J2 CAPITAL MANAGEMENT
MARKET UPDATE

J2 Capital Management | January, 2018 | 4th Quarter 2018 Update

The S&P 500 and the New England Patriots

Selected Benchmarks	4th Qtr. Return	2017 Return
S&P 500 TR	6.64%	21.82%
Russell Mid Cap *Growth*	6.81%	25.27%
Russell 2000 Index	3.3%	14.65%
MSCI All Country World Index gr.	5.84%	24.62%
60% MSCI ACWI/ 40% Agg Bond	3.63%	15.77%
MSCI Emerging Mkts Idx	7.44%	35.28%

S&P and MSCI data provided by S&P and MSCI. Russell index data provided by FTSE-Russell Inc.

In sports, an undefeated season is extremely rare with only three teams in the NFL accomplishing it since 1932 with the New England Patriots being the last in 2007. Like in sports its extremely rare for the stock market to have 12 consecutive months of positive returns but that is precisely what occurred in 2017. 2017 will mark the first time that S&P 500 accomplished the feat.

The S&P 500 currently is on a roll looking a lot like a Tom Brady led New England Patriots. However, according to some, a Patriots Super Bowl win is bearish for the stock market. Don't worry I will not include this indicator in my future analysis.

Market Review:

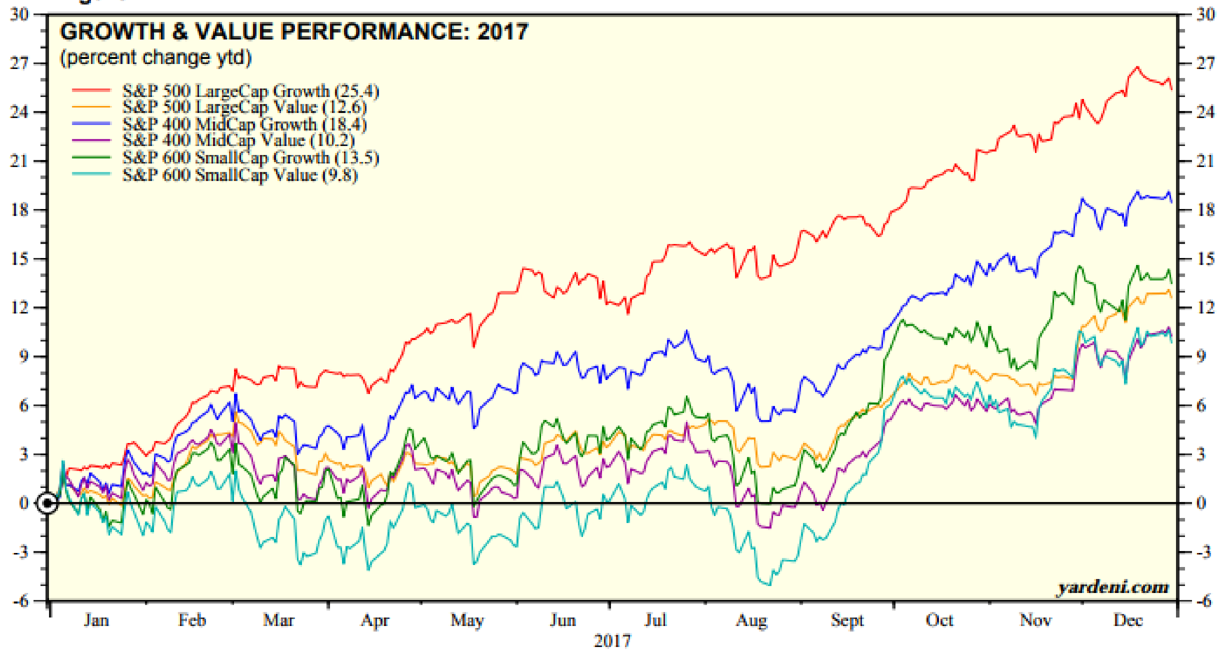
J2 Capital has been calling for a bull market and higher equity prices since August 2016. Many were caught and surprised by the strength of the market. J2 Capital was able to model for much higher corporate earnings than what many were expecting and this without the tax reform included in our analysis. We also argued that old rules around valuations may not apply, another correct assumption as the market has thrown out the old fundamental playbook.

