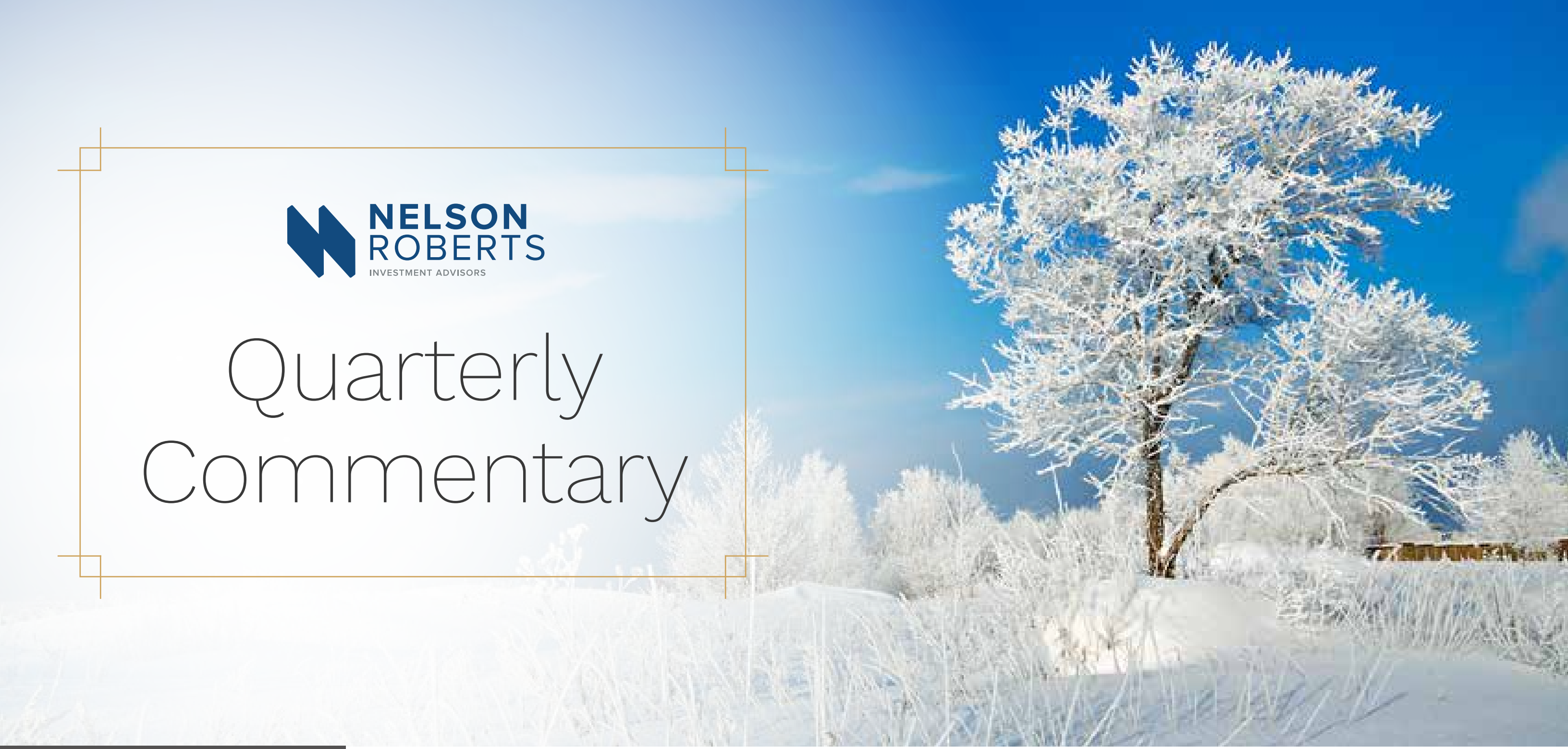

NELSON ROBERTS
INVESTMENT ADVISORS

Quarterly Commentary

2017 | Q4

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Emerging Euphoria

For over a year now, the U.S. markets have continued a steady climb to new highs. In 2017, the S&P 500 was up 21.8% and the Dow Jones rose 28.1%. After declining each of the last two years, international markets produced positive returns in 2017. The international developed markets index (tkr: MXEA) was up 25.7% and the emerging markets index (tkr: MXEF) was up 37.5%.

