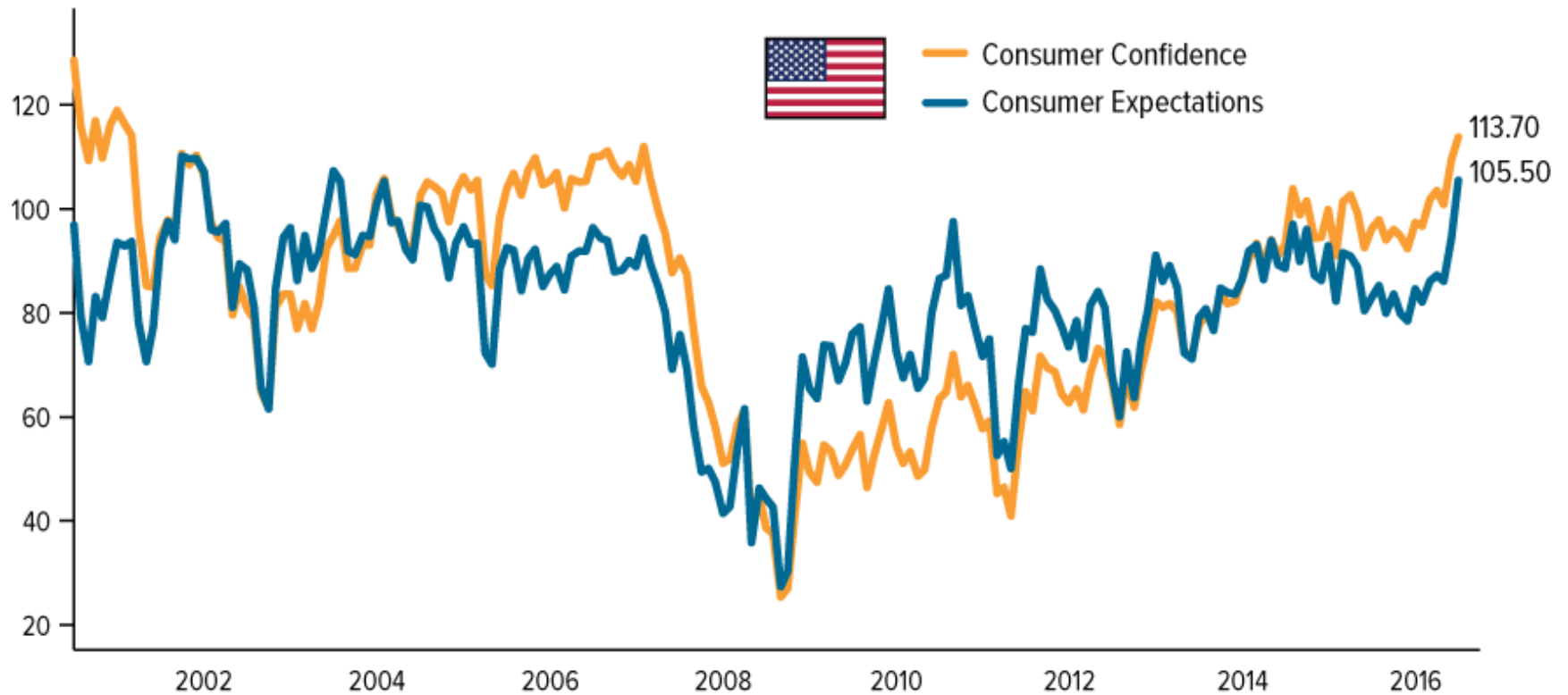


Source: NFIB Small Business Economic Trends, U.S. Global Investors

# Consumer Confidence

- Consumers have been gaining confidence; a reflection of stronger labor markets, rising incomes, lower energy costs and improving home prices. Expectations for tax relief and faster economic growth has boosted confidence further.

