PRESTIGE
WEALTH MANAGEMENT GROUP
Your Personalized CFO

Recap of Q4 2016 and Q1 2017 Markets and Economy

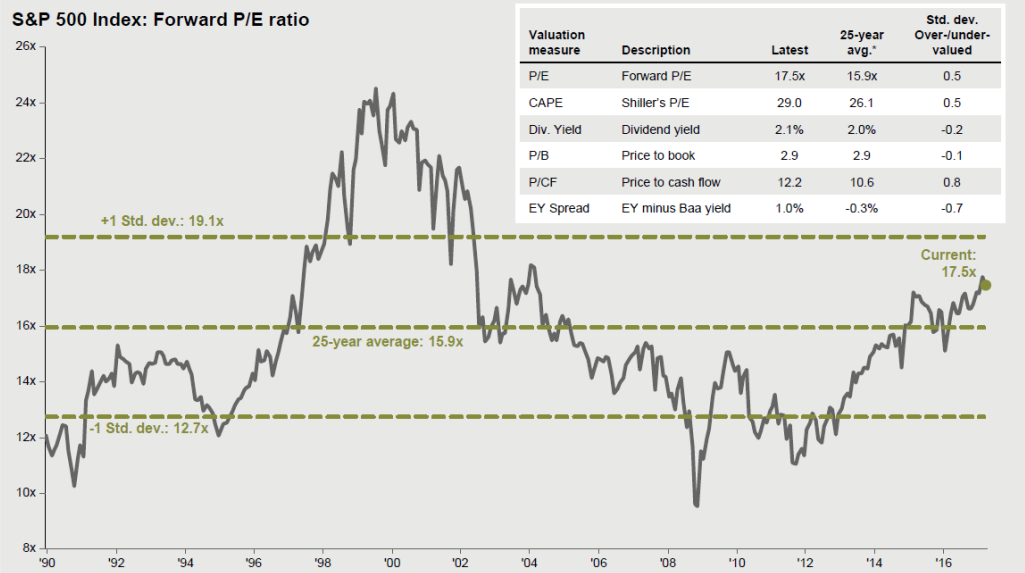
The first quarter of 2017 moderated market action in the fourth quarter of 2016 and saw some major changes in leadership:

4th Quarter 2016	1st Quarter 2017
U.S. equities led by finance stocks	U.S. equities led by technology stocks
Value beat growth	Growth beat value
Small stocks beat large stocks	Large stocks beat small stocks
International stocks down	International stocks up and beat U.S. stocks
U.S. dollar up	U.S. dollar down
U.S. interest rates up	U.S. interest rates down

These quick reversals illustrate the difficulty of trying to time the markets and the wisdom of maintaining a diversified portfolio.

Outlook for Q2 2017 and Beyond

Both of the last two quarters saw U.S. stocks advance, which has led some to conclude that stocks may be overvalued. As shown in the graph at right, the price/forward earnings level of 17.5x for the S&P 500 is only slightly above its average level since 1990. Similarly, Yale Professor Robert Shiller's cyclically adjusted P/E, which uses the average earnings of the past 10 years rather than the consensus forecast of earnings for the next 12 months (forward P/E), is only slightly above average. Also, compared to bond yields, earnings yields on stocks are more attractive than the historical average.



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-valued
P/E	Forward P/E	17.5x	15.9x	0.5
CAPE	Shiller's P/E	29.0	26.1	0.5
Div. Yield	Dividend yield	2.1%	2.0%	-0.2
P/B	Price to book	2.9	2.9	-0.1
P/CF	Price to cash flow	12.2	10.6	0.8
EY Spread	EY minus Baa yield	1.0%	-0.3%	-0.7

