

The logo for Titleist Asset Management, Ltd. is located in the top right corner. It consists of the word "Titleist" in a large, white, serif font, with "ASSET MANAGEMENT, LTD." in a smaller, white, sans-serif font directly below it. The logo is set against a blue rounded square background.

Titleist
ASSET MANAGEMENT, LTD.

The background of the entire page is a dark, monochromatic photograph of a city skyline. The buildings are silhouetted against a dark sky, and their reflections are visible in the water in the foreground. A bridge is also visible on the right side of the image.

Titleist Asset Management
2016 Q4 Market Commentary

The S&P 500 closed out 2016 with a return of 11.98%. The energy sector led the way with a return of 23.7% and was followed closely by the financial sector returning 20.1%. Healthcare was the biggest laggard and only negative performing sector in the index with a loss of -4.4% as drug pricing has become the subject of much debate on both sides of the isle.

The Barclays US Aggregate Bond Index returned 2.65%, barely exceeding inflation. Ten-year Treasuries closed out the year with a return of 2.45% while the Barclay's TIPS Index returned 4.68% as inflation expectations ramped in the wake of the Trump victory and meaningful fiscal stimulus. The Barclay's Municipal Bond Index fared the worst within the fixed income space due to the taxable equivalent yield being reduced in anticipation of a lower ordinary income rate.

Major market indices around the world did not fare as well in 2016. The MSCI Developed World Index returned 1.01% in 2016 and was led by resource-rich nations such as Canada and Norway. Israel suffered the largest drawdown within the index losing -16.98%. Most of the smaller EU nations closed out the year in the red while larger members such as Germany and France eked out low single digit gains.

After declining over 21% in the preceding three years, the MSCI Emerging Market indices were able to overcome strong currency headwinds to generate 11.91%. Brazil and Russia led the way with 66.10% and 56.95% returns, respectively. China has the largest weighting within EM and closed out the year with a small loss.

Within the commodities space, Zinc led the way with a return of 56.94%. Other more relevant commodities such as Brent Crude and Copper returned 24.96% and 15.36%. Soft commodities like Corn and Wheat suffered the largest drawdowns posting returns of -10.05% and -24.3%.

To simply describe 2016 as unprecedented feels like a monumental understatement considering the degree of change both politically and economically. The year started off with the worst January decline for the S&P 500 in stock market history. And as is almost always the case, narrative follows price and predictably a large percentage of economists, market strategists, and members of the financial media were forecasting and positioning portfolios for a recession.

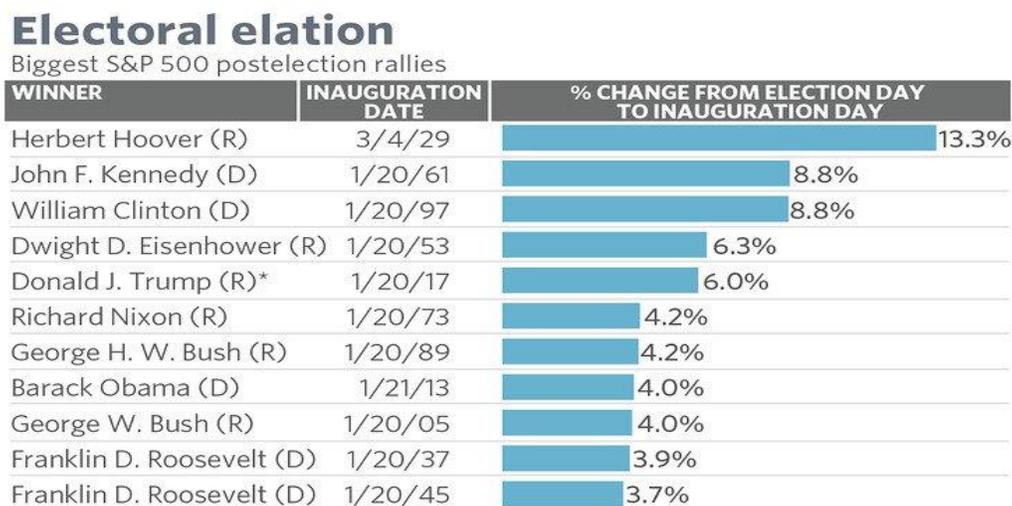
Most major market indices sold off between 12-20% from the peak in Q4 2015 to the trough in mid-Feb 2016; this proved to be an incredible buying opportunity, especially in the U.S. small cap space. In our first half letter we outlined the fact that the U.S. corporate sector been going through an earnings recession for the previous five quarters – primarily due to severe losses in the energy sector. Our base case at that time and continues to be for economic growth and earnings to re-accelerate in the back half of the year and throughout 2017.

