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Listed below are the monthly letters sent to investors in 2017. It should be noted that: ***The market commentary may not necessarily be correlated with returns from Goldman Management, Inc. as trading decisions are based on an array of proprietary indicators and models.***

Thank you for your interest.

February 2017, S&P 2270. The post- election six-week gain (29 trading sessions) in the Dow Jones Average was 9%. Going back to 1900, this post-election six-week gain was the second best since 1924 when the Dow gained. 9.2%. For the previous twelve **new** Presidents since the 1950's, from the Inauguration over the next twelve trading sessions from a risk / reward perspective has been extremely favorable for stock prices. The S&P finished the 12th trading day on Feb. 6th and gained 1.25%, just below the historical average. Reviewing this criterion over a 75-day performance reveals an outcome only slightly better than the historical buy and hold. The largest advance was 8.3% while the worse decline was -3.4%. In contrast, reviewing **all** Inauguration gains over the 75-day performance demonstrates an average outcome that is flattish.

Volatility had mutated recently at mid- month. The Dow Jones Average 21- day trading range (after the sharp election gains) was the smallest ever going back to the early 1900's. The S&P trading range in January using intra-day pricing was 2.5%, the narrowest January on record. Furthermore, the S&P has not declined by more than 1% in over 75 days, a streak that was surpassed only seven other times since 1970. Reviewing those seven periods reveals they were not significant in forecasting the direction for stock prices in the short-term.

Continuing our discussion a few months back regarding the topic of some of the market drivers brings us to the continued strength in the Industrial CRB (ICRB). The strength in the ICRB suggests the potential for greater stability in earnings projections in the near term when compared to the previous few years. In January, the ICRB continued to move to a new recovery high, gaining approximately 2% and is roughly higher by 25% year over year. Additionally, and as detailed in the September letter a handful of leading indicators used to monitor economic forecasts have been suggesting strengthening economic growth. Since then the last two quarters of GDP growth have averaged 2.7%. These gauges continue to remain at "relatively" robust levels. For instance, the Purchasing Manager's in December (released in January) and January's was the best in over two years. Furthermore, the National Federation of Independent Business (NFIB) rose to 105.8, the highest level since 2004, up from 98.4 the previous month. This is the highest

level since 2004 and the fifth highest level since the survey inception in the 1970's. From a percentage standpoint, the jump was the third largest on record.

One of the likely drivers to the post-election rally is the potential change in the tax rate for US Corporations. To review: The average tax rate for S&P 500's companies prior to the sharp declines in oil prices stood at 28%, while the average tax rate for smaller domestic capitalized issues with little overseas exposure is closer to 35%. Expectations are for a decline in the corporate tax rate to 20% and the probability of passage according to many experts is hovering at 75%. Subsequently, an 8% decline in the tax rate for the S&P 500 times a 75% probability of passage equates to 6% gain in the S&P, which occurred little more than a month post-election. While a 15% decline in the tax rate for domestic Corporation's multiplied by 75% equals 12.5%, a gain the Russell 2,000 achieved 11 trading days later, albeit following the Index's 8.4% decline from the prior high.

March 2017, S&P 2364 Stock prices gained ground for the second consecutive month this year and the fourth consecutive month in this sequence, bringing the YTD gain in the S&P to just over 5.5%. Since 1950 a YTD gain greater than 5% by the end of February is not that uncommon, occurring 28% of the time or having occurred in 19 of those years. In two-thirds of these years stock prices were at or near an all-time high. Monthly gains in both the months January and February has arisen in roughly 35% of years since 1950.

