Quarterly NEWSLETTER

SPRING 2018

Commonwealth Bank & Trust Company

4350 Brownsboro Road, Suite 210 • Louisville, Kentucky 40207
502.259.2500 • www.CBandT.com

Accelerating Volatility, Earnings, GDP, Inflation, Interest Rates = Net Positive

Mark J. Kennedy, Executive VP
p: 502.259.2517
e: mark.kennedy@cbandt.com

Volatility returned to markets in 1Q18, snapping a 15-month streak of positive returns. While last year was one of the least volatile periods in market history, with only eight moves of 1%, up or down, 2018 has already seen over 20 such moves. Bond markets did not perform much better. On the back of accelerating jobs and wage (inflation) data, the 10-year Treasury reached its highest level in four years (2.94%) during 1Q18, resulting in losses across most U.S. bond indices for the quarter. The bad news is that neither the inflation question nor the ambiguity over trade tariffs are likely to be resolved very soon, leading us to expect similar volatility in the near term. The good news is that earnings have been revised upward significantly during the first quarter as companies increased earnings guidance after incorporating the full impact of the tax cuts. Additionally, current market valuations are reasonable based on 2018E earnings and moderately below average on 2019E earnings. Traditionally, much like early January, we would expect investors to exhibit more bullish characteristics this late in a bull market cycle, especially in light of improving economic conditions and above average earnings results. Lingering uncertainty over trade sanctions and concerns over Fed action and inflation are likely to perpetuate lukewarm investor sentiment. As uncertainty over these issues dissipates over time, the market will have room to move higher on the prospect of increased earnings and diminished trade war concerns later in the year. However, the overhang of Fed hawkishness and trade skirmishes will likely keep the high multiples and returns associated with late cycle exuberance in check this year.

The market rallied 7.5% in the first few trading weeks of 2018 and posted new highs, breaking through 2,800 on the S&P 500, 26,000 on the Dow Jones Industrial Average, and 7,000 on the NASDAQ in response to the expected impact on corporate earnings and the tax bill that passed in late December. Investor sentiment abruptly reversed course in late January and early February, erasing the earlier gains with the S&P 500 falling 10% over concerns the Fed might accelerate rate increases after a strong jobs report and a 2.9% increase in wages. By mid-March, the market was up 4.2% on the year until discussions about trade tariffs were announced, causing the market to fall once again. International and emerging market stocks outperformed U.S. stocks in 2017, but had mixed performance relative to the U.S. (-0.8% S&P 500, -1.5% EAFE; +1.4% EM) in the first quarter. International markets continued to benefit from a weak dollar (down -11.9% since 01/01/2017) as well as fundamental strength in developed and emerging market economies. After years of flat to down growth, EU growth matched or exceeded U.S. GDP growth in 2017 thanks to extensive quantitative easing and improvement in EU bank balance sheets. Fiscal policies, such as the tax cut and reduced regulations, should enable the U.S. to outgrow the EU in 2018, however, developed international markets currently remain more attractive from a valuation and currency perspective. For more details on CBandT's investment outlook, please visit our Investment Commentary page at: https://cbandt.com/wealth-trust/resources/.

Happy Derby 2018!

Chart 1

Q1 2018
Market Performance – Total Returns

	3/31/18 Level	Q1	1 year
Dow Jones	24103	-2.29%	18.96%
S&P 500	2641	-0.76%	13.97%
NASDAQ Composite	7063	2.59%	20.83%
Russell 2000	1529	-0.08%	11.79%
S&P Midcap	1879	-0.77%	10.95%
Russell 1000 Growth	1367	1.42%	21.25%
Russell 1000 Value	1180	-2.83%	6.95%
MSCI EAFE	2005	-1.53%	14.80%
	Yield	Q1	1 year
Barclays Municipal	2.68	-1.11%	2.66%
Barclays Aggregate	3.12	-1.46%	1.20%
Barclays High Yield	6.19	-0.90%	3.69%

Chart 2

Q1 2018
S&P 500 Sector Performance

	Q1	1 year
Healthcare	-1.22%	11.26%
Consumer Discretionary	3.08%	16.99%
Consumer Staples	-7.12%	-0.88%
Financials	-0.95%	17.99%
Telecommunication	-7.51%	-4.84%
Information Technology	3.52%	27.64%
Materials	-5.51%	10.53%
Energy	-5.87%	-0.15%
Industrials	-1.56%	13.91%
Utilities	-3.31%	1.87%