It is worth noting that just because a particular market or asset class sells off it does not necessarily make it cheaper. Those who added aggressively to risk assets after the first 15% decline during the Financial Crisis had another 40% in declines to endure before the market reached the lows. David Einhorn famously said, “A stock that is down 90% was once a stock down 80% before getting clipped in half.”

It was not long after the dust settled on the market correction in Q1 that the financial markets were blindsided with a surprise outcome to the Brexit vote. Most odds makers in the prediction markets - where real money is wagered - had the odds of Brexit between 5-10% the week of the vote. Most major market indices around the world sold off 5-10% the week following the vote but were able to recover within months. It is still difficult to assess the economic ramifications of the vote on Great Britain and the global economy. The British Pound has fallen substantially since the vote and selling pressure seems

to be accelerating with Prime Minister May's seemingly ambitious desire to exit the union as soon as possible.

And lastly, the Trump victory was by far and away the biggest surprise to capital markets around the world. Dow futures ticked down almost 800 points in overnight trading on election night before recovering by market open the following morning and another 5% through year-end. The chart below illustrates the % change from Election Day to inauguration going back to 1929.

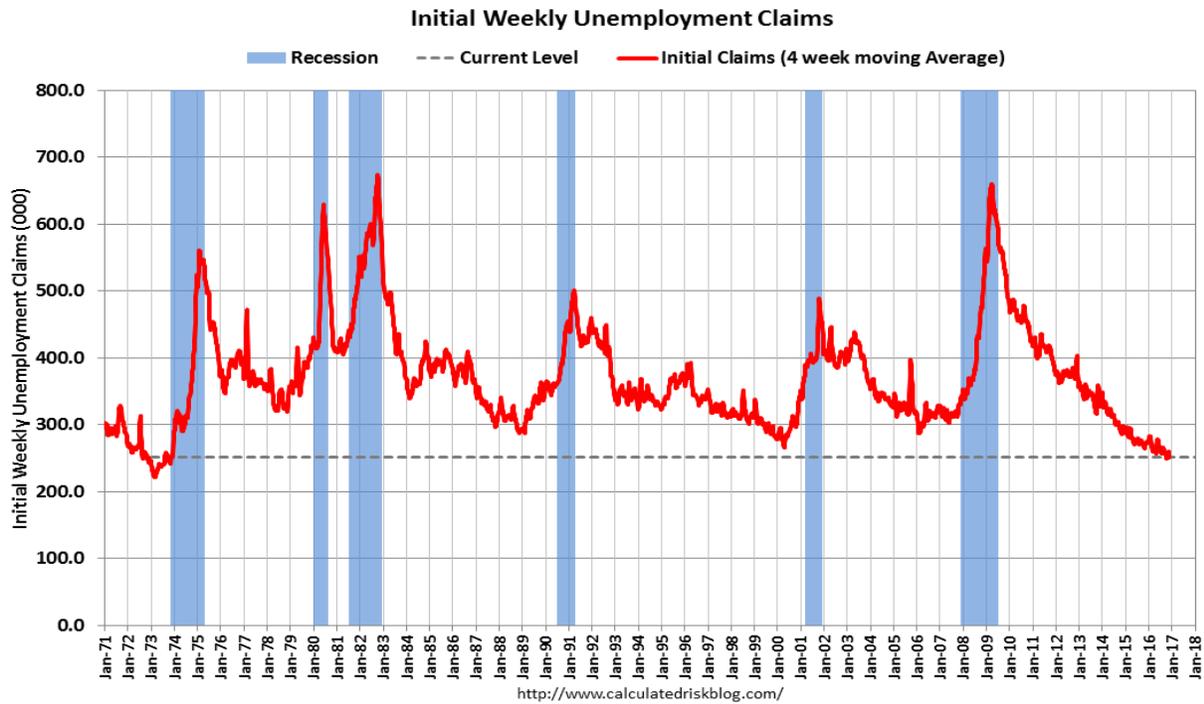


*Through 2 p.m. 1/18/17

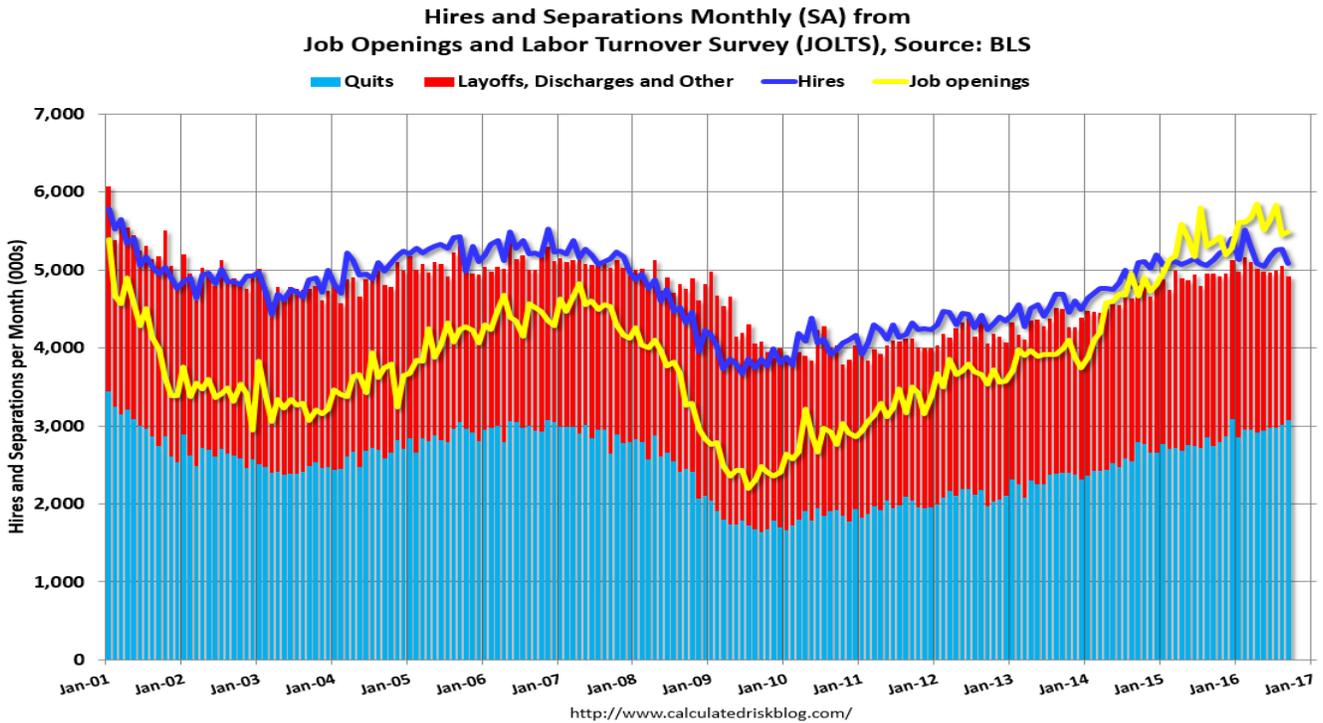
Source: Dow Jones data

To date, markets have been willing to overlook the higher probability of protectionist measures adversely impacting the economy and have reacted positively to what will undoubtedly be a more pro-growth agenda with less regulation, lower taxes, repatriation of overseas profits, and a huge ramp in infrastructure spending.

