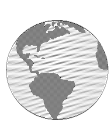
MOSAIC FINANCIAL PARTNERS, INC.

Market Watch
4th Quarter 2017

January 2018 MosaicFP.com

Summary

- The global economy spent 2017 in a synchronous recovery for the first time in a decade, helping to boost markets around the world.
- US stock markets broke a number of records for new highs in 2017.
- International stocks, especially emerging markets, enjoyed exceptional performance.
- Bond returns were positive for the year across categories.
- US unemployment fell to 4.1% by the end of 2017.
- Economic data suggests increased productivity and wage growth as we head into 2018.
- The Federal Reserve, under new Chair Jerome Powell, is expected to continue to increase interest rates while keeping a keen eye on inflation as well as unemployment numbers.
- Many analysts and economists are optimistic about 2018.
- We know that market downturns will arrive at some point, given the cyclical nature of the markets. We are prepared.



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Overview

2017 marked a year of widespread data breaches, the beginning of the Trump presidency, devastating hurricanes, wildfires that raged throughout California, and a cryptocurrency frenzy reminiscent of the Dot.com bubble. However, through it all, 2017 saw a long, steady rise in the stock markets.

It was a year of record highs as we saw the NASDAQ surpass the 7,000 mark, and the Dow Jones Industrial Average roar past the 25,000 mark. US large cap returns reached 21.8%, pushed by the technology sector's rise of 35.4%. Although small cap stock returns were lower in comparison, they still returned a very positive 14.7%. As strong as US market returns were, international markets performed even better.

The fourth quarter of 2017 produced yet more strong returns as the world economy experienced the first period of synchronous global growth in approximately a decade. The US economy had a prosperous year in 2017. Unemployment reached a low of 4.1% for the year; economic growth for Q3 rose to 3% and will likely come in around 3% in Q4 as well. If this happens, it will be the first time the US gross domestic product (GDP) has had three consecutive quarters of 3%+ growth since 2004, according to economists at First Trust.

All primary US bond categories enjoyed positive returns for the year. Fixed income returns in 2017 paled in comparison to the sizable returns equities experienced.

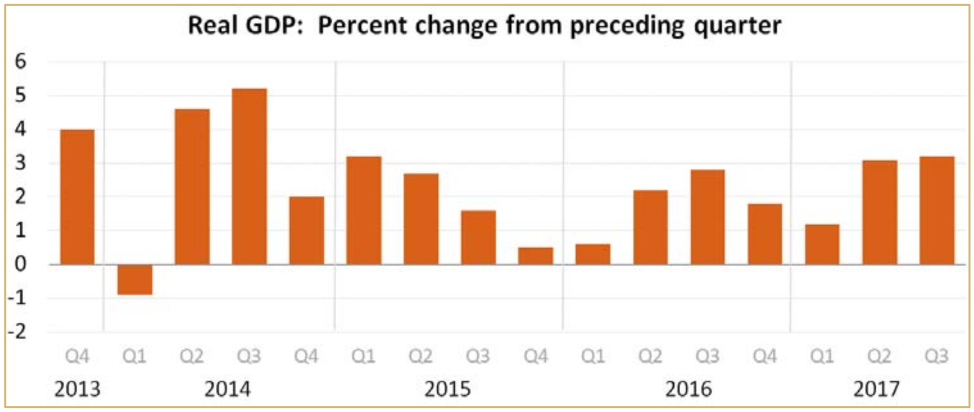
All of the encouraging economic trends seen in 2017 makes us optimistic about the prospects for 2018. We are currently in the second longest economic recovery in US history. With this in mind, many argue a recession must be imminent. However, positive economic data in the US and in most countries globally gives us a less pessimistic outlook. Labor markets are strong, economies are growing around the world, and consumer and investor confidence is high. In addition, consistently low inflation, falling unemployment, and rising standards of living around the world all offer reason for optimism about the year ahead.

Risks lurk nearby, as they always do, but most forecasters see a high likelihood of continued positive results in the coming year.