Proprietary Performance Results

	1st Quarter	1 Year	3 Year	5 Year	Since Inception
Aggressive Growth Fund[1,3]	5.60%	30.88%	14.86%	16.91%	9.66%[1,3]
Science/Technology Fund[4]	6.19%	28.98%	14.21%	17.46%	10.04%
Focused Equity Fund[2]	-1.33%	13.09%	9.53%	11.93%	14.20%
S&P 500	-0.76%	13.97%	10.76%	13.29%	14.70%[2], 9.96%[3], 8.38%[4]
Russell 2000	-0.08%	11.79%	8.39%	11.47%	14.43%[2], 9.17%[3], 7.40%[4]
MSCI EAFE	-1.53%	14.80%	5.55%	6.50%	8.90%[2], 5.19%[3], 4.10%[4]
Strategic Income Builder Fund[5]	-2.55%	7.62%	5.63%	6.80%	9.53%
60% Russell 3000 Value, 40% Barclays Aggregate Index	-2.23%	4.63%	5.30%	7.22%	9.34%

There is no assurance that any of these investment strategies will meet its investment objective. Performance results for each strategy are computed on the strategy's overall returns. Each strategy and index includes the reinvestment of dividends. Past performance does not guarantee future results. Current performance may be lower or higher than the performance results quoted. [1] Net of management fees; performance results of SMC Capital and/or its principals as advisor from inception to 2/28/06 and as sub-advisors to CBandT since 3/1/06. [2] Inception date 12/31/2008. [3] Inception date 7/1/1989. [4] Inception date 3/31/2006. [5] Inception date 12/31/2008.

Fixed Income

In March, meeting for the first time under Chairman Jerome Powell, the Fed raised its benchmark lending rate a quarter-point and forecast a steeper path of hikes in 2019 and 2020, citing an improving economic outlook. The median rate forecast for 2020 now sits at 3.375% implying additional hikes totaling 1.75%. Fed Funds Futures have moved up somewhat this year to be more closely aligned to FOMC projections. However, markets are skeptical, as are we, that the Fed will be able to increase rates to this degree given the prolonged economic cycle and recent market volatility.

Once again, the yield curve flattened this quarter. The 2-year Treasury increased 0.38% while the 30-year rose 0.23%. The widely quoted 10-year Treasury rate was up 0.33% to end the quarter at 2.74%. It had a closing peak of 2.95% in late February and was roughly 2.90% ahead of the Fed meeting. While our base case thesis for a "flatter" curve remains, the direction from here is more uncertain. Jobs were a bright spot early in the quarter, but disappointed in March with only 103k increase in U.S. nonfarm payrolls. Still, payrolls averaged 202k per month for the quarter compared to 182k during 2017. Wage inflation has been a growing concern. In the most recent report, hourly earnings increased 2.7% with the same 4.1% unemployment rate over the last six months. Currently, U.S. economic activity is solid as 4th quarter GDP grew at 2.6% with projections of 2.8% for the current quarter and year. GDP estimates in upcoming years look for slower growth of 2.4% and 2.1% respectively.

During the quarter, U.S. investment-grade bonds struggled, losing roughly -1.5%. Over 12-months, these benchmarks produced a modest 1.2% return, which is in line with our 1-3% forecast in coming years. Most of our fixed income selections produced benchmark-beating performance during both these periods. Volatility increased slightly with the Merrill Option Volatility Estimate (MOVE) index, which measures volatility in Treasury options, averaging 0.6% this quarter. Global bonds fared better with "hedged" global aggregate bonds, ex-US, returning 0.9% (vs. 3.6% unhedged) in the 1st quarter. Over 12-months these returns were 3.4% & 11.8% respectively, according to Bloomberg Barclays. For global bonds, we have mostly allocated to emerging markets. As a proxy, the iShares JPM USD Emerging Markets Bond ETF (EMB) returned -2.3% for the quarter and 3.7% over the last 12-months. The U.S. high yield market also fell, returning -0.9% during the quarter. For the 12 months, performance of 3.7% was reasonable in comparison to investment-grade returns, though the 2.5% differential is less than spread, which remains roughly 4%. Currently that translates into a yield of roughly 6.3% on so-called Junk bonds. Within an April 3rd report, Moody's forecasts that the US speculative-grade default rate will decline from 3.6% today to 2.0% a year from now.

