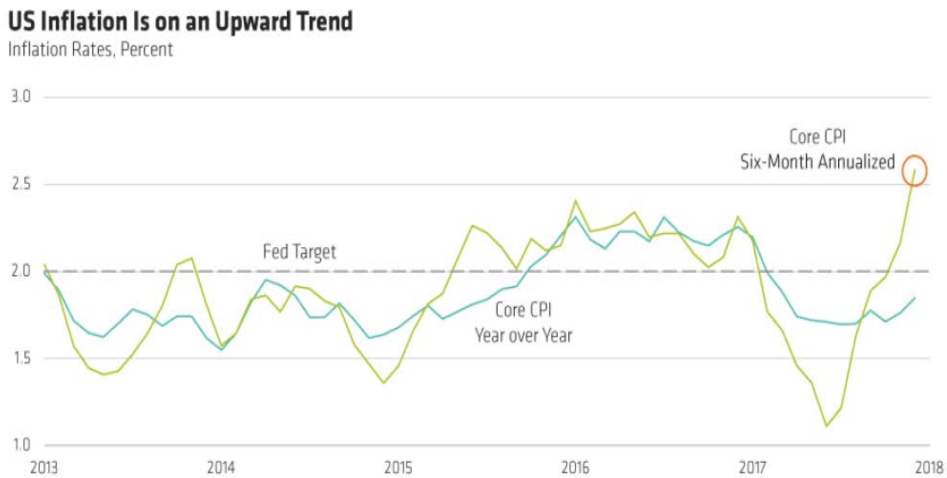
Vanderbilt Ave. Asset Management

1st Quarter 2018

Trump administration trade policies have moved to the forefront. The U.S. has proposed 25% tariffs on steel and 10% on aluminum for selected countries. In addition, Trump initially proposed tariffs on $50 billion of Chinese imports and restricted Chinese investment in U.S. technology. Trump subsequently said he would propose tariffs on an additional $100 billion of Chinese imports-bringing the total to $150 billion. In retaliation, China proposed tariffs on $50 billion of U.S. exports to China and subsequently indicated they would raise this threshold as Trump raised the ante. While on the surface this could be the start of a global trade war, there is a great deal of uncertainty as to the ultimate outcome and ramifications. For example, the steel and aluminum tariffs have been excluded for a number of our major trade partners. In general, trade tariffs are viewed as inflationary. Price increases tend to extend beyond import prices to domestic prices. Tariffs increase the cost of imported goods but also may raise the world price, thereby increasing the cost of domestic prices as well. Moreover, these price increases pass-through to other goods, putting upward pressure on the broader economy. While we expect tariffs to be inflationary, the extent to which they are depends upon the magnitude and scope of the tariffs. The impact on the economy may be more pronounced especially if there is the potential for retaliation by nations targeted by the tariffs. The resultant decline in trade would be detrimental to the economy, having a longer-term lasting effect on growth, productivity and national wealth. Considering the U.S. trade position with respect to the rest of the world, a trade war would not be beneficial. The U.S. accounts for 9% of world exports and 14% of world imports.

Unlike the steel and aluminum tariffs, the actions against China have some backing. There is agreement that China has not played by the rules and that they do not permit imports into China equal access. In lieu of Trump's bilateral approach, most nations believe the way to make progress in pressuring China is through collective action, whereby major economies join forces. There is uncertainty since we do not know the ultimate ramifications of these trade proposals and the resultant retaliatory actions. The hope is that both the U.S. and China see these proposals as unfavorable to their economies and negotiate a compromise agreement whereby some of the U.S. concerns regarding equal access and technology investment can be addressed. Xi, the Chinese leader, has recently said China will be flexible on lowering tariffs for some U.S. imports to China, raising the possibility that there is some room for compromise. China and the U.S. are now in a situation where the possibility of derailing the global economic recovery exists, disrupting global supply chains and destabilizing the huge, opaque and debt ridden Chinese economy. The negotiations will take a matter of months, not weeks, and the road to a successful outcome is potentially bumpy.