Broad global economic growth has resulted in increased profits around the world, driving the equity markets higher. In the U.S., the earnings of the S&P 500 constituents grew 12.5% in aggregate, with analysts predicting another double-digit earnings growth year in 2018. Outside the U.S., the results were even more impressive, with international companies from developed nations enjoying profit expansion of 17% in aggregate.

Individual consumer consumption makes up about 2/3 of U.S. Gross Domestic Product (GDP). Despite an economic expansion that has now lasted 102 months, we have worried that most of the consumer base has not been participating in the recovery. Wage growth had remained stubbornly low and a significant portion of the population had not benefited from the recovery in the value of real estate and the stock market.

However, there are increasing indications that a larger percentage of U.S. consumers has begun to benefit from the near decade-long improvement of the U.S. economy. Median wages exceeded 2007 levels for the first time in 2017. Rising wages and low unemployment suggest that employees will have greater bargaining power. The price of oil has remained well below the elevated levels of the early part of the decade and the low interest rate environment has maintained historically cheap borrowing costs. Debt payments as a percentage of disposable personal income are at the lowest level in nearly four decades. These factors will help put more money in U.S. consumers' pockets. It is no wonder that the consumer confidence level is at a lofty 122.1.

The new tax law will add further stimulus to the economy and could ignite further corporate earnings growth. Investors bought stocks in anticipation of the legislation, which was signed just before Christmas Day, causing an accelerated rise in stock prices through the end of the year.

With so many positive fundamentals, what could derail the momentum of the market? Historically, there have been two culprits: investors themselves and the Fed.

Index Performance	Q4 '17	YTD
Dow Jones Industrials	10.96%	28.11%
Standard & Poor's 500	6.64%	21.82%
EAFE (international stocks)	4.29%	25.69%
Russell 2000 (small stocks)	3.33%	14.63%
Barclays Interm. Gov/Credit	-0.20%	2.14%
Barclays Municipal	0.75%	5.45%

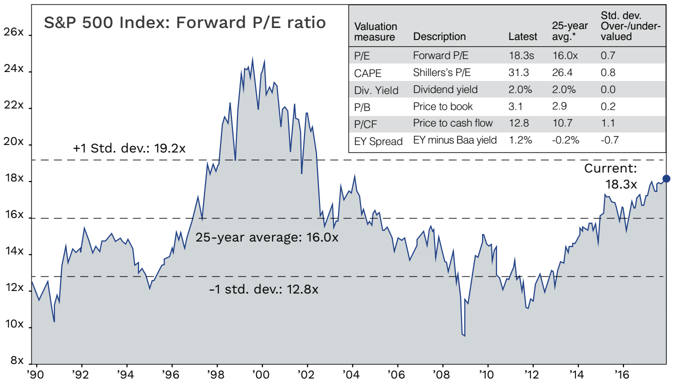
We apply rigorous analysis in asset selection so you can focus on your passion

ECONOMIC OVERVIEW

Emerging Euphoria (cont.)

Long-time readers of this commentary have heard us reference the Sir John Templeton quote that maintains that bull markets “die in euphoria.” In euphoric markets, investors become overly optimistic about future prospects of the market and bid the value up until the price cannot be sustainedby fundamentals.

One of the tools to measure valuation is the forward price-to earnings (P/E) ratio. A forward P/E indicates what investors are willing to pay for anticipated future earnings. In the dot-com-



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-valued
P/E	Forward P/E	18.3s	16.0x	0.7
CAPE	Shillers's P/E	31.3	26.4	0.8
Div. Yield	Dividend yield	2.0%	2.0%	0.0
P/B	Price to book	3.1	2.9	0.2
P/CF	Price to cash flow	12.8	10.7	1.1
EY Spread	EY minus Baa yield	1.2%	-0.2%	-0.7

Source: J.P. Morgan

markets of 2000, investors were paying 27 times anticipated earnings. We all remember how that ended: earnings did not materialize and the lofty valuations came crashing down. There are some signs of euphoric behavior, such as the rapid rise of the “Fab 5” stocks (Alphabet, Amazon, Apple, Facebook and Microsoft) and the wild appreciation of bitcoin. This euphoria has not yet spilled over into the broader stock market, although at 18.3 times anticipated earnings, the S&P 500's valuation is starting to indicate heightened expectations. We think these expectations are warranted, but disappointment from the corporate sector in 2018 would lead to a market decline.