Looking ahead, the economy appears to be on stable footing. Claims for unemployment insurance benefits are trading at the lowest level in over four decades.

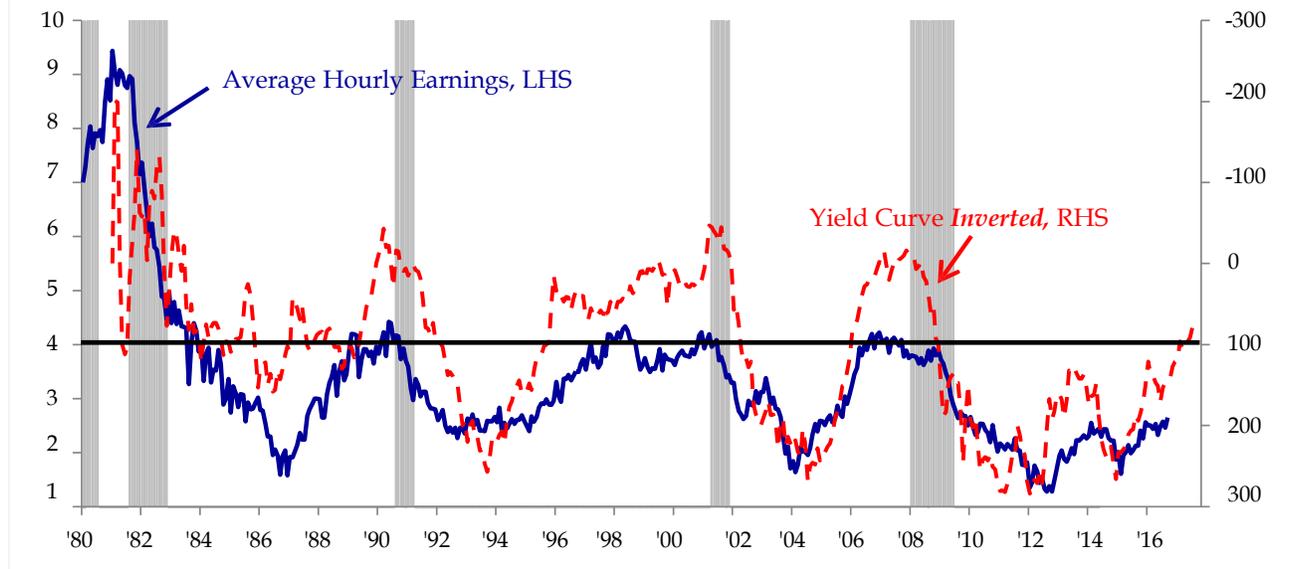


The Job Openings and Labor Turnover Survey (JOLTS) conducted by the BLS have been above 5 million for 20 consecutive months.



Average hourly earnings have increased the most since 2009 with an increase of 2.88% year over year. This is encouraging news however it is worth noting that we are coming from extremely depressed levels following the Great Recession. This number needs to continue to increase in order to have a healthy expansion. Below is a chart illustrating average hourly earnings going back to 1980.