The US Economy

As noted, the United States economy enjoyed a fruitful 2017. In the coming year, we may see boosts from the recently passed Tax Cuts and Jobs Act (TCJA), continued deregulation, and the further normalization of monetary policy. As we head into 2018, these changes should contribute to an increase in productivity along with job and wage growth. This will further encourage domestic economic growth.

According to the Bloomberg Consumer Confidence Index, consumer confidence is at its highest point since 2002. With such heights, and with more people working, an increase in consumer spending is probable in 2018. As consumer spending makes up roughly two-thirds of the US economy, we should see strong economic growth continuing throughout 2018.



Q3 reports showed the GDP growing at 3% year-over-year. This growth rate closely parallels the 3% growth rate typically observed in past economic recoveries (and is an increase over the growth rate achieved throughout most of the current recovery).

Most analysts expect annualized GDP growth to come in at 3% or higher in Q4. Given the recent changes in taxation and regulation, along with the positive trends in employment, we could see annual GDP growth rising to as high as 3.5% in the coming year. One factor that could alter this forecast is a slowing down of the economy prompted a more aggressive series of interest rate hikes by the Federal Reserve. We consider this a highly unlikely scenario.

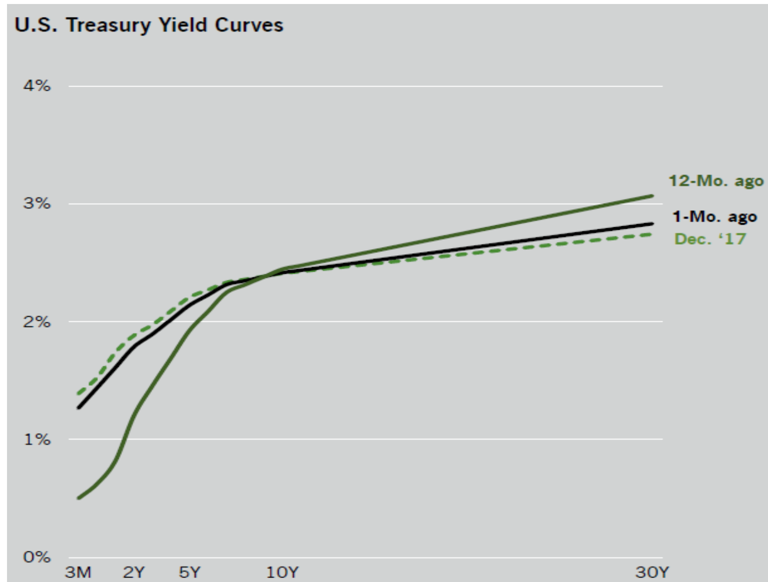
The Federal Reserve increased interest rates three times in 2017, bringing the federal funds rate to 1.5%. at year-end. With the continuing strength of the US economy, most observers expect the Fed to continue to raise rates in 2018. The Fed has forecasted that a target interest rate of 2.5% is likely at the end of 2018.

A closely-watched measure of economic health is the yield curve, a graph that plots interest rates at different maturities. Economists become concerned when the daily Treasury yield curve is flat or inverted (when short-term interest rates are higher than long-term rates), as recessions often follow such conditions. The good news on this front is that, so far, the Treasury yield curve has maintained its positive slope, suggesting no recession appears imminent.

One of the central missions of the Fed is to hold inflation at reasonable levels. Rising inflation could lead the Fed to increase the federal funds rate more rapidly than currently expected in an effort to dampen any inflationary trend.

The chart focusing on the US Treasury yield curves shows the inflation rate since 1970, as measured by twelve-month percentage changes in the price index. As can be seen from the chart, recent inflation has remained well below historical averages.

Most analysts believe that continuing low unemployment will soon push wages higher. This, combined with rising commodity demand due to economic growth, is expected to contribute to an increase in inflation.