More likely, the Federal Reserve will throw a wet blanket on this bull market. Why? The Fed’s mandate is to control inflation while stimulating employment. Inflation has remained benign for nearly a decade, partially because wage growth has been muted. The unemployment rate has steadily declined since 2009 from 10% to 4% today. There are emerging signs of labor shortages. For example, the State of Maine cannot find enough snow plow drivers to keep the roads clear this winter.

Tight labor markets produce employer competition for hiring employees. The tax law reduces the tax on corporate earnings from 35% to 21%, which will further stimulate business expansion and hiring. This is the classic cause of accelerating inflation during an economic boom.

Jerome Powell is set to take over as chairman of the Federal Reserve in February of 2018. He is in favor of the current policy of gradually raising interest rates while decreasing the Fed’s balance sheet. This policy will help to offset the inflationary pressures discussed above. To the extent that inflation starts to accelerate, the Fed will increase the frequency and size of interest rate increases and balance sheet reductions. A steady rise in interest rates will increase the cost of debt service after a decade of declines. Reducing the Fed balance sheet further removes money from the economy.

Higher interest rates and tighter monetary policy serve to moderate economic growth, but they also put pressure on stock market valuations. Eventually, the combination produces a recession and bear market. While we believe the stock market rise will continue well into the New Year, eventually, inflation and higher interest rates will derail this bull market. Expanding euphoria and rising inflation will signal the time to become more conservative with both asset allocation and investment selection.

ASSET MANAGEMENT

Rounding Out 2017

2017 was an overall good year for the stock market, but there were some clear standouts. International markets outperformed domestic stocks, large-cap stocks generally outperformed small-cap, and we saw a dramatic outperformance of growth stocks relative to value stocks across the board. A “growth” company is usually one whose earnings are expected to increase at a faster rate relative to the rest of the market. Growth stocks generally do not pay dividends and trade at higher valuations since investors are willing to pay up for the higher growth. “Value” stocks, on the other hand, are typically more established companies with solid fundamentals, lower valuation and higher dividend yields.

The energy sector, which is made up of mostly value stocks, was the worst-performing sector in the S&P 500. Energy was the lone negative performer in 2017. The technology sector, which is dominated by large growth companies, was the best-performing sector in 2017, with a 38.8% return. Within the technology sector, growth stocks such as Salesforce (tkr: CRM) significantly outperformed value stocks like Oracle (tkr: ORCL).

During the fourth quarter, we made two transactions in our global portfolio, tweaking our investment exposure and benefiting from an announced acquisition.

We added to our position in the Vanguard FTSE Developed Markets ETF (tkr: VEA). International markets have lagged domestic markets over the last three years. We believe that the low price-to-earnings ratio, estimated earnings, and dividend yield are attractive. International markets’ relatively low valuation compared favorably with the S&P 500. This purchase followed an increase in our VEA position in June.

We sold our Cavium (tkr: CAVM) position this quarter after an announcement that it would be acquired. Part of our original thesis on Cavium was that it was an attractive acquisition target. Marvell (tkr: MRVL) announced that it would buy Cavium in a cash and stock deal worth $6 billion. We decided to sell Cavium after the stock price rise that followed the announcement. Marvell develops analog-to-digital interfaces that are applied in data storage and broadband communications. As a larger company with more cash, Marvell’s scale would offer a larger research and development budget for Cavium. However, Cavium would be the combined company’s sole growth engine. Marvell’s largest customers give it significant exposure to the hard disk drive market, which we believe is in secular decline, and we think the combined company would have a weaker thesis than CAVM alone.

> “There are some signs of euphoric behavior… This euphoria has not yet spilled over into the broader stock market, although at 18.3 times anticipated earnings, the S&P 500’s valuation is starting to indicate heightened expectations.”

FIRM UPDATES

After several years with Nelson Roberts Investment Advisors, Tyler Brown departed the firm to pursue an opportunity at a financial sector research firm in the Bay Area. We wish him well in his future endeavors.

The firm also welcomed Kensie Sumiko Rodriguez, daughter of Erin and Fred Rodriguez. Kensie was born on October 16, 2017, weighing 8.3 lbs. She and her parents are doing well.