The S&P last month or to be precise on February 11th, marked its one-year anniversary since the conclusion of a non-economic related bear market. Since WWII all non-recessionary bear markets excluding the 1987 -36% market decline retested the highs within one year. In 1987 Bear Market the rebound required a steep 50% advance to recoup the losses (-34%) and did so, taking slightly more than one and a half years. For the record the S&P's price advance on its one-year anniversary gained 27.3%, which is not that unusual when not associated with a Recession. Additionally, stock prices at the market lows had flatlined over the previous 500- trading sessions or for nearly two years, as the rate of change during this time span declined to zero. Furthermore, the 500-day rate of change continued to hover near zero two other times last year. Just days after Brexit when this level declined to 1% and then after the weekend, before the Presidential Election, the level declined to 2.5%. Stock prices after reaching such a low level in all three of these occurrences rose sharply afterwards. At month's end this level rose to 12%, which is no longer at an extremely compelling level. Reviewing a longer time horizon based on the 2,500-day rate of change (essentially using 10- year rate of change) the Dow Jones Industrials (which goes back to 1900, further than the S&P) stands at 55%, which is also the longer-term average. A reading above 150% is considered overbought, which was last recorded in the year 2,000.

Stock prices persistent gains without any meaningful setback continued last month. There are number of attributes worth noting: The Dow entering the last trading day of the month of February reached 12 consecutive all-time highs, equaling the record in January 1987 (fell short of another record at month's end). The S&P and the Dow Jones Average had not declined on a single session by 1% in 95 trading sessions, the last such occurrence was in 1995. This lack of volatility was much more apparent during the 1950's-1960's when this pattern occurred in 40% of those years. Additionally, the 65- day average of the Volatility Index or VIX reached its lower level since late 1995. The persistence of gains was also noted

using the 14 days RSI. The gauge is based on a momentum oscillator that measures speed and change of prices movements which range from 0-100. For ten-consecutive days the reading on this gauge was above 74.5, the longest streak since 1996. Overall, persistent gains without any noticeable retracements have generally been a favorable development for stock prices, although short-term constraining factors have also emerged.

April 2017, S&P 2363 Included in each monthly letter is a Table labeled Information and Statistics 2002 to the Present which includes the Sharpe Ratio and the Sortino Ratio. One of GMI's mandates/goals is a Sharpe Ratio over 1 on yearly basis and on a cumulative basis. The Sharpe Ratio is the most popular of the risk adjusted performance measures. Although less popular, the Sortino Ratio, may represent a more accurate risk adjusted perspective. The Sharpe Ratio's deficiency is that it effectively penalizes good performance for generating positive returns as it increases the variance or standard deviation. However, logically investors should only be concerned about downside (negative) returns. The Sortino Ratio overcomes this limitation using a modification of the Sharpe Ratio that implements only downside volatility. The table below compares the 15-year track record on S&P 500 total return ("SPTR") VS GMI Prop Account ("GMIPA"). The SPTR Sharpe Ratio since 2002 is at 0.46, Sortino is 0.67, while the GMIPA Sharpe Ratio is 1.08, Sortino at 2.07. Excluding fees to align with the S&P, they would be 1.35 and 2.74 respectively. GMIPA Sharpe Ratio is 135% (column E) more favorable (Column C-B/C) than the S&P's Sharpe and 204% more favorable when comparing Sortino Ratios, and 300% better when using gross returns. The Sortino ratio is also found in the Morningstar Mutual Fund web site under the heading Rating & Risk, where you can scroll below to the title "Volatility Measures 15-year" (many fund do not have 15-year track records). The link to Tactical Allocation is attached. When comparing results it should be noted the S&P's five-year Sortino ratio stands 2.42. ten-year at .78.

[http://news.morningstar.com/fund-category-returns/tactical-allocation/\\$FOCA\\$TV.aspx](http://news.morningstar.com/fund-category-returns/tactical-allocation/$FOCA$TV.aspx)

Sharpe and Sortino Ratios

| A | B | C | D | E |
|----------|------------------|----------|-------------|--------------|
| Ratio's | S&P Total Return | GMIPA | GMIPA Gross | GMIPA/ S&PTR |
| Sharpe | 0.46 | 1.08 | 1.35 | 135% |
| Sortino | 0.68 | 2.07 | 2.74 | 204% |
| Returns | 7% | 12.25% | 16% | |

The S&P on March 21st declined by over 1%, just the first such decline after 109 trading days in a row. Since 1929 there have only been 12 previous times the S&P went at least 100 days without a 1% decline. From a historical perspective stock prices are higher one month later in 76% of the cases and market gains were above average. As stated last month "Overall, persistent gains without any noticeable retracements have generally been a favorable development for stock prices, although short-term constraining factors have also emerged".

