



JOHN D. DOVICH
& ASSOCIATES, LLC

**2017 Kentucky Captive Association
Educational Conference
Economic & Market Outlook**

June 16, 2017

Presenters:

Thomas J. Lalley, CFA[®], CFP[®]

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Agenda

- ◆ Our Firm & Services
- ◆ Economic Comments/Charts
- ◆ Political Environment
- ◆ Market Outlook/Charts
- ◆ Investing Captive Insurance Company Assets

Our Firm

- ◆ Founded by John D. Dovich, CLU, ChFC in 1987
- ◆ Registered Investment Advisor
- ◆ Fiduciary Standard
- ◆ 6 Client Facing Advisors & 1 Chief Investment Officer
- ◆ 13 Total Employees, to include the following credentials:
 - 5 Certified Financial Planners™
 - 3 Chartered Financial Analysts
 - 1 Certified Public Accountant
 - 1 Chartered Life Underwriter/Chartered Financial Consultant
- ◆ Long standing relationship with Valley National Administrative Services (VNAS) with great depth of experience in managing captive insurance company assets
- ◆ Awards
 - 2015 & 2016 Goering Center Family & Private Business All-Star Award Finalist
 - 2015 *Cincinnati Business Courier's* Best Places to Work Finalist



Our Services

- ◆ **Financial Planning**
 - Strategic life planning and comprehensive financial plans
- ◆ **Investment Management**
 - Allocation and diversification
 - Risk/Return Analysis
 - Active portfolio management
 - Institutional custodian with Charles Schwab
- ◆ **Estate Planning/Wealth Transfer**
 - Review of wills/trusts/POAs
 - Tax minimization and asset protection⁽¹⁾
 - Life insurance
- ◆ **Business Planning**
 - Succession planning and exit strategies
 - Retirement plans, executive compensation and benefits
 - Captive insurance companies

Economic Comments

◆ Corporate profits are improving

- S&P 500 earnings growth turned positive in the September 2016 quarter after posting six consecutive quarters of earnings declines. The Energy sector contributed to earnings declines in 2015 and 2016. However, with oil prices stabilizing, energy companies are posting positive increases in earnings in 2017, representing a tailwind for corporate earnings. Revenue growth remains sluggish overall, however.
- Sectors like Technology, Financials, Materials and Real Estate posted earnings growth in excess of 15% during the first quarter of 2017. The S&P 500 posted earnings growth of 15%.

◆ Healthcare reform remains a high priority for new legislation

- The Affordable Care Act is under duress. The lack of progress on repealing and replacing this legislation is causing insurers to consider increasing premiums or exit markets.
- The Centers for Medicare & Medicaid Services projected early this year that national health expenditure growth is expected to average 5.6% annually over 2016-2025 without any legislative changes.
- With rising healthcare costs and an aging population, health care reform will remain a political hot potato.

◆ Oil prices stabilizing in a trading range

- OPEC (Organization of the Petroleum Exporting Countries) recently extended oil production cuts through March 2018 for its members. While this serves to provide some near-term stability in oil prices, US shale producers are increasing production. The US is therefore the culprit in keeping a lid on oil prices since we are increasing production as OPEC lowers production. A number of economists predict that oil prices will remain in a \$40-\$60 per barrel range.

◆ Wage growth inflation gradually picking up

- The Bureau of Labor Statistics reported in May that wages grew 2.5% year-over-year with the unemployment rate at 4.3%, or 6.9 million unemployed. Job growth remains subdued and wage inflation is moderately growing.

Economic Comments (continued)

- ◆ Change in consumer spending behavior rippling through the economy
 - The millennial consumer is providing a great impact to our economy.
 - Historically high student loan debt, delayed household ownership and changing spending habits are affecting the economy.
 - Retail companies are going through a big change as online retail keeps accelerating (not just millennials!) An example of this are the challenges that Macy's is facing. Declining sales and profitability are forcing store closures and major changes in the way that Macy's is merchandising, marketing and pricing its products.

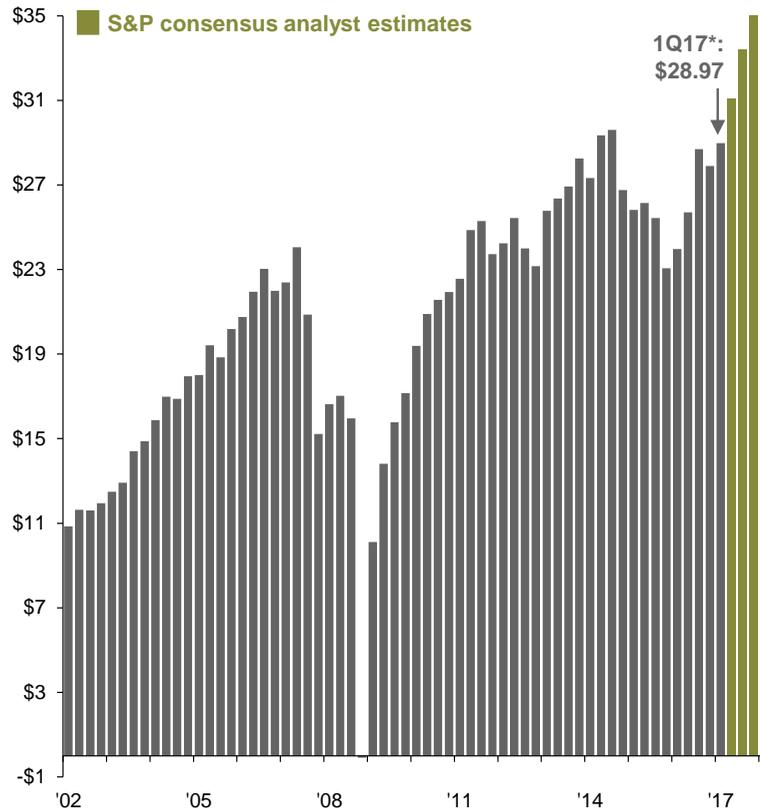
- ◆ Fed continues to gradually raise interest rates – Fed balance sheet reduction next
 - The Federal Reserve has increased the Fed Funds rate 75 basis points since December 2015. (25 basis points in December, 2015, 25 basis points in December, 2016, and 25 basis points in March, 2016.) The current consensus is that the Fed will raise rates another 25 basis points in June, 2017 (meeting has not happened as of this writing) and perhaps one more increase sometime later in 2017. The Federal Open Market Committee (FOMC) is expected to begin addressing its \$4.5 trillion balance sheet where it stores bonds it has purchased to increase money supply after the financial crisis. Coupled with higher interest rates, this will gradually lower money supply with the intention to normalize interest rates.