The World Economy

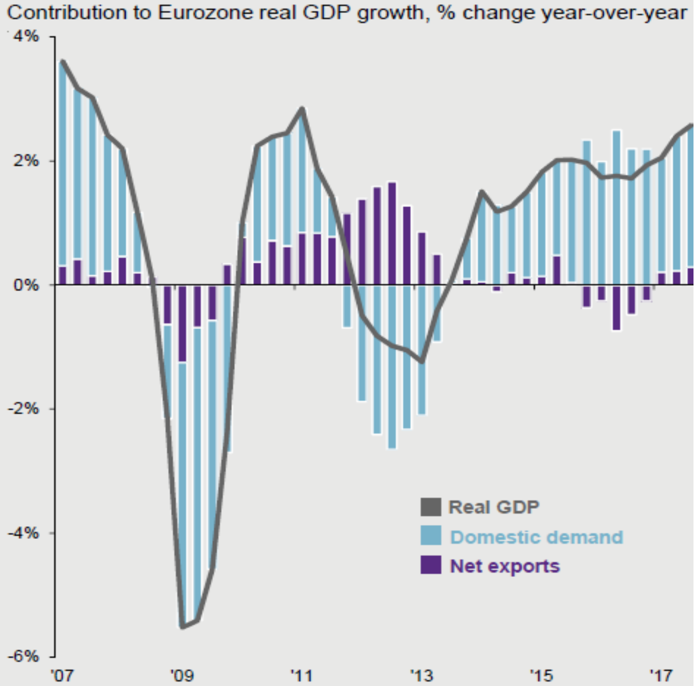
Recently, the global economy has seen a harmonized recovery with economic expansion evident in many countries. Having struggled with economic weakness more recently than the US, both Japan and Europe are now showing improved growth rates. China seems to have stabilized. Both India and Indonesia have passed economic and political reforms that should help strengthen their economies on a fundamental level. These changes are expected to correct past imbalances and provide some protection against vulnerabilities going forward.

There have been broad political shifts in several Latin American countries, resulting in the creation of economic policies that are seen as being more investor -friendly and are thus attracting long-term investors.

The combination of economic progress and political change has helped international currencies strengthen in relation to the dollar. This has been a positive for US investors holding overseas investments as international equities significantly outperformed US investments in 2017. Many forecasters believe this is a trend that will continue in 2018.

Eurozone GDP growth

Contribution to Eurozone real GDP growth, % change year-over-year



As can be seen in the chart focusing on euro zone GDP growth, this area has seen rising economic growth over the last few years. This growth has been fueled by growing domestic demand, strong job creation, and falling unemployment. Current estimates are that euro zone GDP growth will have increased by 2.4% year-over-year in 2017. This trend is expected to continue in 2018.

Brexit negotiations and its related fallout could be problematic for the UK, but the outcome remains to be seen.

