NEWS & INVESTMENT INSIGHTS

FIRST QUARTER | MAY 3, 2017

- The "Trump Trade" Stalls
- An Important Election in France
- The Drums of War
- Delegate Asset Class Perspectives

SUMMARY OF MARKET INDEX RETURNS AS OF MARCH 31, 2017

FIXED INCOME	QTD	1-YEAR	3-YEAR	5-YEAR
Barclays Global Aggregate	1.8%	-1.9%	-0.4%	0.4%
Barclays U.S. Aggregate	0.8%	0.4%	2.7%	2.3%
Barclays Corporate High Yield	2.7%	16.4%	4.6%	6.8%
S&P/LSTA U.S. Leveraged Loan Index	1.2%	9.7%	3.6%	4.6%

EQUITIES	QTD	1-YEAR	3-YEAR	5-YEAR
S&P 500 (Large Cap)	6.1%	17.2%	10.4%	13.3%
S&P Small Cap 600	1.1%	24.6%	9.5%	14.3%
MSCI EAFE Index (International)	7.3%	11.7%	0.5%	5.8%
MSCI Emerging Markets Index	11.5%	17.2%	1.2%	0.8%

OTHER	QTD	1-YEAR	3-YEAR	5-YEAR
HFRI Fund of Funds Diversified Index	1.8%	5.2%	1.7%	3.2%
HFRI Fund of Funds Composite Index	2.3%	6.2%	1.8%	3.2%
Bloomberg Commodity Index	-2.3%	8.7%	-13.9%	-9.5%

Source: Morningstar, Bloomberg. Returns for periods longer than one year are annualized.

Market activity over the first three months of 2017 was largely reactive to geopolitical forces. Events in Washington, Paris, Syria and North Korea remain unsettled to varying degrees and will continue to affect markets in the next quarter and likely throughout 2017. As you will note in our asset class indicators at the end of this letter, we continue to generally recommend that investors seek opportunities in private rather than public markets. Should valuation multiples compress or spreads widen due to increased volatility, adding risk exposure in public equities and fixed income may be prudent for investors, depending on portfolio positioning versus policy targets.

THE "TRUMP TRADE" STALLS

In our last quarterly letter, we noted that the combination of large-scale corporate deregulation, tax cuts, and infrastructure spending would likely provide a tailwind to domestic corporate earnings, resulting in a short-term increase in domestic GDP growth. This optimistic expectation was predicated on the pro-business campaign platform of President Trump, evidenced by the 11.6% increase in the value of the S&P 500 since election night (as of April 26). Now that Trump has been President for 100 days, however, markets are beginning to become skeptical that the policies he spoke of during the campaign will be implemented with the anticipated speed and magnitude. This possibility was put into sharp focus by Trump's initial failure to rally his own party to repeal and replace Obamacare, which may serve as a harbinger of additional conflict over potentially more complicated taxation and spending issues in the future.

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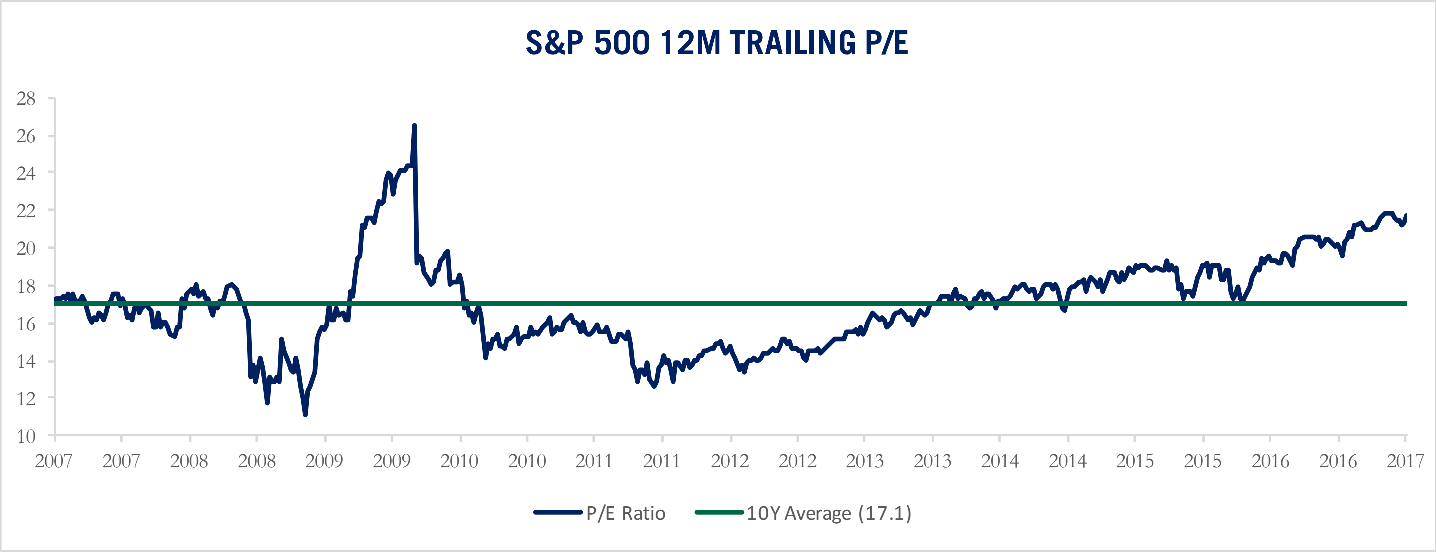
Source: Bloomberg