- ◆ Recession risk for 2017 appears to be low
 - With rising corporate profits, stable oil prices, moderate growth in jobs and wages and a gradual increase in the Fed Funds rate, risk for a recession in 2017 appears low at this time.

Corporate Profits

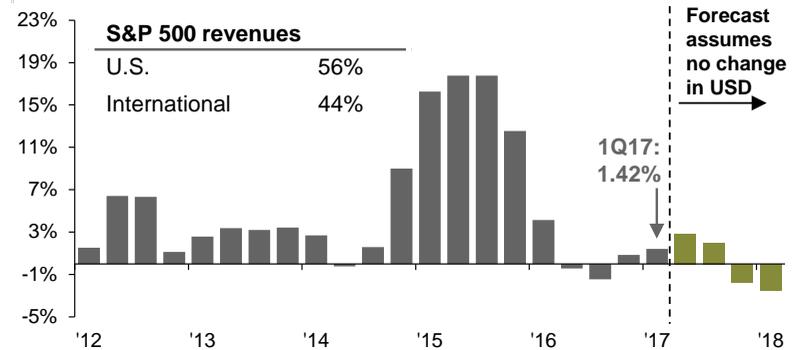
Equities

S&P 500 earnings per share
Index quarterly operating earnings



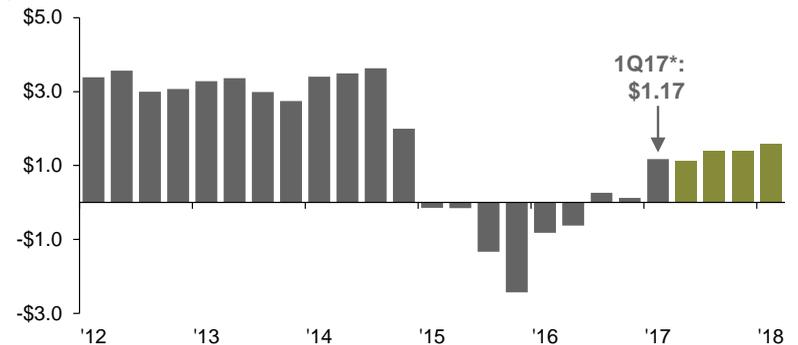
U.S. dollar

Year-over-year % change**, quarterly, USD major currencies index



Energy sector earnings

Energy sector contribution to S&P 500 EPS, quarterly



Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Top right) Federal Reserve, S&P 500 individual company 10k filings, S&P Index Alert.

EPS levels are based on operating earnings per share. Earnings estimates are Standard & Poor's consensus analyst expectations. Past performance is not indicative of future returns. Currencies in the Trade Weighted U.S. Dollar Major Currencies Index are: British pound, euro, Swedish krona, Australian dollar, Canadian dollar, Japanese yen and Swiss franc. *1Q17 earnings are calculated using actual earnings for 97.7% of S&P 500 market cap and earnings estimates for the remaining companies. **Year-over-year change is calculated using the quarterly average for each period. USD forecast assumes no change in the U.S. dollar from its May 31, 2017 level.

Guide to the Markets – U.S. Data are as of May 31, 2017.

Oil Production, Consumption and Prices

Economy

Change in production and consumption of liquid fuels

Production, consumption and inventories, millions of barrels per day

		2014	
		16.6	17.6%
		40.2	9.8%
			7.0%
<hr/>			
		20.2	5.8%
		13.1	14.2%
		99.9	6.8%

0.2 1.7 0.5 0.2 0.5

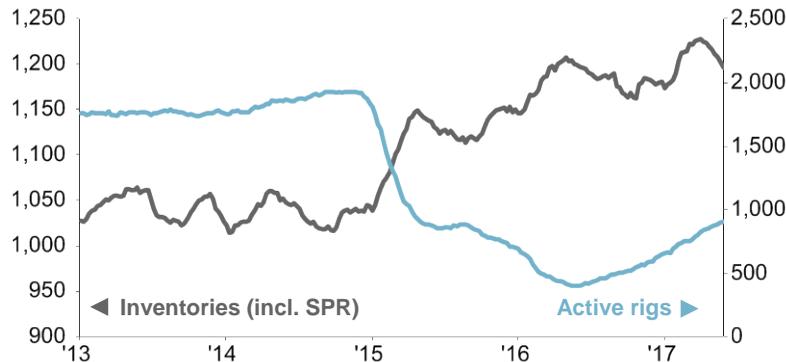
Price of oil

Brent crude, nominal prices, USD/barrel



U.S. crude oil inventories and rig count**

Million barrels, number of active rigs



Source: J.P. Morgan Asset Management; (Top and bottom left) EIA; (Right) FactSet; (Bottom left) Baker Hughes.

*Forecasts are from the May 2017 EIA Short-Term Energy Outlook and start in 2017.

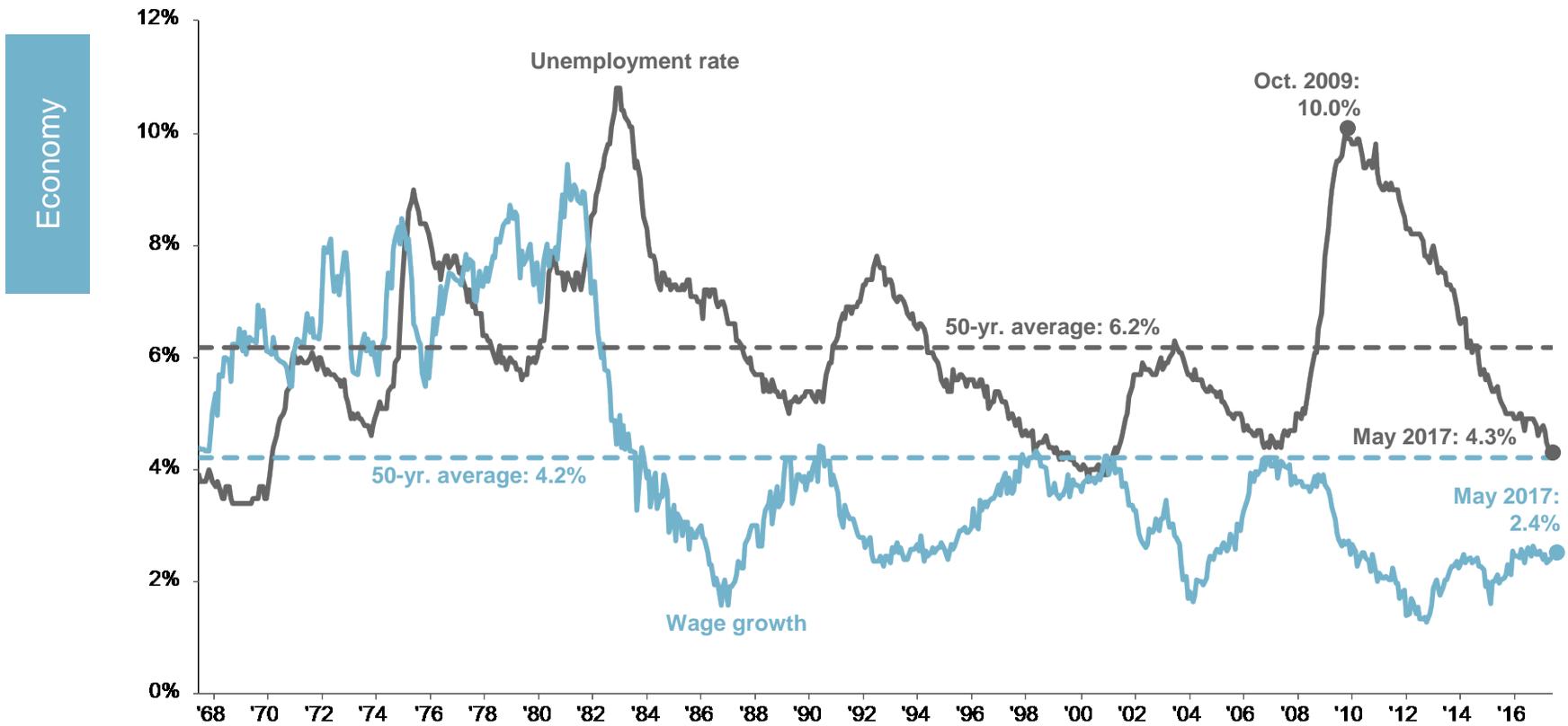
**U.S. crude oil inventories include the Strategic Petroleum Reserve (SPR). Active rig count includes both natural gas and oil rigs.