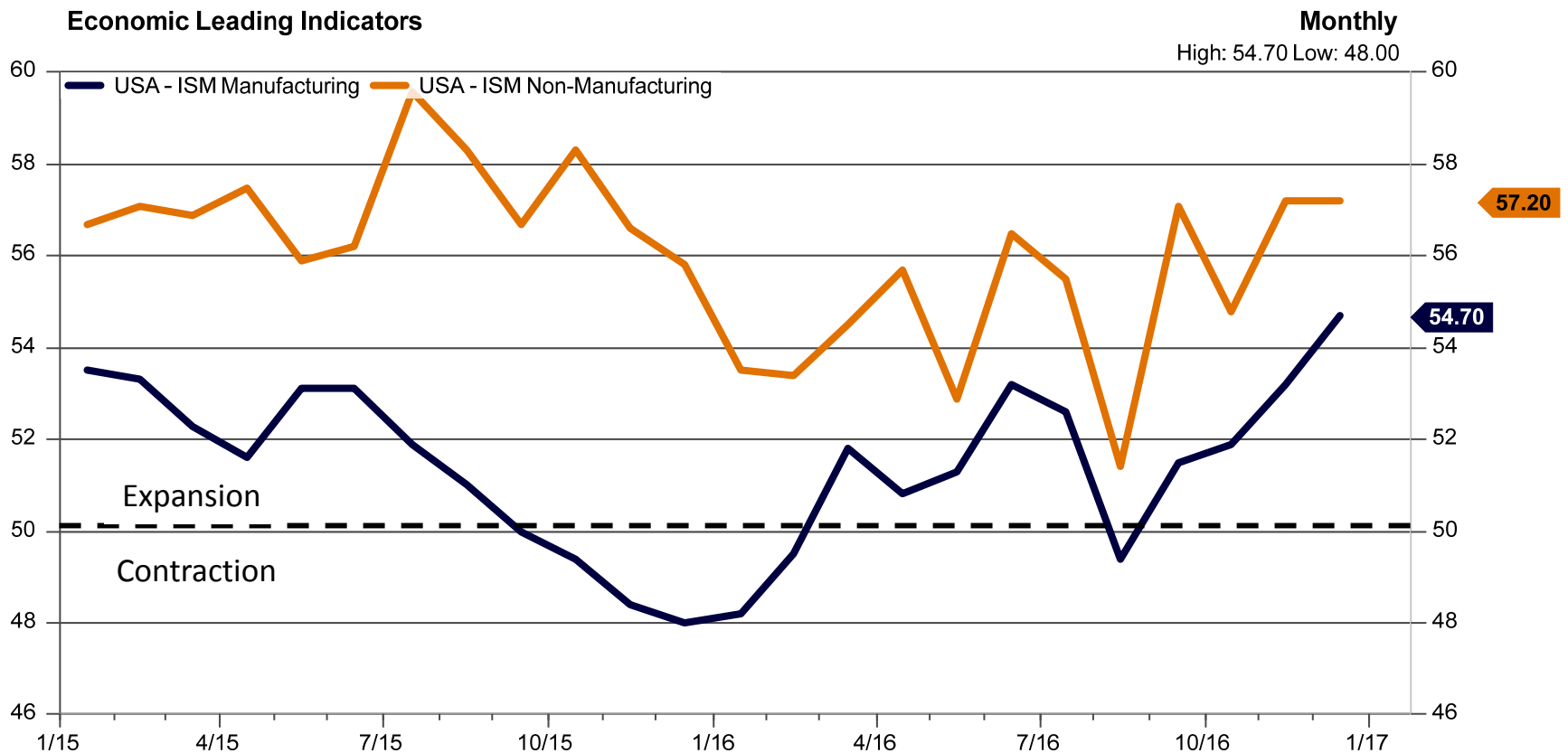
## Consumer Confidence Climbs In December



Source: Conference Board, Bloomberg, U.S. Global Investors

# Economy – Leading Indicators

- Leading indicators of economic activity have been rising nicely in the US and abroad in recent months.
- Faster economic expansion is expected to lead to profit growth and a normalization of interest rates.

