VANDERBILT Ave. ASSET MANAGEMENT

4th Quarter

Third quarter real GDP grew at a 3.2% annualized rate, thereby falling in line with VAAM's forecast and above the consensus outlook. This represented the strongest quarterly growth rate since the first quarter of 2015. It was the first time since 2014 that the economy has grown 3% or more for two straight quarters. After tax profits grew 4.9% from the prior period after falling 2% in the second quarter. Consumer spending, which accounts for about 70% of the economy, continues to be the main driver of growth. Spending grew 0.9% in September from the previous month, which was the quickest pace in eight years. Both the strong labor market and surging stock market have boosted the consumer. December saw 148,000 jobs added in the economy, which was the 87th straight month of expansion and the longest uninterrupted period of job expansion on record. This brought job gains for the year to 2.1 million, the seventh straight year of increases exceeding two million. Wages are up 2.5% year-over-year and are still at the same lackluster pace since late 2015. Although wage growth remains disappointing, household income, which reflects not only hourly pay rates but also how many people have jobs and how many hours they are working, has shown strong gains. There is anecdotal evidence that wages may be accelerating. Workers in metro areas with the lowest unemployment are experiencing among the strongest wage growth in the country. Demand for some skilled workers exceeds their supply and their wages are accelerating. Real wages are up. This a result of average wage growth being steady and inflation remaining low. In the past decade, real wage growth has been stronger than the economic cycles of 1980s, 1990s and early 2000s.

The corporate tax bill that reforms and reduces corporate rates (from 35% to 21%) should provide numerous beneficial impacts. The boost to profits and cash flows will allow corporations to respond to rising demand by investing in capital equipment. Over time this has the potential to boost productivity which should also aid additional wage growth. The lower tax rate, along with the immediate write-off of capital expenditures, will lower the cost of capital. In addition, the tax holiday for cash repatriation enhances cash flow availability for investment. Capex is among a select number of factors, in addition to labor and technology, which play an important role in shaping long term growth trajectories of economies. Business fixed investment represents 12% of GDP, yet contributes some 20% of quarterly volatility in growth. Tax cuts or not, companies are already spending on capex. Until the fourth quarter of 2016, capex growth had been declining for eight straight quarters. This changed in 2017. Through the third quarter of this year, capex on equipment has risen 7.3% at an annual rate which is the fastest pace in three years. The pace of growth in business investment grew 10.8% in the third quarter, which was also the fastest in three years. This pickup in spending has continued into the fourth quarter. For example, shipments of non-defense capital goods, excluding aircraft, rose in November which was the tenth gain in a row for a typically volatile series. Balance sheets are healthy and the cost of capital remains extraordinarily low. Economic growth, not only in the U.S. but globally, offers a prime reason to invest in plant and equipment, along with the fact that the U.S. average age of non-residential fixed assets is 16.3 years. The U.S. economy for years has relied on the consumer for growth while companies underspent. The pickup in capex could temper any shift lower in consumer spending and could help boost productivity.

VAAM is forecasting approximately 3% real GDP growth, not the 4%-5% rate that the Trump administration has advertised. While you may see a 4%-5% growth rate on a quarterly basis, we do not think this rate of growth will be sustained. As we outlined in a previous quarterly, growth converges around population growth plus productivity growth. Population growth has declined in the U.S. over the last 20 years. Over the last 10 years, the prime population (25-54) has only grown 0.1% annually. The last time the U.S. experienced consistent growth of 4% was in the 1980s. The prime population was then expanding at a 2.2% annual rate. Immigration restrictions will also serve as a retardant on population growth. The CBO's baseline GDP forecast is 1.8% (U.S. work force only expand 0.5% annually with productivity growth of 1.3%). It can be difficult to forecast productivity gains. These gains tend to occur in waves and can take time to be realized.

