January 2018 4th Quarter Concorde Investment Management

Domestic Economic Overview

A Message from Concorde Investment Management

We are pleased to provide the following overview of the domestic and international economic backdrop and the financial markets that impacted our investment policy and strategy during the Fourth Quarter of 2017, as well as other articles of interest.

Headline GDP for the 4th quarter was an annual growth rate of 2.6%, slightly less than expectations. Digging deeper into that number reveals positive momentum, especially with the quarter ending on the passage of tax reform. Consumer spending, 70% of the U.S. economy, increased 3.8% during the quarter. That was the quickest pace in 3 years and much faster than the 2.2% growth rate during Q3. Business investment was also strong during the quarter, with equipment purchases rising at an 11.4% annual rate and fixed investments rising at 6.8%. The tax bill, which will be discussed below, incentivizes business investment and we expect this growth rate to remain strong during the next fiscal year. The trade deficit contributed negatively to GDP growth, on the whole subtracting 1.13% from GDP. As the current administration has been been pounding the table about trade and being treated fairly, we only expect this to contribute to more tough talk around the subject. Overall, 2017 had real GDP of 2.3% compared to 1.5% in 2016. A decent year that should set the primer for a robust 2018.

Longer term GDP growth is still in doubt because of the metrics that drive GDP. Mainly, population growth of workers and productivity. Immigration of talented and skilled workers is paramount to achieving long term, sustainable growth. The Bureau of Labor Statistics and Bureau of Economic Activity both point to growth in workers plus growth in real output per worker are what generates real GDP growth. Our current census forecast only has a growth in working age population as .3% over the next decade. That is half the growth number of

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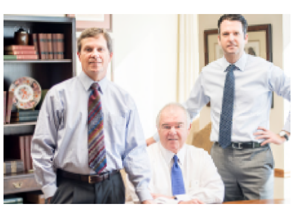
The Concorde Team



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the last decade and well below any numbers since the mid 70's. Real output growth is as low as any time since the decade from '67-'76, however this could be assisted by increased corporate investment. Immigration reform should be a priority for Washington post tax reform if they'd like to solve longer term economic issues.

During last quarter's letter we surmised "….growth rates in the 2-2.5% range and that is all fine but if our GDP does not grow faster than a rate that generates tax revenue sufficient to offset spending then the trajectory of the U.S. economy is unsustainable. The growing realization of that fundamental fact, and the fact that the GOP controlled congress needs some sort of legislative victory prior to the 2018 midterm elections, is why we remain optimistic of a passable tax bill that, at a minimum, will reduce the corporate income tax rate which should have multiple constructive and positive effects on economic growth.". The GOP passed their bill and while there was a lot horse-trading around personal rates, exemptions, and deductions, the drivers of GDP growth from this bill will be the corporate tax rate cut to 21% and immediate 100% expensing on new equipment. There is a mandatory repatriation of cash held overseas which is going to be used for wage increases, stock buybacks, and dividends. It is hard to be negative about much, if any, of the corporate tax reform as evidenced by the fact that the only political complaints are on the personal side (and those complaints were trying to frame an argument about personal tax increases which will happen in 2027 if nothing is changed). Overall, the quarter was solid on every metric, excluding trade imports, and sets the stage for a robust year for actual real economic growth.

International Economic Overview

We discussed the Global Purchasing Mangers' Index for manufacturing, a leading indicator of growth prospects, in our Q3 letter showing positive numbers for both the Developed and Emerging Markets. The Index for every single country (save Italy), is higher as of December than it was in September. Robust indications of global synchronized growth are ongoing. Inflation numbers across the globe are starting to increase as well.

One trick governments across the globe use in order to get debt ratios under control is inflation. Without inflation, the nominal value of debt and ratio of debt to GDP grows at unsustainable rates. The experiments born by central banks using quantitative easing (to the tune of over $30 Trillion) may be finally starting to work as they had initially hoped. Asset prices have been inflated but actual price inflation had been lacking. Estimated nominal GDP global growth is expected to be 5.7% for 2018 which would be the highest nominal year since 2011.

China is always a driver of international economic activity given their size and role in the global economy. Importing raw materials and exporting finished goods means the globe is dependent on the

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International Economic Overview (continued)

Chinese worker and their country's fiscal health. A lot gets written about Chinese debt levels and the concern of their impact on activity. It's important to understand how their debt stacks up and relative percentages to the United States. Public debt, as a percentage of GDP for the Chinese, is 45.7%. The U.S. is sitting at 78.2%. Household debt as a percentage of GDP sits at 46.8% versus the U.S. at 78.2%. The area of concern is non-financial corporate debt which sits a staggering 163.4% relative to the U.S. at 98%. According to the Economist *"…At issue is the definition of "non-financial corporations" as used by the Bank for International Settlements (BIS), the organization that compiled the numbers underpinning the S&P analysis. BIS relies on data from the People's Bank of China, which classifies all local government financing vehicles (LGFVs) as non-financial corporations."*. That definition used in States would be similar to adding the borrowings of Chicago to Union Pacific. Not exactly the same. The point being, private sector debt and leverage is what drives economic slowdowns and the Chinese, if you exclude the local government debt numbers, is relatively better situated than the U.S. or Europe. Still, they, along with every other nation, need to get their borrowings and debt level increases under control.