The failure to repeal and replace Obamacare led to a minor bout of volatility. From a stock market's perspective, the Republican health care bill would have reduced the federal deficit by \$337 billion over the next decade, with a \$1.2 trillion decrease in direct spending and a reduction of \$883 billion in revenues. Obamacare represents roughly a \$1 trillion dollar tax hike over a decade. A potential tax

reform package including a reduction in the Corporate Tax Rate to 20% (from an effective tax rate of 28%) ending the Death Tax and AMT would have reduced tax revenues by roughly \$1 trillion dollars. A continued failure to replace Obamacare would suggest a compromise for the GOP/Trump tax agenda, given the deficit neutral hawks who are prevalent in both the House and Senate. Discussions on the Health Care Bill remain ongoing.

May 2017, S&P 2384 The S&P on March 21st declined by over 1%, the catalyst manifesting from the impasse on the passage of the Health Care Bill in the House. As detailed last month, the passage of this Bill would have been a \$1 trillion dollar revenue source for the Gov't, enough for a reduction in the Corporate Tax Rate to 20% (from an effective tax rate of 28%). The S&P over the next four weeks failed to recoup the March 21st market declines. By the end of April the S&P had recouped the losses but was only fractionally higher relative to the March 20th close. Late note: the GOP Health Care Bill passed the House on Thursday, while passage in the Senate is unclear.

March 21st also signified the first time in over 100 trading days that the S&P declined by 1%, one of just 12 other occurrences since 1929. For the record, the S&P four weeks later gained just ½% or 4X less than the historical norm. The Health Care impasse may have also been the culprit for the lack of resilience.

In the first 100 days since the Inauguration the S&P gained over 5%. Comparing Inauguration periods for all new Administration since 1950 ranks this gain as the 3rdth best or in the top 75%, and the 5th best rally if we check all the way back to 1933. Reviewing the five market gains of roughly 1% or greater in the first 100 days since 1950 historically demonstrates further gains over the next six months in all five, with a median return at roughly 6%. Please note that the sample size is very size small.

The S&P's YTD gains at the end of April was 6.5%. To put these gains in perspective, since 1950 YTD gains 6.5% or greater by the end of April have occurred in 37% of all years. The NASDAQ Composite YTD was 12.35%. Gains of 12.35% or greater has also occurred in 35% of all years since the inception of the NASDAQ in 1971.

VXO, which is the older version of a volatility measure on the S&P, declined on the second trading day after the French election to 8.6. Since the inception of this index in 1986 the value on a closing basis has declined below this level only one other time, on July 3rd 2014. Reviewing the lowest half a dozen VXO readings reveals they were insignificant regarding the shorter term outlook for stock prices. Late Note: On May 1st the "newer" VIX on a closing basis touched its lowest reading in over 10 year or since February 2007.

As mentioned a few months ago, a host of indicators suggested the typical downward revisions in earning reports would be less troublesome than in the last six years. The historical revision compared to the first quarter of 2017 is depicted in the chart below. At month's end the blended (reported and estimated results) for the first quarter has increased to 12.5% from 9% at the end of March and is back to the growth levels that had been anticipated at year end. This growth rate is the highest since the Q3 2011.

Calendar Year EPS Revisions



Note: Typical Path is revisions for 2011-16; indexed to 100 at 11.8
Source: S&P, Thomson Financial, FactSet, and RBC Capital Markets

June 2017, S&P 2412 The S&P since the Presidential Election has gained 12.5%. Given the recent political turmoil and heightened investor concerns regarding the Trump & GOP election mandates being potentially in jeopardy brings up a challenging question: Can investors quantify these risks? One possible yardstick is to determine what percentage of the market gains can be attributed to the implementation of GOP mandates Vs economic fundamentals. One measure is to determine the change in the S&P's forward PE (which is based on the expected earnings over the next twelve months divided by the S&P) which presently equates to 17.5 and compare it to the forward PE that existed before the election, or 16.5. Dividing these ratios, $17.5/16.5$ implies a 6% advance in forward PE's in the S&P which can be attributed to the elections, everything being equal (or ceteris paribus) and 6.5% is due to the market fundamentals/improvement in earnings.