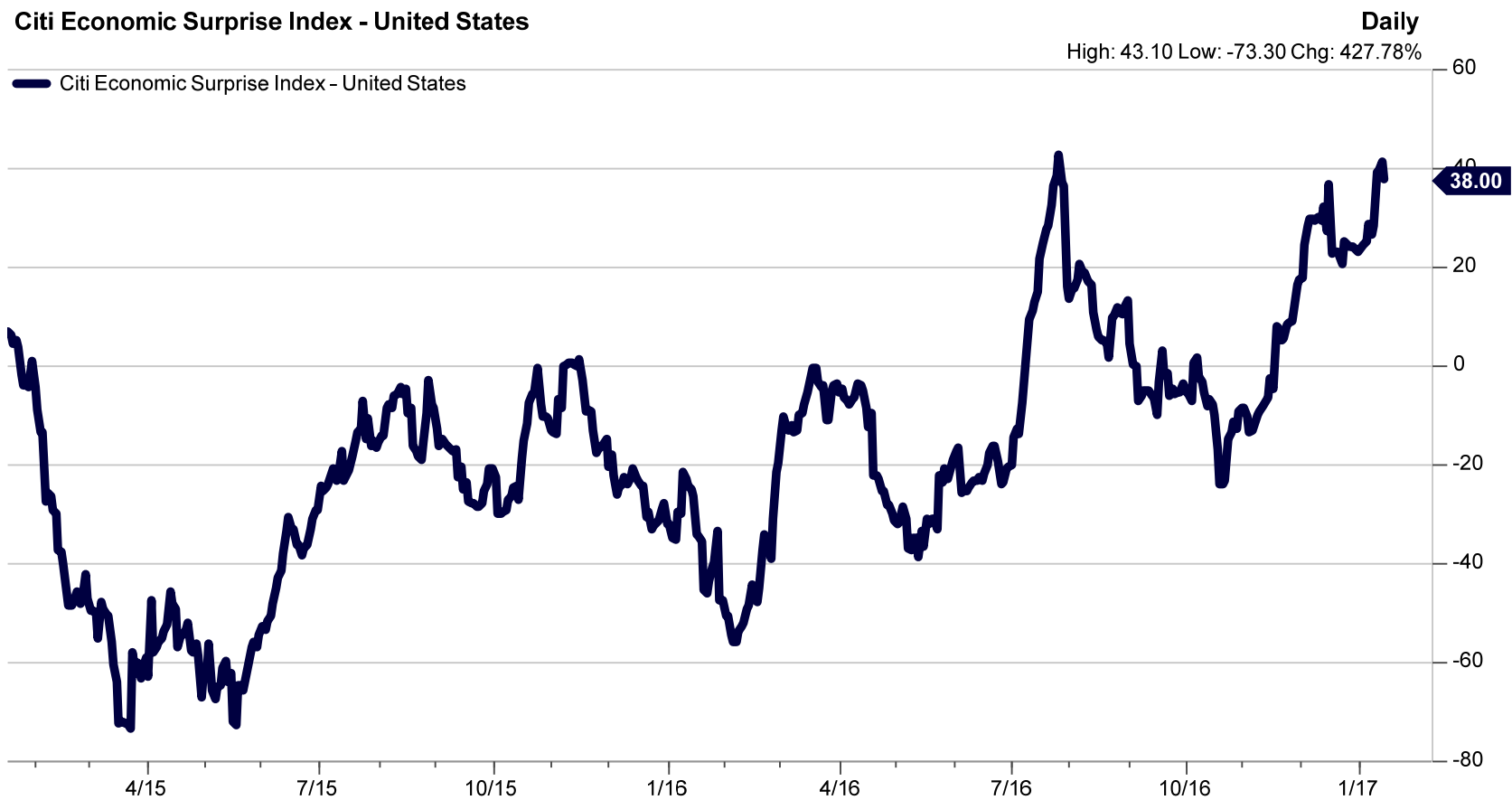


Source: FactSet Research Systems

# 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.

Citi Economic Surprise Index - United States

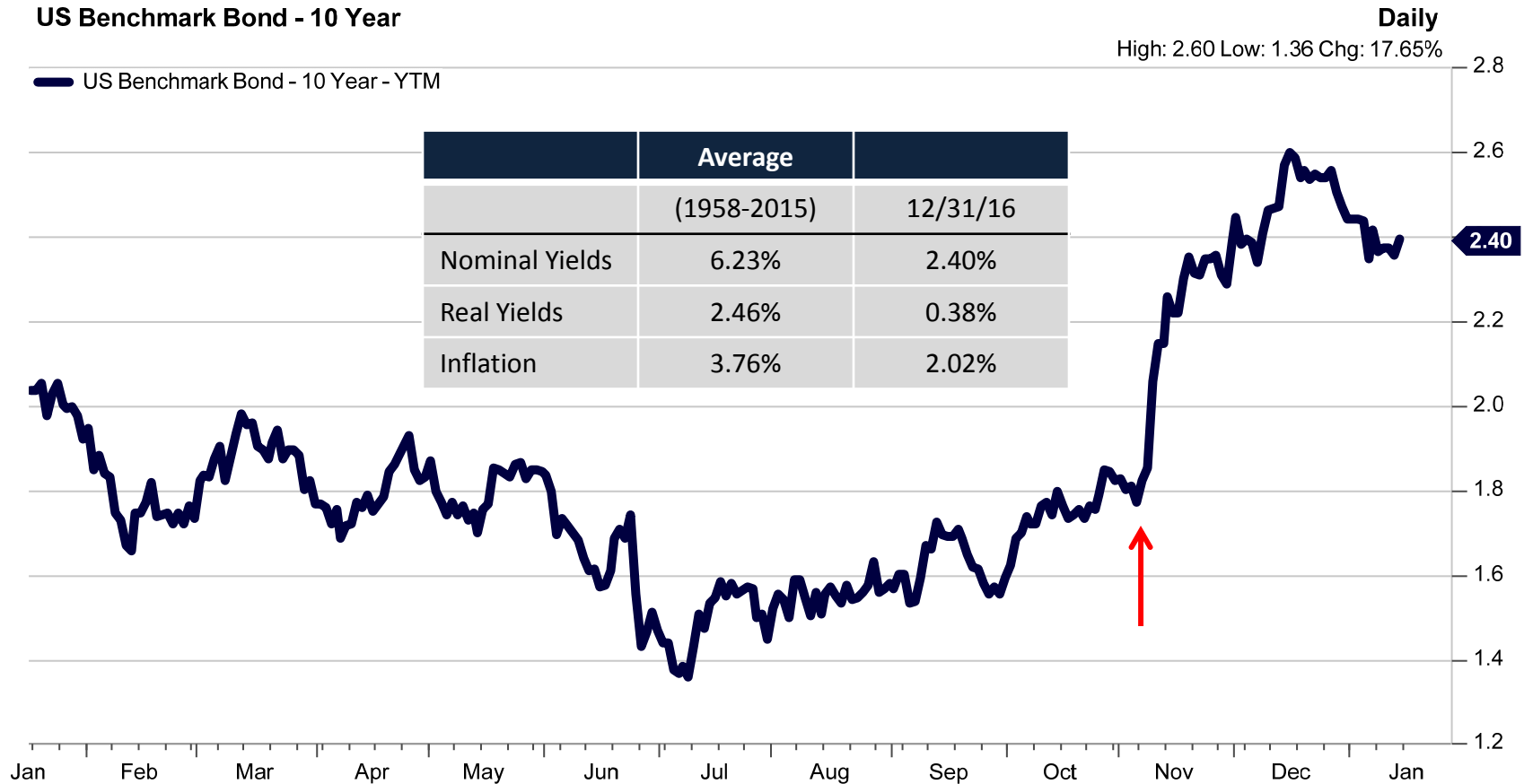




# Stronger Growth – Higher Yields

- 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.