Brent crude prices are monthly averages in USD using global spot ICE prices.

Guide to the Markets – U.S. Data are as of May 31, 2017.

Unemployment and Wages

Civilian unemployment rate and year-over-year growth in wages of production and non-supervisory workers
Seasonally adjusted, percent

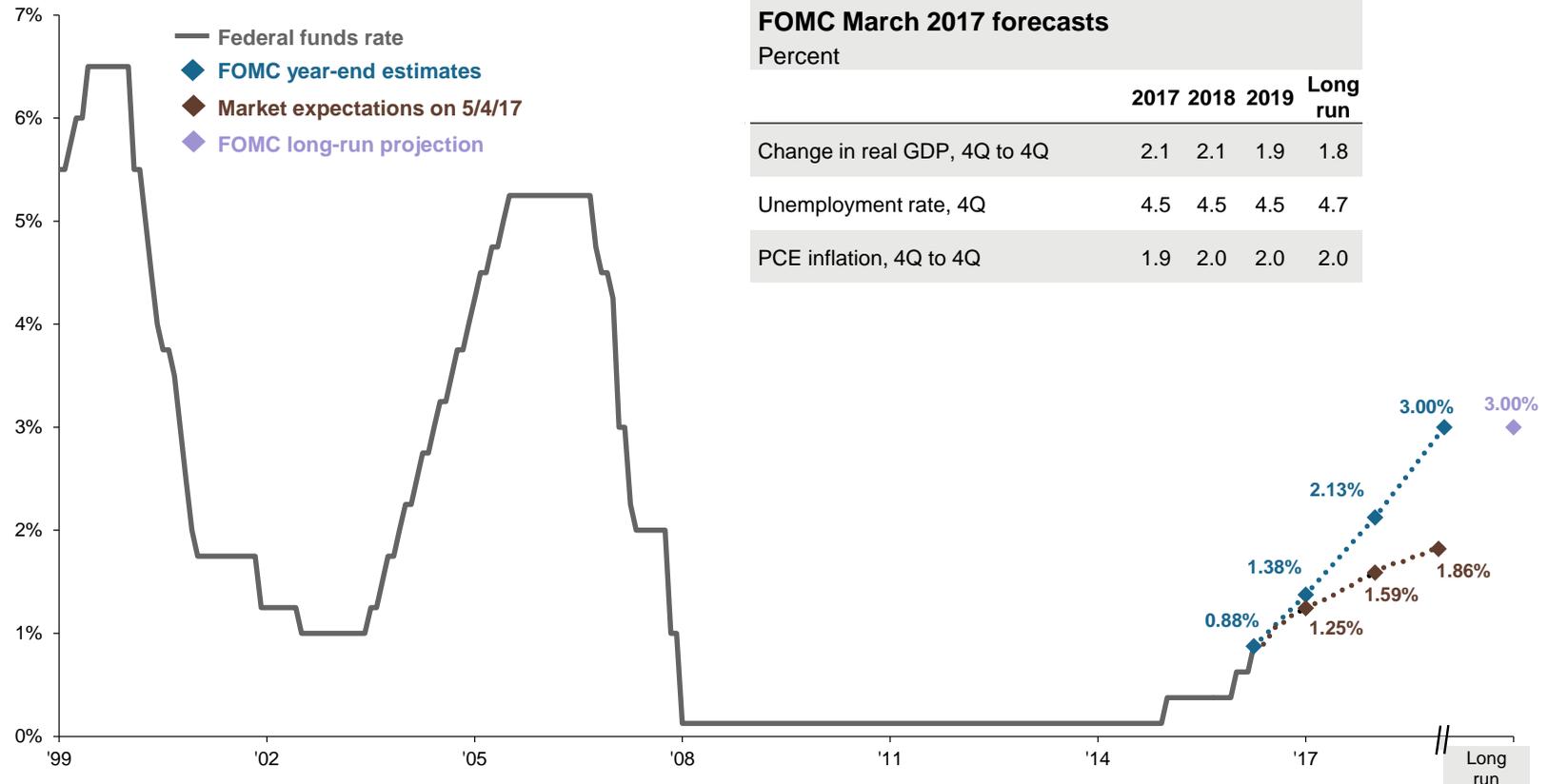


Source: BLS, FactSet, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of May 31, 2017.

The Fed and Interest Rates

Federal funds rate expectations

FOMC and market expectations for the fed funds rate



Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.
 Market expectations are the federal funds rates priced into the fed futures market as of the date of the May 2017 FOMC meeting.
Guide to the Markets – U.S. Data are as of May 31, 2017.