The 10-year anniversary of the last Bull Market top is approaching. Using monthly data, the S&P peak was reached exactly 10 years ago or at the end of May. The S&P's earnings in 2007 were at \$91.5 per share with a PE at 16.75. By the end of this year earnings are expected to reach \$131, or a present PE ratio of 18.35. The 10-year bond yield in 2007 hovered in a range between 5.3%-4% while the range this year has varied between 2.6% to 2.25%. The PE at 18.35 is roughly 9.5% higher than in 2007, but with interest rates roughly 50% lower and based on the S&P earning's yield ($1/PE \times 100$) at 5.5% may not be that excessive. Additionally, the market declines in 2007 were most likely attributed to excessive levels in real estate prices, not market valuations.

The S&P from its monthly peak at the end of May 2007 to the monthly trough (February 2009) incurred a decline of 52.6%. GMIPA during this corresponding period lost 1.19%. Reviewing the second worst decline since 2002, from February 2002 to September 2002 when the S&P fell -29%, GMIPA during this corresponding period declined by 1.0%. The third worst decline in the S&P occurred from May 2011 to September 2011 when the S&P lost -17.07%. GMIPA during this time period declined by -6.4%. On a cumulative basis during these three periods the S&P declined by a whopping **98.67%**. GMIPA's cumulative decline was **8.6%**. Past Performance is Not Necessarily Indicative of Future Results.

The S&P's YTD gains at the end of May were roughly 7.5%, which is not that extraordinary as gains equal to or above this threshold since 1950 have occurred roughly 1/3 of the time. Witnessing YTD gains above 7% in the first five months of the year, a low volatility environment in the first 100 trading days and multiple new multi years highs occurring during the year is a rare combination. There are only two other such occurrences excluding this year. They were in 1995 and 1964, although the sample size is

small both periods led to further gains during the remainder of the year. Additionally, the vast outperformance of the NASDAQ Composite Vs. the S&P has generally been a favorable development for equity prices based on the maximum intra-signal declines Vs maximum intra- signal gains recorded over the next six months.

Continuing the topic from previous letters, expectations were for the limited downward earnings revisions in the first part of the year. Earnings as detailed last month not only held steady but actually rose, unlike previous years. A study by McKinsey found that analysts have meaningfully have cut yearly estimates from 1985 to 2008 except two instances in 2005 and in 2006. This year, analysts are cautiously raised their earnings estimates.

July 2017, S&P 2423 The initial hike in the Federal Funds rate occurred in the middle of December 2015 and in the middle of May 2017 reached its 1 ½ year anniversary. The general assumption and as detailed in these letter in late 2015 was for a slow tightening cycle. Slow tightening cycles have initially been generally favorable periods for equity prices. There periods under review in this tightening periods are: 4/55, 9/58, 7/63 and 9/77. The S&P since initial hike gained over 9% one later and at month's end or just over 19 months later advanced by 19%. In reviewing these periods stock market struggled and eventually declined when market interest rates began to increase in an unorderly fashion, typically well after the first year after the initial hike. Market risk in these periods rose after the first year but that was also dependent on the behavior in market rates (such as three- year and ten- year Treasury Notes). Market rates such as three and ten-year notes stood at 1.35% and 2.27% respectively when the Federal Reserve initially raised the Federal Funds Rate raised rates. Presently three-year notes stand at 1.52% and the ten -year rate at 2.27%. The only similar period in the slow tightening cycle was in 1963-64 when interest rates rose by roughly ten- basis points one year since the initial hike and by the end of the second anniversary only by another 5-10 basis points. Two years after the initial hike in 1963 and helped by a "tame" market rates stock prices advanced by 32% (valuations presently are less favorable than in 1964) and escaped the three other time periods when stock prices eventually succumbed to the pressures of higher market rates.

