Sheaff Brock

Innovative Portfolios for Intelligent Investors™

MARKET UPDATE

March 2018

Benchmarks: The S&P 500 Index is a market capitalization-weighted index comprised of the 500 stocks with the largest market capitalizations trading in the United States. This is not a managed portfolio and does not reflect the deduction of fees or expenses; returns include dividends. The Barclays US Aggregate Bond Index is a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market in the United States, including Treasuries, government-related and corporate securities, mortgage backed securities, asset-backed securities and CMBS (agency and non-agency). The CBOE S&P 500 Buy-Write Index (BXM) is a passive total return index based on buying an S&P 500 stock index portfolio, and selling the near-term S&P 500 Index (SPX) covered call option, generally on the third Friday of each month. The SPX call will have about a one month expiration, with an exercise price just above the prevailing index level, slightly out of the money. The BXM Index does not take into account significant factors such as transaction costs and taxes and, because of factors such as these, investors should be expected to underperform passive indexes. The BXM Index represents a hypothetical buy-write strategy. DB Commodity Index Tracking Fund (DBC) The PowerShares DB Commodity Index Tracking Fund seeks to track changes in the level of the DBIQ Optimum Yield Diversified Commodity Index Excess Return™ plus the interest income from the Fund's holdings less the Fund's expenses. The Fund is designed for those who want a convenient way to invest in commodities. The Index is composed of futures contracts on 14 of the most heavily traded and important physical commodities in the world. The Fund and the Index are rebalanced and reconstituted annually in November. The Alternative portfolio is a commodity centric portfolio of ETFs and mutual funds whose constituents' profits are highly sensitive to general commodity prices. It may perform differently than DBC since the composite does not hold futures contracts. Indexes are unmanaged and unavailable for direct investment. Benchmark returns include reinvestment of income, but do not reflect taxes, or other fees that would reduce performance. Performance information of benchmark indexes is included for comparison purposes only. Two general types of benchmarks are provided.. The first type is a well-known and widely-recognized index, such as the S&P 500 Index (described previously), and the Barclays US Aggregate Bond Index (described previously). These types of indices are not selected to represent an appropriate benchmark, but rather to allow for comparison of a composite's performance to that of a well-known and widely recognized index. The second type of index is a narrowly-focused (NF) index selected on one or more characteristics, such as asset class, style or strategy, geographic area, or sector, for example, similar to characteristics of a composite. Although a NF index may have characteristics similar to those of a composite, actual composite holdings will differ significantly from the securities that comprise an index. Consequently, use of a NF index does not indicate that a composite will achieve returns, volatility or other results similar to those of the index. The composition of a NF index will not reflect the manner in which a composite is constructed in relation to investment holdings, Portfolio guidelines, restrictions, sectors, correlations, concentrations, volatility or tracking error targets, all of which are subject to change over time. Comparison of a narrowly-focused index to a composite must be limited to the similar characteristics. Clients should NOT expect performance comparable to a narrowly-focused index in an actual account. (continued below)

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Any portfolio returns mentioned are composite total returns, and are net of fees and commissions. There is the chance that market conditions or portfolio performance may deteriorate in the future, and clients may experience real capital losses in their managed accounts. Portfolios are compared to the performance of various indices although the portfolio, which contains much fewer positions, may not reflect the securities making up these indices. None of the indices may be an appropriate comparison index as our managed accounts may own companies not represented in the benchmarks. All clients of SBIA who desire to participate in option transactions receive the option disclosure document, titled Characteristics and Risks of Standardized Options, which outlines the purposes and risks of option transactions. Despite their many benefits, options are not suitable for all investors. Individuals should not enter into option transactions until they have read and understood the risk disclosure document which can be obtained from their broker, any of the options exchanges, or OCC. All investment strategies carry risk, and transactions in options may carry a high degree of risk. Options derive their value from underlying equities or indices, and the derivative value is directly related to the underlying security, thus they carry many, if not more, of the same risks as the underlying equity or index. Sellers of options should familiarize themselves with the type of option (i.e. put or call) which they contemplate trading and the associated risks. You should calculate the extent to which the value of the options must increase for your position to become profitable, taking into account the premium and all transaction costs. Selling ("writing") an option generally entails greater risk than purchasing options. Although the premium received by the seller is fixed, the seller may sustain a loss well in excess of that amount. The seller will be liable for additional margin to maintain the position if the market moves unfavorably. Standstill option yield is calculated by dividing the aggregate annual option time decay by the aggregate account values. The yield is reflected gross of management fees. There were no other strategies employed to obtain the results portrayed other than those strategies disclosed in the SBIA ADV or other disclosure brochure. SBIA provides this Newsletter for general informational and educational purposes, and where appropriate, to assist in explaining the portfolios and composites. It is not investment advice for any person. Information is obtained from sources SBIA believes are reliable, however, SBIA does not audit, verify, or guarantee the accuracy or completeness of any material contained therein. The statements and opinions reflect the judgment of the firm, and along with the information from third-party sources and calculations, are made on the date hereof and are subject to change without notice. SBIA does not assume liability for any loss that may result from reliance by any person upon any material in this Newsletter. Clients or prospective clients are directed to SBIA's Form ADV Part 2A and to one or SBIA's representatives for individualized information prior to deciding to participate in any portfolio or making any investment decision. SBIA does not provide tax advice. Clients are strongly urged to consult their tax advisors regarding any potential investment. **Past performance does not guarantee future results, there is always a possibility of loss.**