As discussed in previous quarterly updates, we are in a positive feedback loop, otherwise known as momentum.

The S&P 500 is currently working on being up an incredible 15 out of the last 15 months! We are now seeing many metrics and technical indicators reaching levels that haven't been seen in many years if not decades or ever. It is just not a U.S. market story either as emerging markets, after many years of idling around have finally sprung to life. The same is seen across the globe as the feeling of a global economic upswing has raised animal spirits to a level not seen since 1999.

Growth trounces value in 2017:
Throughout 2016 and 2017 J2 Capital believed that growth would win over value. As shown below growth, regardless of market cap handily beat value stocks.

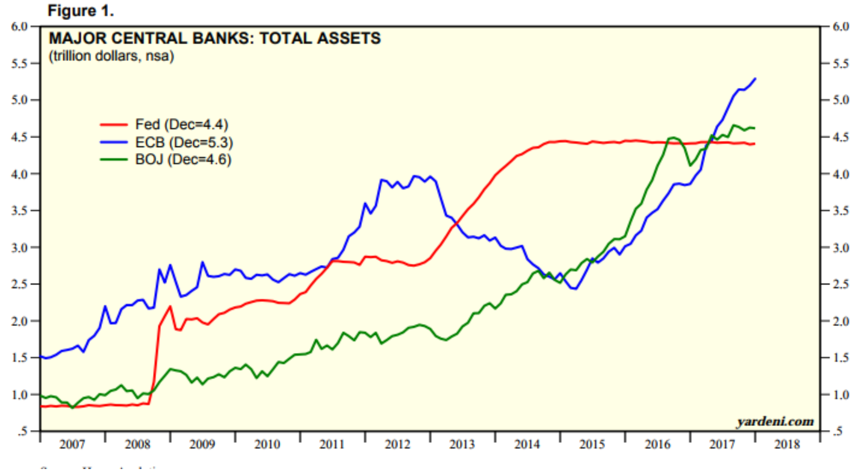
Figure 4.



Source: Frank Russell Company, Haver Analytics, and Standard & Poor's Corporation.

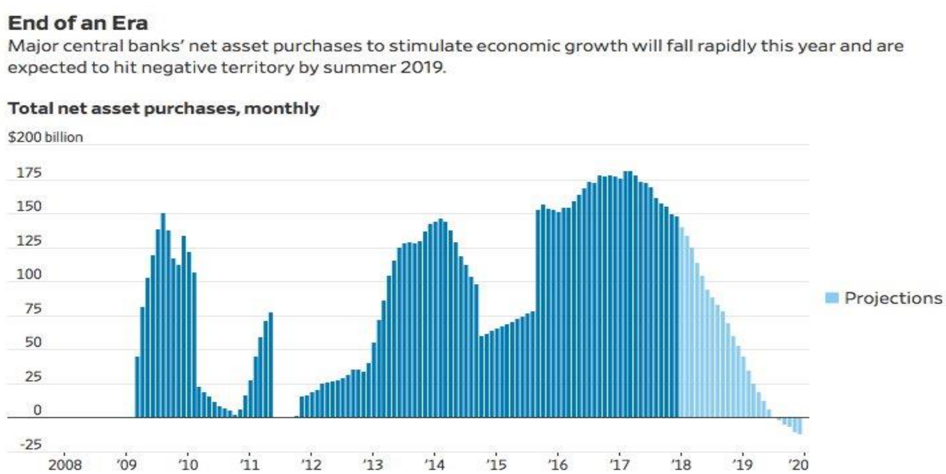
Investor enthusiasm and the red-hot market is due to a few things. First, earnings started to come in a lot better than what many thought. J2 Capital was early in telling the earnings rebound story in 2016, and it was a significant theme in us calling for a bull market continuation. Additionally, many need to understand that markets are liquidity driven. Global liquidity has done nothing but gone up. As the U.S. reins in their QE programs, many other nations have continued their own **(figure 1).**

Total Assets of Major Central Banks



Source: haveranalytics

In liquidity driven markets things like P/E ratios that fundamental managers look at don't matter as much. Eventually, the tide will go out as the U.S. and other nations cut their Q.E. programs and switch to (Quantitative Tapering). Asset purchases by global central banks are forecasted to shrink starting this year.