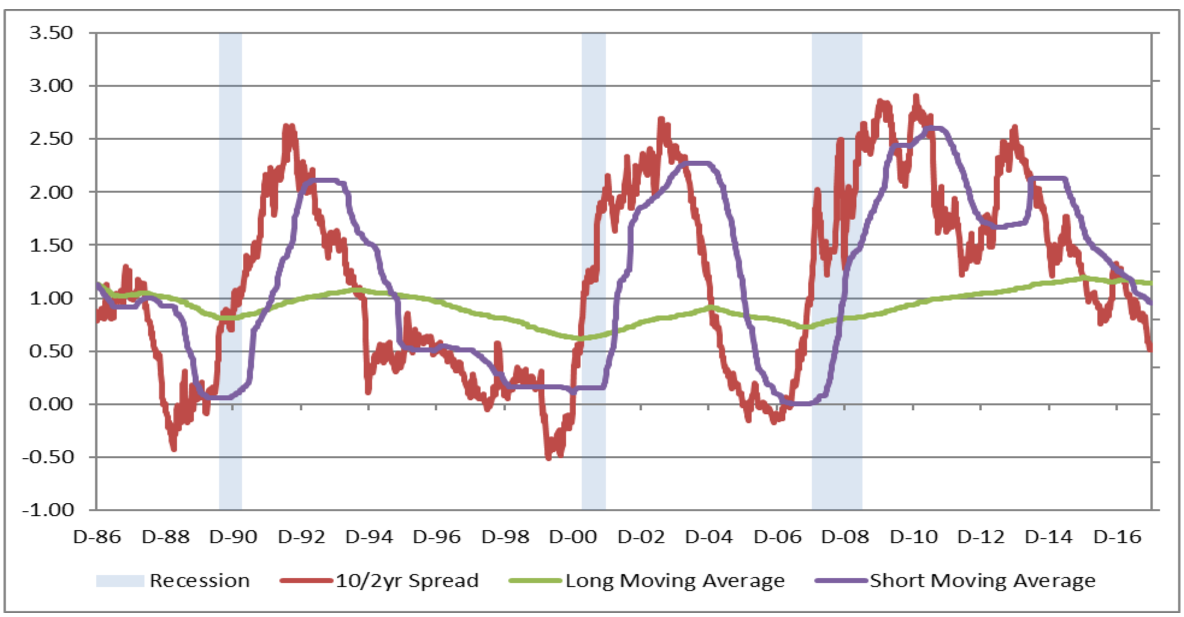
The Federal Reserve completed their third 25 basis point rate increase of the year to 1.25%-1.50% for the fed funds rate. They cited the low inflation rate (1.5% versus their 2% objective) and modest wage growth in support of their gradual policy of interest rate increases. Further, they said it could take a longer period of a continued strong labor market to achieve their inflation objective.

The yield curve continued to flatten as 2017. The year came to an end with short rates rising in tandem with expected FOMC action and ultimately outpacing long rates. Across tenors, the movement in rates was significantly more pronounced than during the previous quarter. Overall, rates ended the period higher by about 22 basis points on average. As anticipated, the 2 and 10 year spread compressed further by an additional 34 basis points. The following table shows the yield curve at the end of the fourth quarter.

	9/30/2017	12/29/2017	Change
3-month Treasury Bills	1.04	1.39	+0.35
6-month Treasury Bills	1.19	1.53	+0.34
2-year Treasury Bond	1.48	1.89	+0.41
5-year Treasury Bond	1.94	2.20	+0.26
10-year Treasury Bond	2.33	2.40	+0.07
30-year Treasury Bond	2.86	2.74	-0.12
10-year vs. 2-year	85	51	-34

The overall movement in yields has benefited a short duration strategy, as the negative impact of rising rates on bonds is mitigated by the limited exposure to interest rate moves. Accordingly, the relative performance has benefited from the increase in rates.

As a follow up to our previous report, we provide an update to our yield curve analysis. The following graph shows the historical behavior of the yield curve slope, as measured by the spread between 10 and 2-year rates. For added context, the long run and short run average is added for comparison purposes. Consistent with the previous quarter's trend of a flattening yield curve, the momentum characteristics continue to indicate a further narrowing of the spread between 10 and 2-year rates. While this is still not a cause for concern, the indicator continues to signal a decline in the slope of the curve.

