Kayne Anderson Rudnick
Investment Management

Market Review

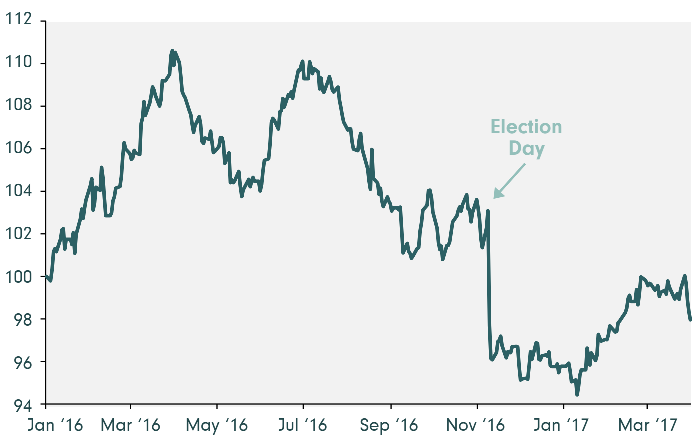
First Quarter 2017

Is the Trump Bump Becoming the Trump Dump?

First Quarter Performance

Stocks are off to a terrific start so far in 2017, with the S&P 500 Index advancing 6.07% in the first quarter, international markets up 7.25%, and emerging markets even stronger at 11.44%. A style rotation continued during the quarter, with growth benchmarks outperforming value indexes and large stocks outperforming small stocks—the opposite of what happened in 2016. The asset classes and equity sectors that benefited the most from Donald Trump's surprise election cooled off and have lagged materially so far this year (See chart: *2016 Democratic Portfolio Relative to the Republican Portfolio*).

2016 Democratic Portfolio Relative to the Republican Portfolio
(100 = 12/31/2015)



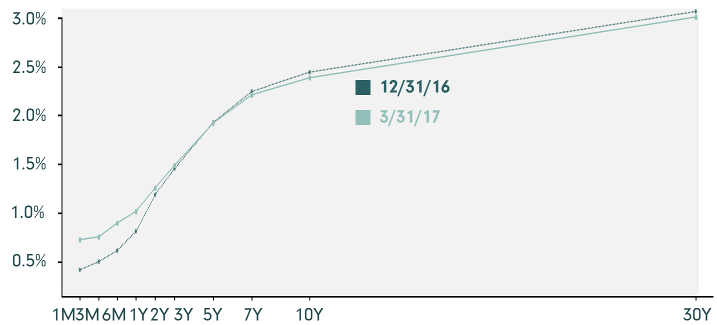
Data is obtained from Strategas and is assumed to be reliable. Strategas' Republican and Democratic portfolios aim to identify those companies and sectors that would most benefit from a respective Republican or Democratic victory. Past performance is no guarantee of future results.

Bonds reversed course in the first quarter after a difficult fall. The broad U.S. bond market advanced 0.82%, California municipal bonds returned 1.57%, high yield was up 2.71%, and emerging-market debt increased 3.90%. Importantly, the yield curve flattened during the first quarter, with the U.S. Federal Reserve raising short-term interest rates one quarter of a point, but longer term interest rates barely budged (See chart: *U.S. Yield Curve*). The 10-Year U.S. Treasury yield actually fell slightly from 2.44% a quarter earlier to 2.39% as did the 30-year rate which fell from 3.07% to 3.01%. Investors are now grappling with how much of Trump's agenda will actually make its way into law and when it will occur.

Trump Bump?