Equity Markets

Domestic and international markets capped a very good performance year with a solid quarter. Divergences in geography sectors and styles continued to be quite large as all groups did not perform at high levels. International markets generally out-performed most of the broad domestic indices. Fundamental corporate results continue the surge which began in mid-2016 and have underpinned the stock market gains over that period. Developed international markets, primarily Western Europe, could continue to outperform, as they did for all of calendar 2017, as fundamentals have surprised more than almost any other region and valuations are still below historical norms. Emerging markets, beyond the economic bounce backs in significant economies like Brazil and Russia, have benefited from a generally weaker U.S. dollar in 2017. Regarding our U.S. markets, increases in earnings and cash flows have supported recent advances and valuations for the market in general are reasonable at current interest rates. We continue to believe that continued investment is justified even if bond rates rise modestly as long as earnings growth is modest or better. Certainly the recent strength may be driving some individual valuations above the fair value range, thus reinforcing the need to be selective in individual company selection. The impact of the recent tax legislation remains to be seen but may have positive long term effects on corporate capital spending, as we discuss below in the Domestic Economy overview regarding Corporate Tax reform.

Fixed Income

Short term U.S. Treasury yields (5-year maturity and less) continued to rise persistently during the quarter as the impact of normalizing the benchmark Federal Funds rate by the Federal Reserve continued to impact the bond market. Since December 2013 when the markets first began to anticipate this Fed action (although the first Fed Funds increase did not occur until December 2015) these shorter maturity treasury note yields have risen dramatically (see table below). As a result of these moves and the less robust increases in medium and longer maturity rates, the yield curve has flattened considerably and is now in a more normal configuration. What happens next will depend more on changes in inflation and economic growth which will dictate fundamental rather than government policy influence on the market. As the artificial environment of the last 8-10 years has driven significant capital to higher risk assets, such as corporate and international securities, these markets have become at best fairly valued. Current economics and default rates support valuations of the investment grade and high yield domestic corporate markets, but there is little margin for error. We believe maintaining some exposure there is warranted as long as at least a slow growth scenario going forward is expected. Some international corporate and government markets are still recovering from weaker fundamentals and represent better value, although with more predictive risk. Some diversified exposure to these markets is also warranted. Assuming the economy is likely to maintain stability for the next 1-2 years, the real risk for domestic fixed income is an unexpected rise in inflation expectations that could come from a wage spike caused by the tight labor supply for skilled positions. We are concerned enough about this risk to continue to emphasize primarily short to medium term issues. Spread credit markets have recovered nicely in 2016 and 2017 after being damaged in the risk off period from mid-2014 through 2015. Performance will be difficult to match in the near future, but we still recommend a diversified approach with an emphasis toward higher quality and shorter maturities providing some defensive characteristics.

U.S. Treasury Maturity	Treasury Note Yields	
	12/31/13	12/31/17
1 Year	0.1%	1.8%
2 Year	0.4%	1.9%
3 Year	0.8%	2.0%
5 Year	1.8%	2.2%
		*Source: JP Morgan

Avoid This 529 Misstep to Help Maximize Savings

Taking money out of a 529 plan seems like it should be the easy part, but if 529 investors don't carefully right-size their 529 plan distributions, they may find that they owe both a penalty and extra taxes.

The key is that is that in any tax year (not academic year), investors want to ensure that the amount they withdraw from the 529 college savings plan doesn't exceed their qualified education expenses. Investors need to figure in tax-free educational assistance such as scholarships and grants and also factor in the impact of credits, such as the American Opportunity Tax Credit or the Lifetime Learning Credit.

Any amount withdrawn in excess of qualified expenses will be subject to taxes on the earnings portion of the withdrawal and could incur a 10% penalty. If investors figure the amount correctly, though, no tax or penalty will be due.

Know What's Covered

Investors need to calculate their qualified education expenses. This will be referred to as the QEE. But before that, it is important to know what is and isn't covered.

- Tuition and fees. Books, supplies, and equipment. This includes the cost of any computer technology, related equipment, and/or related services such as Internet access. The technology, equipment, or services qualify if they are used primarily by the beneficiary of the plan during the years the beneficiary is enrolled at the college or university.

- Room and board. This has a few important caveats. The student must be enrolled at least half time in the institution, and the room and board expenses can't exceed the greater of these two amounts:
    1. The allowance for room and board that was included in the cost of attendance determined by the college or university.
    2. The actual amount charged if the student is residing in housing owned or operated by the eligible educational institution.

That means off-campus housing is considered a 529-eligible expense, but only to the extent that it doesn't exceed the greater of the two aforementioned amounts. If a student is planning to live off campus, it's a good idea to call the campus housing department and confirm the qualified housing costs amount when calculating QEE.

Calculate Your QEE

Per the IRS, taxes do not have to be paid on the contributed amount (as 529s are funded with after-tax dollars) and generally aren't owed on any earnings distributed from a 529 if the total distribution is less than or equal to adjusted qualified education expenses. It's important to figure this number accurately, lest investors will owe taxes--and possibly a 10% penalty--on the overdistribution, or the portion of the distribution in excess of QEE. If the investor's child receives a scholarship, the 10% penalty on a nonqualified withdrawal is waived up to the amount of the scholarship. However, the investor will still owe taxes on the earnings portion of the overdistribution.