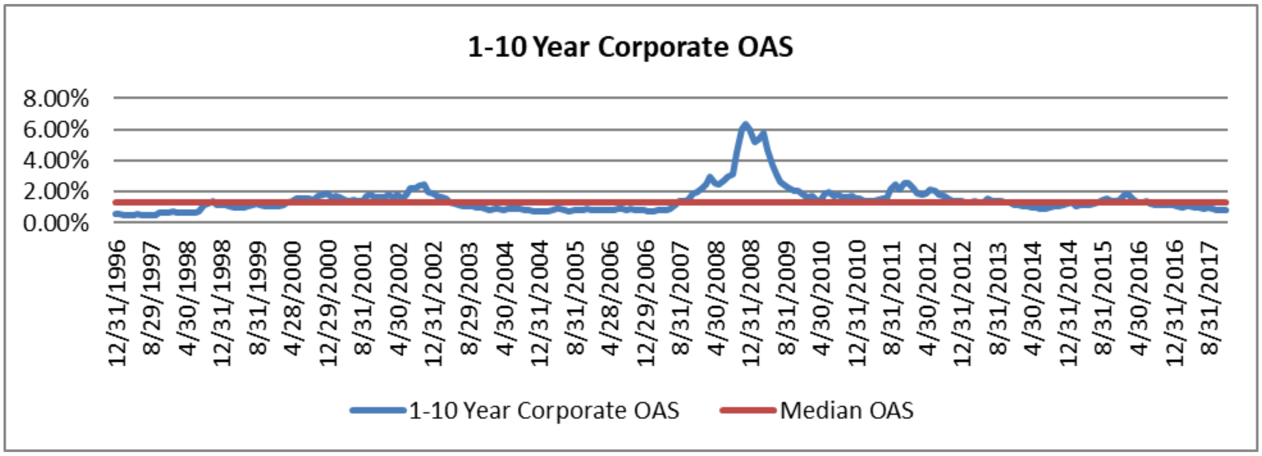


10 minus 2 year spread Source: Federal Reserve Economic Data

Corporate Securities

The corporate bond market enjoyed another banner year during 2017 following its strong performance in the prior year. The intermediate corporate bond sector, as measured by the ICE BofA ML ("ICE") 1-10 Year US Corporate Bond Index, provided 0.60% of excess return over comparable U.S. Treasury securities during the fourth quarter and 2.80% for the full year. These returns were provided by the higher income of the sector and 0.33% of spread tightening for the full year. The shorter end also had a strong relative performance year as the ICE 1-3 Year US Corporate Bond Index had 0.20% of excess return during the quarter and 1.49% for the full year while spreads tightened by 0.36%. Solid U.S. and global growth supported corporate financial fundamentals throughout the year and drove the outperformance of the sector. Our overweight allocation to the sector was beneficial to performance.

The two-year tightening in corporate spreads have driven Option Adjusted Spreads ("OAS") to the lowest levels of this economic cycle. As shown in the graph and table below, corporate OAS are now approaching multi-year tights. For instance, the ICE Intermediate Corporate Index OAS reached 0.71% during February 2005, the tightest during the 2000's. For the shorter ICE 1-3 Corporate OAS, the low was 0.50% during December 2006.



1-10 Year Corporate OAS	0.79%	1.28%	0.48%
1-3 Year Corporate OAS	0.52%	0.93%	0.39%

OAS from ICE BofA ML Corporate Indices

Barring significant de-leveraging, it is unlikely that spreads will compress significantly from current levels. Current valuations are, however, supported by the financial fundamentals of the sector. As discussed in earlier quarterly reports, EBITDA/Interest Coverages are relatively strong, thus EBITDA is growing in line with increases in debt and recent corporate earnings have been strong. For instance, 78% of all companies reported earnings that exceeded or were in line with market expectations, a relatively strong result. The recently enacted tax cut is expected to provide a boost to cash flow and push out the recession risk. Therefore, we remain overweight to the sector but our expectations are for excess returns to be in line with the incremental interest income of the sector, not spread compression.

We have a number of investments in the banking sector. The sector has dramatically improved its' financial fundamentals since the 2008 recession and the sector's financial meltdown as shown in the table below.

	Bank of America		**BB&T Corp**		**Citigroup Inc.**		**JPMorgan**		**U.S. Bancorp**		**Wells Fargo**	
	3rd Quarter '17	2009	3rd Quarter '17	2009	3rd Quarter '17	2009	3rd Quarter '17	2009	3rd Quarter '17	2009	3rd Quarter '17	2009
Net Charge-Offs	0.4%	14.2%	0.4%	7.1%	1.1%	19.3%	0.6%	14.0%	0.5%	8.3%	0.3%	8.8%
Nonperforming Assets % TCE & Res	3.8%	25.7%	3.6%	32.8%	2.5%	20.4%	3.1%	14.1%	3.2%	19.0%	5.5%	25.8%
Loan Loss Reserve % Nonperforming Assets	147.0%	88.0%	219.0%	62.0%	248.0%	108.0%	220.0%	160.0%	321.0%	130.0%	121.0%	92.0%
Return on Assets	1.0%	0.3%	1.2%	0.6%	0.9%	-0.1%	1.1%	0.6%	1.4%	0.8%	1.0%	1.0%
Return on Equity	9.0%	1.0%	9.7%	5.2%	7.9%	-4.6%	11.6%	7.1%	14.5%	9.1%	10.2%	12.5%
Tier 1 Capital Ratio	13.2%	10.4%	11.8%	11.5%	15.3%	11.7%	14.3%	11.1%	11.1%	9.6%	14.0%	9.3%

Data from Barclay's Capital Credit Research & Bloomberg

Each of these companies have improved their capital levels and the quality of their assets. Their actions provide a significantly stronger credit profile and an attractive investment opportunity.

