Pilot Capital Management Inc.

Quarterly Investment Commentary

Date: April 10th, 2017
From: Greg Staub, CFA, Ph.D.; Matthew Staub, CFA
To: Pilot Capital Clients & Friends

Dear Clients and Friends,

Your reports for the first quarter of 2017 are enclosed. This letter gives a review of the quarter and briefly summarizes our current investment views.

First Quarter 2017 Market Review

Market/Index	2016 Close	As of Mar. 31st	Month Change	*Quarter Change*	Year-to-Date Change
DJIA	19,762.60	20,663.22	-0.72%	*4.56%*	4.56%
S&P 500	2,238.83	2,362.72	-0.04%	*5.53%*	5.53%
Russell 2000	1,357.13	1,385.92	-0.05%	*2.12%*	2.12%
Global Dow	2528.21	2691.45	1.36%	*6.46%*	6.46%
Fed Funds	0.50% - 0.75%	0.75% - 1.00%	25 bps	*25 bps*	25 bps
10-Yr Treasury	2.44%	2.38%	-1 bps	*-6 bps*	-6 bps

Riding the momentum following the presidential election, stocks surged for much of the first quarter of 2017. Buoyed by the anticipation of tax cuts and policies favorable to domestic businesses, the benchmark indexes listed here reached historic highs throughout the quarter. At the end of January, the Dow reached the magic 20,000 mark for the first time, while the tech-heavy Nasdaq gained almost 4.50% for the month. The trend continued in February, as stocks posted solid monthly gains. The Dow closed the month with a run of 12 consecutive daily closings that reached all-time highs. The S&P 500 also achieved a milestone — 50 consecutive trading sessions without a daily swing of more than 1.0%. At the close of trading in February, each of the benchmark indexes listed here posted year-to-date gains, led by the Nasdaq, which was up over 8.0%. March began with a bang but ended with a whimper. The Dow closed the first week of the month at over 21,000, while the Nasdaq gained over 9.0% year-to-date. However, energy stocks slipped as the price of oil began to fall. Entering mid-March, investors exercised caution pending the potential Fed interest rate hike and the push for a new health-care law. Following its mid-March meeting, the Fed raised interest rates 25 basis points, while the move to replace the ACA with a new health-care law failed for lack of congressional support. For the quarter, each of the indexes listed here posted impressive gains over their fourth-quarter closing values. The Nasdaq climbed the most, posting quarterly gains of close to 10.0%, followed by the Global Dow and the S&P 500, which achieved its largest quarterly gain in almost two years. Long-term bond prices increased in the first quarter with the yield on 10-year Treasuries falling 6 basis points. Gold prices also climbed during the first three months of the year, closing the quarter at $1,251.60 — about 8.5% higher than its price at the end of the fourth quarter.

Investment Commentary

Headlines over the past quarter were dominated by a few key themes: President Donald Trump's first days in office, the Federal Reserve's continued interest rate path, and increasing geopolitical concerns.

Early Days of the Trump Administration

The beginning of the Trump Administration has been a dominant theme since his election in November. As his administration began to take shape investors continued to bet that tax code changes, deregulation, and infrastructure spending would be a boon for the economy and markets. The first quarter of 2017 has clearly demonstrated one thing – that policy shift will not occur in a quick and decisive manner. This is not uncommon, and major legislation is rarely passed in the first days or months of a new administration.

Among a few bumps in the road for a young Trump Administration was the failure to pass sweeping legislation to repeal the ACA. While this garnered a great deal of headline coverage, it should not have been a major shock, as Republicans themselves could not agree on the exact details of a replacement plan. A flat-out repeal of the ACA was a slim possibility from the start, and it was always more likely that smaller bills chipping away at less popular parts of the act would be the real outcome. This is still very much a possibility.