Our base case for 2018 is that the yield curve will remain flat but be pushed up as short-term rates rise. We remain confident in our 1-3% return forecast for investment grade bonds over the next 3 to 5 years. Overall, yield is a strong predictor of future returns and the Bloomberg Barclays Aggregate index is currently yielding around 3.1%. That said, we continue to recommend a tactical underweight to core fixed income in favor of high quality dividend paying stocks and alternative strategies.

Focused Equity

For the first quarter and the twelve months ending March 31, the strategy returned -1.33% and 13.09%, respectively, versus a -0.76% and 13.97% increase for the S&P 500 Equity Index. Since inception, the strategy has narrowly trailed the S&P 500's annual return of 14.70% by -0.50% with an annualized gain of 14.20%. However, the fund has achieved these results taking on meaningfully less risk than the S&P 500 with a beta of 0.88 and capturing only 90% of the index's annualized standard deviation, thus producing annualized alpha (the amount of risk-adjusted performance greater than the benchmark) of 1.15 since inception (12/31/2008).

Boeing Co. (BA)
1/1/2018 – 3/31/2018

Leaders: Cyclical sectors, Industrials (+2.26%) and Consumer Discretionary (+1.61%), lead the strategy during the first quarter. High quality growth stocks remained in favor. Aerospace/Defense contractors Boeing (BA, +11.7%) and Lockheed Martin (LMT, +5.9%) were outperformers in the industrials sector, while Amazon (AMZN, +23.8%) led our Consumer Discretionary selections. Payment networks MasterCard (MA, +15.9%), Visa (V, +5.1%) and PayPal (PYPL, +2.7%) led the technology sector. For the last twelve months, many of the same holdings were top performers (BA, +89.8%; LMT, +29.4%; AMZN, +.55.3%; MA, +56.8%; V, +35.5%; PYPL, + 75.7%), however, leadership was broader. Home Depot (HD, 20.4%), JP Morgan (JPM, +27.9%), Microsoft (MSFT, 41.3%), Stryker (SYK, +23.5%) and Nextera (NEE, +30.4%) also strongly contributed to returns over 12 months.

Laggards: Energy (-10.05%), Materials (-8.72%) and Consumer Staples (-7.77%) were the largest detractors from performance during the first quarter. DowDupont (DWDP, -10.1%) fell during the quarter over trade tariff fears and news that the strategic split up of the company would take longer (2019). After rallying earlier in the quarter, Kroger (KR) ended the quarter down -12.4% over food and labor cost concerns, despite a promising relationship with Ali Baba (BABA). Interest rate sensitive names, Enbridge (ENB) and Ventas (VTR), were the worst performing stocks during the first quarter, down -18.87% and -16.45% respectively, as we saw the 10-year Treasury yield rally approximately 40bps during Q1. Facebook (FB, -9.45%) had the largest negative impact on the strategy's return during the first quarter amidst headlines surrounding the Cambridge Analytica scandal. Over the last twelve months, Celgene (CELG, -28.32%) was the worst performing company in the portfolio, falling on concerns of their primary drug, Revlimid, losing patent protection in 2024, while the company maintains revenue projections through 2030.

Strategic Income Builder

For the quarter, the Strategy (SIB) returned -2.55% somewhat behind its blended benchmark return of -2.23%, which is weighted: 60% Russell 3000 Value & 40% Barclay's US Aggregate. During the last 12 months, SIB was 3% ahead of its benchmark results (7.62% vs. 4.63%). Since inception (1/1/09), the SIB strategy has returned an annualized 9.53%, slightly ahead of the benchmark return of 9.34%. The yield generated from the strategy has consistently exceeded that of its benchmark. On a risk-adjusted basis, the Strategy has generated a positive alpha of 1.08% annualized with a beta of 0.89. The success of the portfolio is the result of an attractive mix of income producing securities, exposure to global markets and tactical allocation.