Political Environment

- ◆ President Trump's prolific use of Twitter has created numerous headlines for investors to evaluate. Within his first 100 days, President Trump spoke frequently about how he was going to negotiate better prices for government contracts and the healthcare industry. As an investor, should we be concerned about this?
 - When President Trump chided Boeing in early December about the new 747 Air Force One being too expensive, the stock initially sold off a little. The stock is 22% higher since he made those comments.
 - President Trump has repeatedly criticized drug prices since his January 10th comments that the pharmaceutical industry is “getting away with murder.” The comments initially caused pharmaceutical and biotech stocks to decline; however, they have fully recovered and have posted modest results overall.
 - The point here is that investors should be focused on their long-term goals. The fundamental outlook of the economy and companies is more important than sensationalism, whether on the part of the President, politicians or the media. Buying opportunities seem to present themselves after these type of headlines.

- ◆ Presidential Agenda
 - President Trump's agenda has been to repeal and replace the Affordable Care Act, slash taxes, deregulate the banking industry, invest in American infrastructure, suspend immigration, increase deportation of undocumented immigrants and impose import taxes.
 - President Trump has been met with resistance on the Affordable Care Act and immigration reform.
 - Tax reform and banking deregulation have been pushed back as a result.
 - Overall, the Trump agenda is facing resistance on many fronts and progress on his main initiatives face continued delay.
 - Focus on revising trade agreements, such as China, could be a positive for several industries.

- ◆ Overseas Elections
 - Populist movements in foreign countries are similar to the one in the US. There are multiple elections occurring where conservative/traditional politicians are being challenged.
 - Uncertainty in the UK has increased as election results deliver a hung parliament.
 - The results of remaining elections in Germany this fall may have an impact on financial markets later in the year.

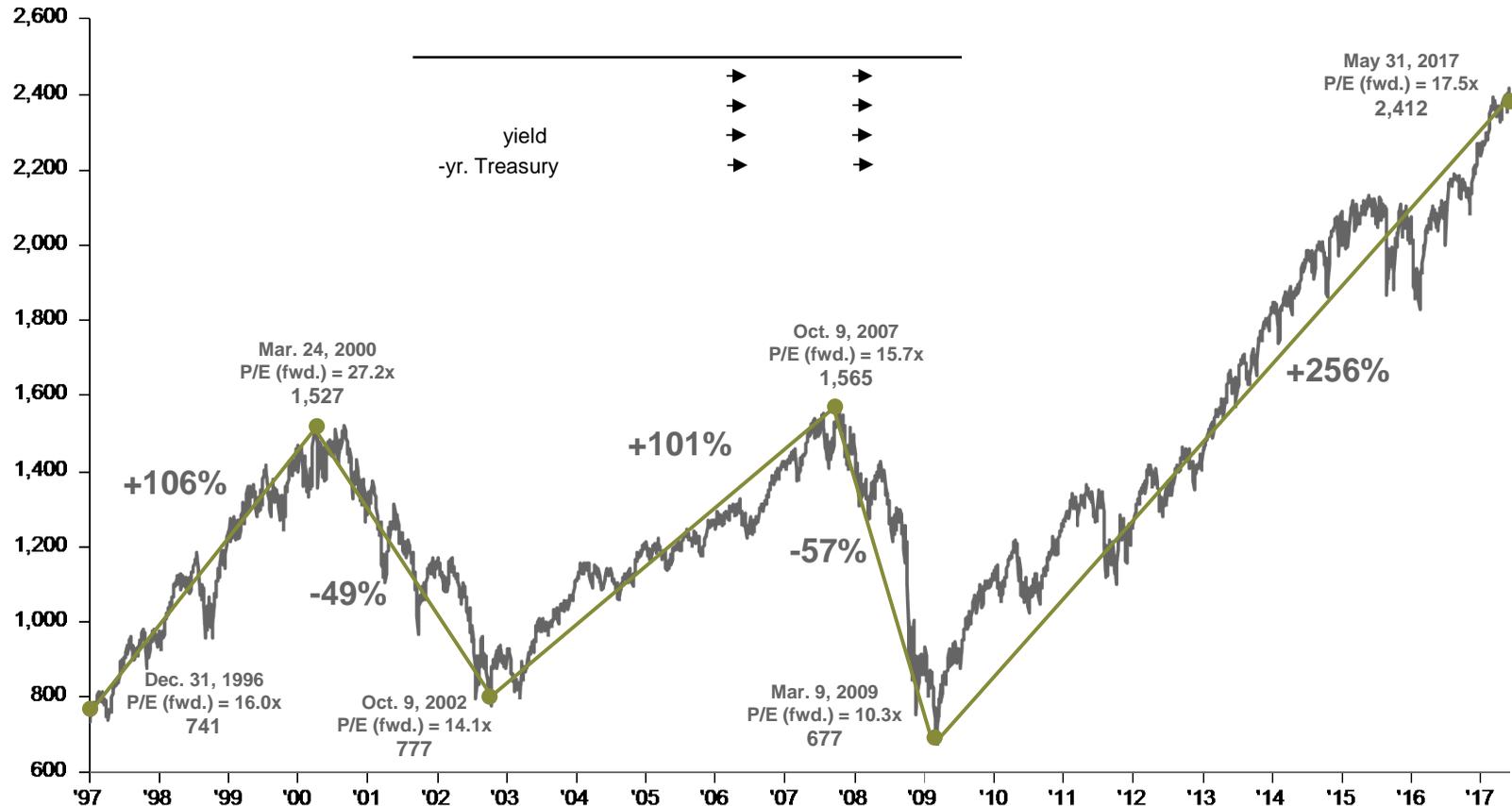
Market Outlook

- ◆ Stocks remain in a nine year bull market run rising over 250% since the bottom hit in 2009.
- ◆ Low volatility in the stock market, higher volatility in sectors
 - In the aftermath of the elections, stocks received a “Trump bump.” The S&P 500 has gained over 12%. President Trump’s pro-growth agenda initially positively impacted financials, energy and industrial stocks.
 - The rally in financials and energy stocks has since faded.
 - Technology, Healthcare, Consumer Discretionary, Consumer Staples and Utilities are performing well.
 - These sectors are growth and defensive-oriented sectors.
 - For the rally to continue, we need to see Financial and Energy sectors to perform better.
- ◆ International stocks in 2017 are outperforming US stocks.
 - International stocks have significantly underperformed US stocks since 2008, but that has changed so far in 2017.
 - YTD, International stocks (MSCI EAFE) are up 15% vs. a gain of 1% in 2016.
 - The S&P 500 (US large cap stocks) is up nearly 10% YTD vs. a gain of 12% last year.
- ◆ Fed increasing interest rates may restrain future growth in financial markets and economy
 - Higher interest rates alone are not necessarily bad for the economy.
 - The pace of interest rate hikes and the severity of these hikes are a great influence on stock and bond markets.
- ◆ Potential lower returns in the intermediate term
 - Stocks have rallied nicely year-to-date on strong corporate profits and optimism about pro-business legislation making its way through Congress.
 - With low interest rates and stocks near record highs, there is risk that returns may be constrained over the next three to five years. However, the outcome of new US legislation and foreign elections could influence more economic growth and positively affect global economies.
 - We believe long-term investment returns are ultimately dependent on successful asset allocation strategies and active asset management.