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> "Talent hits a target no one else can hit. Genius hits a target no one else can see."
>
> Arthur Schopenhauer

Trade deficits (don't matter)**, tariffs** (do matter)**, and the stock market** (matters to people reading this):

There has been a lot of talk about the effect of tariffs on both the U.S as well as on countries that trade with the U.S. A goal of the administration is to reduce the trade deficit with better "trade deals". Let's look at trade deficits, the effectiveness of tariffs, and what the stock market might do as a result.

Photo by alphastockimages.com

A **trade deficit** means the U.S. buys more stuff from other countries than they buy from us. The U.S has had the largest trade deficit on the planet every year since 1975. This year, we will buy from other countries about $2.9 trillion of stuff we need, and we will sell other countries about $2.3 trillion of stuff they need. The difference, about $600 billion is the trade deficit. Trade happens because we are good at making or doing some things that other countries aren't good at, so they buy from us. We are good at food, machinery, expensive electrical equipment, industrial supplies, aircraft, medicine, medical supplies, and services like business consulting. Other countries are good at making fabric, clothing, cheap electronics, cars, oil, and other commodities. Here is what the Cato Institute says:

No aspect of international trade is talked about more and understood less than America's trade deficit. Most Americans believe the trade deficit is evidence that American companies are failing to compete in global markets or that U.S. exporters face "unfair" trade barriers abroad. The popular thinking on trade deficits is simple, appealing—and wrong. And, contrary to the headlines, trade deficits are not necessarily bad news for the U.S. economy. They may even be good news.

Here is what Investors Business Daily says:

Few concepts in economics are more misunderstood than the balance of trade. People seem to assume that a trade deficit is bad and a trade surplus is good. The assumption is that countries with a trade surplus are economically stronger than countries with a trade deficit. But, of the 10 largest economies with trade surpluses in 2016, only two had much stronger GDP growth than the U.S.


Day

Hoover Signs Tariff Bill; Takes Effect at Midnight; Revises Eight Year Old Rates

Tariffs do matter. The Smoot-Hawley Tariff Act signed into law by Herbert Hoover caused the 1930's depression. A lot of talking heads, rightly so, have their shorts in a wad about Trump's tariff threats. In this week's Barron's, Ed Yardeni addressed tariffs in an interview. Dr. Yardeni is one of our favorite economists...and yes we know it is a sad state of affairs to have a favorite economist, let alone admit to the fact. It's OK to have a favorite artist, singer, or ice cream flavor, but a favorite economist is sort of pitiful.

Barron's: Are we heading for a trade war that will derail the markets?

Yardeni: The president is hard to predict, which makes the stock market's reaction hard to predict. The stock market is the one poll Trump follows. If it continues to decline, it will make him realize that [imposing tariffs] isn't a good way to proceed.

Now it's important to recall that Ronald Reagan also came in as a protectionist and imposed 100% tariffs on Japanese semiconductors and twisted their arms with auto export restraints. It worked: It brought a lot of Japanese production here.

My sense is Trump is taking extreme stances, trying to convert multilateral trade deals into more easily adjustable bilateral trade agreements. He then compromises to get more or less what he wants. Assuming Trump succeeds in making trade fairer for Americans without crippling free trade overall, it would be positive for the U.S. and for stocks.

Photo by cafecredit.com

Yardeni went on to discuss the **stock market**:

Barron's: Credible people believe that after such a long bull market, we're headed for a long period of low returns. Yet you remain bullish.

Yardeni: The earnings story is phenomenal. The tax cut has added seven percentage points to earnings growth this year. To quote a well-known president, that's yuuge. The valuation story is getting clipped because of the Fed normalizing rates and bond yields moving somewhat higher. I estimate Standard & Poor's 500 index earnings of $155 this year, up 16.8%, and $166 for 2019, up 7.1%. I have a 3100 target for the S&P 500 *(about 28,000 on the Dow Jones Industrial average - DJIA)*, or 18.7 times 2019 earnings. I am sticking with it, though the trade fracas could push my target from the end of this year out to next year.

We have said for a while that the DJIA could trade up to a similar level; which must be why we think Dr. Ed is so smart.