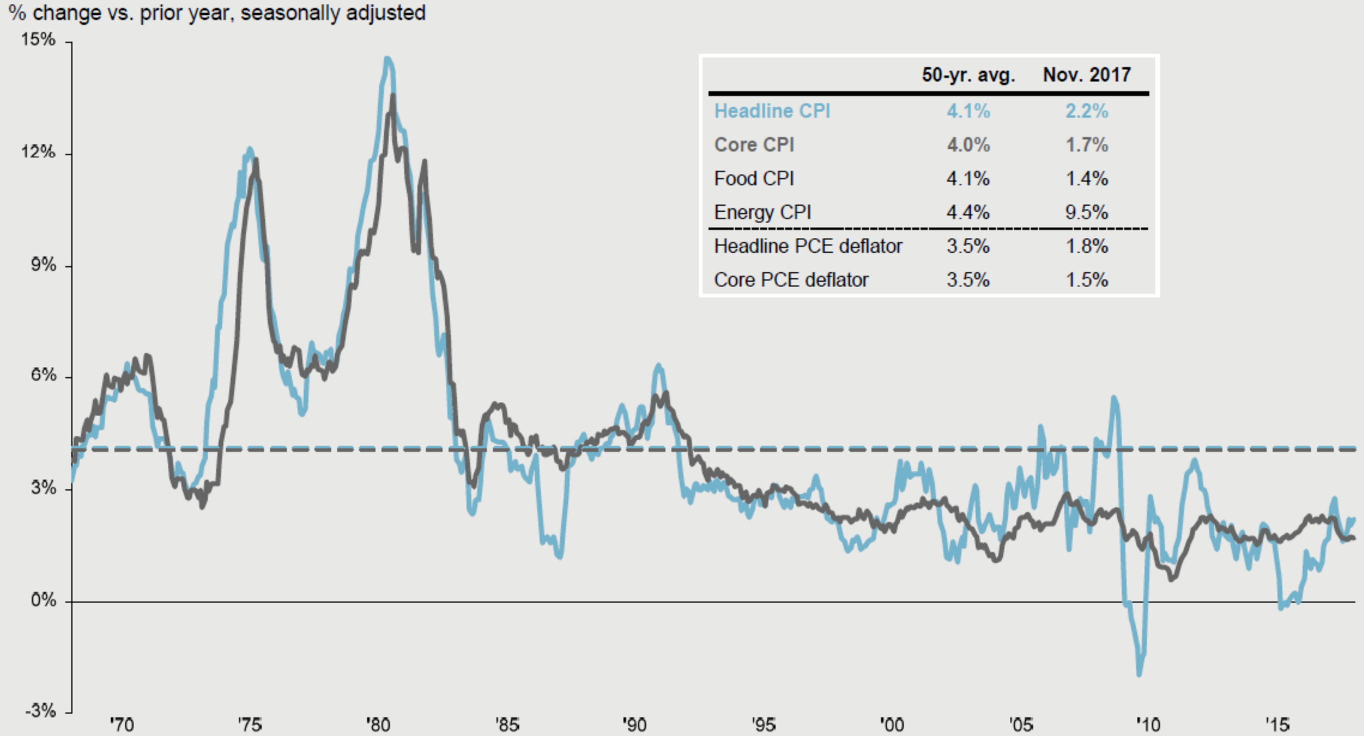
France's President Emmanuel Macron is boldly reforming the French economy. If successful, this should contribute to enhanced economic growth. Elections in Spain, Italy, and Germany should offer additional clues as to the prospects for future economic direction.

The Japanese economy finally appeared to be coming out of its two decade-long funk in 2017. Japan's solid economic growth was fostered by the Bank of Japan's monetary policy as well as by positive corporate earnings (which are expected to improve further in 2018). Japan's unemployment has fallen to 2.8%, the lowest level in almost twenty years. The of Japan's Prime Minister Shinzō Abe, enacting his "Abenomic" policies of fiscal stimulus, structural reform, and strong monetary measures, seems to be making a difference. Japan's risks include geopolitical tensions in the Korean Peninsula and the risk of increased US protectionism as the US struggles with a widening trade deficit.

As indicated by the MSCI China Index, China posted a return of 54.3% in 2017. This return stems from a reflationary policy that has helped boost profit margins and helped Chinese corporations manage their debt loads. There has also been a growing demand for Chinese exports by emerging market economies and other countries, which has helped bolster trade and

CPI and core CPI

% change vs. prior year, seasonally adjusted



	50-yr. avg.	Nov. 2017
Headline CPI	4.1%	2.2%
Core CPI	4.0%	1.7%
Food CPI	4.1%	1.4%
Energy CPI	4.4%	9.5%
Headline PCE deflator	3.5%	1.8%
Core PCE deflator	3.5%	1.5%

offers a positive outlook for the New Year. Consumer confidence in China is at its highest point in 24 years.

The MSCI Emerging Market Index saw lofty returns of 37.8% in 2017 (with 7.5% of that percentage added in Q4). Despite this rise, emerging market stock valuations appear reasonable, especially when compared against their historical levels and the valuations of developed market equities.

Most analysts believe emerging market equities still have positive growth potential given valuations and the expectation that emerging economies will continue to improve.

Conflicts on the Korean Peninsula or in the Middle East could impact emerging market economies. Likewise, should major central banks begin to increase interest rates, this could lead to a slowdown in some emerging market economies.