S&P 500 Index at Inflection Points

Equities

S&P 500 Price Index



Source: Compustat, FactSet, IBES, Federal Reserve, Standard & Poor's, J.P. Morgan Asset Management.
 Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat.
 Forward price to earnings ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
 Guide to the Markets – U.S. Data are as of May 31, 2017.

Market Volatility: Low despite long duration of expansion

Equities

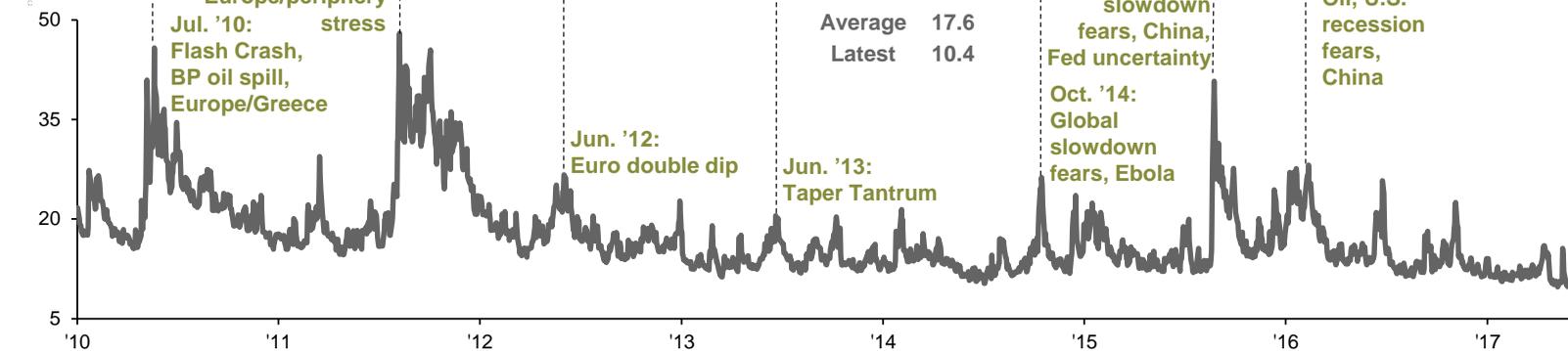
Major pullbacks during current market cycle

S&P 500 Price Index



Volatility

VIX Index



VIX	Level
'08 Peak	80.9
Average	17.6
Latest	10.4

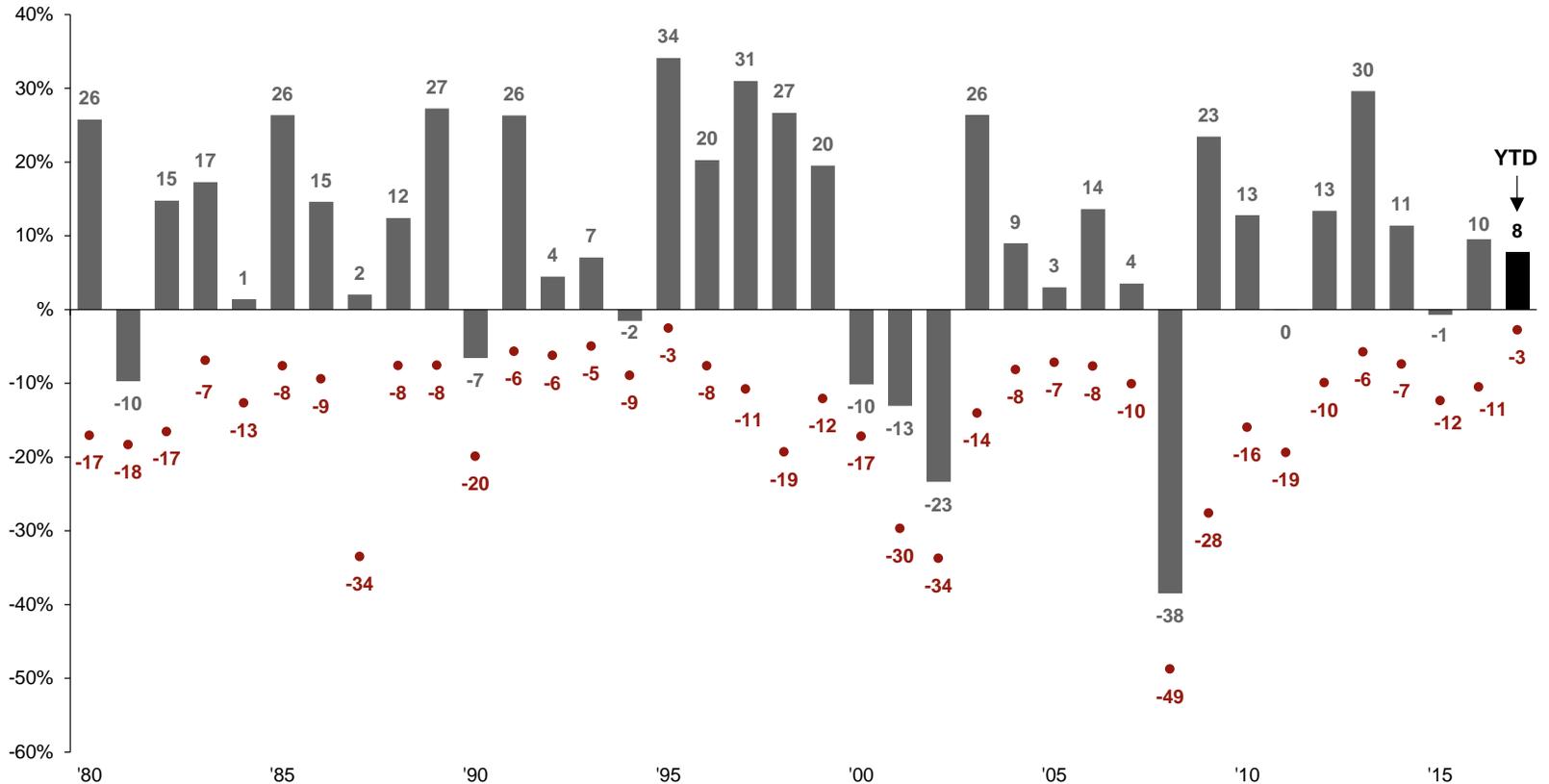
Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Bottom) CBOE.
Drawdowns are calculated as the prior peak to the lowest point.
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20 of 37 Years: A 10% Correction is Surprisingly “Normal”