VAAM has an inflation outlook of 3% for the core CPI, higher than the consensus forecast. The year-over-year increase in money velocity has been going on since the third quarter of 2016 and is causing concern about potential inflationary pressures. The six-month annualized core CPI has accelerated since mid-2017 (see graph below). The bond market has been signaling a rise in inflation with the breakeven rate between the 10-year U.S. Treasury and 10-year TIPS rising above 2%, which is the highest level since 2014. In addition to signals from the financial markets, energy prices have risen this year. Leadership change at the State Department could lead to the reinstatement of sanctions on Iran, and that could place further upward pressure on energy prices. The U.S. dollar has fallen in value since last November, which puts upward pressure on import prices. In contrast with the past four or five years, these trends suggest that inflation should now be added to the list of variables investors need to weigh when considering strategy.

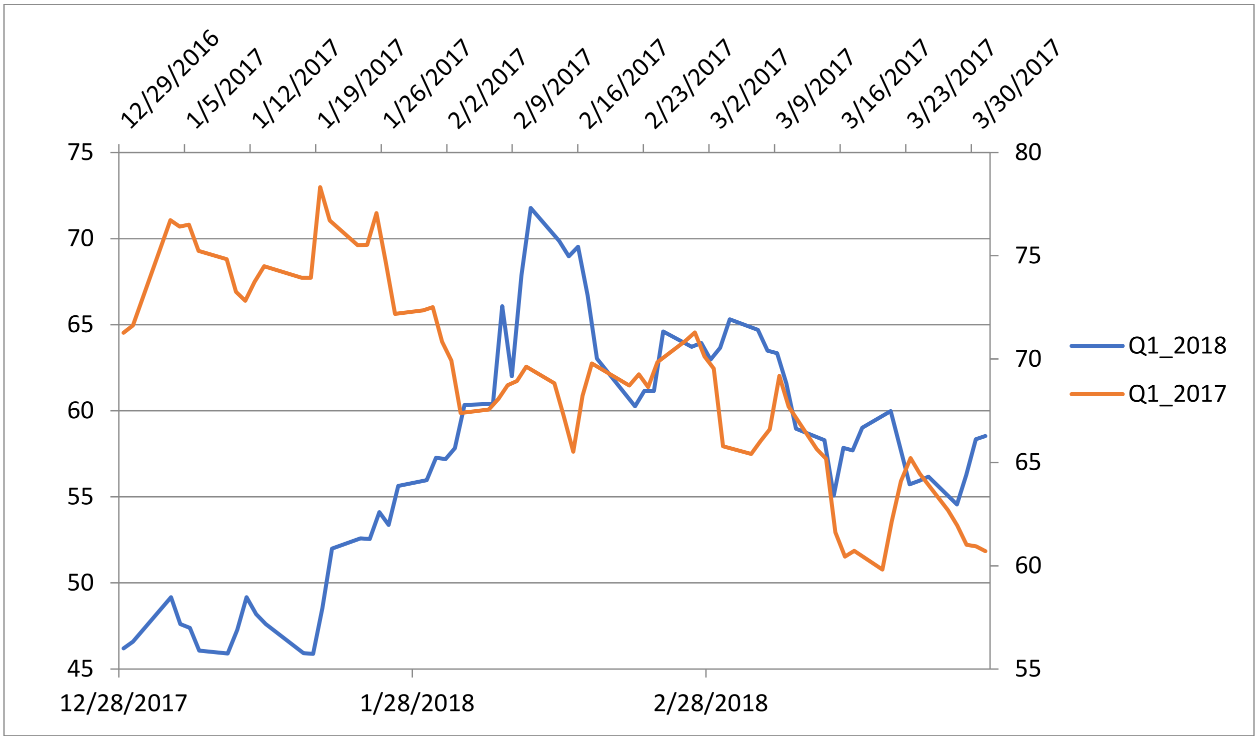


Through February 14, 2018
The Federal Reserve's inflation target is the Personal Consumption Expenditures (PCE) Price Index. The Core Consumer Price Index (CPI) excludes food and energy prices.
Source: Thomson Reuters Datastream