Markets:
February was a negative month for the stock market which ended one of the longest positive streaks ever. But, as Chaucer wrote in the 1300s, "There is an end to everything, good things as well", and our comment on the streak ending could be summed up with two words, 'bout time.

About a week after you get this, first-quarter earnings season will start, which will be the first one under the new lower corporate tax rate. In the first two months of the quarter, analysts raised earnings estimates both for the quarter, and for the year. This estimate increase is the largest increase during the first two-months of a year since Factset started tracking it in 1996. As it was written this week in Louis Navellier's blog, "While investors may be wringing their hands over interest rates, inflation, and tariffs, the market is about to get a serious earnings jolt that will overwhelm everything else. Strap in friends, we're likely going much higher."

<u>Portfolio Updates</u>
January was good, February, not so much (except for the option overlays). Volatility has popped higher, which helps if you sell options, but has a tendency to unnerve equity investors. Interest rates have jumped up with the 10-year Treasury rate now at 2.8%, double from where it was last summer. Volatility seems kinda-sorta high, but in reality it is just back to average.

WARNING

#1 Remember, you will now start receiving corporate mailings and proxies in your mailbox. Vote them or pitch them, your choice.

#2 Some of you will be getting a management agreement update by DocuSign. Be on the lookout. Easy, secure, and fast.

Dividend Growth & Income
Our dividend-driven equity strategy had a great 2017 and a terrific January, but then gave some back in February (but we're still well ahead of our benchmark). Through February, the composite earned a total return of 2.8% gross-of-fees and 2.5% net-of-fees. As a comparison, our benchmark, the Dow Jones Select Dividend Index, <u>lost</u> money by posting a total return of –2.2% during the same period. The portfolio is fully invested in 25 stocks, has exposure to 10 of the S&P 500's 11 sectors (no utility stocks), and pays an average dividend yield of 3%. Remember how we talked about earnings estimates going up? Our portfolio's average estimate has risen 9.5% in the last 90 days vs. 7.6% for our benchmark's average earnings estimates.

IntelliBuilD Growth™
A portfolio based on *Investors Business Daily's* IBD 50 and New America stock lists. It looks for growth, growth, and nothin' but growth. IntelliBuilD takes great American growth stocks and then applies a value screen to find 33 growth stocks with the lowest "downside risk" characteristics. The last sentence was a repeat from last month's newsletter, but it bears repeating. IntelliBuilD followed a great 2017 with a solid start to 2018 by gaining 2.3% gross-of-fees and 2.0% net-of-fees vs. 1.8% for the S&P 500 and –1.7% for the S&P Mid-cap 400. This is a quantitative-screened systematic strategy which doesn't allow for much human input. By the way, speaking of computers, do you know why in the movie *2001, A Space Odyssey*, the computer was named HAL? When the movie came out in 1968, IBM was the most powerful tech company. Since HAL was supposed to be smarter, one-up, and ahead of IBM, he was given a name with each letter of his name being one letter ahead of I and B and M. Learned something new didn't you? IntelliBuilD has a higher beta than the market at 1.3, but according to Panaray the portfolio has sales and earnings growth about 2X higher than the S&P 500. You are getting paid for the volatility. Also, the portfolio's earnings estimates have increased over 13% in the last 90 days.

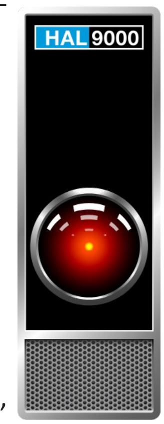

Photo: Wikimedia Commons

Bulls of the Dow
2017 was a great year for the Bulls. Through February of 2018, it was also our #1 offering by gaining 4.1% gross-of-fees and 3.8% net-of-fees, vs. the S&P 500 return of 1.8%. The Bulls consist of only 10 stocks, so comparison against an index with 500 could be questioned...but we are comparing it to "the market", which is a fair fight. Bulls can fight too. The earnings estimates for the Bulls portfolio have increased 10% in the last 90 days. You know what the one stock out of the ten Bulls that analysts have not increased estimates on? IBM...HAL probably already knew.

Covered Call
Recent volatility has allowed us to write calls farther out of the money, receive higher premiums for calls, or both. The total return of the composite gained 0.15% gross-of-fees or –0.16% net-of-fees through February. This compares to the CBOE S&P 500 Buy-Write Index loss of -0.5% through February.

Preferred Income
Preferred equities, which are a bond in a stock's clothing, had a very good 2017, but the rising interest rates of 2018 have effectively put preferred stocks on sale. Prices on preferreds as measured by the preferred

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stock ETF (PFF) are the lowest they have been since the end of 2015. The composite had a total return of –1.8% gross-of-fees and –2.1% net-of-fees through February vs. the S&P US Preferred Stock Index return of –1.1%. When prices drop, but the dividends stay constant, the yield increases. Do you have patience and wouldn't mind collecting a potential average dividend of about 6% while you wait for prices to recover? Who knows how long price recovery takes, but 6% ain't shabby while you wait.