Equities

S&P 500 intra-year declines vs. calendar year returns

Despite average intra-year drops of 14.1%, annual returns positive in 28 of 37 years

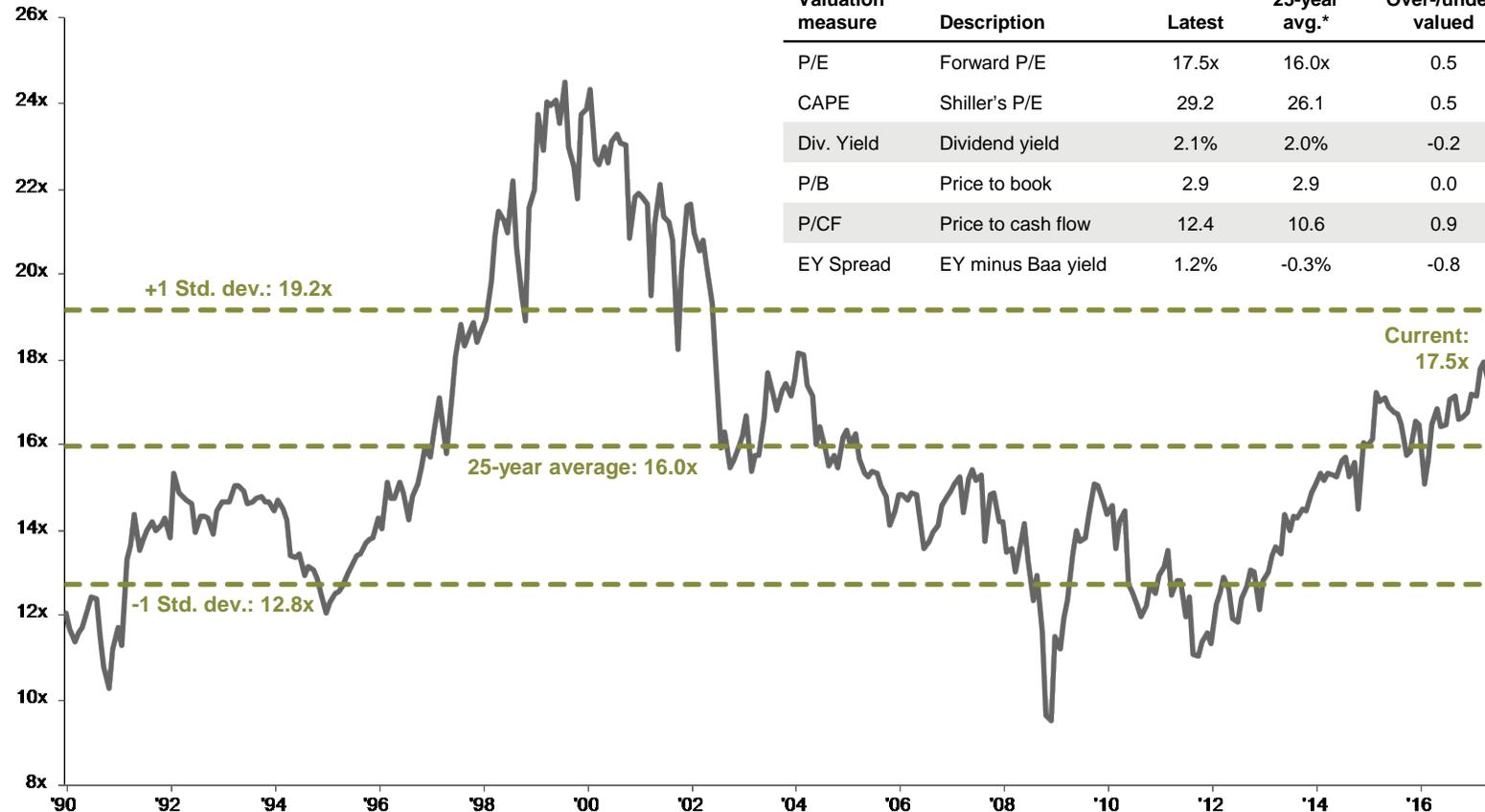


Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management. Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2016, over which time period the average annual return was 8.5%. The 2017 bar represents the year-to-date return and is not included in the average annual return calculation. *Guide to the Markets – U.S.* Data are as of May 31, 2017.

S&P 500 Valuation Measures: Slightly Above Average

Equities

S&P 500 Index: Forward P/E ratio



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 May 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.

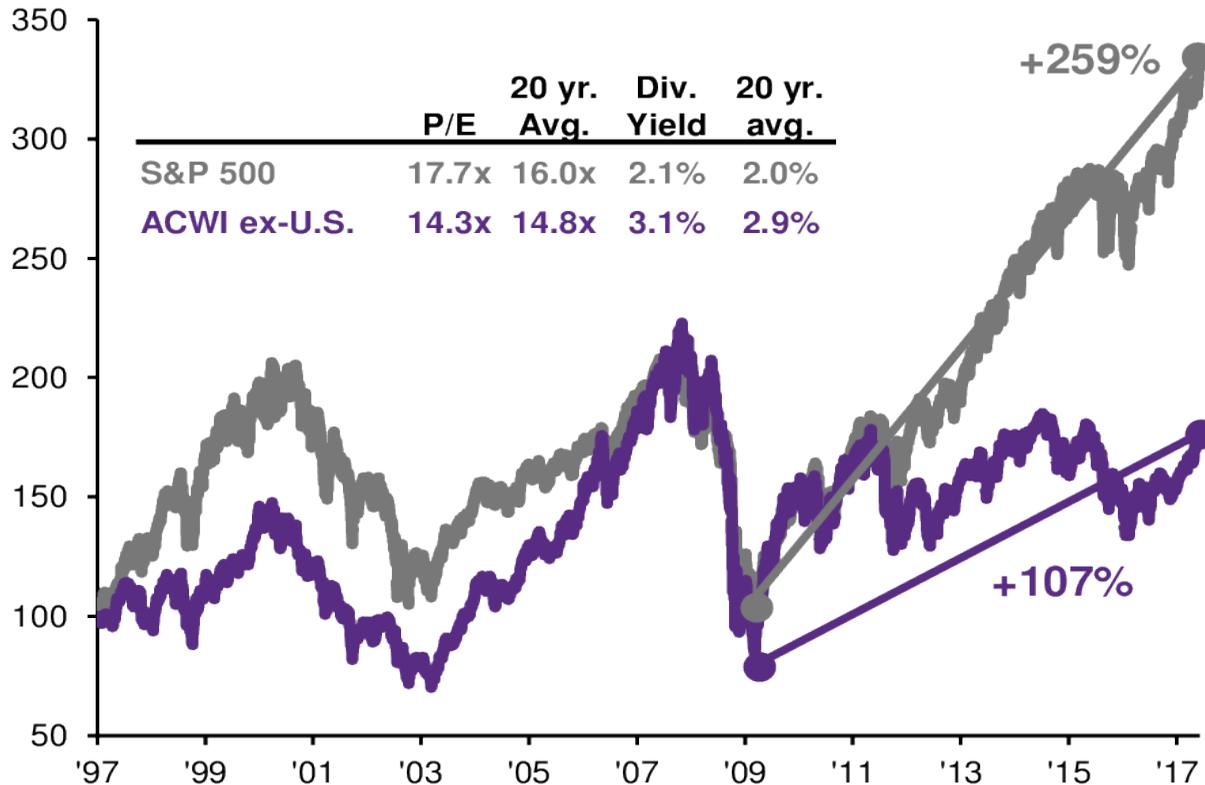
*P/CF is a 20-year average due to cash flow data availability.