Asset Backed and Mortgage Backed Securities

While the short end of the U.S. Treasury curve continued to flatten throughout the fourth quarter, short ABS and short MBS both returned positive excess and total returns versus Treasuries, despite negative price returns resulting from the market backup. Specifically, short ABS posted a price return of -0.32%, with a total return of 0.17% and excess return versus Treasuries of 0.19%. Similarly, the short MBS index returned -0.62% based on price return, with 0.02% total return and 0.24% excess return versus Treasuries. Year to date 2017 returns were similar, with negative price returns, accompanied by positive total and excess returns. Specifically, short ABS returned -0.37% price return, 1.54% total return and 0.97% excess return versus Treasuries. Short MBS posted -1.48% YTD 2017 price return, with 0.82% total return and 0.18% excess return versus Treasuries.

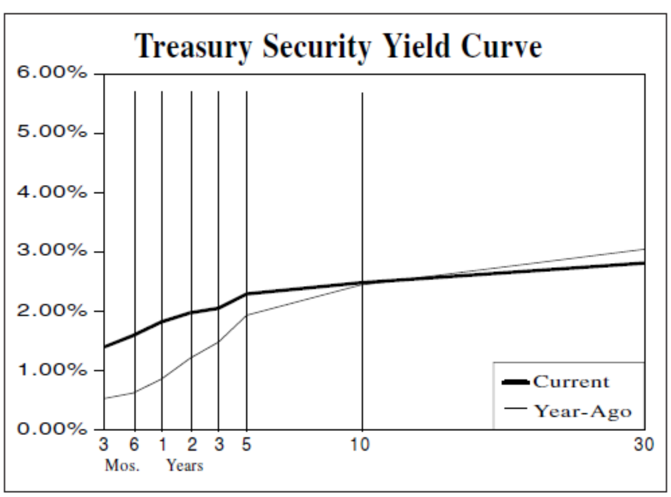
The ABS in our portfolios are short AAA-rated securities backed by credit card and auto loans. Spreads in these sectors began the year tight and continued to tighten even more due to the high level of collateral and low borrower delinquencies. Unlike MBS, these bonds are not very sensitive to interest rate movements and either pay down with a bullet payment or through a structured payment schedule. We like the yield contribution from these quality securities on the short end of the curve.

The MBS portion of our portfolios is invested in short, super seasoned Agency MBS which offer default and prepayment protection. The Agency rating insulates these securities from defaults. Due to the seasoning of the collateral backing these securities, they experience stable prepayment levels that do not fluctuate greatly with moves in interest rates. The loans backing these securities are "burnt out," meaning the balances are lower and experience less benefit from refinancing and, therefore, prepayments occur more consistently from month to month, based more on seasonality than on interest rate movements.

Selected Yields

	Recent (1/3/18)	*3 Months Ago (10/4/17)*	*Year Ago (1/4/17)*
TAXABLE			
Market Rates			
Discount Rate	2.00	1.75	1.00
Federal Funds	1.25-1.50	1.00-1.25	0.50-0.75
Prime Rate	4.50	4.25	3.75
30-day CP (A1/P1)	1.54	1.19	0.66
3-month Libor	17.00	1.34	1.00
U.S. Treasury Securities			
3-month	1.40	1.06	0.53
6-month	1.59	1.21	0.62
1-year	1.82	1.31	0.86
5-year	2.29	1.92	1.93
10-year	2.48	2.32	2.44
10-year (inflation-protected)	0.51	0.50	0.44
30-year	2.81	2.87	3.04
30-year Zero	2.83	2.96	3.13

	Recent (1/3/18)	*3 Months Ago (10/4/17)*	*Year Ago (1/4/17)*
Mortgage-Backed Securities			
GNMA 5.5%	2.90	2.38	1.99
FHLMC 5.5% (Gold)	3.07	2.80	2.43
FHLMC 5.5%	2.94	2.36	2.27
FHLMC ARM	1.98	1.89	1.76
Corporate Bonds			
Financial (10-year) A	3.37	3.29	3.59
Industrial (25/30-year) A	3.74	3.87	4.11
Utility (25/30-year) A	3.80	3.90	4.19
Utility (25/30-year) Baa/BBB	4.06	4.21	4.60
Foreign Bonds			
Canada	2.07	2.12	1.71
Germany	0.46	0.45	0.28
Japan	0.01	0.06	0.07
United Kingdom	1.21	1.38	1.34
Preferred Stocks			
Utility A	5.86	5.78	5.96
Financial A	5.77	5.78	5.99
Financial Adjustable A	5.46	5.47	5.48



Source: Value Line, Inc.