The goldilocks backdrop is a vague term to describe an economy that is not too hot or too cold, or a depiction of sustainable moderate growth that has low inflation. The only difference presently is that a Federal Reserve's friendly monetary policy is not present while market rates as mentioned above is still considered in benign and inflation remains tame. Goldilocks environments typically lift most if not all sectors, both defensive (non- economic related) and those dependent upon economic growth. This environment has been present in the past few months, allowing stock prices to continue to record new highs.

This so called near goldilocks environment/ lack of concerns should be noted with near and repeated new lows in the VIX (VXO, older version) which towards month-end recorded another record low. Since the retest of the market lows in February only once has the S&P declined by more than 2% on a weekly basis or a span greater than 70 weeks. The last 2% weekly decline occurred in the first week of September or over 40 weeks ago. Since 1950 only a few times has the S&P in a 70- week period not declined more than 2% in a week (not accounting for continuation of the signal) and all occurred before

the year 1966. Based on this criteria and limited occurrences would suggest overall risk /reward ratio over the next six months skewed in favorable ratio for equity prices. Past performance is not necessarily indicative of future results.

Continuing the theme (for a few quarter ago) that earnings expectations hold steady and on a relative basis much better than the previous years. According to FactSet estimated earnings for the second quarter have fallen by 2% since March 31. This percentage decline is smaller than the trailing 5-year average (-4.3%) and the trailing 10-year average (-5.9%) for a quarter.

August 2017, S&P 2470 No letter Kate W. Interview sent out instead

September 2017, S&P 2472 In November- 2015 we featured a segment on profit margins as related to both the business cycle and to the investment cycle. Dating back to 1973 a peak in profit margins has not been an encouraging sign for the stock market or the economy as every period except one coincided with a recession. The only time a contraction in profit margins did not lead to recession was in the years 1985 - 1986 when crude oil prices from November 1985 to March 1986 plunged by 67%. The November 2015 writing segment observed similar crude oil behavior and came to a matching non-recessionary conclusion. For the record, a recession and a bear market were avoided in 2016. In the second quarter of this year profit margins rose to a record 10.22% (10.8% if using the data from Thomson Reuters) from a previous peak of 10.10% which occurred in the third quarter of 2014. Abnormally low inflation levels and interest rates are likely contributing factors in the margins moving to a record. "Excesses" that normally accompany late stages of an economic recovery remain dormant. New highs in profit margins extend the recessionary concerns into the distant future. "Market commentators" who are concerned about the reversion-to-the-mean will still have to be patient.

Since the inception of the S&P in 1928 in only six years has the S&P total return in all of the months in the first half shown a positive return. In 2017 this rare pattern manifested again. Historically, once in this regime, over the remaining six months the S&P has finished higher by more than 8%, advancing 66% of the time by year-end. In the two periods when the S&P failed to advance in the second half both failed to advance into the seventh month, unlike this year when the S&P advanced in the month of July. Past Performance Is Not Necessarily Indicative of Future Returns. The S&P total return in 2017 for the record has advanced for 10 consecutive months, the longest streak since 1995.

Lack of market turbulence has been one of the themes this year. The S&P has not recorded a 3% decline from its closing highs in over 200 days, the second longest streak since 1995-1996, when the total rose to the record of 241 days. From a historical perspective, the S&P has typically declined by 3% or more in a given year over 4 times a year, while 5% declines have occurred roughly 2.5 times a year.

The Industrial CRB (as highlighted in the past year and a half) towards month end moved to a recovery high and is roughly 30% above the lows from late 2015. The rate of gain in past year and a half rose above 28% in May. Only seven other clusters reaching such a lofty level have occurred in the past 50 years. From a historical perspective crossing above this threshold has been a favorable development for stock prices when not accompanied by a disorderly rise in market interest rates. The robust reading is also consistent with OECD which tracks 45 countries who all are expected to grow this year. 33 (73%)

are positioned to accelerate from a year ago. It's the first time since 2007 that all are growing and the acceleration the most since 2010. 2007 is also the last time prior to the present when the CRB achieved a similar milestone. Although the levels are bullish the stock market's valuations levels would suggest the gains will likely be tempered. Once again Past Performance Is Not Necessarily Indicative of Future Returns.