For the quarter, our equities returned -3.58%, lagging the Russell 3000 Value, which was down -2.82%. Information Technology (+4.9% return) and Healthcare (-1.6%) were the best performing sectors while Consumer Staples (-9.4%) and Industrials (-7.6%) were most costly in dollar terms. Dividend yield on the equity holdings is currently 3.1% or roughly 0.6% higher than the Russell 3000 Value and over 1% more than the S&P 500. Intel (INTC +13.6%) was our biggest mover within the tech sector during the quarter. Intel's pivot to become a data center and "Internet of Things" company has become more robust as sales reaccelerated in those groups during 4Q. Adjusted earnings of $1.08 per share was 37% above the previous year's $0.79. Similarly, Cisco (CSCO +12.8%) is making a transition to a balanced mix of hardware and software, with a goal of deriving 50% of sales from software over the next few years. Several high-growth products, such as network security, are helping to offset the weakness in legacy product sales. Procter & Gamble (PG -13.0%) was our most costly stock within consumer staples. Activist Nelson Peltz was recently awarded a seat on the board after winning a proxy fight last summer by a small margin. This should bring focus back to the basics, as P&G still falls short of peer-group growth despite its category overhaul a year ago.

Quarterly fixed income performance of -0.84% compared favorably vs. the Bloomberg Barclays Aggregate Bond return of -1.46%. Over 12 months, fixed income results were also good at 2.62% vs. 1.20%. Our tactical position within high yield contributed again, however, returned only -0.4% for the quarter. Our multi-sector fixed income selections continue to perform well. Fixed income allocation finished the quarter near 26%. International bonds outperformed the U.S. aggregate benchmark returning -0.94%. This international allocation is roughly 9.0% of our fixed allocation and is currently dedicated entirely to emerging market bonds. Projected yield on the fixed income portfolio is currently 3.7% which compares to 3.1% for the Bloomberg Barclays Aggregate at quarter end.

Alternative allocations returned -0.76% during the quarter which also compares favorably to the fixed benchmark. Portfolio allocation remained stable at just over 4%. In general, we believe we can reduce portfolio volatility and enhance returns over time utilizing alternatives. While income generation is possible, it is difficult to predict in these strategies. In December, income/gains payouts ranged from 3.4% to 3.9% and these were the only payments during last year.

Science & Technology Strategy

Netflix, Inc. (NFLX)
1/1/2018 – 3/31/2018

The Science & Technology strategy (SciTech) returned 6.19% for the first quarter, outperforming the NASDAQ 100 (3.15%), the broader NASDAQ Composite (2.59%) and the Lipper Science & Tech Fund Index (5.44%). For the last 12 months SciTech returned 28.98% vs. 22.32% for the NASDAQ 100, 20.83% for the NASDAQ Composite and 28.67% for the Lipper Science & Technology index. Over the long run the strategy is beating the Lipper SciTech index on a risk adjusted basis, has a Sharpe Ratio of 1.21, and runs a 0.87 beta to the index, indicating higher risk-adjusted returns.

Leaders: Netflix (NFLX), which is 4.48% of the fund, was one of the largest contributors of positive performance over the first quarter and last 12 months. The stock continues to outperform, up 54.1% for the quarter and 99.9% for the last 12 months. The performance has been driven by subscriber gains that have re-accelerated and exceeded expectations. Align Technology (ALGN) was one of the best performing stocks for the fund, up 13.1% or the quarter and 118.9% for the last 12 months. The strength in ALGN continues to come from overseas sales (up 35%) as routine dental work becomes a part of standard healthcare after studies demonstrated links between good dental health and overall health.

