QUANTITATIVE ASSET MANAGEMENT, LLC
Investment & Advisory Services

January 1, 2018

Quarter Ending December 31, 2017

Year-to-Date Performance	Last Full Quarter	YTD	Index Close
Dow Jones Industrial Average	11.0%	28.1%	24,719.22
NASDAQ Composite Price	6.6%	29.6%	6,903.39
Standard & Poor's Averages	6.6%	21.8%	2,673.61

Dear Clients,

2017 was a very prosperous year for the U.S. stock markets. The bull market rally that started in 2009 continued to gain strength in 2017. The Dow Jones, NASDAQ and S&P 500 all rallied to new highs and experienced their best performance since 2013. Although we anticipated a strong 2017, we did not expect performance numbers this robust. Fund flows into exchange traded funds (ETF's) and low-cost index funds pushed the markets to these unexpected levels and this causes us some concern.

Entering into 2017 market fundamentals pointed towards the possibility of a strong year. Economic growth was positive, unemployment numbers continued to hit all-time lows and favorable Federal Reserve policies encouraged investment into the equity markets. In addition, the new 2017 tax law overhaul (lower income tax, lowered corporate tax rates and incentives for companies to return overseas cash) was viewed favorably by investors and provided more positive momentum to the markets.

As we stated above (and in previous letters), there are aspects of the market that continue to cause us concern. It is our belief that the ETF/index fund/no-brainer investment philosophy is pushing U.S. markets and certain company valuations to excess. This investment style is based upon a formula-not fundamental analysis. The ETF/index fund phenomena is hard to quantify but we wanted to provide some context to our thesis.

- A record $476.1 billion was added to U.S.-listed ETF's
- The Dow hit a record high 71 times last year. On average, a new high was hit more frequently than once a week.
- For the first time ever in its 90-year history, the S&P 500 rose every month in 2017.
- The S&P's largest pullback in 2017 was 2.8%, the smallest since 1995.
- The average daily volatility of the stock market (VIX) was lowest of any year since the VIX inception in 1986.

- At year end, the S&P 500 has gone 382 days without a 5% pullback, which is two weeks shy of an all-time record.

On their own, these statistics do not suggest the bull market is over. However, they do indicate that investor's dollars continue to flow heavily into an already top-heavy/overvalued market place. Each incremental dollar that is added to these investment tools automatically adds to the already oversaturated valuations of these companies. Whether it is chasing performance or fear of missing out (FOMO), it is our belief that investors are not paying attention to one very important metric, VALUATION.

This leads us to try and answer the question, what is next? We have always defined ourselves at QAM as value investors. Or in simple terms, trying to find sound investments at reasonable valuations. We feel too many of today's investors (whether they know it or not) are simply speculating on their investments and partaking in the "greater fool theory". The only way most of today's investors will make money is if they can sell their already "overvalued" stocks to someone else at an even higher more outrageous valuation sometime in the future. As an example, pointed out by investor Jeff Gundlach, today's European "junk" bond interest rates are virtually identical to rates for U.S. Treasury bonds. Investors in European "junk" bonds are willing to accept the same no-default return as they are for U.S. Treasury bonds. At QAM, that is an investment philosophy that does not work over the long term.

Most of the above commentary paints a very cautious outlook, which is merited. However, we feel there continues to be a silver lining. Even though certain parts of the investable markets are stretched and overvalued, we continue to believe there are lots of attractive valuations in the market. The markets are hyper-focused on a handful of companies and are paying little attention to names that are not Apple, Facebook, Amazon and Netflix. In addition to the strong economic numbers and tax reform, this bifurcation should provide the opportunity to continue to find good investment ideas.

Sincerely,

Jeffrey L. Farni Sr.
John C. Farni