Guide to the Markets – U.S. Data are as of May 31, 2017.

International Stocks vs. US Stocks

There are many arguments in favor of international stocks

S&P 500 & MSCI AC World ex-U.S., Dec. 1996 = 100, U.S. dollar price return



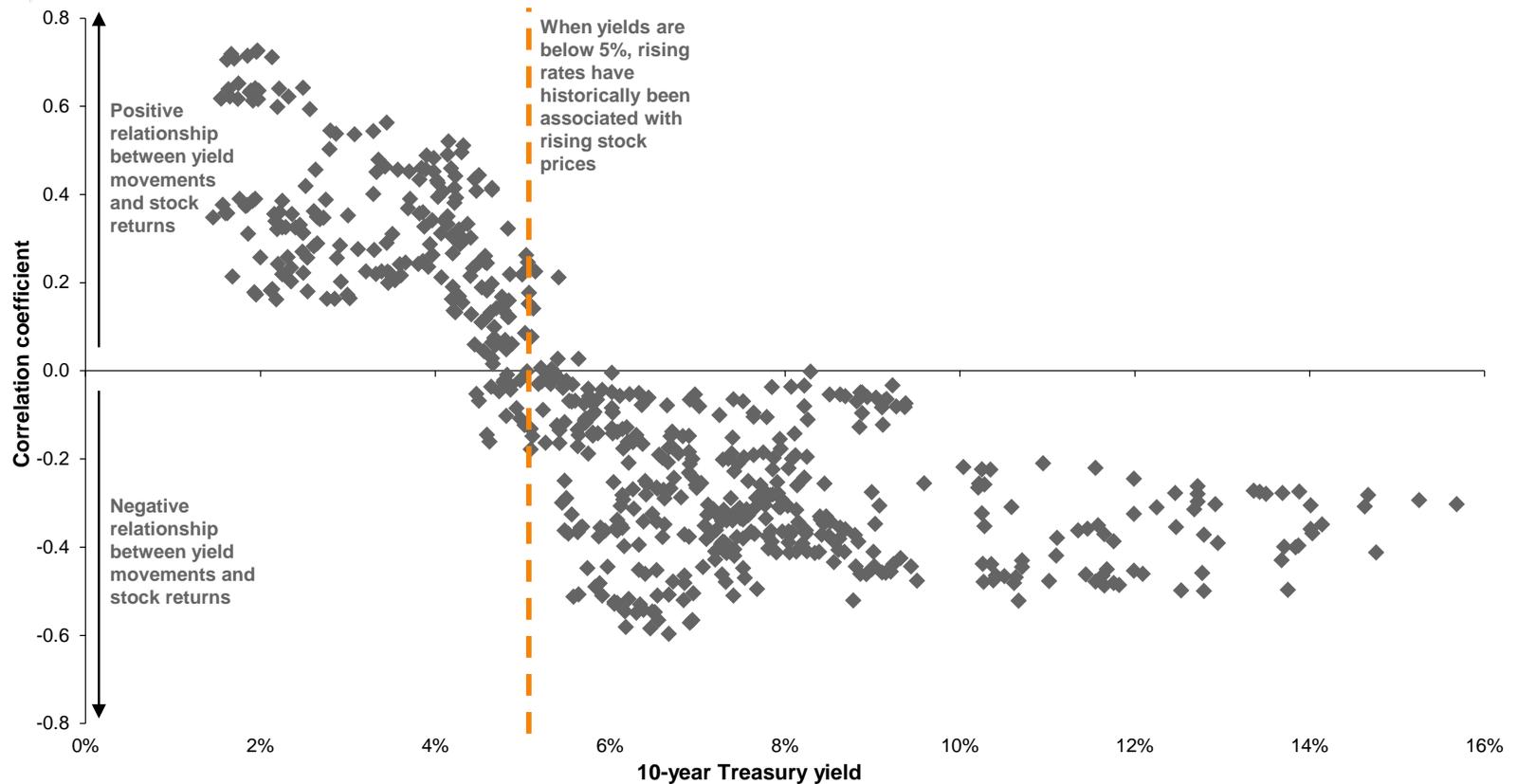
Source: MSCI, Standard & Poor's, FactSet, J.P. Morgan Asset Management.

Interest Rates and Stock Returns

Equities

Correlations between weekly stock returns and interest rate movements

Weekly S&P 500 returns, 10-year Treasury yield, rolling 2-year correlation, May 1963 – May 2017



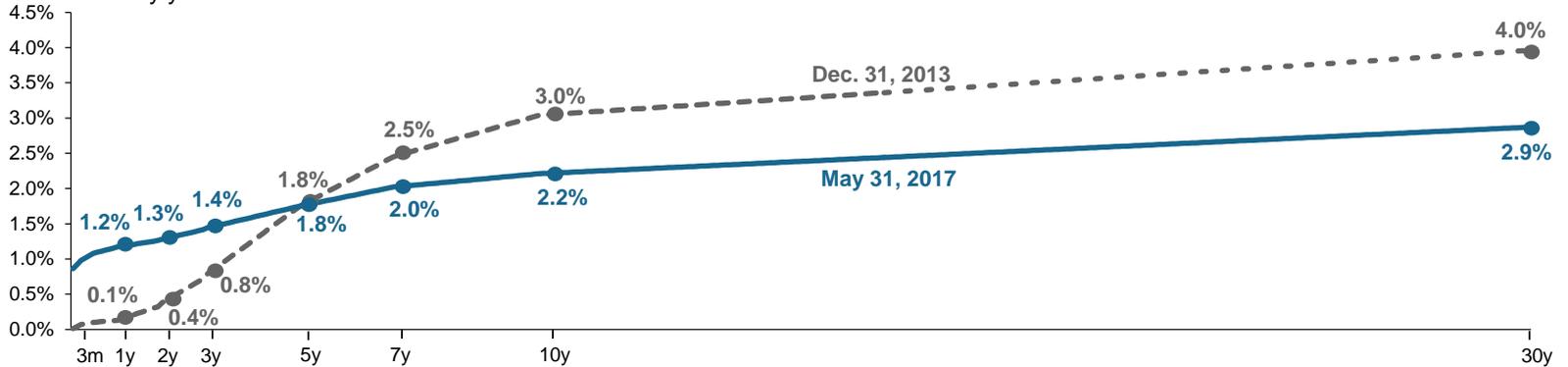
Source: FactSet, Standard & Poor's, FRB, J.P. Morgan Asset Management.
 Returns are based on price index only and do not include dividends. Markers represent monthly 2-year correlations only.
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Shape of the Yield Curve