Real Estate Income and Growth

REITs have taken a roundhouse to the noggin so far in 2018. Rising interest rates and the fear of inflation are the culprits. As measured by the Vanguard REIT Index ETF (VNQ), prices on REITs haven't been this cheap since 2014. The dividend income is still high, which is why Income is the portfolio's first name.

Alternative

Emerging markets and commodities provided a solid 2017, although these assets have been treading water in 2018. Several strategist/economist/guru types we respect are preaching that commodities, metals, and materials may be the comeback kid in 2018-2019. Time will tell if inflation is coming out of its cave.

The following option overlay products are intended to be additive in return to other investments held in an account, and are not appropriate for all investors. Historically, the cash-flow from overlays has been positive from year-to-year. However, realized gains and losses are very inconsistent. These are long-term strategies and may not produce capital gains over the short-term.

Put Income Overlay

2017 was the best year for realized gains this strategy ever had. 2018 through February has been the best start to a year the strategy has ever had. Through February, David and Seth have done a yeoman's job by realizing 2.21% gross-of-fees and 1.90% net-of-fees. Being an overlay, which is additive to returns generated by the underlying account collateral, this is difficult to compare to an index, but as a comparison the S&P 500 has returned 1.83% during the same period.

Index Income Overlay

This is our simple overlay using three put option credit-spreads on the SPDR® S&P 500 ETF (SPY), staggered monthly. The volatility spike has been good, actually very good for the strategy. Late last year, when volatility was low, our 3% out-of-the money spreads were only yielding about 3.5%. The last two positions we put on with the VIX higher allowed us to be further out-of-the-money and generate higher yields; 6% for our May spread, and 5.8% for the June spread. The April position with a 269 strike may be the first one we have to roll.

If you have any questions or comments regarding this letter, including any portfolio or composite, please contact our Chief Compliance Officer, Audrey Kurzawa at audreyk@sheaffbrock.com; you can also reach her, or any other Sheaff Brock representative, at 317-705-5700.

Style	Performance Update Portfolio	Thru Feb. 2018	2017	2016	2015	2014	2013	2012	2011
Fixed Income	**Preferred Income** - Preferred stocks	-2.14	7.44	1.61	5.23	14.01	-4.59	9.19	
Growth and Income	**Covered Call Income** - Quality stocks & covered calls	-0.16	12.93	6.16	-1.11	6.33	22.28	10.23	-11.09
	Dividend Growth & Income - Dividend paying stocks	2.50	21.99	11.07	-7.27	5.04	36.23	12.17	5.62
	Real Estate Income & Growth - REITs/real estate stocks	-10.19	2.99*	*5/1/17 inception					
Growth	**IntelliBuilD™ Growth** - IBD growth stocks	2.03	25.40	-2.85	2.46	7.55	11.18*	*10/1/13 Inception	
	Bulls of the Dow - 10 stocks of the Dow Jones 30 Indus.	3.79	33.76	9.39	0.97	12.10	23.99*	*2/1/13 Inception	
Alternative	**Alternative** - Metals, foreign currencies, commodities	0.02	17.51	4.38	-8.24	-4.25	-0.72	9.02	-7.64
Option Overlay	**Put Income** - Overlay of short equity puts	*1.90*	*5.66*	*0.21*	*-8.86*	0.55	4.04		
	Index Income - Overlay of unleveraged put credit spreads	0.43	2.68	3.76*	*6/1/16 inception date				
	Index								
	S&P 500	1.83	21.83	11.96	1.38	13.69	32.39	16.0	2.1
	CBOE S&P 500 Buy/Write	-0.48	13.00	7.06	5.24	5.64	13.26	5.20	5.72
	Barclays Aggregate Bond	-2.09	3.54	2.65	0.55	5.97	-2.15	4.2	7.8
	DB Commodity Index Tracking Fund (NAV Total Rtn.)	-0.26	5.12	18.50	-27.41	-28.18	-7.57	3.31	-2.71

Composites include all fully discretionary accounts. Composite performance consist of all client accounts that are at least 80% invested in the strategy. Returns are presented net of management fees and all trading expenses, and the reinvestment of all income. Put Income results are only realized gains and Index Income reflects the total return of only the option overlay. Returns are calculated using the highest fee to reduce the composite gross of fee return to obtain the composite net of fee return. An analysis is performed on a quarterly basis to determine the highest fee paid in the portfolio as the highest fee paid may change over time . Fees are described in SBIA's ADV Part 2A. *Denotes partial year, with note reference. Prior to October 1, 2015 Preferred Income was sub-advised by Trust Investment Advisors, Indianapolis, IN. Please see additional disclaimers on the next page.