As domestic equity markets appear to have priced in a large economic reform package coming early in Trump's presidency, the potential for a smaller reform package coming later than initially anticipated could have a large negative impact. This impact could be exacerbated by the high valuations of domestic equities, both on an absolute basis and relative to long-term averages. As illustrated by the chart below, the 12-month trailing P/E ratio of the S&P 500 Index (large cap) as of April 26 was 21.7, 28% higher than the 10-year average P/E of 17.1.



Source: Bloomberg

Small cap equities, as measured by the S&P 600 Index, appear to be slightly less overvalued, with a 12-month trailing P/E ratio of 27.4 as of April 26, 9.9% higher than the 10-year average of 24.9.

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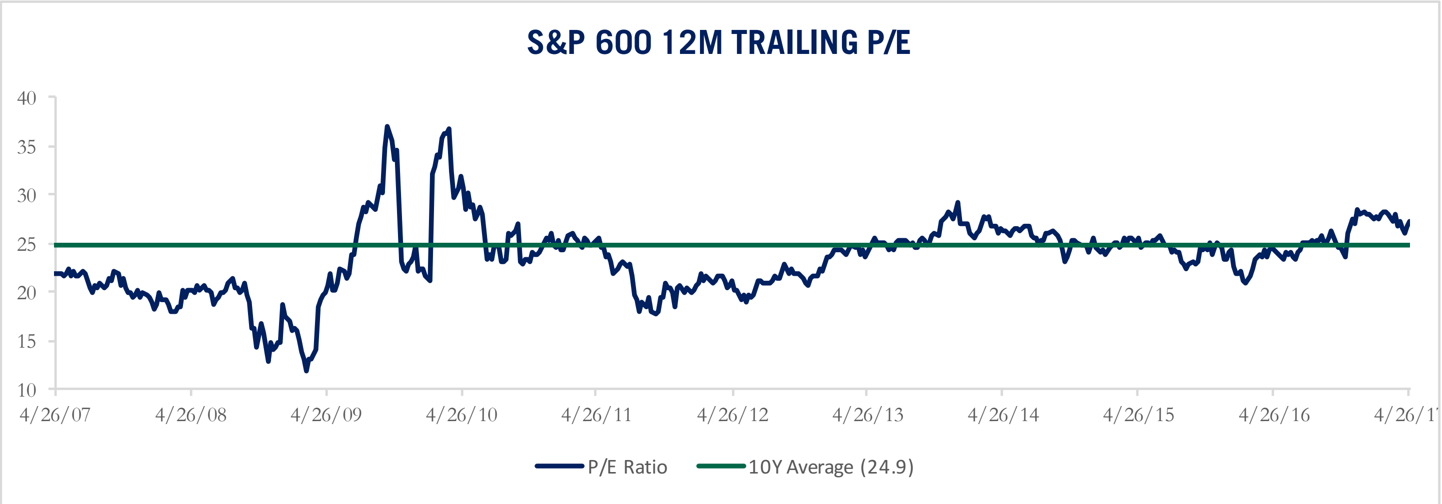

Source: Bloomberg

Relatively rich valuations in the US equity markets are of concern because, if anticipated pro-business policy reforms do indeed take a long time or are of less magnitude than markets currently anticipate, domestic equities have a rather long way to fall to meet long-term average valuations. Thus, we are lowering our recommendation on domestic large and small cap equities from neutral to neutral-to-underweight.

Of course, if the Trump administration is able to work with Congress to implement reforms as originally planned, the boost to domestic GDP growth could be significant, justifying high valuations. In an encouraging step for markets, on April 26, Treasury Secretary Steve Mnuchin announced plans for tax reform that included a decrease in the federal corporate tax rate from 35% to 15%, which would be a boon to corporate bottom lines. Additionally, the plan calls for a decrease in the marginal tax rate for the highest individual tax bracket from 39.6% to 35%. The Trump administration has indicated a goal of passing tax reform by the end of 2017.