A major source of potential inflationary pressure is the strong labor market. With the unemployment rate (4.1%, the lowest since 2000) showing the economy running at full employment and GDP growth strong, a continuing question is why haven't wages risen more than they have? One explanation has been that there is slack in the labor supply. However, that may not be the case. The labor force participation rate has declined to 62.9%. The rate, still hovering near the lowest level since the 1970s, will continue facing downward pressure as older workers retire. In some sectors, there are already labor shortages.

Economic activity should remain robust due to a consumer (70% of GDP) with an improved balance sheet and a labor market supporting disposable income. Job growth has risen for 90 straight months which is the highest uninterrupted expansion on record. For the first three months of the year, hiring averaged 202,000 a month, up from 182,000 a month in 2017. Studies show that consumer spending leads to business spending and labor gains thus triggering a positive loop that encourages additional growth. Robust capex spending by businesses that have cash flow strength can buttress and extend an economic cycle. On a macro basis, cap ex is among a select number of factors, in addition to labor and technology, that play an important role in shaping the long-term trajectories of economies. The White House CEA points out that business fixed investment represents 12% of GDP yet contributes some 20% of quarterly volatility in growth, suggesting its disproportionately large impact on short-term growth. In the U.S., the average age for non-residential fixed assets is 16.3 years, making plant and equipment the oldest since 1963 and in need of modernization. The recent U.S. corporate tax rate reduction from 35% to 21% will lower costs and possibly lead to more investment. An immediate write-off across a range of capex spending was included in the new legislation. A tax holiday to repatriate overseas profits that could be deployed for infrastructure projects and other business investments was also included in the new legislation. Corporate earnings growth will support cash flows. For the fourth quarter, 78% of companies met or exceeded earnings expectations. Reducing the corporate tax rate further enhances the profit outlook. Earnings are expected to increase 18%-20% in 2018.

The yield curve experienced a major re-pricing as the first quarter of 2018 ended. Yields rose across the term structure by about 34 basis points on average. The curve continued to flatten through the quarter, albeit at a significantly slower pace than in the prior quarter. The surge in rates across the board was accompanied by a major increase in volatility in financial markets. The volatility in Treasuries, as measured by the Merrill Option Volatility Estimate ("MOVE") index, reached a peak of +54%, relative to the beginning of the quarter.