WEALTH MANAGEMENT

New Tax Law

The GOP recently passed the Tax Cuts and Jobs Act, the biggest tax overhaul since 1986. Most taxpayers will see a 1-4% reduction in their marginal tax rate. While the $4,050 personal exemptions are repealed, the standard deductions nearly doubled, to $12,000 for individuals and $24,000 for joint filers. The child tax credit will also double, from $1,000 to $2,000.

The deduction for state and local taxes (SALT)—which includes property taxes—will be capped at $10,000. The mortgage interest deduction will be limited to interest on new mortgages under the $750,000 limit (down from $1 million), while interest on home equity lines of credit will no longer be deductible.

Owners of pass-through businesses will be able to deduct 20% of their business income. This does not apply to service businesses, including accountants, lawyers, investment advisors, and other businesses where the "the principal asset of such trade or business is the reputation or skill" of its employees and owners. However, service business professionals whose income is under the phase-out limits, starting at $315,000 for joint filers and $157,500 for individuals, would qualify for the deduction.

The Alternative Minimum Tax (AMT) was not repealed for individuals, but the exemption levels have been increased. This means that most people will no longer be subject to AMT unless they have very large adjustments such as the Incentive Stock Option bargain element.

The estate tax threshold was doubled to $11.2 million per individual. This will result in far fewer estates being subject to estate taxes.

The new tax law also expands the use of 529 savings plans beyond college costs. People may now withdraw up to $10,000 annually to cover qualified expenses for K-12 education.

While lowering the marginal tax rates should lower taxes for many, the loss of deductions will end up increasing taxes for some, especially for residents of states with high income taxes, such as California, New York and Connecticut.

We encourage you to speak with your accountants and reach out to us with further questions.

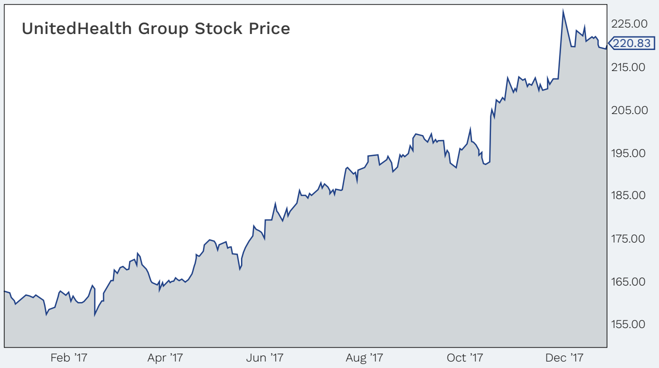
	CURRENT TAX LAW	NEW TAX LAW
Standard deduction	$6,350 individual/ $12,700 joint	$12,000 individual/ $24,000 joint
SALT deduction cap	None	$10,000
Mortgage interest deduction cap	Mortgages under $1,000,000	New mortgages under $750,000
Pass-through income	Taxed as ordinary income	20% deduction for qualifying businesses
Estate tax threshold	$5.49 million per person	$11.2 million per person

FEATURED EQUITY

UnitedHealth Group (tkr: UNH)

UnitedHealth Group (tkr: UNH) is the largest health insurer in the United States, covering 50 million lives across a diverse membership base. The company has leading market positions in all private and public health insurance segments, including Medicare and Medicaid as well as employer-based coverage and military service members. Its size gives it price negotiation power with providers, the ability to create or buy provider networks and spread its costs over a large population. UnitedHealth Group has consistently outperformed its peers and successfully navigated the upheaval in the insurance markets following the Affordable Care Act and the current attempts to repeal it. UNH is also operating businesses in South America, where it owns a large health insurer in Brazil and recently entered into an agreement to acquire Banmedica, a vertically-integrated health services company based in Santiago, Chile with 890,000 covered lives, clinics and five hospitals.

In particular, we believe the company's rapidly-expanding Optum division truly sets it apart from other insurers. Optum Health Services operates three business segments: OptumHealth, population health management and health care delivery; OptumInsight, which provides health information, technology, services and consulting to participants in the health care industry; and OptumRx, UNH's pharmacy benefits manager, which is on track to fill over 1.2 billion prescriptions this year. Optum serves 124 million individuals (nearly 40% of the US population) and four out of five major US hospitals. Optum also has a network of more than 67,000 pharmacies. In the last two years, OptumHealth has made a major push into the acquisition of facilities such as urgent care centers and outpatient surgicenters. Additionally, Optum recently announced that it would acquire DaVita Medical group, which serves 1.7 million patients per year in 300 medical clinics and urgent care centers. The continued expansion into direct provision of care allows UNH to better steer patients to the most appropriate level of care, with the goal of saving money for everyone while still ensuring that people get the services they need. Optum has been a major growth driver for UNH over the past several years. The integration of Optum's services



Source: YCharts

with the health insurance business represents an evolving model of healthcare and UNH has been ahead of this curve.

