

From: Aequitas Investment Advisors

Subject: Making Progress Despite the Noise and Uncertainty

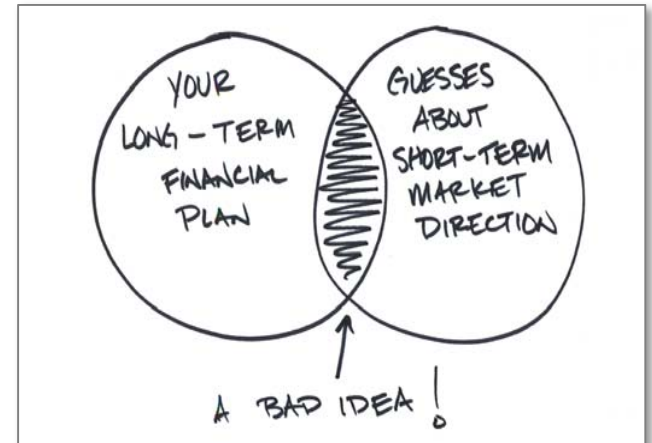
Dear Client,

Customarily, we open our quarterly letter with commentary on the investment markets and how future economic and geopolitical events might impact our portfolios and future financial wellbeing. While there is an ample supply of uncertainty on the horizon, history has taught us that the global economy has endured a wide range of scenarios, including recessions, world wars and political crises. Just over the last twelve months, for example, the global economy has managed to perform rather well despite a raft of uncertainties, including questions about the impact of Brexit, China's slowing growth, the dysfunctional political scene in Washington and, most recently, troubling developments on the Korean Peninsula. The media outlets are having a field day with all of this, of course, as they weave both fact and pure speculation into dramatic narratives which serve mainly to raise our anxiety levels and keep us tuned in for more "late breaking news."

In this quarter's letter, we'll begin with a review of the recent and quite positive investment results; provide a contribution from the newest addition to the Aequitas Team (Tim Nash, whom we're very happy to have aboard!); we'll next examine an interesting comparison of last year's investment winners and this year's winners (yes, diversification is alive and well); finally, we'll offer closing thoughts which might convince us all to be optimists (it's worth a try at least). We are also including two insightful sketches from Carl Richards, a Certified Financial Planner specializing in investor education and editor of the *Behavior Gap* website and blog. Carl's sketches appear in *The Wall Street Journal* and *New York Times* and are renowned for their simplicity in highlighting the "gap" which often exists between human behavior and disciplined financial planning. Carl's first sketch, *A Bad Idea!*, points out that prognostications, or guesses, about short-term movements in the stock market have very little to do with achieving our long-term financial goals. In fact, the result of overlapping short-term guesses with our long-term plans usually ends up being counterproductive and costly. A

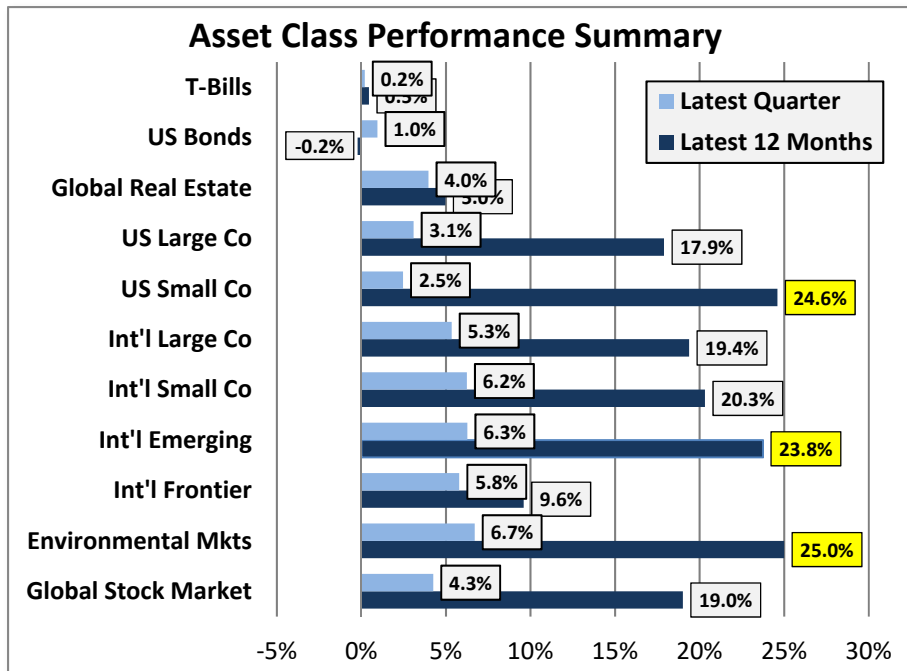
2016 study published by the Vanguard Group found that the average Vanguard investor underperformed the broad stock market by approximately 3% per year due mostly to "the allure of market timing and temptation to chase performance." In other words, attempts to time the stock market and select mutual funds based on past

performance can prove very costly! The good news coming out of the Vanguard study was that a financial advisor acting in the investor's best interest can help investors avoid the 3% annual performance loss by providing "relationship-oriented services such as cogent wealth management via financial planning, behavioral coaching, and guidance." The other good news is these are the very services we provide to our clients and strive to continually improve.