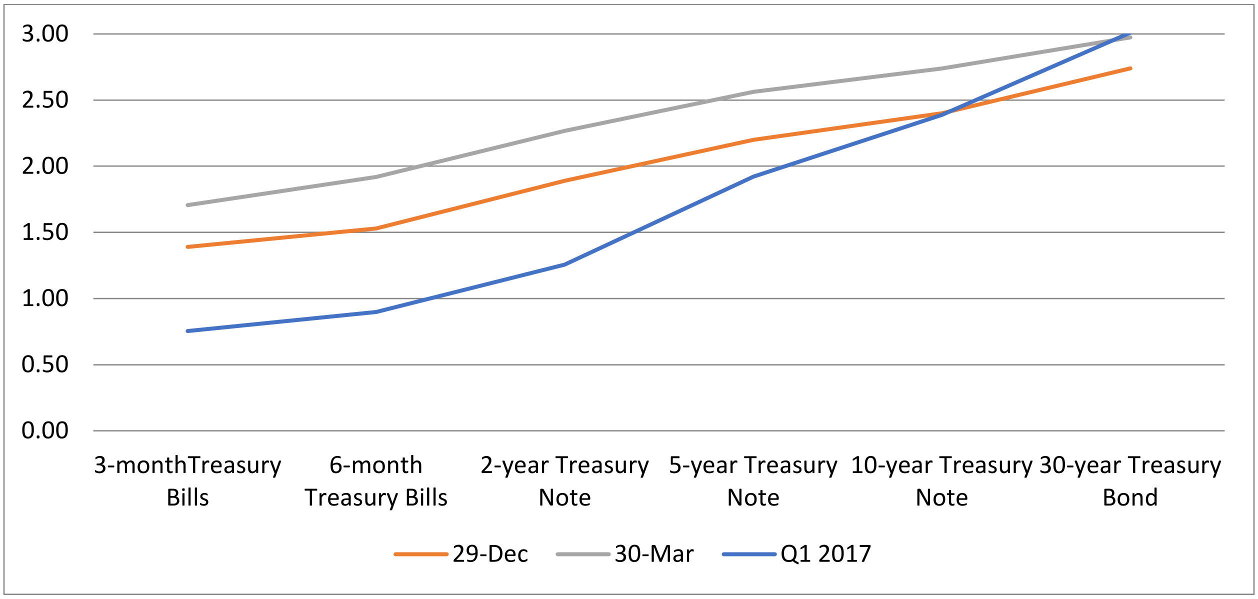


MOVE index, Source: Bloomberg Data

Across tenors, the movement in rates was more pronounced than during the previous quarter. As we anticipated, the two and ten-year spreads compressed further. However, the flattening was less pronounced, as the spread only tightened by 4 basis points. The table below shows the yield curve at the end of the first quarter.

	12/29/2017	03/30/2018	Change
3-monthTreasury Bills	1.39	1.71	+0.32
6-month Treasury Bills	1.53	1.92	+0.39
2-year Treasury Note	1.89	2.27	+0.38
5-year Treasury Note	2.20	2.56	+0.36
10-year Treasury Note	2.40	2.74	+0.34
30-year Treasury Bond	2.74	2.97	+0.23
10-year vs. 2-year	51	47	-4

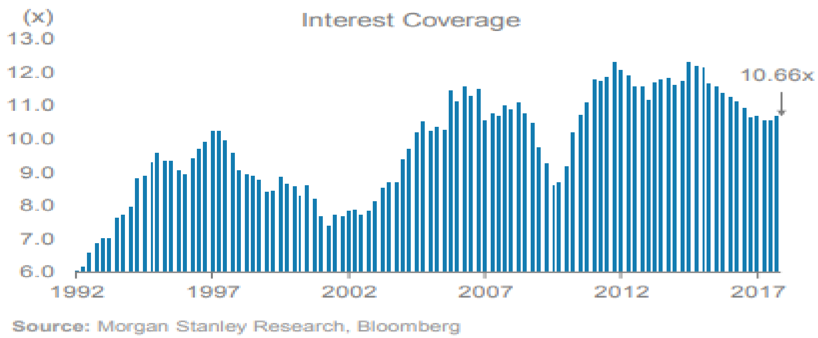
Relative to last year, the yield curve shifted upwards and flattened by about 66 basis points on average.



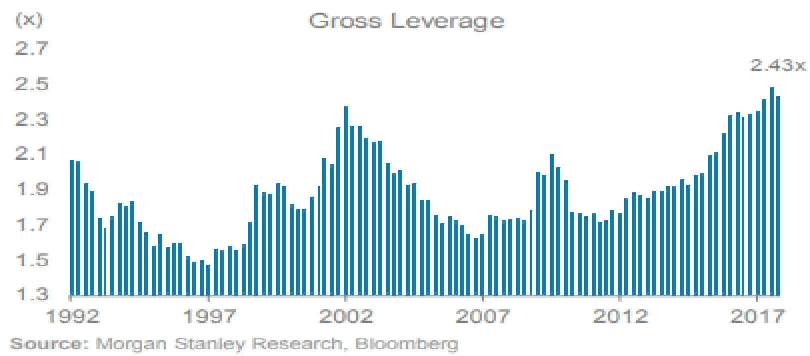
Select US Treasury Yields Source: Bloomberg Data