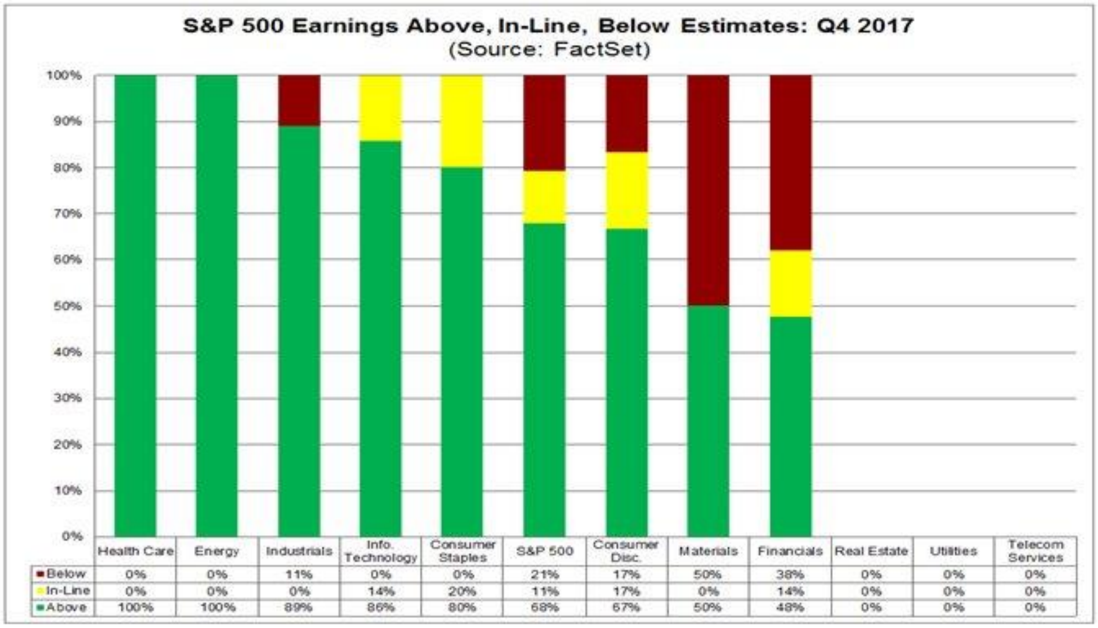
Note: Total purchases include the Bank of England, U.S. Federal Reserve, Bank of Japan and European Central Bank. January 2008-February 2009 and June-September 2011, amounts were between 0 and −$0.05 billion.
Source: Deutsche Bank

With that as our backdrop, our short-term view is a little more cloudy and little less enthusiastic, but hopefully only in the short term. Where others were concerned about earnings and valuations in early 2017, J2 had great vindication in the bull market thesis. Our 2018 outlook feels neutral at the current moment given the significant run-up in prices. That is not to say we still don't see a lot of great individual setups in the market, we do! While we do not want to step away from this excellent momentum market, we do want to approach it a little more methodical.

Our number one most significant concern here in the next month revolves around earnings season. So many stocks have rallied so much that I question how much a lift they can get from continued positive earnings announcements and guidance. We have been arguing for a new valuation paradigm, but frankly, we are wondering what the limits to this are in the short term. Sentiment seems a little too enthusiastic at present. There are no bearish opinions to be found now.

The rally that has occurred in the past 15 months was built upon on analysts getting earnings expectations wrong. The global excess liquidity I touched upon earlier provided the accelerant once those earnings came in better.

We now have the reverse, now where expectations are rising. The current S&P 500 growth rate for 2018 has increased from 12.3% to 18.6%. Additionally, thus far 68% of companies have beaten EPS estimates which is below the five-year average. I do not like the fact that earnings expectations are now rising as it makes the hurdle that much higher for stocks to leap over.



Source: FactSet

I have other questions I am left with as we head through 2018 with no current feel with how they may turn out.

We are very uncertain what is going to happen with interest rates and bonds as we move through this year. The market at times is showing its hand that it believes there may be upward pressure in inflation expectations thus affecting bond yields. I can make an argument for higher inflation, but I can also see inflation and interest rates meandering throughout the year much as they have been for several months. A ceiling on inflation has been covered by me previously and as I wrote, has to do with demographics, debt, and technological advancements which are inherently deflationary.