AN IMPORTANT ELECTION IN FRANCE

On April 23, French citizens voted in the first round of their highly anticipated presidential election. The top two finishers, pro-European Union ("EU") centrist Emmanuel Macron and anti-EU, far-right Marine Le Pen, will face off in a May 7 runoff to determine the ultimate winner. In the immediate aftermath of the first round of voting, markets rallied based on the above-expectations performance of Macron, who is generally trusted among business leaders and is strongly in favor of France remaining in the EU. Le Pen, riding the coattails of the rise in populism and Brexit, made France's potential departure from the EU a pillar of her campaign.

A Macron win on May 7, largely priced into markets, would alleviate pressure on the stability of the EU in the short term. A win by Le Pen, however, would likely cause substantial volatility and a potentially large drop in the value of European equities due to fears that France would leave the EU and Eurozone, hastening its ultimate collapse. **Pending the outcome of the election, we reiterate our neutral-to-underweight posture on EAFE equities. A Macron win**

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combined with increased economic growth (which remains very low) would likely cause us to recommend a more neutral posture later in 2017.

THE DRUMS OF WAR

For the past 72 years, the world has thankfully turned without a major global war. Over the past year, however, the risk of such an event appears to be rising. Events in Syria and unsettling actions by North Korea have caused increased tension among the U.S., China, and Russia. Should this tension break into an armed conflict, the impact on markets could be severely negative. **A tail risk like war always exists and generally remains a tail risk; currently this risk appears to be increasing. We do not recommend any actions in response to this increased tail risk now; nevertheless, it as a key risk for the coming year.**

DELEGATE ASSET CLASS PERSPECTIVES

Our short- to medium-term asset class perspectives are below.

⇊ UNDERWEIGHT ↓ NEUTRAL-TO-UNDERWEIGHT = NEUTRAL ↑ NEUTRAL-TO-OVERWEIGHT ⇈ OVERWEIGHT

ASSET CLASS	VS. POLICY ALLOCATION (AS OF 12/31/16)	VS. POLICY ALLOCATION (AS OF 3/31/17)	NOTES
Cash	⇈	⇈	Carries material option value, especially during times of uncertainty and high valuations.
U.S. Investment Grade Debt	↓	↓	Low coupons and low yields fail to adequately compensate investors for duration risk.
Global Fixed Income	⇊	⇊	Fails to adequately compensate investors for duration risk. Populism is a growing risk in the EU. Elevated currency volatility risk adds an additional level of uncompensated risk.
Bank Loans	⇈	↑	While bank loan prices have recently rallied, they provide protection from rising rates due to floating rate structures and relatively attractive yields.
U.S. High-Yield Debt	↓	↓	Increased risk due to relatively tight spreads and long duration. Surge of fund outflows could cause liquidity issues.
Emerging Market Debt	=	=	Provides relatively high current yield. Stabilization in commodities markets aids net exporters.
Private Debt	⇈	⇈	Compelling illiquidity premium relative to public markets with a relatively high yield.

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ASSET CLASS	VS. POLICY ALLOCATION (AS OF 12/31/16)	VS. POLICY ALLOCATION (AS OF 3/31/17)	NOTES
U.S. Large Cap Equity	=	↓	Anticipated policy initiatives may take longer to implement and at a lower magnitude than originally expected. Valuations remain elevated.
U.S. Small Cap Equity	=	↓	Anticipated policy initiatives may take longer to implement and at a lower magnitude than originally expected. Valuations remain elevated. MLPs remain attractive due to oil market stabilization, relatively high yields, and long-term growth potential.
EAFE Equity	↓	↓	The effect of monetary stimulus has only recently begun to manifest itself in economic stabilization and improvement. Populism is a growing risk, mitigated somewhat by a French election result potentially favorable to the EU.
Emerging Market Equity	=	=	If underweight, buy on weakness due to long-term growth potential and low valuations relative to domestic equities.
Private Equity	↑↑	↑↑	Compelling illiquidity premium relative to public markets. Favor small and middle market buyout, secondaries and sector specialists.
Hedged Strategies	↑↑	↑↑	Provides uncorrelated returns, alpha opportunities and a reduction in overall portfolio risk.
Real Assets	=	=	Seek to capitalize on idiosyncratic risk, but be wary of the effect of rising rates.
Commodities	=	=	Further stabilization in underlying commodity prices is required for an overweight recommendation.