The failure of the Obamacare repeal and passage of a suitable replacement has led to questions about how much of President Trump's agenda will actually be enacted by Congress. Even though the Trump

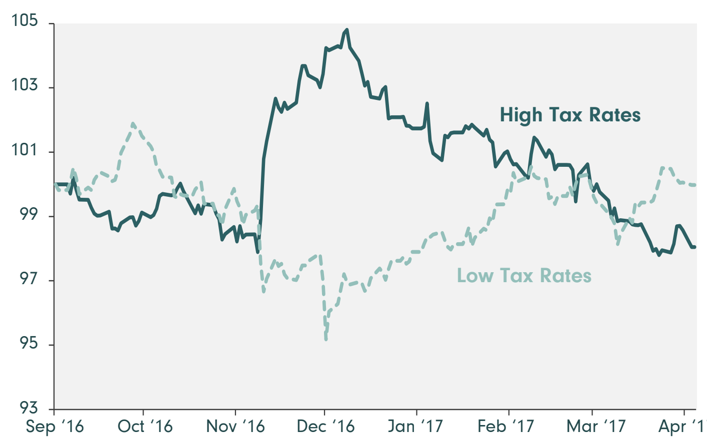
U.S. Yield Curve



Data is obtained from Bloomberg. Past performance is no guarantee of future results.

Administration has pivoted towards tax reform, the market doesn't seem to have much confidence that agenda will be accomplished any time soon (See chart: *Companies with High Tax Rates Relative to the S&P 500® vs. Companies with Low Tax Rates Relative to the S&P 500®*).

Companies with High Tax Rates Relative to S&P 500® vs. Companies with Low Tax Rates Relative to S&P 500®
(Indexed to 100, 9/1/2016)



Data is obtained from Strategas and is assumed to be reliable. Strategas' High Tax Rate Index identifies the S&P 500 stocks with income tax expense as a percent of income before income taxes greater than 35% for the last three years. Strategas' Low Tax Rate Index identifies the S&P 500 stocks with income tax expense as a percent of income before income taxes less than 35% for the last three years. Past performance is no guarantee of future results.

Cyclical stocks, which have the most to gain from the passage of Trump's agenda, have lagged defensive stocks so far this year. So why are stocks continuing to perform well? Since last summer, improving energy prices and economic growth in many foreign markets have been driving a steadily improving U.S. economy. In addition, corporate earnings have stopped declining (after two years of being in decline), and are actually starting to accelerate. Also contributing to the climb of the stock market is the fact that CEO and small business optimism has soared now that the uncertainty of the presidential election is behind us and investors see Trump's administration as more pro-business (See chart: *Small*

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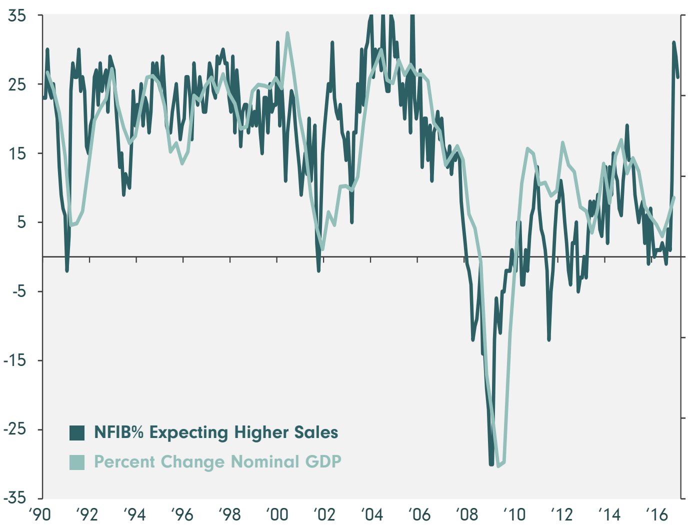
Business Sales Growth Expectations). Such optimism is more likely the result of investors believing that the election of a Republican majority in Congress and the White House will spell the end of increasing regulation and taxes rather than investor confidence in the ability of President Trump and Congress to work together to pass the legislation.