Federal Reserve Data

BANK RESERVES

(Two-Week Period; in Millions, Not Seasonally Adjusted)

	Recent Levels			Average Levels Over the Last...		
	12/20/17	**12/06/17**	**Change**	**12 Wks.**	**26 Wks.**	**52 Wks.**
Excess Reserves	2194042	2181708	12334	2158352	2157758	2126323
Borrowed Reserves	43	6	37	14	13	14
Net Free/Borrowed Reserves	2193999	2181702	12297	2158338	2157745	2126310

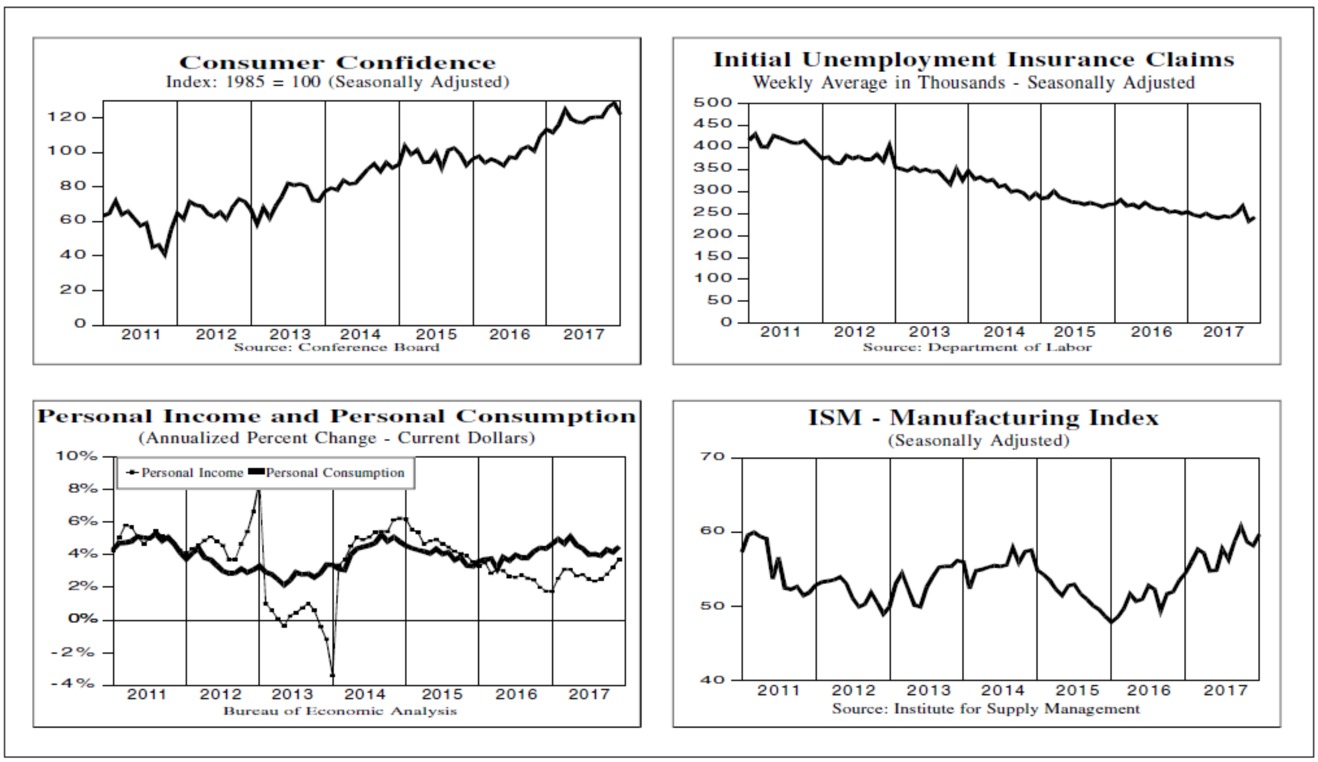
MONEY SUPPLY

(One-Week Period; in Billions, Not Seasonally Adjusted)

	Recent Levels			Ann'l Growth Rates Over the Last...		
	12/18/17	**12/11/17**	**Change**	**3 Mos.**	**6 Mos.**	**12 Mos.**
M1 (Currency+demand deposits)	3643.7	3649.2	-5.5	9.0%	9.3%	9.2%
M2 (M1+savings+small time deposits)	13863.1	13866.0	-2.9	5.0%	5.0%	5.1%

Source: Unites States Federal Reserve Bank

Tracking the Economy



Source: Value Line, Inc.