US Equities

Equity prices saw a large jump in the last quarter of 2017, assumed due to the expected passage of the TCJA. The S&P 500 Index rose 6.6% in the Q4 of 2017. This boosted the year's total return to 21.8%..The Russell 2000 Index, which measures US Small Cap stocks, increased by 3.3% in the final quarter of 2017 bringing the year's total return to 14.7% (a strong return, but modest in comparison to that of the S&P or NASDAQ). The NASDAQ, bolstered by information technology companies, rose by a whopping 29.6% in 2017.

One of the trends we have been monitoring closely during the market rise has been the performance of growth versus value and small cap versus large cap. The last few years have seen large cap stocks outperforming small caps and value stocks being overwhelmed by growth. As you are aware, market trends are cyclical. Historically, small companies have generated higher returns than large, and value has outperformed growth. This is something that we believe will continue to hold true over time, as is reflected in our investment approach. This said, as technology and globalization continue to change the global financial landscape, we will be watching these fundamental trends very closely.

International Equities

International equities posted the year's strongest returns in 2017. As measured by the MSCI EAFE Small Cap Index., international small stocks finished the fourth quarter up 6.1%, adding to a 33.5% return for the year. International large stocks returned 4.3% in the fourth quarter, bringing the 2017 total to 25.6% (MSCI EAFE Large Index). In part, these very strong

Country / Region	Returns 2017	Returns 2016	Returns 15-year ann.	15-year realized volatility
Regions / Broad Indexes				
AC World ex-U.S.	27.8	5.0	9.2	18.9
U.S. (S&P 500)	21.8	12.0	9.9	14.5
EAFE	25.6	1.5	8.6	18.4
Europe ex-UK	27.8	0.3	9.4	21.2
Emerging markets	37.8	11.6	12.7	23.0
MSCI: Selected Countries				
United Kingdom	22.4	0.0	7.1	18.5
France	29.9	6.0	8.8	21.7
Germany	28.5	3.5	11.5	25.1
Japan	24.4	2.7	7.2	17.4
China	54.3	1.1	16.2	27.2
India	38.8	-1.4	14.9	30.8
Brazil	24.5	66.7	15.8	34.9
Russia	6.1	55.9	8.8	37.3

returns were attributable to the relative strength of foreign currencies in relation to the dollar; foreign currencies saw their best performance against the US dollar since 2007 in the final quarter of the year.

Fixed Income

Fixed income (bond) returns were positive across the board, even as the Federal Reserve Bank began gradually raising interest rates. Bond prices are inversely related to interest rates; as interest rates rise, the prices of existing bonds will typically decline (and increasingly so, for bonds with longer maturity). Despite the Fed raising the federal funds rate to 1.50%, longer-term interest rates stayed relatively steady while inflation remained under control.

The Barclays US Aggregate Bond Index rose in Q4 by 0.4%, finishing the year with a 3.5% gain. Treasury Inflation-Protected Securities (TIPS), which helps investors hedge against inflation, rose 1.3% in Q4, ending the year up 3.0%. Emerging market bonds fell slightly in Q4 but finished the year up 8.3% as measured by the JP Morgan Emerging Market Bond Index.

Global Real Estate

With international real estate now available in funds and ETFs, holding a global real estate portfolio is possible. Global real estate saw returns of 3.3% in Q4 closing the year with a gain of 8.6% for 2017.