Laggards: As volatility in the market increased, some stocks posted losses for the quarter and last 12 months. Celgene (CELG) has continued to be an issue for the portfolio with news in late February that the FDA issued a "Refusal to File" letter regarding the New Drug Application for Ozanimod, which targets auto-immune diseases such as multiple sclerosis and ulcerative colitis. CELG sold off -14.5% for the quarter and was down -28.3% for the last 12 months. After re-modeling CELG, we believe that the stock is undervalued currently, and will continue to hold, while paying attention to what we believe are the two main drivers of CELG's growth: replacing Revlimid revenues and getting Ozanimod back on track. Facebook (FB) was the largest detractor from performance for the quarter falling, -9.4%, but remains up 12.5% for the last 12 months. FB was down after special counsel Robert Mueller requested files from Cambridge Analytica in relation to Russian interference in the US presidential election. Several reports subsequently came out detailing the scale of data harvesting possible through FB, which Cambridge Analytica was using. The FB CEO, Mark Zuckerberg, recently testified in front of Congress in April. We believe that FB and others selling ads generated from user data will face new regulations that may mirror new regulations to be implemented in the EU in May. This will likely cause some short-run uncertainty and costs, but we believe FB will continue to dominate the advertising space in the long run, along with Alphabet (GOOGL).

Small Cap Composite

The Small Cap Value Composite returned 0.22% for Q1 versus -2.64% for the Russell 2000 Value index. For the past 12 months, the Small Cap Value stands at 10.98% while the benchmark is at 5.13%.

One top contributing holding in the Portfolio during Q1 was Blackhawk Network Holdings Inc. (HAWK), a prepaid payment network offering gift cards and rewards. On January 16, 2018, HAWK announced it will be acquired by private equity firms Silver Lake and P2 Capital Partners for $45.25/share in cash, a +24% premium to the prior day close or 94% of our $48 assessed value. Another top contributor during the quarter was Cannae Holdings Inc. (CNNE, +11%), which owns various restaurant brands (O'Charley's, 99), a healthcare IT company (T-System), and a 33% stake in HR software and services firm Ceridian. In mid-January, Ceridian submitted a draft registration statement for an upcoming IPO. Later in the quarter, CNNE's Q4 2017 earnings report confirmed Ceridian's strong revenue growth and margin improvement trends remain intact. We trimmed the stock during the quarter as it approached our assessed value. Another positive contributor was Mitel Networks Corp. (MITL, +13%), a provider of unified communications and collaboration products and services. MITL has a long-term opportunity to convert its 70 million on-premise users into billions of dollars of recurring cloud revenue. Currently, MITL's win rate within the installed base is more than 80%.

Blackhawk Network Holdings, Inc. (HAWK)
1/1/2018 – 3/31/2018

One bottom contributing holding in the Portfolio during Q1 was Liberty Expedia Holdings Inc. (Cl A) (LEXEA), which owns a 15.7% super-voting equity interest in online travel agency Expedia (EXPE). EXPE's Q4 2017 results were below expectations and management lowered 2018 EBITDA growth guidance. Margins are being temporarily compressed because EXPE is accelerating its investments for cloud migration and property acquisition growth. Another bottom contributor was Armstrong Flooring Inc. (AFI, -20%), a producer of wood and laminate flooring products for residential and commercial buildings. AFI reported in-line Q4 2017 results with luxury vinyl tile (LVT) growth driving its resilient flooring segment while increased competition pressured the wood flooring segment. Another weak performer during the quarter was Motorcar Parts of America Inc. (MPAA, -14%), a remanufacturer of starters, alternators, and other auto parts. MPAA reported soft Q3 results and lowered annual guidance. Despite market share gains in all of its product lines, MPAA sales declined as its customers sought to reduce in-store inventories.

We continue to believe small cap stocks are well positioned relative to large cap. Additionally, while challenges may lie ahead in 2019, we continue to expect small cap stocks will deliver modestly positive returns in 2018.

Kentucky Municipals

Quarterly bond issuance by Kentucky municipalities increased to $1.5 billion from $991 million in the previous quarter. The decline of issuance due to tax reform seen at the national level was not the case in KY. Competitively awarded deals were only $431 million with negotiated deals of $1.07 billion. Deal size was very strong averaging $37.5 million with 40 new issues in total.