Fixed income

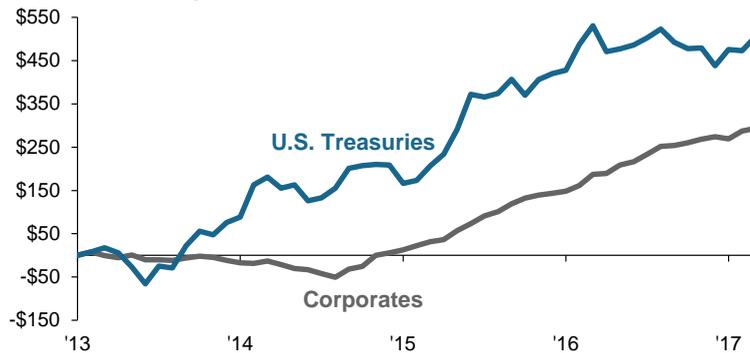
Yield curve

U.S. Treasury yield curve



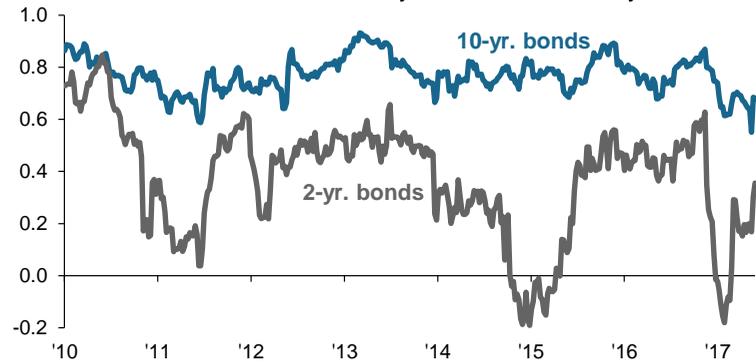
Private foreign investor net flows to U.S. fixed income

Cumulative foreign private net flows into USTs and Corporates, \$ billion



Correlation of government bonds

Correlation* between U.S. Treasury and German Bund yields



Source: FactSet, J.P. Morgan Asset Management; (Bottom left) U.S. Treasury.

*Rolling six-month correlation of weekly change in yield.

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Investing Captive Insurance Assets

- ◆ Investing captive insurance assets can be complex. There are questions to ask prior to determining how to invest these assets.
 - What is the ownership structure of the captive? With the recent tax law change, it likely will be aligned with the operating company's ownership structure.
 - If there are multiple owners of the captive, are there differences in investment philosophy regarding risk and return expectations and time horizon?
 - Considering multiple owners, how do these investments interface with the owner's other investments?
- ◆ What are the tax advantages of investing captive insurance assets?
 - While the underwriting profit of small 831(b) captives is not subject to income tax, income earned on captive asset investments is taxed at the corporate tax rate.
 - Take advantage of the corporate tax rate graduated structure. For example, first \$50,000 of income is at a 15% rate.
 - Qualifying dividends are subject to a 70% Dividends Received Deduction.
 - Consider tax exempt bonds as part of your fixed income allocation.
 - No favorable capital gains rate within a C corporation.
 - While investments made for captive investment assets should consider tax benefits, we don't believe taxes should drive the investment decision.
- ◆ How to invest captive insurance assets?
 - Assets for a captive insurance company should be approached from a broad diversification standpoint, including adequate cash reserves, since potential claims may need to be paid.
 - Development and ongoing monitoring of an Investment Policy Statement.
 - Assets may be invested in mutual funds, ETFs, stocks, bonds or cash.⁽²⁾
 - Other investment portfolios (IRAs, 401ks, etc.) should be viewed in conjunction with your captive insurance company assets to arrive at an asset allocation, consistent with your overall investment goals.

Disclosures

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The Cincinnati Business Courier's Best Place To Work award is drawn from nominations by current employees. Employees of the nominated companies are surveyed and ranked on their responses by an independent third party, Quantum Workplace. Companies are rated in areas such as senior leadership, team effectiveness, work recognition and benefits. Quantum then tabulated the scores to determine who ranked highest in each of five size categories. There were 62 finalists in 2015.

The Goering Center Family & Private Business All-Star Award is drawn from submissions from Privately Held or Family Owned businesses. An independent panel of judges review the applications and determine finalists for the award based on the impact the company has had on its surrounding community. The judges assess applications based on various criteria but consistent elements are identified across all entries, each year; Is there a compelling story? What is the success, how is it measured, is it supported? Is the entry complete, are all the questions fully answered? 75 semi-finalists are named and from that group, 12 finalists and 6 winners are named.

Index Definitions:

Each index reflects an unmanaged universe of securities without any deduction for advisory fees or other expenses that would reduce actual returns, as well as the reinvestment of all income and dividends. An actual investment in the securities included in the index would require an investor to incur transaction costs, which would lower the performance results. Indexes are not actively managed and investors cannot invest directly in the indexes. The past performance of an index is not a guarantee of future results.

S&P 500: Standard & Poor's (S&P) 500 Index. The S&P 500 Index is an unmanaged, capitalization-weighted index designed to measure the performance of the broad U.S. economy through changes in the aggregate market value of 500 stocks representing all major industries.

⁽¹⁾Neither Asset Allocation nor Diversification guarantee a profit or protect against a loss in a declining market. They are methods used to help manage investment risk. Asset protection plans should be developed and implemented well before problems arise. Due to the fraudulent transfer laws, asset transfers that occur close in proximity to the filing of a lawsuit or bankruptcy can be interpreted by the court as a fraudulent transfer. Proper structuring of these assets is imperative please seek proper legal and tax advice prior to engaging in re-titling/structuring of any assets. Please note that laws are subject to change and can have an impact on your asset protection strategy. John D. Dovich & Associates, LLC does not offer legal or tax advice. Please consult the appropriate professional regarding your individual circumstance

⁽²⁾Mutual Funds and Exchange Traded Funds (ETF's) are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from the Fund Company or your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

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