Alternatives

Master Limited Partnerships (MLPs) continued to experience challenges in 2017. MLPs

Market Returns

2015	2016	2017
Int'l Sm 9.9	BDCs 24.4	EM 37.8
EM Bonds 1.8	Small US 21.3	Int'l Sm 33.5
Mrgr Arb 1.7	MLP 18.7	Int'l Lrg 25.6
Intermed Bonds 1.1	Large US 12.1	Timber 21.9
Large US 1.0	EM 11.6	Large US 21.8
ST Bonds 0.7	EM Bonds 9.6	Small US 14.7
Mgd Futures 0.04	Timber 8.3	REITs 8.6
Int'l Lrg (0.4)	TIPS 4.7	EM Bonds 8.3
REITs (0.4)	REITs 4.6	Mrgr Arb 6.8
TIPS (1.5)	Int'l Sm 2.6	TIPS 3.0
BDCs (4.1)	Intrmed Bonds 2.1	Intrmed Bonds 2.1
Small US (4.4)	Int'l Lrg 1.5	Mgd Futures 2.0
Timber (7.0)	ST Bonds 1.3	ST Bonds 0.8
EM (14.6)	Mrgr Arb (0.8)	BDCs 0.1
MLP (31.7)	Mgd Futures (6.1)	MLP (8.8)

invest in energy infrastructure. It's a relatively stable business that produces a steady revenue from royalties paid for transportation and storage. Although MLP returns should not be affected by the price of oil, they unfortunately are. As oil prices have risen or declined over the past few years, the prices of MLPs have moved up and down in rough parallel. MLPs lost 1.8% in the forth quarter and declined 8.81% for the year. As economies continue to prosper, and world demand for energy increases, we expect to see MLPs post positive long-term returns.

Timber was one of our top performers this year. Timber has been doing exceptionally well as real estate markets continue to grow and world trade increases (think shipping pallets and paper). The FTSE NAREIT Timber REIT Index, saw returns of 4.9% in the fourth quarter and 21.9% for the year.

Managed Futures had a remarkable Q4 return of 7.5%, bringing managed futures back into positive territory and closing out the year up 2% as measured by the SG Trend Index. Managed futures have consistently offered diversity in portfolios given their low correlation to stocks and bonds and their ability to make money in positive or negative markets. They have recently suffered through a prolonged period of weak performance, but we continue to believe normal cycles will apply here as well, eventually making them an attractive part of a successful portfolio.

Merger Arbitrage: This combination of holdings is intended to produce a low-volatility investment that generates a more bond-like return that is less sensitive to interest rate changes. In the final quarter of 2017 Merger Arbitrage added 1.2% for a total return of 6.8% in 2017.

Business Development Companies (BDCs): BDCs have some parallels to venture capital, as these are companies that lend to newer and restructured companies. Because this business model can be volatile, BDCs are not part of most moderate/conservative portfolios. As represented by the Wells Fargo Business Development Company Index, Q4 brought a -3.2% return, closing the year with a 0.1% return. While 2017 did not prove positive for BDCs, the past three years have seen BDCs generate an average annual return of 6.1%.

Conclusion

Structuring a well-built investment portfolio means mixing a variety of investments—each of which may shine under different circumstances. A diversified portfolio will inevitably have some weaker performers, even in good years like 2017. But when challenging market years occur, some of these same strategies can shine—as happened in the Dot.com market crash and the Great Recession.

As investment managers and financial planners, it is our job to peel back the emotion that riddles the markets, to stick to positive, fundamentally backed theories, and to continue to build upon and protect the hard-earned wealth of our clients. While risk and uncertainty may be daunting, rest assured that Mosaic's strategic investment approach and portfolio management will help keep you on track in pursuit of your goals and help you avoid emotional reactions to short-term events.

We want our clients to enjoy growth, but to do so prudently. Investing can be an emotional rollercoaster. We believe a steady, long-term approach that employs a variety of investments is most likely to enable you to stay the course when markets are most challenging.

We are well prepared for 2018 and beyond. Optimistic data from economies around the world, strong underlying investment principles, and continuously questioning how we might do things better should all contribute to another good year.

Thank you for allowing us to be of service to you.

Your Team at Mosaic Financial Partners

Sources: *Baron's, BNP Paribas, US Bureau of Economic Analysis, Charles Schwab, JP Morgan, Federal Open Market Committee (FOMC), Morningstar, WSJ, Ned Davis Research Group, Nuveen, Reuters, Schroder's, T Rowe Price, First Trust Bank, Bloomberg Consumer Confidence Index, United States Department of Labor.*