

During the first quarter of 2017, U.S. equity markets reversed the relative performance trends experienced in 2016. Specifically, large cap equities outperformed small caps and the financials, industrials, and energy sectors lagged healthcare, technology, and utilities. The S&P 500 and Russell 2000 Value appreciated 6.1% and -0.1%, respectively during the quarter. While investors have growing concerns over whether or not Trump's agenda of corporate tax reform, broad regulatory relief, infrastructure spending, and healthcare reform will be implemented, capital markets remain well supported by improving economic survey data, "soft data", low interest rates, liquidity injections by foreign central banks, and continued credit creation in the unregulated banking system. However, we must acknowledge that margins and equity valuations are at or near all-time highs and that the business and credit cycles are quite mature **(Chart 1 & 2)**.

CHART 1

Profit Growth and Margins

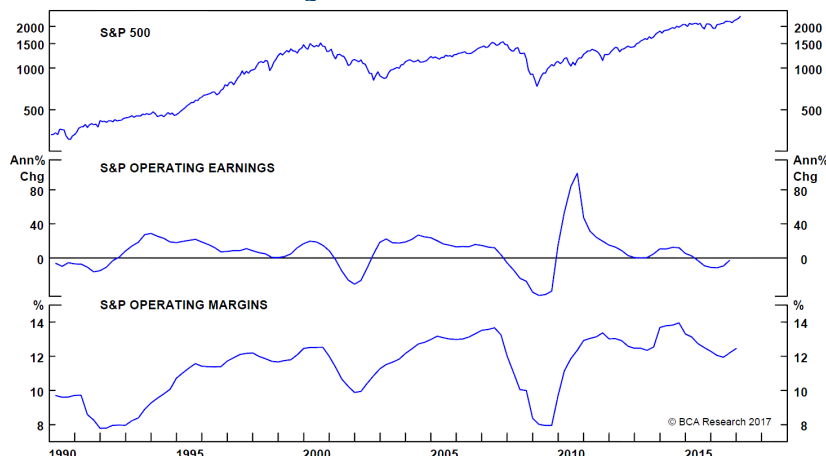


CHART 2

Cyclically-Adjusted P/E Ratio



The Federal Reserve has begun raising interest rates. Although interest rates should increase at a measured pace, the risks are heightened compared to prior rate hike cycles in light of current valuations and the leverage that remains globally in both the private and public sectors. In order to continue to support current valuations and expect further market appreciation, credit markets need to remain a material supplier of liquidity at low real rates.

With earnings estimates for 2017 declining modestly during the quarter, it is important for nominal GDP growth, industrial production, and consumer spending to increase in coming quarters to justify the price appreciation equity markets have experienced over the trailing twelve months. Therefore, we continue to believe that new pro-growth fiscal policies are necessary in order to achieve earnings expectations in 2017 and 2018. As we continue to transition from monetary to fiscal stimulus, we expect market volatility to increase from today's exceptionally low levels.

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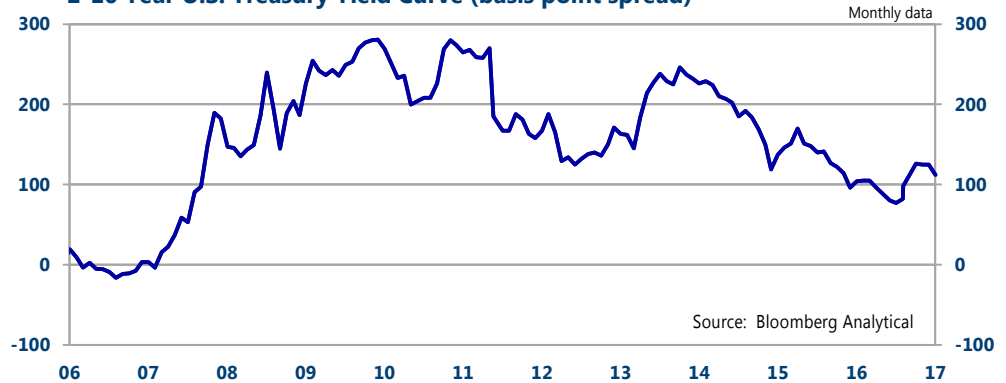
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As the nature of the market continues to change, there are still individual stocks that will perform well over the medium term. Our outlook remains balanced, stock-specific, and not reflective of opportunities in specific industries, regions of the world, or broader market indices.

CHART 3

2-10 Year U.S. Treasury Yield Curve (basis point spread)



After a significant rise in U.S. Treasury yields and volatility during the previous quarter, the first quarter of 2017 saw stability return to the overall Fixed Income marketplace. The bellwether 10-year Treasury note yield declined five basis points to 2.39% and the 2-Year to 10-Year yield curve flattened slightly (**Chart 3**). The Federal Reserve Board continued its well telegraphed gradual rate normalization policy by increasing the Federal Funds Rate by 0.25% to 1.00% on March 15th. We expect one to two more rate increases during the balance of the year, but only if the economic data remain solid and there are no major shocks to the global financial system.

Corporate bonds remain the most attractive sector within the investment grade universe, and therefore we expect to maintain our overweight allocation going forward. Improving fundamentals and strong investor demand for higher yielding bonds drove risk premiums down to 122 basis points over Treasuries in the quarter, after ending 2016 at 130 basis points over Treasuries. The best performing sector was financials as the new administration pushes to roll back some of the burdensome regulations imposed after the 2008 financial crisis.

Municipal bond yields moved in unison with Treasury markets during the quarter. With the agenda in Washington now turning to economic stimulus and major tax reform, we expect increased volatility within the tax-exempt market. Taxable equivalent yields for investors in the higher tax brackets remain more attractive than those of similarly rated corporate bonds.