Currently, we are getting a hefty dose of asset price inflation which if not monitored may eventually someday lead to a significant break in stocks that would occur suddenly. A healthy equity pause or pullback soon would not be the worse situation. At its current rate of change in 2018, the market is on pace to advance 80% this year! I do not need to tell you how unsustainable and unrealistic that is.

Where to from here?

We believe that given the euphoric rise with no pullback along with exuberant enthusiasm raises risks in the short term higher than we have seen in years. A pause would be healthy. Straight line advances in a 30-degree upward angle almost never stick no matter how good things are. Should stocks not pause, we would expect to see many months of gains given back very quickly.

Longer term we still like the bull market and our continuing thesis of growth over value. We believe that a new long-term bull market is underway in disruptive technologies and medical advancements.

As we have noted in the past year, advisors risk their clients being left out by ignoring this part of the market. We would advise taking advantage of any dips occurring in tech and growth stocks this year as a way to diversify your clients.

J2 Risk Managed RS Leaders is an excellent vehicle to gain exposure to these areas of the market and is an excellent complement to other managed strategies on the Regal platform.

Selected J2 Capital Management Strategies Review

J2 Capital produced strong results across all strategies both on both a risk-adjusted and absolute basis.

RS Leaders and Tactical Global Rotation were our two best performing strategies and took advantage of a bull market in growth stocks and the developing emerging market bull market.

J2 RCI Tactical Strategies (Aggressive, Growth, Moderate)

Our RCI Tactical strategies produced excellent risk-adjusted returns in 2017. Both our Growth and Moderate strategy achieved our internal goal of capturing 2/3rds of the benchmark upside with Beta's less than 50% of the benchmarks. Our Aggressive strategy was a little off catching just over 50% of its benchmark.

We made heavy use of emerging markets throughout the year including Russia, Japan, and Latin America. We tried to balance these historically higher volatile asset classes with excess cash and long-term Treasuries.
Our positioning, timing (except small cap), and forecasts were as proper as I could ask, but we could have been a little more aggressive in increasing our favorite asset classes, especially in the Aggressive strategy.

Our Nasdaq 100 (QQQ) position led the way for us in 2017, and our tactical call in holding Japan (EWJ) led to superb low volatility gains along the way.

Our timing in small-cap was not right during the latter half of 2017. We made a call in the 3rd quarter that small-cap growth should power ahead of large caps. While small caps did achieve outperformance, the volatility in the latter half of 2017 forced me to reduce risk. In the short term, it appears that the play is in large cap multi-nationals that can benefit from the weak dollar.

Current positioning: The portfolio is tilted towards emerging markets and developed international equities. Due to my uncertainty with bonds, we decided to sell out of all fixed income except for a position in floating rate bonds that tend to hold up better in rising interest rate environments. Again, my current thinking is interest rates are anchored in a sideways situation in which case still argues for me to keep bonds as an underweight or non-existent for now. In our effort to avoid bonds, we are currently making use of a Long-Short ETF and excess cash higher than I would like. The excess is cash is not hurting us as our Emerging market exposure is outpacing U.S. equities here in 2018.

J2 Tactical Global Rotation

J2 Tactical Global Rotation. We are happy we the returns achieved in 2017. Our 4th quarter performance was a little sub-par due to both Latin America and Asian equity ETF positions underperforming. Those areas now bearing fruit in 2018 like we thought they might. We hope to play a little catch-up here in 1st quarter 2018.

Current positioning: we are 90% invested utilizing ETF's that invest in Australia, Sweden, Thailand, Malaysia, Latin America as well as our long-time holding in Japan.

J2 Risk Managed RS Leaders

I have been highlighting this strategy as a top choice all last year as I felt that everything was lining up for this strategy. Momentum strategies and those companies growing their earnings, in general, had a great 2017. RS Leaders participated in this momentum bull market and still continues to achieve excellent results early in 2018.

We rode some of the best growth stories all year and were rewarded. The portfolio was dominated by technology whose allocation made up close to 50% of the portfolio as we entered the 4th quarter. We decided in the 4th quarter to sell into some of our best-performing stocks that were at the time believed to be extended to the upside.