October 2017, S&P 2519 In the Kate Welling interview I gave in August was a discussion regarding the major theme affecting stock prices and its ramifications. As noted last year in our monthly letters, the major theme then was a non-recessionary stock market decline, which is typically short-lived. The 500-day rate of change is a useful guide once the level approaches zero. Additionally, a market bottoming process is historically etched out in months, not years. According to our analysis one of the major themes that has developed this year is the Federal Reserve tightening cycle and the reaction in market rates. Tightening cycles can be broken into two phases: a fast cycle when rates are hiked each meeting (every 6 weeks) or a slow tightening cycle whereby interest rate hikes are spread out over months. In general, in a slow interest rate cycle the stock market has historically become increasingly vulnerable a year and a half into the interest rate cycle as interest rates have tended to react in an unfavorable manner. Only in 1964 and in the most recent cycle have interest rates flatlined this late into a slow interest rate cycle. The 10-year note closed at 2.27% when the Federal Reserve initially hiked rates in December 2015, or 22 months ago and finished last month at 2.33%. The 5-year note is higher by only 10 basis points during this time span. For the record, in early 1966 market rates already more than 2.5 years into the tightening cycle started a sustainable rise which then led to a 20% bear market in stock prices.

As of the end of last month, the S&P has not had a 3% pullback in over 220 days, 21 days away from the record of 241 days from January 1996. Not so coincidentally, the seven other times the streak rose above 100 days, three occurred from 1964 to 1966 - a period of subdued bond reaction to the Federal Reserve tightening process. 1964 was also the year when the S&P rose in 10 months of the year. This S&P period of low volatility - excluding Brexit and the November Election - is now roughly 1.5 years in the making.

For the 26th time since 1950 the Dow Jones average win streak has reached 9 consecutive days (on 9/20) and notably this is the third such streak this year. Historically, after such an occurrence the S&P has vastly outperformed the average buy and hold strategy over the next three to six months. Furthermore, the adage, "sell in May and go away" was not applicable this year as the S&P has been higher in each of these months (as well as the past 11 months). Since 1928 the S&P has reacted favorably in the last quarter of the year after similar winning streaks. The S&P reached a 12-month high in September, another bullish prop for equity prices. Lastly the S&P has been higher for eight consecutive quarters, just the fifth such occurrence, but also a historically positive bias over the intermediate outlook. Past Performance Is Not Necessarily Indicative of Future Returns.

November 2017, S&P 2575 The lack of volatility continued in the month of October, which has notoriously been one of the most volatile months of the year. The average absolute change in the S&P 500 this year has been 0.30%. Since the inception of the S&P the lowest reading occurred in 1964 (see

Kate's interview and last month's letter regarding the interest rate parallels between 1964 and the 2017) when the level reached 0.26%. The four lowest readings were in 1952, 1963, 1964, 1965 and 1996 and the average gain in the S&P in those years was 19.4%. Using another variation of volatility, the steepest market decline in this calendar year ranks as the second narrowest in history, although two months remain. This year's worst decline amounted to -2.8%, slightly larger than the record low decline of -2.5% in 1995. The five lowest readings were all less than -5%; the years when these occurred were 1995, 1964, 1958, 1965 and 1961. It is worth noting that these periods saw very robust market returns in the final quarter of the year. Last month, the S&P broke a streak for the longest stretch without a market decline of 3% or greater. The previous record spanned 242 trading days or roughly 11.5 months, which was set in 1995 ending in January 1996.

Since the election the S&P has gained roughly 20% in nearly twelve months. Expectations for Corporate taxes being lowered to 20% from the current effective tax rate of 28% have become highly anticipated. Forward twelve-month PE ratio in the S&P stood at 16.5 on the eve of the Election. Presently the forward PE stands at 17.9, or an increase of 8.5%, roughly similar to the expected percentage reduction of the Corporate tax rate.