Corporate Securities
After the strong performance during 2017, corporate bond market performance faltered in the first quarter of this year. A combination of factors throughout the quarter pressured corporate spreads, including a spike in equity volatility, a fall in equity prices, growing concern of trade wars and tight valuations/spreads. For instance, the Intermediate Corporate Index as measured by the ICE BAML 1-10 Year U.S. Corporate Index was 0.79% over comparable U.S. Treasuries at the beginning of the year but ended the quarter at 1.00%. Due to the move in spreads, the sector underperformed comparable maturity U.S. Treasuries by 0.57%. The shorter 1-3 year Corporate Index also experienced the same movement in spreads. It began the quarter at 0.52% over U.S. Treasuries and by quarter end was at 0.76%. This move drove the excess return of the Index to -0.23%. Your portfolio's return for the quarter was adversely impacted by its overweight to the sector.

The financial fundamentals of the corporate credit market have not significantly changed since the last quarter. For instance, corporate earnings remain strong and, as mentioned previously, 78% of companies have met or exceeded expectations in the fourth quarter. This result is in line with previous quarters. Given our expectations for economic activity based on strong job growth, solid capex spending and the cut in the corporate tax rate, corporate earnings and cash flow should remain supportive of corporate bond valuations. Our investment focus on cash flow (EBITDA) and leverage results in a more mixed outlook for the sector. Interest coverage (EBITDA/Interest Expense) remains well within a normal historical range for this indicator, though it is down significantly from its earlier peak.

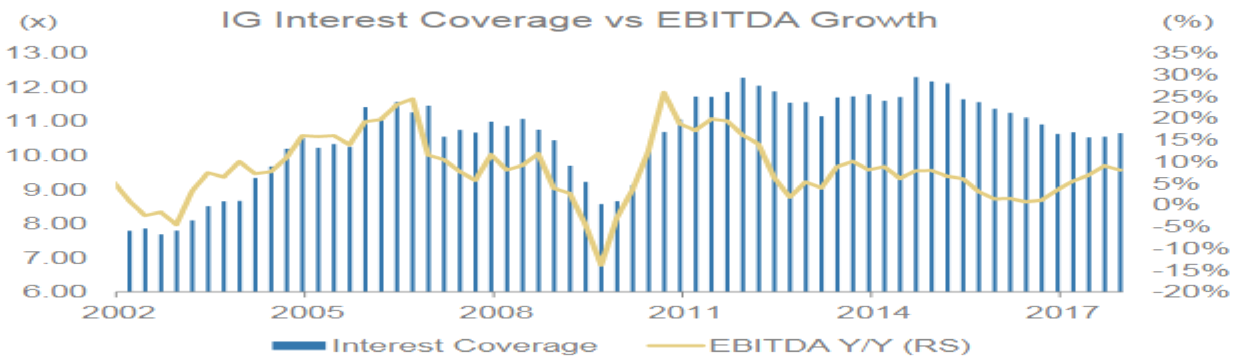


However, gross leverage (Debt/EBITDA) is at an elevated level as seen in the chart below:



The rise in debt levels has exceeded the growth in EBITDA during the expansion. Capex spending has been depressed as compared to prior economic expansions. The capex to sales ratio in the last quarter was only a modest 4.2% as compared to over 5% during the prior expansion, and as high as 7% during the 1990's (data from Morgan Stanley and Bloomberg). Since capex will normally lead to improved productivity and higher GDP growth, both important components to improving corporate cash flow over time, the lack of spending has held back cash flow growth during this expansion. Debt issuance has been more focused on merger and acquisition activity and share buybacks, which do not lead to an improvement in corporate cash flow. The recently enacted tax law change, especially the repatriation of cash held overseas, should mitigate debt issuance during 2018. In fact, during the first quarter investment grade credit issuance has fallen from $190.3 billion during the first quarter of 2017 to $141.6 billion in 2018. Growth in corporate cash flows and a lower rate of debt issuance should improve this ratio over the coming months. In addition, the high levels of cash on corporate balance sheets also support corporate credit quality, as net leverage (Debt-Cash/EBITDA) is at a more sustainable 1.81 times, albeit still higher than in previous expansions (Morgan Stanley and Bloomberg).