## US Benchmark Bond - 10 Year



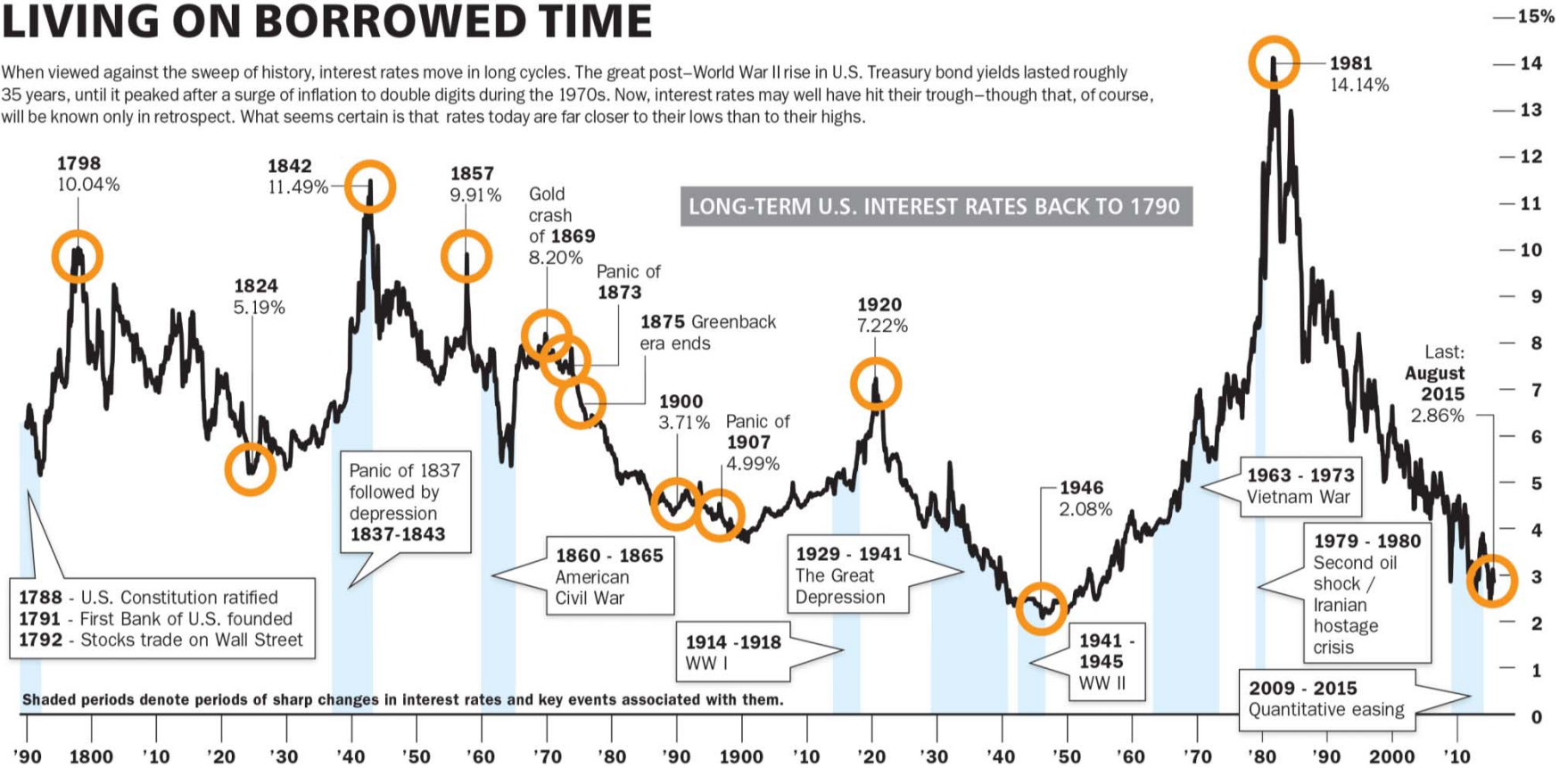
Source: FactSet Research Systems

# Bond Holders Beware

- It is important to place the recent climb in bond yields into a proper historical context. Yields could certainly rise significantly higher from here and place considerable downward pressure on bond prices.

## LIVING ON BORROWED TIME

When viewed against the sweep of history, interest rates move in long cycles. The great post-World War II rise in U.S. Treasury bond yields lasted roughly 35 years, until it peaked after a surge of inflation to double digits during the 1970s. Now, interest rates may well have hit their trough—though that, of course, will be known only in retrospect. What seems certain is that rates today are far closer to their lows than to their highs.