UnitedHealth Group is a core holding in our healthcare sector. We believe it is positioned for further growth with its successful Optum division, and that it will perform well regardless of any legislative changes we might see down the road.

(The preceding information regarding the featured equity should not be construed as a recommendation to purchase the security. It should not be assumed that future returns will be profitable or will equal the historical performance. Please contact us for a complete list of holdings.)

TOP 15 HOLDINGS

- iSHARES S&P SMALL-CAP ETF
- VANGUARD DEVELOPED MARKET ETF
- ALPHABET INC.
- AMAZON.COM INC.
- UNITEDHEALTH GROUP INC.
- VANGUARD EMERGING MARKETS ETF
- COSTCO WHOLESALE CORP.
- VERIZON COMMUNICATIONS INC.
- STRYKER CORP.
- CISCO SYSTEMS INC.
- AKAMAI TECHNOLOGIES INC.
- UTILITIES SECTOR SPDR
- ROPER TECHNOLOGIES INC.
- THE TRAVELERS COS INC.
- SALESFORCE.COM INC.

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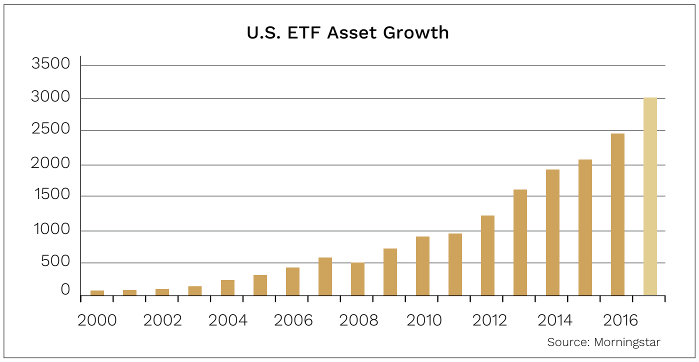
SPECIAL TOPIC

Exchange-Traded Funds

Exchange-traded funds (ETFs) have been around since the early 1990's, but in recent years they have exploded in popularity. ETFs saw record growth during 2017 in the U.S. as both institutions and retail investors moved money out of traditional mutual funds and individual securities and into ETFs.

ETFs are similar to mutual funds in that they hold baskets of securities, but they differ in that they trade like stocks. Demand for ETFs has increased as they are often cheaper, more tax-efficient and easier to trade than equivalent mutual funds. Brokerage firms have responded to increased demand by creating ETFs that track essentially every sector, region and asset class of the equity and fixed income markets. The number of ETFs available to trade in the U.S. has gone from fewer than 100 in 2000 to more than 1,900 at the end of 2016. The increasing popularity of passive investing has helped drive ETF asset growth and has sparked a fee war between firms like Vanguard, Blackrock and Charles Schwab as they try to attract new assets. Approximately $300 billion flowed into ETFs in 2017, with that number estimated to rise to $400 billion in 2018.

When used correctly, ETFs can be a valuable part of a portfolio. However, ETFs with a narrow focus on a particular country or sector hold risks that investors need to be aware of. A lack of in-depth analysis could lead to an investor comparing apples and oranges when looking at ETFs with similar names. For example, Vanguard and Barclays both offer emerging market ETFs, but Vanguard does not consider South Korea as an emerging market country while Barclays does. Also, some ETF providers classify Amazon as a technology company, while others classify it as a consumer discretionary company. These differences often have a material impact on performance.



Improved liquidity and lower expense ratios have made ETFs a more attractive tool for portfolio managers to gain diversification and exposure to the equity and fixed income markets. We plan to continue using ETFs to complement our core investment holdings.

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For additional information on the services of Nelson Roberts Investment Advisors, or to receive our newsletters via e-mail or be removed from our mailing list, please contact us at 650-322-4000.

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