Ultimately, the ability to service debt is a function of cash flow growth, which is based on economic activity.



Source: Morgan Stanley Research, Bloomberg, Citigroup Index LLC

Therefore, we are comfortable remaining overweight the sector until signs of a slowdown in the U.S. growth rate appear. Since valuations of the sector are not cheap, your exposure is in companies with relatively high cash flow generating capabilities. In addition, the overall duration of the holdings is on average shorter than the relevant index duration to protect against an unexpected economic slowdown and/or rising interest rates. During the first quarter, Toyota Motor Corp. (Aa3/AA-), a leading car manufacturer, was added to the portfolio. Their net leverage is 3.7x and the sum of their cash and long-term investments/receivables exceeds their outstanding debt. They had a significant positive earnings surprise in their last quarter. PACCAR Inc. (A1/A+) was also purchased during the quarter. PACCAR is a manufacturer of trucks, including Kenworth, Peterbilt and DAF. They also offer financing and truck leasing. Their gross debt was 2.7x, while their net leverage was 1.6x in the fourth quarter. EBITDA/Interest Expense was 25.5x for 2017. They had a positive earnings surprise in the past quarter.

Asset Backed and Mortgage Backed Securities

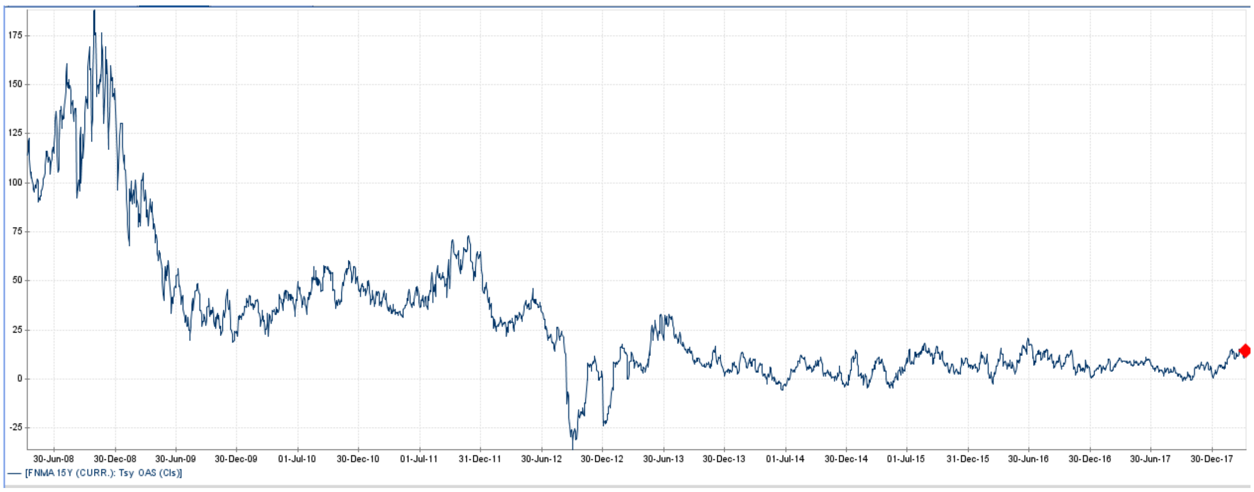
After strong performance in 2017, ABS and MBS returns were flat to weaker in the first quarter of 2018. The short ABS index posted flat returns of +0.01% for total return and -0.02% for excess return versus similar duration U.S. Treasury issues. The MBS index returned -1.21% on a total return basis, translating to -0.40% on an excess return versus Treasuries.