Bank-qualified (BQ) issuance was only $52 million or 3% for the quarter while non-BQ issuance was the majority, coming in at $1.4 billion or 96%. We historically have used non-BQ because yields were typically higher. As we suspected, BQ yields are converging with non-BQ given the effective 21% corporate tax rate or 20% deduction for S-Corp banks. There was taxable issuance of roughly $15 million or 1% of quarterly issuance. We view taxable municipals as alternatives to corporates depending on spread. Visible KY supply is light with $191 million on the calendar in coming months. Deals of note include an $833 million tax-free negotiated issuance by the Public Energy Authority of Kentucky (PEAK). Morgan Stanley was not only the underwriter but also serves as guarantor for payments due under the Prepaid Gas Purchase & Sale Agreement (GPA). Thus the A3 Moody's rating on this PEAK deal was mostly based on Morgan Stanley's credit quality. Proceeds will go towards prepayment of roughly a 30-year supply of natural gas for various participants. Many years ago, tax-free deals for natural gas prepayments were under scrutiny of the IRS. These have since been dismissed without imposing any penalties. Another deal of note included $222 million in mostly tax-exempt issuance by the University of Kentucky (rated Aa2/AA) for various facility renovations. Included in these were completion and updates to various Pavilions of Chandler Hospital as well as the Kentucky Children's Hospital new Neonatal Intensive Care Unit. Also slated for improvements are the University's Law, Chemistry-Physics, & Enoch Grehan Journalism buildings.

KY bonds continue to perform in line with the national market. The S&P Municipal Bond Kentucky Total Return Index returned -1.03% vs. -1.11% for the Bloomberg Barclays Municipal Index this quarter. For 12-months, these returns were 2.78% vs. 2.66% respectively.

ASSET ALLOCATION OUTLOOK

LAST QUARTER			THIS QUARTER	
WE BELIEVED →	**ACTIONS TAKEN →**	**RESULTS**	**WE BELIEVE →**	**ACTIONS WE ARE TAKING**
DOMESTIC EQUITIES			DOMESTIC EQUITIES	
We thought the market rally will continue into 2018 with the potential for another 5%-10% total return. We were concerned that the 7% January rally would result in a pullback. We expected small & mid cap to outperform on tax reform.	Trimmed U.S. large cap stocks, moved to underweight. Maintained overweight on small/mid cap stocks.	The market pulled back in February, recovered in March, but fell to a loss of -0.8% (14% LTM) for large cap S&P 500 at quarter end and remains below year end in April. Small and mid cap stocks posted small losses of -0.1%, but outperformed large cap.	Bearish negative market sentiment over Fed/Inflation and trade will moderate. We remain optimistic that small & mid cap will outperform on tax reform impact and higher domestic market exposure.	Continue to trim U.S. large cap stocks on rallies and maintaining underweight allocation. Maintaining overweight on small/mid cap stocks.
INTERNATIONAL EQUITIES			INTERNATIONAL EQUITIES	
We expected the dollar to remain range bound in the near term.	We are maintained our overweight allocation to emerging markets and developed international stocks.	The dollar fell another 2% during 1Q18 (-11% since 1/12017). Emerging markets (+1.4% 1Q18, 24.9% LTM) outperformed, but developed international stocks (-1.5%) lagged during the quarter, but continues to outperform last 12 months (+14.8%)	We expect the dollar to remain range bound in the near term. We believe rate increases from the Fed and higher relative U.S. GDP growth could pressure the dollar higher later this year (2H18?).	We are maintaining our overweight allocation to emerging markets and developed international stocks. We are watching the dollar and expect it to remain within 3%-5% of current levels. We may cut international/ EM exposure if the dollar rallies sharply.
FIXED INCOME			FIXED INCOME	
We expected a 0.25% Fed Funds rate increase in March and the Fed to remain constructive for at least the first half of the year.	We remained underweight core bonds. We remained overweight credit/high yield bonds. We maintained our allocation to emerging market bonds and did not add to weights due to historically tight spreads.	The Fed raised the Fed Funds rate 0.25% March. Core bonds returned -1.46% in 1Q18, while high yield bonds generated a -0.90% return. International and EM bonds returned 1.36% and 2.52%, respectively, on an unhedged basis; and -0.12% and -1.48%, respectively, with currency hedged.	We expect a 0.25% Fed Funds rate increase in either June and/or September. We are concerned GDP and wage growth could lead to a rise in inflation in 2H18, which could result in more hawkish Fed action.	We remain underweight core bonds. We remain overweight credit/high yield bonds, but are shifting to shorter duration credit. We are reallocating some core intermediate bonds to shorter duration IG floating rate and short-term bonds.
We believed munis were at fair value to slightly undervalued at the beginning of 2018.	We maintained an equal weight to munis and were concerned how tax policy would impact muni returns and funds flow.	Munis outperformed core bonds in the quarter (-1.11% vs. -1.46%) and for the last twelve months (2.66% vs. 1.20%).	We believe munis are at fair value to slightly undervalued at the beginning of 2018.	We are maintaining an equal weight to munis at this time.
ALTERNATIVE ASSETS			ALTERNATIVE ASSETS	
After a record low period, volatility would increase in 2018. We think the trade talks, rate increases and GDP/ inflation surprises would act as catalysts for higher volatility mostly later in the year.	We maintained ~8% allocation to alternatives. We continued to watch gold for a breakout.	Volatility returned to the market with >20 1% moves in 1Q18 vs. 8 in 2017. SG CTA alternatives index fell -2.87 as alts funds increased weightings to U.S. equities. CB&T's Liquid Alpha alternatives CTF fell only -0.06% in 4Q17, because it intentionally has little exposure to U.S. equities. Gold increased 6.93%.	We expect volatility to remain high in 2018. We think trade talks, rate increases and inflation surprises will continue to act as catalysts for higher volatility.	We are maintaining ~8% allocation to alternatives. We expect to increase to 10% after equity exposure is reduced in alts models. Within the alternatives strategies we are skewing to relative value strategies versus directional trendfollowing. We continue to watch gold for a breakout and are not adding to or reducing positions.