Some of these positions were some of the best growth stories in the market with personal favorites like Netflix, Align Tech, and Intuitive Surgical, but our risk management indicated that we sell and wait for better setups in other stocks. December saw us increasing cash to almost 25% of the portfolio by primarily selling down our technology positioning and diversifying into some other themes.

Current Positioning: We have increased our positioning in financial, industrial, medical, pharma, and biotech as we believe these sectors offer some better risk-reward. We also like the way a lot of the stocks, especially in healthcare and biotech are acting. We bumped back up our equity allocation and are sitting at 85% invested, 15% cash. Our plan over the next few weeks is to watch earnings and see how the market leaders react before we commit our excess cash.

Currently, I have a list of around 25 stocks that look like they are ready for another advance up but will be patient in entering. The best scenario for RS Leaders would be a swift and broad pullback in the market that would allow me to reload.

RS Leaders selected top holdings: (34 stocks total)

Description	Symbol	Sector	Industry	Weight
Cash	Cash	Cash	Cash	**15%**
HOULIHAN LOKEY INC COM CL A	HLI	Financial	Investment Services	4.1
E*TRADE FINANCIAL CORP COM	ETFC	Financial	Investment Services	3.8
ABIOMED INC COM	ABMD	Healthcare	Medical Equipment	3.7
BWX TECHNOLOGIES INC COM	BWXT	Industrial	Electronic Controls	3.6
CDW CORP COM	CDW	Technology	Computer Svcs	3.4
TOTAL SYS SVCS INC COM	TSS	Technology	Computer Svcs	3.3
LIGAND PHARMACEUTICALS INC COM	LGND	Healthcare	Biotech	3.3
TRINSEO SA COM	TSE	Industrial	Chemicals	3.0
FORTINET INC COM	FTNT	Technology	Software Security	3.0
MONSTER BEVERAGE CORP COM	MNST	Consumer Products	Beverages	3.0
BANK OF THE OZARKS COM	OZRK	Financial	Regional Bank	2.7
WESTERN ALLIANCE BANCORP COM	WAL	Financial	Regional Bank	2.7
CENTENE CORP COM	CNC	Healthcare	Healthcare Facility	2.6
MARKETAXESS HOLDINGS INC COM	MKTX	Financial	Investment Services	2.5
APPFOLIO INC COM CL A	APPF	Technology	Software	2.5
ALIBABA GROUP HLDG LTD ADR	BABA	Services	Specialty Retail	2.4
			Totals:	**49.7**

J2 Tactical Strategies available

*Certain strategies may be only available to direct clients of J2 Capital Management RIA. Please check with your Broker Dealer.

Tactical Stock

RS Leaders: Momentum based growth stock strategy

$75,000 minimum

Tactical ETF

RCI Tactical Models: Broad Based equity & Fixed Inc.

Sector Rotation: Sector Tactical ETF

Global Rotation: Country- International ETF

Tactical Annuity

J2 is a TPIA on Jefferson National platform
Monument Advisor Fee Based Annuity

RCI Models / Sector Rotation / Tactical Income options.

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For: Investment Advisor Only Use-Not for public

Disclosures:

Orion Advisor Services provide indexes returns. Blended indexes are rebalanced daily and are quoted as gross or total return). The U.S. Dollar is the currency used to express performance. J2 Strategy returns are presented as asset-weighted time-weighted net of 3rd party management fees and include the reinvestment of all income but after all trading fees and all expenses charged by the underlying funds and investment vehicles. Net of fee performance was calculated using annual maximum 3rd party model based fee of 0.50%. Model Fees are deducted quarterly at a rate of 0.125%. Please see disclosure presentations for full disclosures.

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J2 Capital Management claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. J2 Capital Management has been independently verified for the periods July 1, 2008, through December 31, 2016. The verification report is available upon request.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

Fees: Strategy returns presented here in this quarterly/year-end review are composited gross and net of our maximum model based .50%bps fee. For full disclosure of fees, please see the full disclosures that accompany this factsheet. These can also be found on our website www.j2cmonline.com.

J2 Capital Management RIA clients should review their Investment Advisory Contracts for full fee disclosures. These fees will reduce the overall gross returns shown in this review summary.

*The U.S. Dollar is the currency used to express performance

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