The credit quality of ABS in your portfolio remains strong. Credit card charge offs are low and automobile loss rates are in line with expectations for continued strong performance on a fundamental basis. The securities we buy and own all have weighted average lives less than three years and are rated AAA. In the first quarter we added a 1.4-year COMET credit card security to your portfolio. Priced at 98.3, this short AAA-rated security yields 2.56%, which is 44 basis points above Treasuries. This security pays a coupon of 1.33%, is locked out from prepayments, and is expected to pay off in August 2019.

The MBS portion of your portfolio is invested in short super seasoned Agency MBS which offer default and prepayment protection. The Agency rating insulates these securities from defaults. Due to the seasoning of the collateral backing these securities, they experience stable prepayment levels that do not fluctuate greatly with moves in interest rates. The loans backing these securities are "burnt out," meaning the balances are lower than relatively newer mortgages. Therefore, borrowers benefit less from refinancing, and prepayments occur more consistently based on seasonality more than interest rate movements.

To take some relative value gains in your portfolio, we sold FHR 4316 DA. This seasoned MBS's spread had tightened versus Treasuries, so we took this opportunity to lighten down slightly on the sector.

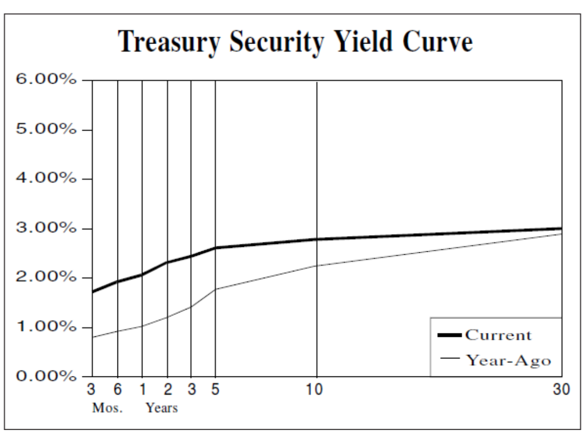
As expected from the MBS index performance, the Option Adjusted Spread ("OAS") levels have recently widened (see chart below). Specifically, the OAS levels of 15-year maturity current coupon MBS have widened from 0 at the end of 2017 to 14 at the end of March 2018. Despite these wider spreads, however, the underlying quality of the securities remains strong.



Selected Yields

	Recent (4/11/18)	3 Months Ago (1/10/18)	Year Ago (4/12/17)
TAXABLE			
Market Rates			
Discount Rate	2.25	2.00	1.50
Federal Funds	1.50-1.75	1.25-1.50	0.75-1.00
Prime Rate	4.75	4.50	4.00
30-day CP (A1/P1)	1.86	1.56	0.96
3-month Libor	2.34	1.70	1.16
U.S. Treasury Securities			
3-month	1.72	1.42	0.80
6-month	1.92	1.58	0.92
1-year	2.06	1.77	1.02
5-year	2.61	2.33	1.77
10-year	2.78	2.56	2.24
10-year (inflation-protected)	0.67	0.57	0.28
30-year	3.00	2.90	2.89
30-year Zero	3.03	2.94	2.99

	Recent (4/11/18)	3 Months Ago (1/10/18)	Year Ago (4/12/17)
Mortgage-Backed Securities			
GNMA 5.5%	3.43	2.93	2.29
FHLMC 5.5% (Gold)	3.37	3.10	2.40
FHLMC 5.5%	3.35	3.00	2.27
FHLMC ARM	1.97	1.90	1.75
Corporate Bonds			
Financial (10-year) A	3.83	3.46	3.43
Industrial (25/30-year) A	4.07	3.82	4.02
Utility (25/30-year) A	4.41	3.89	4.10
Utility (25/30-year) Baa/BBB	4.06	4.16	4.48
Foreign Bonds			
Canada	0.50	2.16	1.51
Germany	0.04	0.54	0.20
Japan	1.39	0.09	0.03
United Kingdom	1.21	1.29	1.05
Preferred Stocks			
Utility A	5.95	5.87	5.82
Financial A	5.48	5.85	5.79
Financial Adjustable A	#REF!	5.48	5.48



Source: Value Line, Inc.