Kentucky Pension Reform and Legislative Update

Pension Reform

Frankfort, KY - Teacher Protests

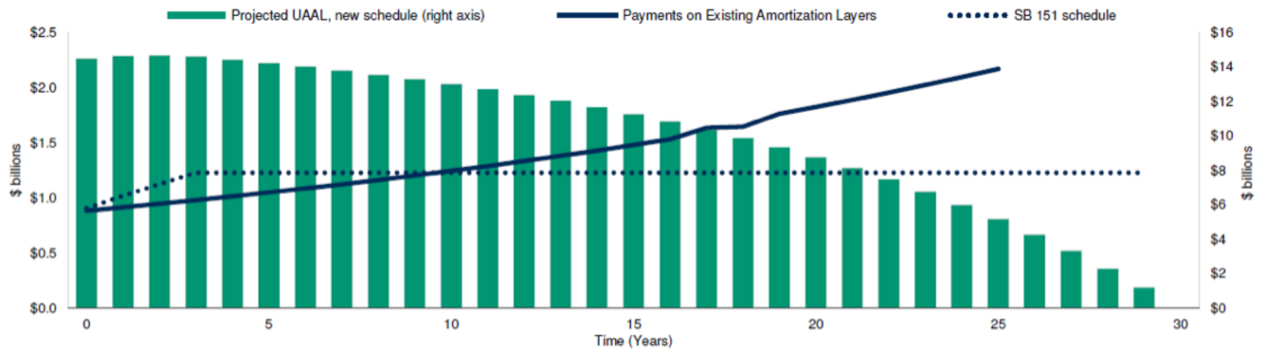
Kentucky teachers remain at the center of a growing trend of protests over pay and pension benefits. A recent West Virginia nine-day strike resulted in a 5% raise for teachers. Similar protests were occurring in Oklahoma and Arizona. On Thursday March 29th, a pension reform bill (SB 151) passed the Kentucky House (49-46 vote) and then Senate (22-15) despite protests from teachers. Governor Bevin indicated his support for state pension overhaul and tweeted that public employees owe “a deep debt of gratitude” to lawmakers who voted for the bill. The bill preserves most benefits for current employees. Current and retired teachers would still get an annual increase of 1.5% in their retirement checks, higher than an earlier 1% increase proposal. Also, the legislation would not change how long current teachers must work before being eligible for full retirement benefits. New hires, however, would go into a hybrid plan. New hires would be guaranteed to get back all of the money they and taxpayers contribute to their retirement accounts, plus 85% of any investment gains. The state would keep the other 15% of any gains.