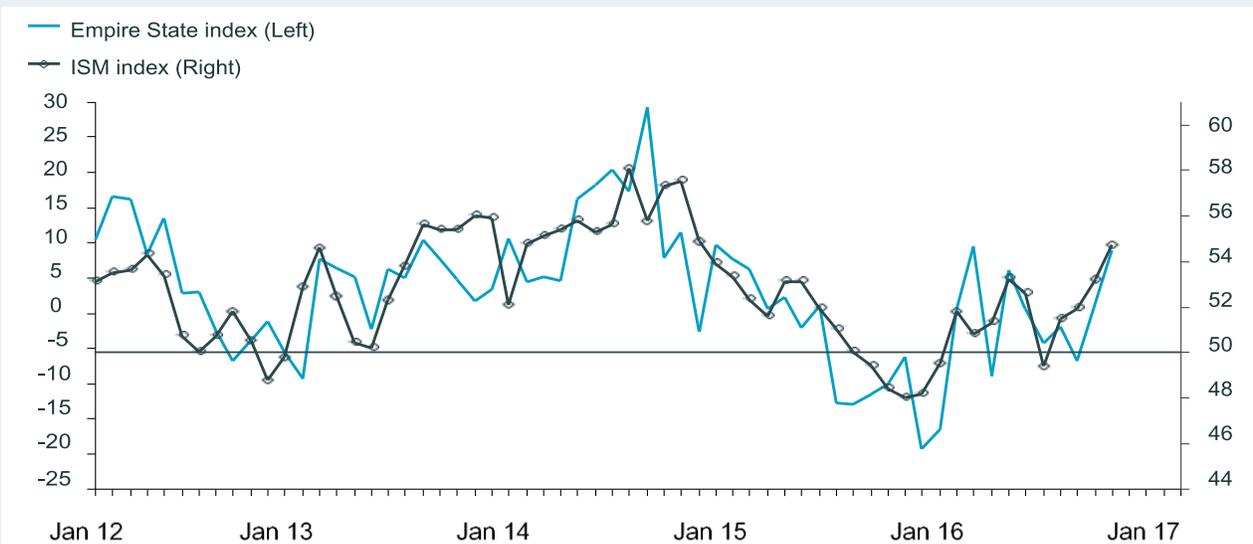
**Average Hourly Earnings:
Production and Nonsupervisory Workers (Y/Y, SA, \$/Hour)
vs. 10/2 Spread (bps, 12 Mo Lead)**



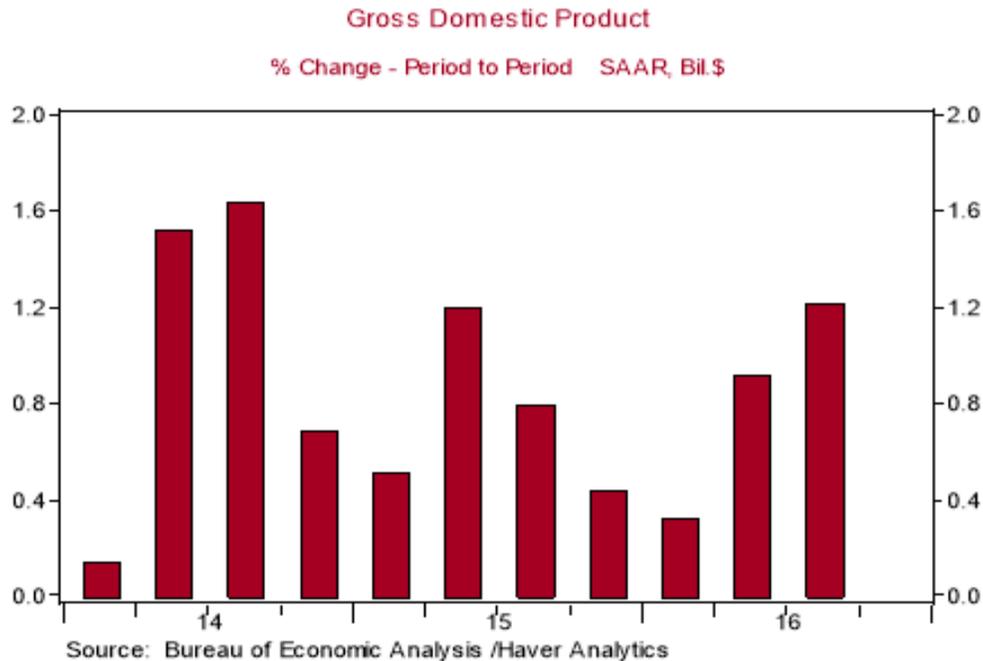
Source: U.S. Bureau of Labor Statistics

Other economic indicators such as unemployment, auto sales at record highs, ISM manufacturing sending stronger signals, housing starts accelerating, and GDP growth are beginning to trend back up.