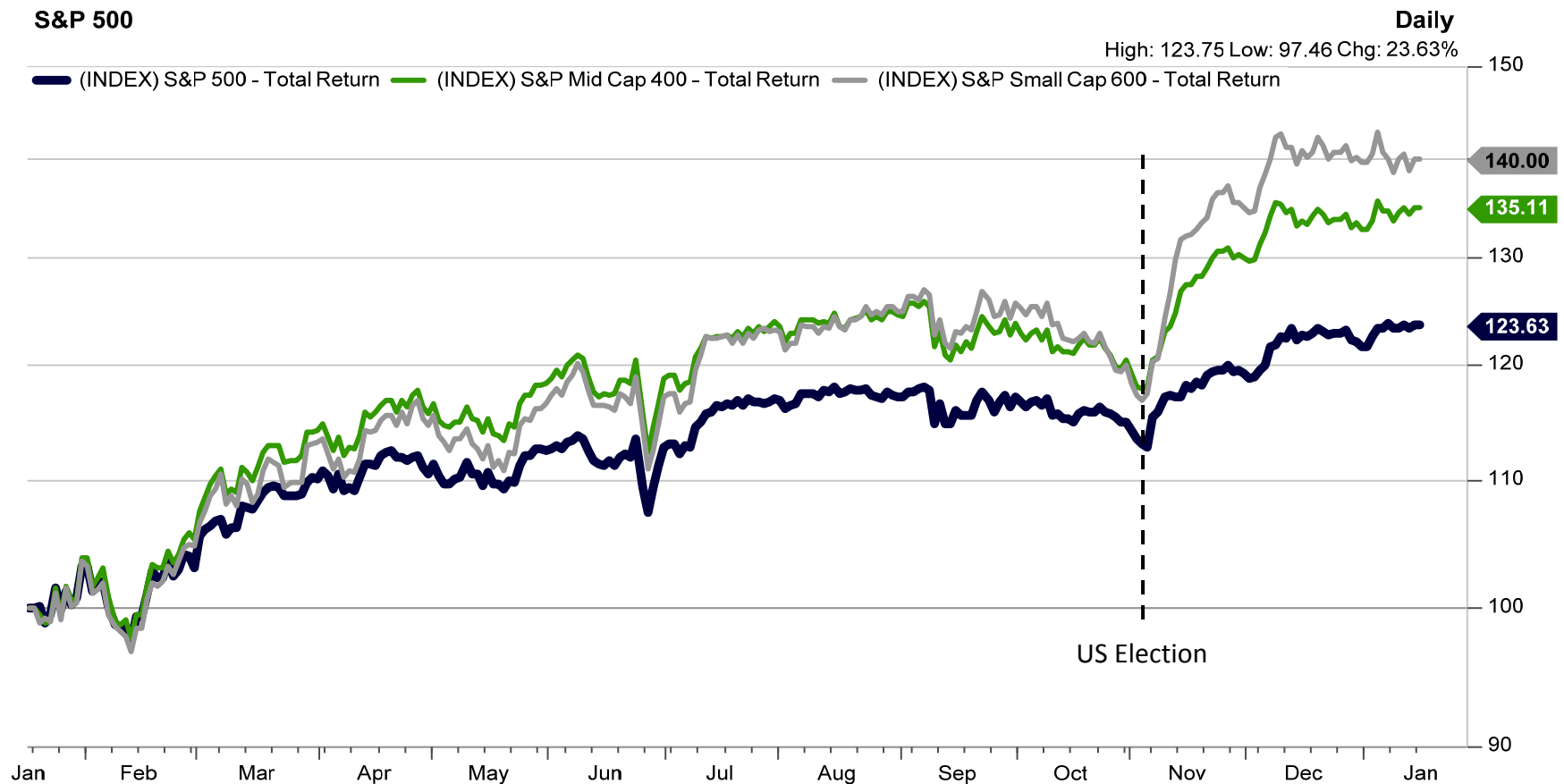
Source: Bianco Research

Barrons – November 19, 2016

# Policy Expectations Fuel Stocks

1 Year

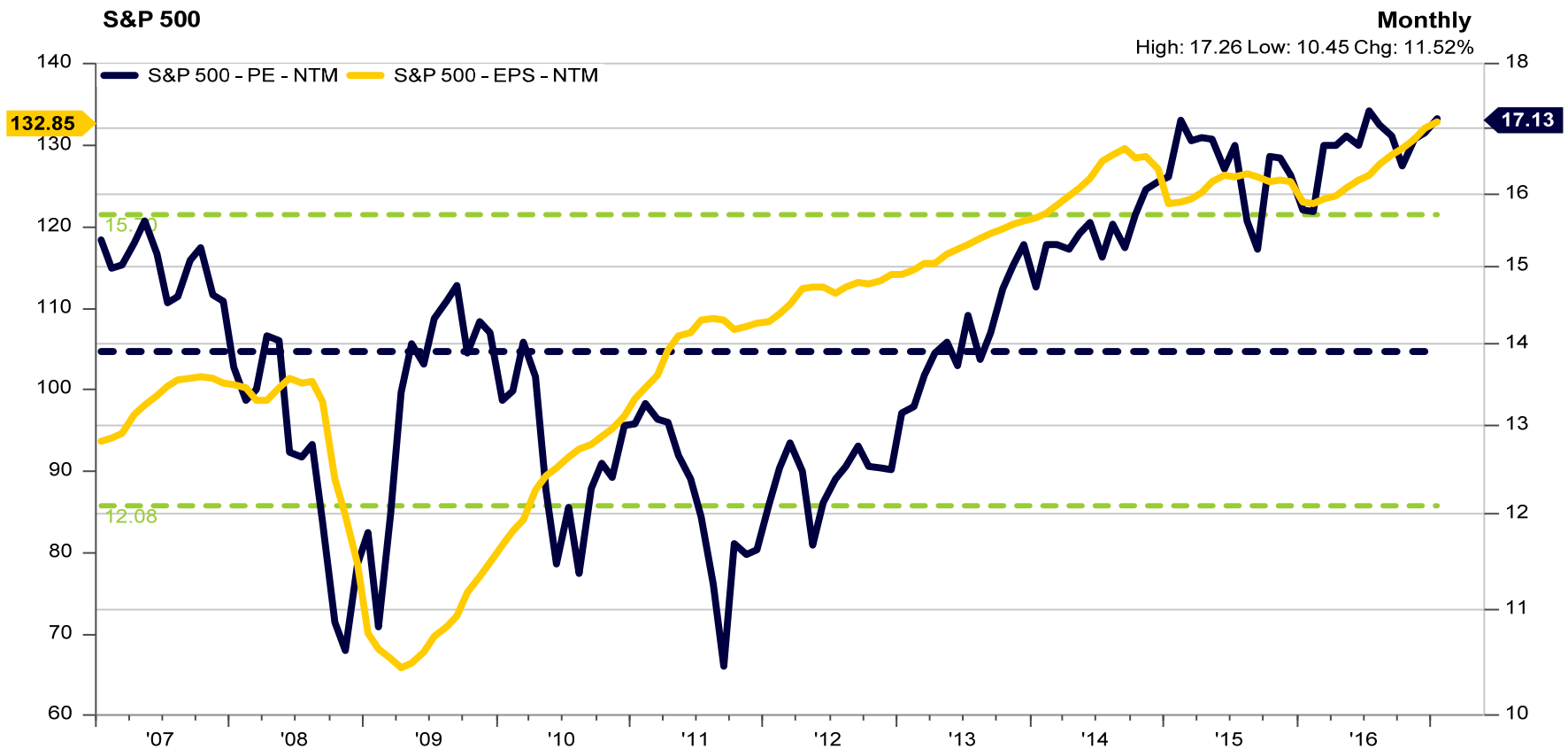
- Smaller companies are expected to capture greater benefit from faster domestic growth, an easing regulatory environment, and lower taxes.
- Markets are pricing in accelerating economic expansion and rising profits.