The next day, hundreds of Kentucky teachers called in sick to protest the surprise pension reform bill, forcing nearly two dozen districts to close while educators rallied outside of the governor’s office. Then on Monday, all of Kentucky’s public schools were closed as thousands of teachers flooded the Capital in Frankfort. While a majority were out on spring break, 21 districts closed to allow for a day of protest or because teachers called in sick.

This bill (SB 151-pensions), signed April 10, requires level-dollar funding for state retirement plans that front-loads payments in an attempt to keep the state systems from insolvency (see chart below). The law also caps some sick-leave benefits, eliminates some death benefits, and makes it easier for the state to curtail benefits to new hires. However, the law doesn’t provide new revenue or other cuts that Bevin said were necessary to prevent the systems from failing. Rating agencies Moody’s and Standard & Poor’s are cautiously positive about Kentucky’s pension reform and believe it could be a “significant step” if successfully implemented. They caution, however, that the state’s reform plan might have “negative credit implications” if reform legislation is struck down in court.

SB 151 moves toward a more level repayment schedule for TRS' unfunded liabilities

Moody's comparison of current Kentucky TRS unfunded liability amortization vs. SB 151



“UAAL” stands for unfunded actuarial accrued liability. Our projections omit asset smoothing for simplicity. Does not reflect any accrued liability reductions that may materialize from SB 151's removal of sick leave from final salary formulas.

Source: Moody's Investors Service, based on Kentucky TRS actuarial valuation and SB 151

Kentucky Budget/Legislature

On Monday April 2nd, lawmakers approved a $480 million tax increase to help balance the state budget. In between the Senate and House passing HB 366, Bevin issued a statement questioning whether the budget and tax overhaul bills were “fiscally responsible.” Nevertheless, Republican House members urged their colleagues to pass the bill that day so the Legislature could preserve the ability to override a possible Bevin veto in the weeks to come. Democrats opposed the bill claiming they did not have time to read it.

The bill’s main trade-off lies between a state income tax reduction and sales tax base increase, according to analysis by the liberal Kentucky Center for Economic Policy. Corporate and individual income tax rates would be set at a flat 5% and an exclusion for pension income would be reduced. While the 6% sales tax will be broadened to include services such as auto repair, pet care, and health club memberships.

Continued on back page.

Kentucky Budget/Legislature *(continued)*

During floor debate, several Democrats decried HB 366 as a "shift" from wealthy to poor Kentuckians and criticized one of the bill's main revenue drivers, a 50-cent per-pack increase in the cigarette tax, as a diminishing source of funding. That increase could raise an estimated $128 million in 2019 and $110 million in 2020. "We have to think of the long-term impact, 10, 20 years," Sen. Robin Webb (D) said. "Maintaining the base, and not relying on non-sustaining income like the cigarette tax. Again, we stand here putting it on the backs of people who are addicted, people who are impoverished, as part of the plan."

Republicans said that the bill was necessary to fund the $22 billion budget and provide greater funding for schools than Bevin's original proposal. They also said several aspects of the bill would help stimulate Kentucky's economy by encouraging new business investment. "This will increase the competitiveness in this state when it comes to jobs," Sen. Damon Thayer (R) said. "This also will make us more like our surrounding states by lowering the rates and broadening the base." Several pointed to a new score from the conservative Tax Foundation, saying the bill would make Kentucky the 18th friendliest state for business, raising the Bluegrass State up from 33rd. Writing about the score, Senior Policy Analyst Jared Walczak said despite what he considered flaws, "the plan creates a more stable sales tax, with less effort devoted to picking winners and losers through the tax code."

As an indication of veto potential on the budget bill, Governor Bevin vetoed a measure allowing cities, counties, school boards and other government bodies to phase in soaring pension costs, saying that a provision that allows some smaller entities to "buy out" of the public pension system is fiscally irresponsible. Bevin's veto of HB 362 drew immediate expressions of alarm from officials and calls for legislators to either override the veto or fix the buyout provision.

As expected, Bevin vetoed both the tax increase and the two-year operating budget. He declared them irresponsible, saying the new taxes would not generate as much money as lawmakers thought and would leave a $50 million hole in the budget after two years. He criticized lawmakers for approving $600 million in new spending while ignoring some of their contractual obligations, including funding for a high-speed internet network in all 120 counties.