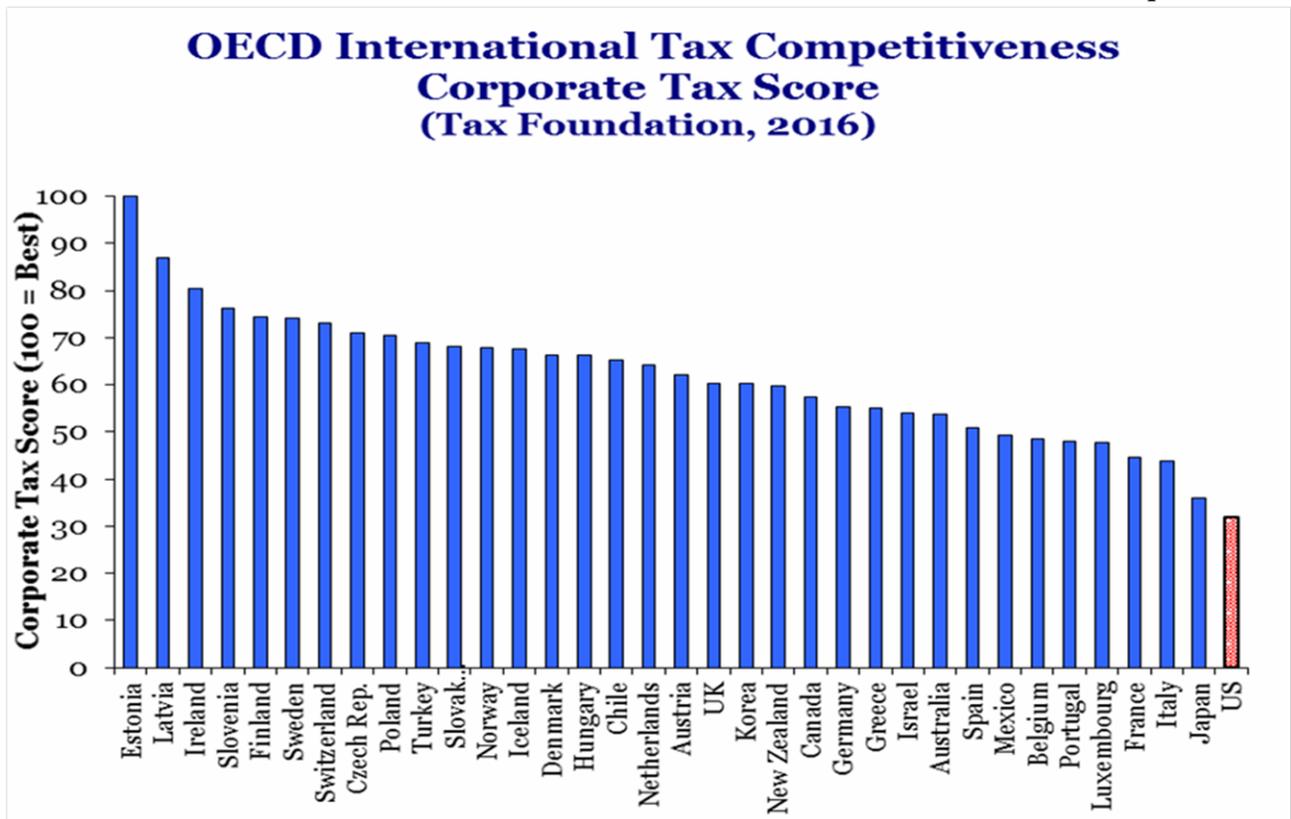
MANUFACTURING SURVEYS ARE RECOVERING



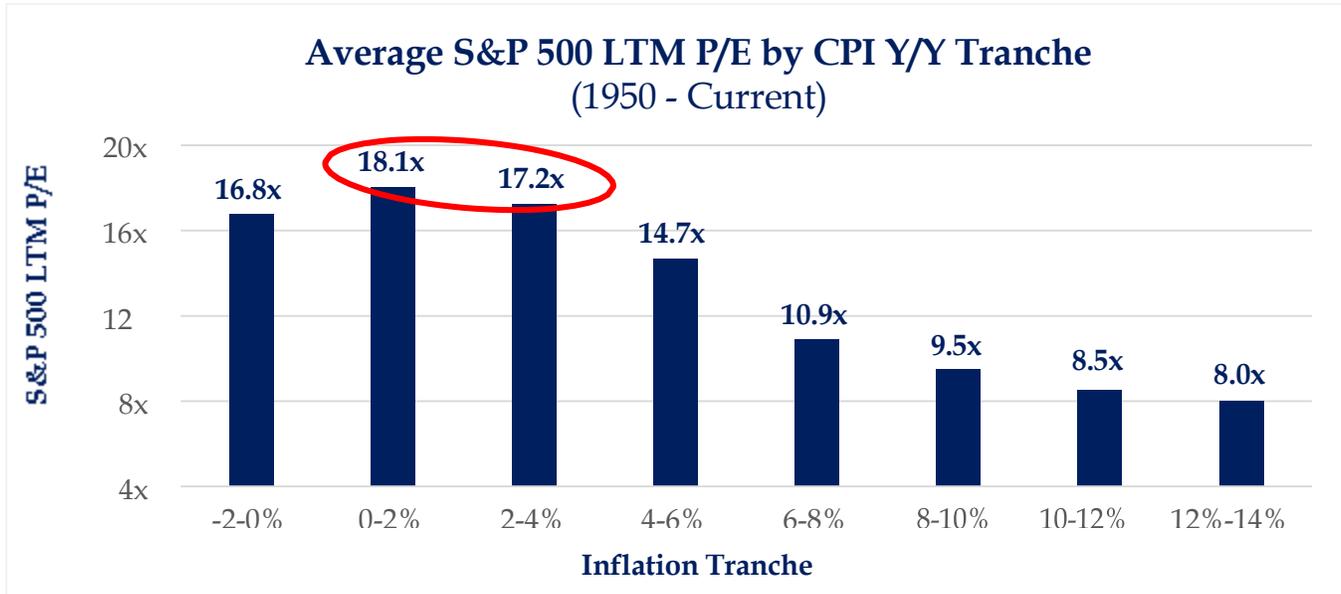
Source: nyfed.org & the Institute for Supply Management



With economic conditions on both stable and improving footing we think there will be a favorable investment environment given valuations are currently at reasonable levels, interest rates remain historically low, and there is a wave of pro-growth policies such as tax cuts, less regulation, repatriation of cash held overseas, and infrastructure spending in the legislative pipeline. The chart below illustrates how unfavorable business conditions have been in the U.S. relative to the rest of the developed world –



The market is trading at 17x 2018 consensus earnings and is right in line with historical valuations given the growth rate and interest rates. We do not see a lot of risk in earnings multiples in the short term. The chart below illustrates that multiples do not meaningfully compress until inflation hits 4%, a highly unlikely outcome for at least another few years.



Our portfolios are positioned for economic conditions to continue improving and as a result, are weighted more heavily towards sectors that would benefit in a reflationary environment. We will continue to make adjustments to the portfolio as market conditions change. Thank you for giving us the opportunity to manage your account.

- Byron Fields
Chief Investment Officer