# PE & Earnings - NTM

10 Year

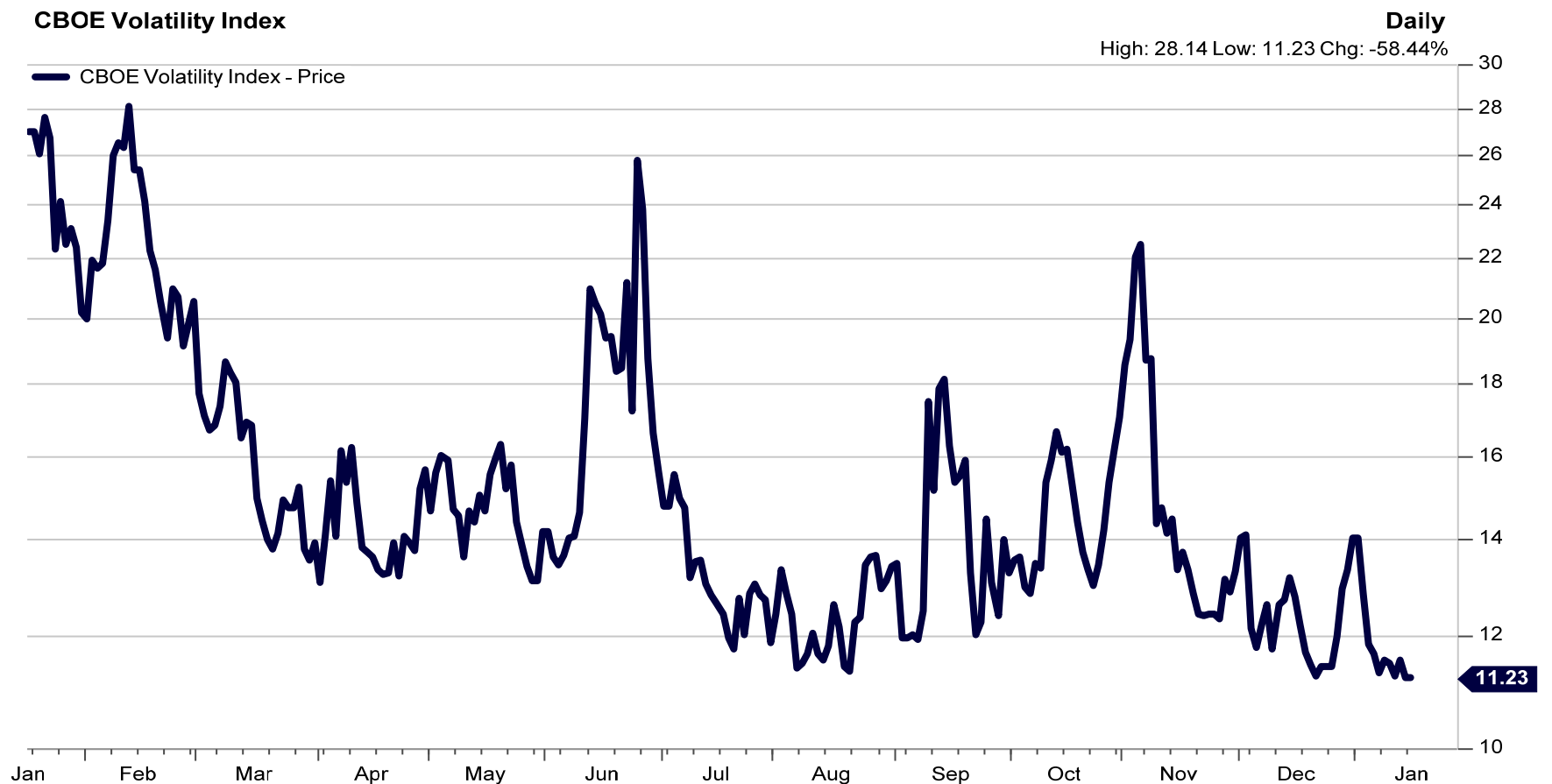
- After four quarters of declining earnings, profit growth has returned and is expected to be near 8% in 2017.
- Investors have embraced better economic conditions, feel more certain about earnings growth, and have been willing to pay higher multiples to own stocks.