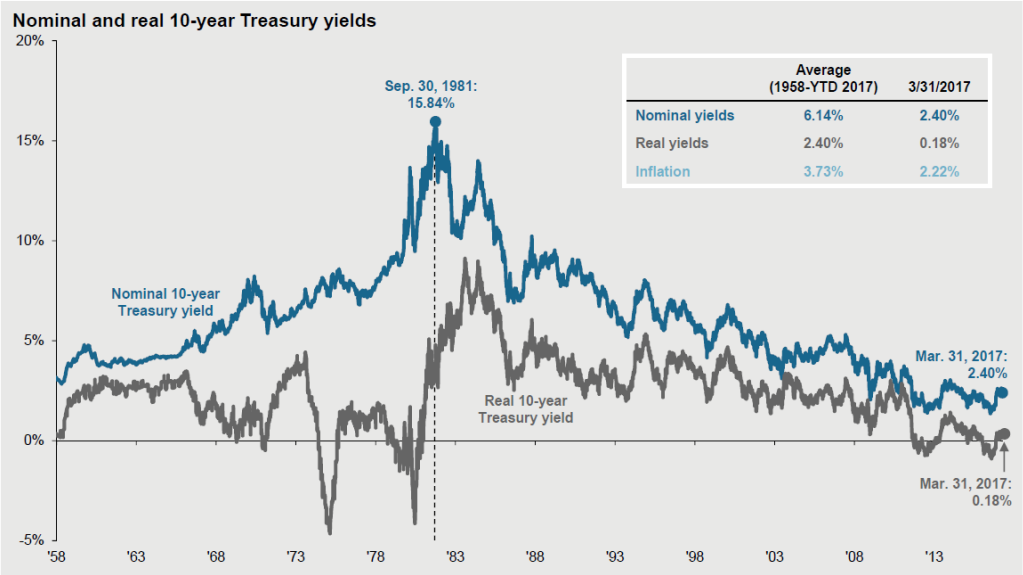
Source: FactSet, FRB, IBES, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management.
Price to earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since December 1989, and FactSet for March 31, 2017. Average P/E and standard deviations are calculated using 25 years of FactSet history. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-month consensus dividend divided by most recent price. Price to book ratio is the price divided by book value per share. Price to cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. over-/under-valued is calculated using the average and standard deviation over 25 years for each measure.
*P/CF is a 20-year average due to cash flow data availability.
Guide to the Markets – U.S. Data are as of March 31, 2017.

J.P.Morgan
Asset Management

Many observers believe that U.S. stocks have rallied based upon anticipation of changes in government policy—lower taxes, less regulation, and higher spending on infrastructure in particular. If the pace or

magnitude of policy changes is less than hoped for, the market may correct. On the other hand, if these changes do happen, the market may rally. Recent geopolitical events have reminded us that we live in an unstable world. For example, North Korea has continued to be a source of concern. If tensions flare, stock prices may decline. Finally, the rise of populist politicians in many places around the world highlights a risk of increased barriers to trade and decreased cross-border cooperation of any kind. This could hamper economic growth around the world. Stock investors should expect some volatility. Over the long run, however, stocks have rewarded investors with very attractive returns well in excess of inflation.

Given the uncertainty of stock returns, investors have traditionally turned to bonds to provide steady income and stability of value. However, the income (yield) on bonds has been declining for many years. The benchmark 10-Year Treasury bond now has a yield that is unlikely to provide any real return after inflation. Investors must balance the desire for principle protection (short-term risk) against the desire for inflation protection (long-term risk).



Source: BLS, Federal Reserve, J.P. Morgan Asset Management.
Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month except for March 2017, where real yields are calculated by subtracting out February 2017 year-over-year core inflation.
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With the Fed expected to raise short-term interest rates another 2-3 times this year, and perhaps start to slow or even cease its purchases of Treasury and mortgage bonds after that, the widespread expectation is that yields may creep up in the months ahead. At Prestige, our bond portfolios currently have a significantly lower level of interest rate risk (duration) than the overall U.S. bond market, which will help provide some downside protection if interest rates do in fact increase. We do not just blindly follow the U.S. bond market index weights. We believe that managing the duration risk in our clients' bond portfolios is one of the ways that we add value for them.

We also seek to add value by managing the domestic vs international weighting in our clients' stock portfolios. We take a "middle way." On the one hand, we do not completely avoid international stocks, which admittedly have added risks compared to U.S. stocks, such as country and currency risk. On the other hand, we do not blindly follow the country weights of the overall global equity market, which would require us to have roughly half of the portfolio in non-U.S. stocks. Our typical allocation is 75% U.S. and 25% non-U.S. This provides some diversification and participation in global growth while also controlling risk, and recognizes the fact that we in the U.S. are part of a global economy.

It is impossible to forecast what will happen to the dollar, interest rates, foreign vs. domestic stocks, or large vs. small stocks, so we keep our clients well diversified by spreading assets across all of these dimensions. Doing so helps to lower risk over the long run. Part of our job is to provide as steady a course as possible through the inevitable rough patches for our clients. We seek to take the emotions out of investing.

We continually monitor your portfolio. While we cannot control financial markets or interest rates, we keep a watchful eye on them and make strategic adjustments to the portfolio as needed.

Our focus is on helping you meet your personal goals based upon your financial plan. We can discuss your specific situation at your next review meeting or you can call to schedule an appointment. As always, we appreciate the opportunity to assist you in addressing your financial matters.

Roy Williams, ChFC Kevin Means, CFA John DeAngelo, CFP® Alyssa McMahon, MBA, CFP®, CFA

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Sources for graphs: *JP Morgan Market Insights.*

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