

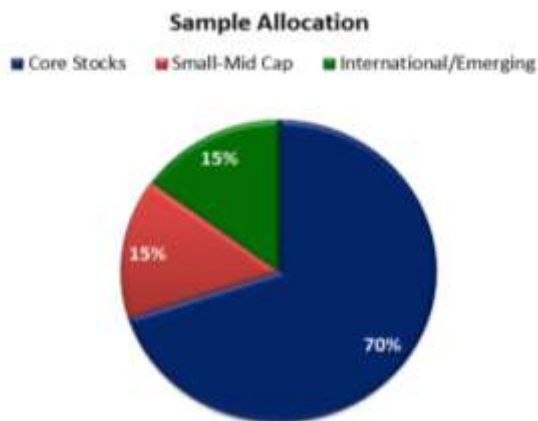
The Benefits of Diversification...Really!

Since equity markets have been recently dominated by U.S. large capitalization (cap) stocks it is worthwhile to review the benefits of diversification. **The concept of diversification is that investors can improve their risk-return profile by investing in multiple investments versus concentrating the balance in a single investment.** With tactical adjustment- reducing the overvalued and buying the undervalued- opportunities may enhance returns further. However like most investment strategies diversification can experience extended periods of time where it doesn't seem to add value. Does that mean investors should change their focus and target a narrower selection of investments? Not likely.

We have managed our TW Diversified strategy since we began Tillar-Wenstrup Advisors, LLC over 15 years ago. This strategy adds to our original TW Core strategy that is focused mainly on domestic large-cap growth and value companies. TW Diversified offers investors a single portfolio allocated both strategically and tactically in a wider range of securities giving more complete diversification in one portfolio:

- **Strategically allocates to small-, mid- and large-cap domestic and international equities.**
- **Tactically overweight areas we judged to be attractive and underweight those we see as less attractive.**

Two areas we added to in 2016 were domestic small- and mid-caps and international stocks. Both areas represent opportunity in valuation and diversification of not "having all your eggs in one basket." After trailing badly in 2014 and 2015 small- and mid-cap domestic stocks came roaring back in 2016. Entering the year our portfolios were significantly underweight small- and mid-cap stocks and we aggressively added to them as our outlook brightened. This strategy was especially rewarded in the fourth quarter after the election. Trump's pledge to reduce taxes and regulation was rightly perceived by the market to most benefit small- and mid-cap domestic companies.



We believe a similar thing could happen to international stocks in 2017. The outperformance of domestic versus international stocks has been truly epic. Over the past five years large-cap domestic stocks have outperformed large-cap international by 8.6% annualized and by over 6% annualized over ten years. When confronted with extreme readings like these our experience has taught us to "lean against the wind" and bet on a

reversion to the mean like we experienced with domestic small- and mid-cap last year. So far, so good in 2017 - despite being universally hated the international indices are smartly outperforming domestic indices. There is good reason to believe this reversal in fortune will last awhile to the benefit of diversified portfolios.

James Tillar, CFA and Steve Wenstrup

OUTSIDE COMMENTARY

Leuthold Weeden Capital Mgt. 4th Qtr.16 Market Commentary-excerpt

The most remarkable feature of this decade's stock and U.S. economic recoveries has been the lack of consumer and investor confidence that's accompanied them. Despite a tripling of the stock market from 2009 lows and a decline in the unemployment rate to 4.7%, there's nothing that remotely resembles the excitement that accompanied similar market and economic achievements during the late 1990s. But that may be in the process of changing. Confidence—along with the stock market—surged in the weeks following the presidential election, and in early 2017 there's talk of a rebirth of "animal spirits"—just as the bull market approaches its eighth birthday.

We're contrarians at heart, and the burst of optimism in the past two months certainly registers as a negative in our investor sentiment work. We've observed that while corporate and investor attitudes might have been subdued throughout much of the economic cycle, their *actions* haven't been quite so conservative. For example, issuance of low-grade debt during the last two years has far exceeded the levels of that near the top of the last business cycle (2006-2007), with lenders loosening loan covenants in predictable late-cycle fashion. Meanwhile, most of our Intrinsic Value measures have climbed above their 2007 peaks. It appears that these already-stretched measures of corporate fundamentals will become even more stretched before the onset of the next bear market and recession.

Our stock market disciplines remain moderately bullish, reflecting fairly uniform strength across all capitalization tiers and most equity sectors. Among the industries we consider to be market bellwethers, only the interest-sensitive Utilities has failed to join the major indexes at new highs. However, other interest-sensitive groups—like Banks, Brokerage, and Insurers—have strengthened on a relative basis as bond yields have climbed, suggesting that interest rates haven't moved up enough to provide serious competition to stocks. And we think there's a positive, offsetting "confidence" effect that's resulted from the move away from crisis-based interest rate policies.