The Industrial CRB Index has been highlighted in the past year and a half and was further detailed in the September letter. By the middle of this year this Index's rate of change in the past year and a half rose above 30%. There have been only seven periods (excluding clusters of readings above this threshold over an 18-month time span) in the past 50 years. The reading as stated was a favorable development for stock prices when not accompanied by a disorderly rise in market interest rates. Following a similar narrative and an index that is somewhat correlated is the monthly survey from ISM or the Institute for Supply Management (Manufacturing), a reading based on surveys covering more than 300 manufacturing firms. A reading between 48 to 50 suggests a flattish expected level of growth in manufacturing. The reading at the end of September rose to 60.8 from 58.8. Since the inception of the data series in early 1948, a reading above 60 has occurred just under 15% of the time. From a historical perspective and not including clusters of readings above 60 within a twelve-month span, readings above 60 have been a contributor to an unfavorable backdrop for equity prices when accompanied by a disorderly rise in market rates such as those combined occurrences at the end of September 1987, in the first quarter of 1973 and July 1966. Excluding this combination with rates negates the "too hot" reading from the initial reading above 60%. The record shows that even in the absence of disorderly rates this combination has led to gains in stock prices the following month only 38% of the time and an average market decline that is greater than -2%, and a flattish market performance over the next six months. Past Performance Is Not Necessarily Indicative of Future Returns.

December 2017, S&P 2648 S&P Profit margins based on operating earnings in the past two quarters came in at 10.15% in the second quarter and 10.25% in the third quarter. Profit margins in the second quarter touched the highest level in this business cycle and then topped that hurdle in the third quarter. As detailed in previous letters, "Reviewing the seven cyclical peaks in profit margins dating back to 1927 reveals that only once did a peak in profit margins lead to an immediate cyclical high for stock prices". That quote is based on a data series using all Corporations data series ("ACD") both public and private, and consists of profit divided by GDP to determine profit margins. According to this data series profit

margins in the third quarter stand at 9.5% which is roughly 90 basis points below a record. This data series was likely impacted by the sharp declines in the energy complex as earnings in that sector were vastly below the record highs. This data series corresponds with another data series from the S&P which tracks reported earnings (in contrast to operating earnings). In the past few years we have deemphasized the negative economic narrative derived from earnings because it has imperfectly depicted real economic activity while amplifying the negative inputs from the energy complex with regards to earnings. Similarly, although the more accurate ACD data series is distorted by oil prices, the general health of corporations remains strongly intact and subsequently the record high in operating margins implies a favorable environment for corporations and suggests equity prices would not be vulnerable to an economically induced decline. Lastly, ACD profit margins may still reach a new peak in profit margins though that may take another year.

The S&P on November 15th incurred its largest daily loss in 50 days, ending one of the longest streaks without a loss greater than -0.50%. Only a handful of such occurrences have been observed since the inception in the S&P in 1928. Using a liberal 40 trading days without a decline greater than -0.50 and buying after such occurrence has seen stock prices higher one month later 85% of the time and the only loss was fractional (-0.2%). For the record the S&P 10 days later after this recent pullback gained over 3%. More than half of the signals occurred between 1963 -1965 which had a similar monetary backdrop to the present environment. In only one day in the past few months has the S&P traded below its 20-day moving average. The S&P has still not encountered a 3% decline this year, adding to the new record for this statistic established one month ago. More typically, the frequency of 3% declines has averaged one every 22 days. Furthermore, it's the longest period without a 5% correction, the 10th longest without a 10% correction and the second longest span without a 20% correction. Additionally, the S&P has been positive for 8 straight quarters just four other times and all finished higher in the following quarter. The S&P in the first two months of the quarter has gained 5.1%. The S&P total return is higher in the first 11 consecutive months of the year, a record. Only in 6 of the prior years has the S&P been consecutively higher in the first 6 months of the year.

The S&P pain or draw-down this year has amounted to 2.8%, the second shallowest on record. The 1995 decline of 2.5% the shallowest. The YTD gains stands at 18%, or a gain to pain ratio of 6.4. Since 1950 a ratio this high has occurred only three other times. Although sample size is small has not led to intermediate high for stock prices.

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

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