Federal Reserve Data

BANK RESERVES

(Two-Week Period; in Millions, Not Seasonally Adjusted)

	Recent Levels			Average Levels Over the Last...		
	03/28/18	03/14/18	Change	12 Wks.	26 Wks.	52 Wks.
Excess Reserves	1996657	2109908	-113251	2075080	2116716	2134358
Borrowed Reserves	18	12	6	35	25	18
Net Free/Borrowed Reserves	1996639	2109896	-113257	2075045	2116693	2134340

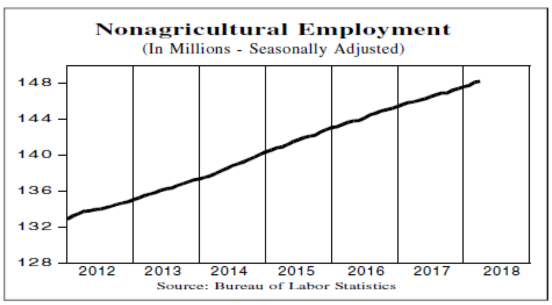
MONEY SUPPLY

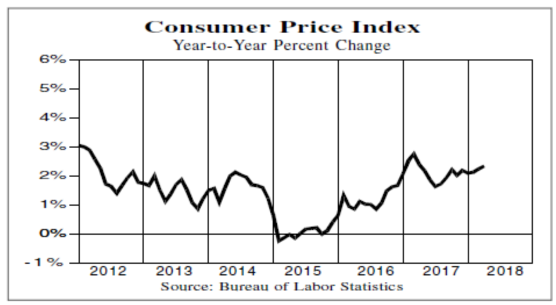
(One-Week Period; in Billions, Not Seasonally Adjusted)

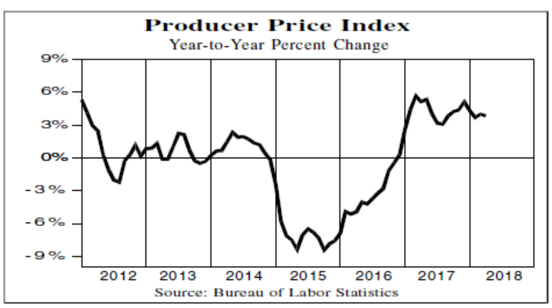
	Recent Levels			Ann'l Growth Rates Over the Last...		
	03/26/18	03/19/18	Change	3 Mos.	6 Mos.	12 Mos.
M1 (Currency+demand deposits)	3665.0	3657.4	7.5	5.5%	6.1%	6.9%
M2 (M1+savings+small time deposits)	13935.6	13900.8	34.8	2.9%	3.2%	3.9%

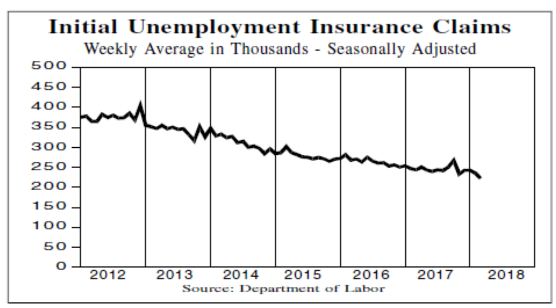
Source: Unites States Federal Reserve Bank

Tracking the Economy









Source: Value Line, Inc.