# 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.



# The Periodic Table of Investment Returns

Annual Returns for Key Indices Ranked in Order of Performance (1997-2016)

1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	CAGR
S&P 500	S&P 500	MSCI EM	Bloomberg Comdty	FTSE NAREIT	Bloomberg Comdty	MSCI EM	FTSE NAREIT	MSCI EM	FTSE NAREIT	MSCI EM	Barclays Glob Agg	MSCI EM	FTSE NAREIT	Barclays Muni Bond	FTSE NAREIT	Russell 2000	FTSE NAREIT	Barclays Muni Bond	Russell 2000	FTSE NAREIT
33.36%	28.58%	66.52%	31.84%	13.93%	25.91%	55.92%	31.58%	34.36%	35.06%	39.73%	4.79%	79.05%	27.95%	10.70%	19.70%	38.82%	28.03%	3.30%	21.31%	9.67%
Russell 2000	MSCI EAFE	MSCI EAFE	FTSE NAREIT	HFRX Hedge Fund	Barclays Glob Agg	Russell 2000	MSCI EM	Bloomberg Comdty	MSCI EM	Bloomberg Comdty	Barclays Muni Bond	Barclays US Corp HY	Russell 2000	FTSE NAREIT	MSCI EM	S&P 500	S&P 500	FTSE NAREIT	Barclays US Corp HY	Russell 2000
22.36%	20.73%	27.95%	26.37%	8.67%	16.53%	47.25%	26.10%	21.36%	32.57%	16.23%	-2.47%	58.21%	26.85%	8.28%	18.66%	32.39%	13.69%	2.83%	17.13%	8.25%
FTSE NAREIT	Barclays Glob Agg	HFRX Hedge Fund	HFRX Hedge Fund	Barclays US Corp HY	Barclays Muni Bond	MSCI EAFE	MSCI EAFE	MSCI EAFE	MSCI EAFE	MSCI EAFE	HFRX Hedge Fund	MSCI EAFE	MSCI EM	Barclays Glob Agg	MSCI EAFE	MSCI EAFE	Barclays Muni Bond	S&P 500	S&P 500	S&P 500
20.26%	13.71%	26.66%	14.29%	5.28%	9.60%	39.50%	21.02%	14.33%	27.29%	11.90%	-23.25%	32.75%	19.36%	5.64%	18.09%	23.58%	9.05%	1.38%	11.96%	7.68%
Barclays US Corp HY	HFRX Hedge Fund	Bloomberg Comdty	Barclays Muni Bond	Barclays Muni Bond	HFRX Hedge Fund	FTSE NAREIT	Russell 2000	FTSE NAREIT	Russell 2000	Barclays Glob Agg	Barclays US Corp HY	FTSE NAREIT	Bloomberg Comdty	Barclays US Corp HY	Russell 2000	Barclays US Corp HY	Russell 2000	MSCI EAFE	Bloomberg Comdty	Barclays US Corp HY
12.76%	12.94%	24.35%	11.68%	5.13%	4.72%	37.13%	18.33%	12.16%	18.37%	9.48%	-26.16%	27.99%	16.83%	4.98%	16.35%	7.44%	4.89%	-0.39%	11.77%	7.03%
Barclays Muni Bond	Barclays Muni Bond	Russell 2000	Barclays Glob Agg	Russell 2000	FTSE NAREIT	Barclays US Corp HY	Barclays US Corp HY	S&P 500	S&P 500	S&P 500	Russell 2000	Russell 2000	Barclays US Corp HY	S&P 500	S&P 500	HFRX Hedge Fund	Barclays US Corp HY	Barclays Glob Agg	MSCI EM	MSCI EM
9.19%	6.48%	21.26%	3.18%	2.49%	3.82%	28.97%	11.13%	4.91%	15.79%	5.49%	-33.79%	27.17%	15.12%	2.11%	16.00%	6.72%	2.45%	-3.15%	11.27%	5.62%
Barclays Glob Agg	Barclays US Corp HY	S&P 500	Russell 2000	Barclays Glob Agg	Barclays US Corp HY	S&P 500	S&P 500	Russell 2000	Barclays US Corp HY	HFRX Hedge Fund	Bloomberg Comdty	S&P 500	S&P 500	Russell 2000	Barclays US Corp HY	FTSE NAREIT	Barclays Glob Agg	HFRX Hedge Fund	FTSE NAREIT	Barclays Muni Bond
3.79%	1.90%	21.04%	-3.02%	1.57%	-1.41%	28.68%	10.88%	4.55%	11.85%	4.23%	-35.65%	26.46%	15.06%	-4.18%	15.81%	2.86%	0.59%	-3.64%	8.63%	5.00%
MSCI EAFE	Russell 2000	Barclays US Corp HY	Barclays US Corp HY	MSCI EM	MSCI EM	Bloomberg Comdty	Barclays Glob Agg	Barclays Muni Bond	HFRX Hedge Fund	Barclays Muni Bond	S&P 500	Bloomberg Comdty	MSCI EAFE	HFRX Hedge Fund	Barclays Muni Bond	MSCI EM	HFRX Hedge Fund	Russell 2000	HFRX Hedge Fund	MSCI EAFE
2.41%	-2.55%	2.39%	-5.68%	-2.29%	-5.88%	23.93%	9.27%	3.51%	9.26%	3.36%	-37.00%	18.91%	8.44%	-8.87%	6.78%	-2.25%	-0.58%	-4.41%	2.50%	4.85%
Bloomberg Comdty	FTSE NAREIT	Barclays Muni Bond	S&P 500	S&P 500	MSCI EAFE	HFRX Hedge Fund	Bloomberg Comdty	Barclays US Corp HY	Barclays Glob Agg	Barclays US Corp HY	FTSE NAREIT	HFRX Hedge Fund	Barclays Glob Agg	MSCI EAFE	Barclays Glob Agg	Barclays Muni Bond	MSCI EM	Barclays US Corp HY	Barclays Glob Agg	Barclays Glob Agg
-3.39%	-17.50%	-2.06%	-9.10%	-11.89%	-15.50%	13.39%	9.15%	2.73%	6.64%	1.88%	-37.73%	13.40%	5.54%	-11.55%	4.32%	-2.55%	-2.11%	-4.47%	2.09%	4.40%
MSCI EM	MSCI EM	FTSE NAREIT	MSCI EAFE	Bloomberg Comdty	Russell 2000	Barclays Glob Agg	Barclays Muni Bond	HFRX Hedge Fund	Barclays Muni Bond	Russell 2000	MSCI EAFE	Barclays Muni Bond	HFRX Hedge Fund	Bloomberg Comdty	HFRX Hedge Fund	Barclays Glob Agg	MSCI EAFE	MSCI EM	MSCI EAFE	HFRX Hedge Fund
-12.31%	-25.96%	-4.62%	-13.78%	-19.51%	-20.48%	12.51%	4.48%	2.72%	4.84%	-1.57%	-42.86%	12.91%	5.19%	-13.32%	3.51%	-2.60%	-4.20%	-14.60%	1.59%	4.24%
*The HFRX Hedge Fund Index was established in 1998	Bloomberg Comdty	Barclays Glob Agg	MSCI EM	MSCI EAFE	S&P 500	Barclays Muni Bond	HFRX Hedge Fund	Barclays Glob Agg	Bloomberg Comdty	FTSE NAREIT	MSCI EM	Barclays Glob Agg	Barclays Muni Bond	MSCI EM	Bloomberg Comdty	Bloomberg Comdty	Bloomberg Comdty	Bloomberg Comdty	Barclays Muni Bond	Bloomberg Comdty
	-27.03%	-5.17%	-30.73%	-20.93%	-22.10%	5.31%	2.69%	-4.49%	2.07%	-15.69%	-53.08%	6.93%	2.38%	-18.16%	-1.06%	-9.52%	-17.01%	-24.66%	0.25%	0.50%