Small Business Sales Growth Expectations Predicting 7% GDP Growth
(Bureau of Economic Analysis, National Federation of Independent Business)



Data is obtained from Strategas and is assumed to be reliable.
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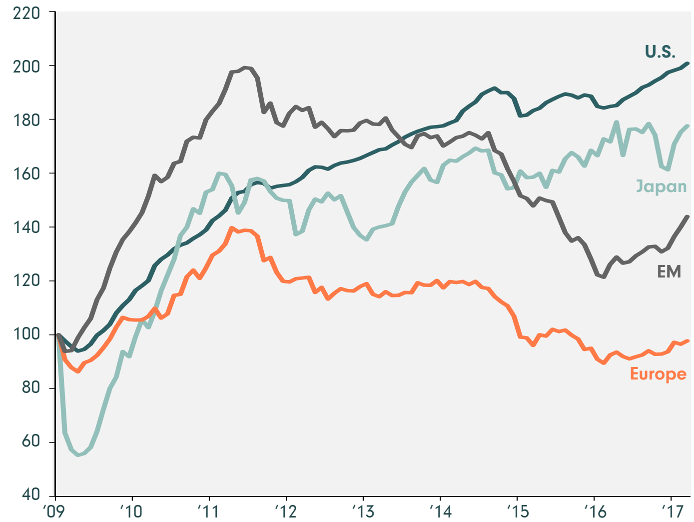
One of the largest question marks of Trump's presidency as he entered office was how his administration would deal with our trading partners. So far, it appears his stance on trading with Mexico (NAFTA) and China, in particular, has softened from his campaign rhetoric. Despite the fact that the Trump Administration frequently garners negative headlines, the stock market has tended to focus on improving domestic and foreign profits, as well as the rampant innovation and disruption at the corporate level.

2017 Outlook

We believe the stock market and business activity are off to a good start. Globally, corporate sentiment and the business environment seem to be improving, which is quite a change from the last several years (See chart: *Global Earnings*). Trump's policy agenda is becoming clearer than it was during the election. However, it is still too early to declare that we have all the details on his agenda for trade policies and foreign affairs.

We believe improving business sentiment will translate into improved growth, assuming the price of crude oil stabilizes in the $45 to $60 range. We expect GDP growth to be in the 2.5% to 3.5% range and S&P 500 earnings-per-share growth, which we estimate will be in the high single digits, to pick up over the remainder of the year and into 2018. In the fixed income market, we still believe there will be some modest upward pressure on longer-term bond yields as the year unfolds. Corrections in the equity market may occur at any time, but conditions for a more meaningful equity bear market do not seem

Global Earnings
EPS, U.S. Dollar, NTMA, Jan. 2009 = 100



Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management Guide to the Markets – U.S. data are as of March 31, 2017.
Past performance is no guarantee of future results.

to be in place. Our patience in not overreacting to last fall's Trump rally has been rewarded. We'll adjust our portfolios if Trump's actual initiatives become reality, rather than speculation or random proposals. From a stock selection perspective, we'll continue to focus on quality companies with protective moats that can do well in both good and bad economic times.

Douglas S. Foreman, CFA
Chief Investment Officer
Douglas S. Foreman, CFA is Chief Investment Officer, Portfolio Manager, and a member of the Executive Management Committee. He has approximately 31 years of investment experience.

The S&P 500® Index is a market capitalization weighted index which includes 500 of the largest companies in leading industries of the U.S. economy. The MSCI® EAFE Index is a free float-adjusted market capitalization index that measures developed foreign market equity performance, excluding the U.S. and Canada. The MSCI® Emerging Markets (EM) Index is a free-float adjusted market capitalization index tracking the equity performance of global emerging markets. The JP Morgan Emerging Markets Bond Index Global is a benchmark index for measuring the total return performance of international government bonds issued by emerging market countries that are considered sovereign (issued in something other than local currency) and that meet specific liquidity and structural requirements. The Bloomberg Barclays U.S. Aggregate Bond Index is a market value weighted index that tracks the daily price, coupon, pay downs and total return performance of fixed-rate, publicly placed, dollar-denominated and non-convertible investment grade debt issues with at least $250 million par amount outstanding with at least one year to final maturity. Performance is calculated on a total return basis with dividends reinvested. The Bank of America Merrill Lynch U.S. High Yield Index tracks the performance of U.S. dollar denominated below-investment-grade corporate debt publicly issued in the U.S. domestic market. The Bloomberg Barclays California Municipal Bond Index is a market capitalization-weighted index of California investment-grade municipal bonds with maturities of one year or more.