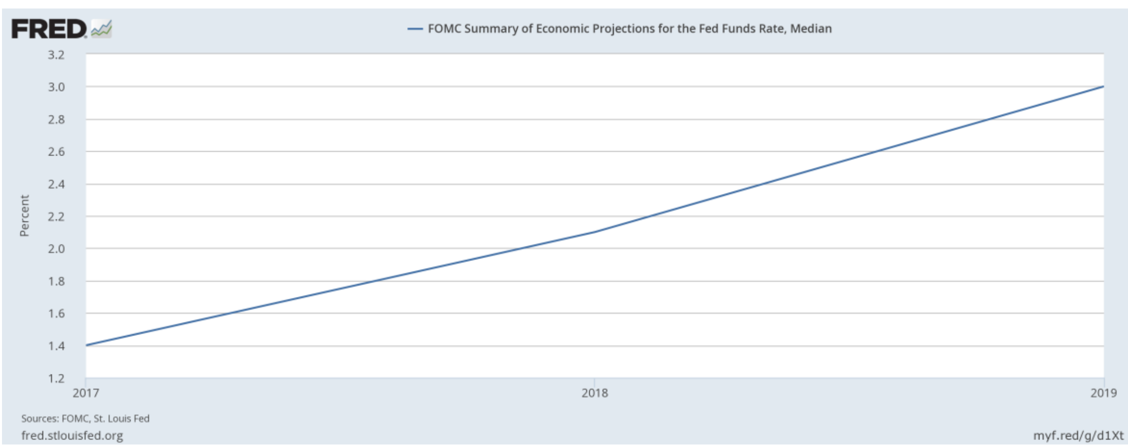
Nonetheless, this setback has been spun by many into a reflection of the Trump Administration's ability to enact major legislation. This is a bit of a stretch as, alluded to earlier, it often takes much more political bargaining and longer than two months to enact major legislation. The predictability of this outcome is evidenced by the limited market reaction. It did not knock the Trump rally completely off the rails, rather, it appears to have had the effect of spurring the market to re-evaluate winners and losers in a trump administration. For instance, failure of the ACA repeal would be a positive for transaction-oriented healthcare companies, as the higher healthcare utilization associated with the ACA would be positive for these companies.

While the reality of the first few months of Trump's Presidency has been a mixed bag of headlines, it is still far too early to justifiably label the administration a failure, success, or anything in between.

The Federal Reserve

In short, the Federal Reserve shocked no one with its March rate increase. The Fed increased its Fed Funds Rate target to 0.75%-1.00% in one of the more broadly anticipated decisions in recent memory. Due to this widespread anticipation, market reaction was limited. Equity markets shrugged off the rate increase as the health of the economy appears sufficient to support a normalization of rates. On the bond side, the Barclays Aggregate Bond Index responded in a predictably negative fashion given its high interest rate risk exposure. Many of the bond funds in Pilot Capital's portfolios (including multi-sector bonds, high-yield bonds, and absolute-return-oriented strategies) held up well in this environment, and we expect them to continue doing so.

Markets seem to be agreeing with the Federal Reserve's plan for two more rate increases this year. We see no reason to doubt the Fed's plan or market expectations, and expect no major market reaction from a moderate pace of interest rate normalization off historic lows. Further, we see no reason to make any major changes to our bond positioning.



Geopolitical Concerns

Geopolitical conflict stole the spotlight toward the end of the third quarter. While concerns such as these are always on the radar, it is important to remember that geopolitical events come in two varieties: 1) those that affect markets, and 2) those that do not.

On March 29th, the United Kingdom officially triggered its exit from the European Union, kicking off a multi-year negotiation on many factors impacting trade. This is an example of a geopolitical event that could affect international markets, but one in which the likely outcome is still an amicable trade relationship, albeit politically strained from time to time. Though many experts put the timetable for negotiation at around two years, no one really knows how long this process is going to take, and there is still a chance that Brexit doesn't happen (though betting on this would be risky in and of itself).

Developments in Syria and the resulting strain on Russian/U.S. relations, while concerning, is a geopolitical event with limited direct market implications. According to the US Census Bureau's foreign trade statistics, 2016 trade between The U.S. and Russia totaled only $20.3bn, with only $5.8bn in exports to Russia. With exports to Russia at less than 0.01% of GDP in recent years, direct trade effects would be of little consequence. While an escalation of recent events to the level of direct conflict could have broader reaching implications for trade, in particular through contagion and spillover effects in the EU (where trade represents a larger portion of EU GDP), even this would not be economically devastating. The Syria/Russia situation is one that will require monitoring, but one for which there are no urgent market implications.

Thank you for your continued trust and confidence in Pilot Capital Management. As always, should there be any questions, please don't hesitate to contact us.

Sincerely,

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