Source: Factset and Bloomberg. All data represents total return for the stated period. Past performance is not indicative of future returns. Data are as of 12/31/16.

# The Periodic Table of Investment Returns

(1997-2016)

The Periodic Table of Investment Returns highlights the benefits inherent to diversifying investment portfolios among different asset classes and geographical regions. The rankings are highly variable from year to year and clearly depict the unpredictability of returns. This table displays annual returns for 10 different indices over the last 20 years. Each year, the indices are ranked according to their annual performance, with the best performing index at the top. Vigilant Capital Management utilizes the indices below as proxies for each asset class and to evaluate investment performance. Brief descriptions of each index can be found below. Past performance is not indicative of future returns.

Asset Class	Index - Description
Equity	<ul style="list-style-type: none"> <li>● <b>S&amp;P 500</b> – measures the performance of large-cap US stocks. The S&amp;P 500 is a market-value-weighted index of 500 stocks that are traded on the NYSE, AMEX, and NASDAQ.</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>Russell 2000</b> – measures the performance of small-cap US stocks. The Russell 2000 is a market-value-weighted index of the 2,000 smallest stocks in the broad-market Russell 3000 Index. These securities are traded on the NYSE, AMEX, and NASDAQ.</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>MSCI EAFE</b> – is a Morgan Stanley Capital International Index that is designed to measure the performance of the developed stock markets of Europe, Australasia, and the Far East.</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>MSCI Emerging Markets</b> - is a Morgan Stanley Capital International Index that is designed to measure the performance of equity markets in 21 emerging countries around the world.</li> </ul>
Fixed Income	<ul style="list-style-type: none"> <li>● <b>Barclays Global Aggregate Bond</b> – (formerly the Lehman Brothers Aggregate Bond Index) includes US government, corporate, and mortgage -backed securities with maturities of at least one year</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>Barclays US High Yield Bond</b> – measures the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&amp;P 500 is Ba1/BB+/BB+ or below, excluding EM debut</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>Barclays U.S. Municipal Bond</b> – (formerly the Lehman Brothers Municipal Bond Index) includes approximate 1,100 US municipal bonds; 60% of which are revenue bonds and 40% of which are state government obligations</li> </ul>
Hard Assets	<ul style="list-style-type: none"> <li>● <b>Bloomberg Commodity Total Return</b> – (formerly the Dow Jones – UBS Commodity Index) is comprised of 22 exchange-traded futures on physical commodities. The index represents 20 commodities, which are weighted to account for economic significance and market liquidity. In addition, this index includes returns on cash collateral invested in 13 week (3 Month) U.S. Treasury Bills.</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>FTSE NAREIT All-Equity REIT</b> – measures the performance of all tax-qualified REITs with more than 50% of total assets in qualifying real estate assets other than mortgages secured by real property. The index is a free-float adjusted, market cap-weighted index of US Equity REITs.</li> </ul>
Alternatives	<ul style="list-style-type: none"> <li>● <b>HRFX Global Hedge Fund Index</b> – is designed to be representative of the overall composition of the hedge fund universe. It is comprised of all eligible hedge fund strategies. The index uses quantitative techniques and analysis to ensure the Index is a pure representation of its corresponding investment focus.</li> </ul>

# Disclosure

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