Asset Class Performance Review

The investment markets have performed remarkably well over the past twelve months ending June 30th despite the uncertainties. Stock market observers refer to this phenomenon as "climbing a wall of worry," or the notion that investors have confidence the uncertainties will be resolved at some point in the future. Driven by improving levels of economic activity in both the developed and emerging markets, as well as an improving employment picture around the globe, stock prices worldwide have risen by close to 20%. The biggest gains were seen in the Environmental Markets (+25%), US Small Co's (+24.6%) and Emerging Markets (+23.8%). Next in line were Int'l Small Co's (+20.3%), Int'l Large Co's (+19.4%), US Large Co's (+17.9%) and Int'l Frontier Markets (+9.6%). Global Real Estate lagged (+5.0%) and US Bonds posted a small loss (-0.2%); both being negatively impacted to some extent by the Fed's continuing path toward higher interest rates. Lastly, US T-Bills came in at 0.5% (low risk = low return).



For the quarter, the picture was quite similar with solid gains across the board. The laggards were unsurprising; US T-Bills eked out a small gain (+0.2%) and US Bonds recovered a bit (+1.0%). The Global Stock Market rose by 4.3%. Returns for the other asset classes ranged from 2.5% (US Small Co's) to 6.7% (Environmental Markets); a rather tight range which is unusual.

Travel Notes from Our Newest Member, Tim Nash

As part of my "onboarding process" with Aequitas, I had the privilege and opportunity to attend three days of training with Dimensional Fund Advisors (DFA) at two back-to-back conferences at their home office in Austin, Texas. As you may know, DFA was founded by David Booth back in 1981, a pioneer in the passive management movement, and many of their funds serve as the "investment engine" for the various asset classes we use in our client portfolios.

My key takeaway was that DFA is an amazing organization, rooted in powerful academic research, adding incremental value through a disciplined, logical, defensible process, which seeks to identify "dimensions" in the market which have historically provided higher returns. Having spent most of my career in the field of risk mitigation, i.e., taking steps to reduce adverse effects on portfolios, I like to break risks down into smaller, less-correlated pieces, while embracing

multiple ways to add value over the long term. Here are several ways that DFA adds value to client portfolios:

1. Capitalizing on inefficiencies created by the tremendous popularity of index-based investing which attempts to replicate an index that must be reconstituted on an annual or semi-annual basis. Dimensional does not mimic third party indices as index funds do, rather, they define asset classes through proprietary measures which allows them to buy and sell stocks on their own terms without price distortions.
2. Capitalizing on inefficiencies created by the multitude of underperforming active managers as they buy from, and sell to each other. DFA's disciplined buy and sell approach allows them to take advantage of less patient fund managers who buy and sell based upon market timing decisions. Less patient sellers of stocks often accept lower prices in order to implement their trades.
3. Exploiting other distortions in valuations due to the fear and greed emanating from articles published in the financial press. For example, during the Financial Crisis of 2008, DFA was the only major fund company which had positive cash flows *into* stock funds rather than outflows (the discipline of rebalancing at work!).
4. Tilting exposures toward small cap stocks, stocks with lower prices (i.e., value stocks) and stocks of companies with higher profitability.

The people I met were all impressive professionals. The lectures were outstanding. The speakers were engaging and the content was delivered in a very compelling manner. I have never been so engaged in three days of lectures - sitting in the front row, actively participating far more than I ever did in college, business school, or during my CFA and CAIA coursework. No frills. Just solid content, delivered in a very logical and compelling manner.

Finally, here are three interesting quotes I recall from the conference room:

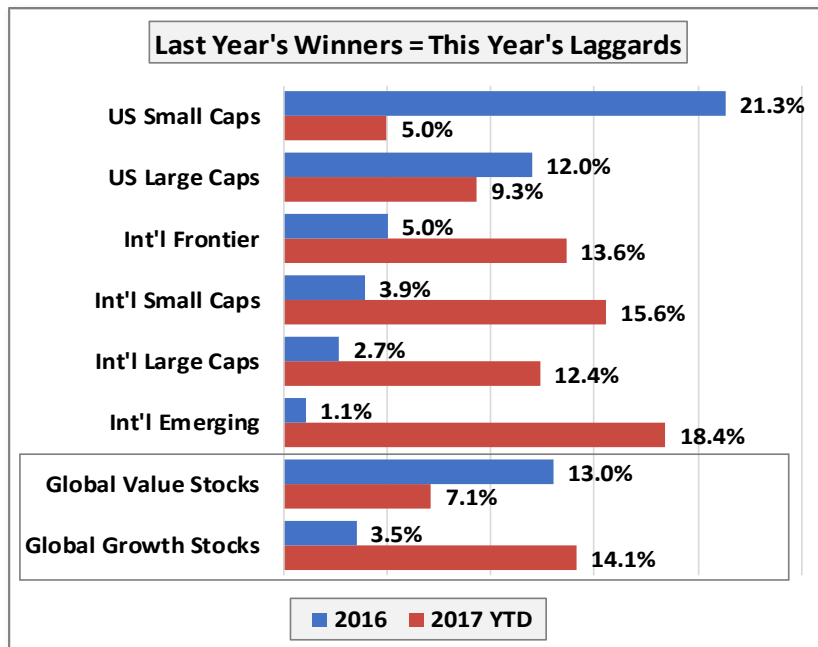
- Regarding DFA's Trading Process: "Our trading strategy is like being the house rather than being one of the gamblers." In other words, gamblers bet on future stock movements which is less than a 50-50 proposition when factoring-in transaction costs. DFA understands that remaining patient and owning favorably priced stocks over the long run will likely generate higher returns.
- Regarding Alternative Investments (such as hedge funds): "Wealthy investors have more flexibility to speculate, and many do, all too often at their own expense."

Chasing Performance

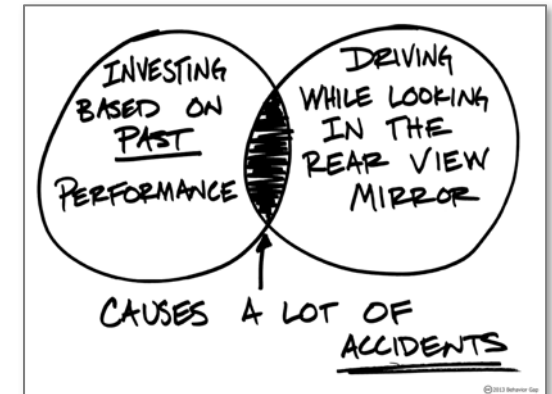
- Regarding the Financial Press: "We are at war every day against the financial media (i.e., The Jim Cramer effect) which feeds clients with paranoia, using unsubstantiated headlines to increase viewership and sell more ads. We need to stay focused on keeping our investment process disciplined with our clients so that decisions are based on the long-term view rather than on short-term emotional reactions."

On the flight home, I crystallized some of my new perspective using road navigation as a metaphor to explain three different approaches to investment management. To me, active management now looks like asking for directions from strangers as you go, indexing looks like a AAA TripTik Travel Planner and DFA looks like Waze.....and while talking to strangers may be the most interesting way to travel, and a AAA TripTik may be the cheapest and most predictable, I suspect that Waze is more likely to get you there sooner, safer and with more fuel in the tank for your next trip.

This is an exciting time for us all. The key is to maintain discipline throughout the excitement, stick with the financial plan, maintain one's heading, and make fine tuning adjustments based on changing goals and objectives rather than the latest tweet or headline. I look forward to working with all of you in the coming months and years ahead! - *Tim Nash, CFA, CAIA, Chief Portfolio Strategist*



There is probably no clearer example of the high cost of chasing performance and the benefits of being diversified than comparing asset class performance results of 2016 to those so far in 2017. In the chart at the bottom left, note how last year's winners ended up being this year's laggards. In 2016, the top performing asset class was US Small Cap stocks (+21.3%) which benefited from the belief that less regulation and lower corporate tax rates might benefit smaller companies more than larger companies. The loser last year was the Emerging Markets asset class with a paltry gain of 1.1%. The picture has completely reversed so far in 2017 with Emerging Markets leading the way (+18.4%) while US Small Cap stocks are now lagging (+5.0%). The results are similar for the other asset classes we've included in the chart. Looking at Value stocks versus Growth stocks worldwide leads to the same conclusion (with the caveat that Value out-performed Growth on a cumulative basis over the entire 18-month period). Finally, we've included another sketch from Carl Richards pointing out the peril of investing based on recent past performance.



Closing Thought

As mentioned in the opening paragraph, history has demonstrated the remarkable endurance of our global economy. Of course, the human spirit is the engine driving the economy. A great example of economic resilience and human spirit can be seen in one of the most distressed regions of the world, Iraq, as residents are beginning to return to the city of Mosul which was recently liberated from ISIS occupation. On the UN Refugee Agency's website, we found an article entitled, *Amid ruins of war in Mosul, residents start to rebuild*. The article states, "As the battle for Mosul raged around them last year, Rabah Mahmoud Ali and his family were ejected from their home by armed militants. After Iraqi forces took back control, they returned to find the roof and first floor of their house badly damaged by bombs, their possessions looted, and all the windows shattered. But determined to get their old life back, Ali borrowed some money and set a team of construction workers to repair the damage. 'I've got into debt because of all the building work,' he says. 'But I am optimistic about the future.'" Amen

