Second Quarter 2017

The Strategist's Corner

Gone Fishin'

By Lorenzo Newsome, Jr., CFA, FRM, PRM

Inside this Issue

Fixed Income and Equity Market Commentary - 1

Review and Outlook - 3

There is the old "sell in May and go away" strategy that investors like to throw around during the summer months. This year may be a little different. It may become "change your tune and buy in June". If this strategy catches on, remember that I coined the phrase!

If you were to go away, where would you go and what would you do? I have a suggestion: go fishing. There has been plenty of choppiness in the financial markets based on tweets, sound-bites, speculation and random noise. Lasting results have been slow to materialize, causing some minor waves in the markets. Goin' fishin' could have a mellowing influence that could help clear investors' heads. The peace, quiet and calm could help reduce some of the stress of work and life. A change of scenery, the feel of freedom, being away from work, and just interacting with nature is a wonderful state. There is nothing like a day spent interacting with nature. It brings on the appreciation of being alive like nothing else.

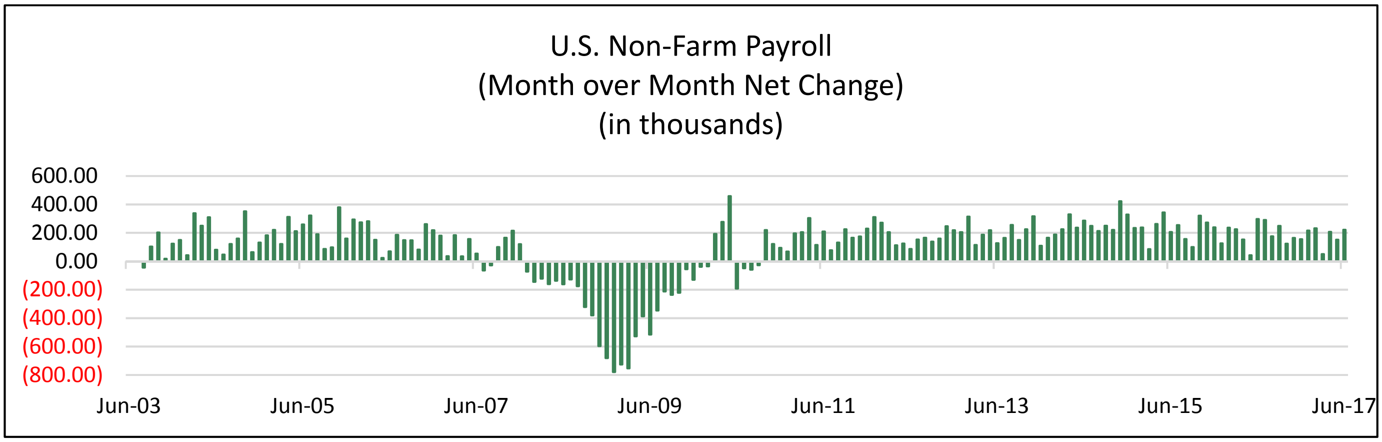
Most anglers will agree that the primary reason they go fishing is the thrill of the pursuit. The fun of it all, that's what matters the most. The hooking, the tracking, the wait, the feel of a fighting fish, and the triumph of the catch or the pain of failure. The sport allows time to think. Fishing has many characteristics and lessons that parallel the investing profession. Deep concentration and deep thinking are needed to be creative and navigate the trends and direction of the financial markets.

Every wiggle of the fishing line is not a mammoth catch, just as every security purchase is not a big winner. The chase ends up teaching so many valuable things, like persistence and patience. It's a small and calm way of experiencing life. Fish that refuse to give in and fight till the end, and the ones that trick you, teach valuable lessons. We learn from the experience. We learn that it takes conviction and willingness to stand up to the crowd and to stay focused on long-run economic and financial trends.

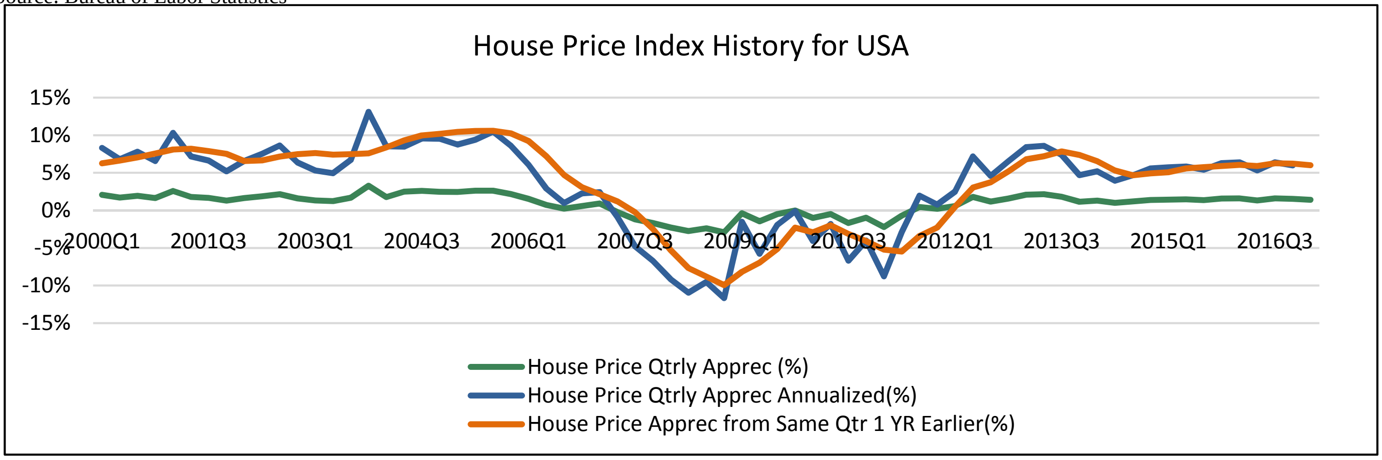
"Every wiggle of the fishing line is not a mammoth catch, just as every security purchase is not a big winner."

The S&P 500 Index has had positive returns of 0.91%, 1.16% and 0.48% for each month of the second quarter of 2017, respectively. The adage "sell in May and go away" isn't working so well this summer as the equity markets continue to break new highs. It is probably a short-term market advance for the remainder of the summer, but there could be more risk of a sharp decline than a continued rise in the markets.

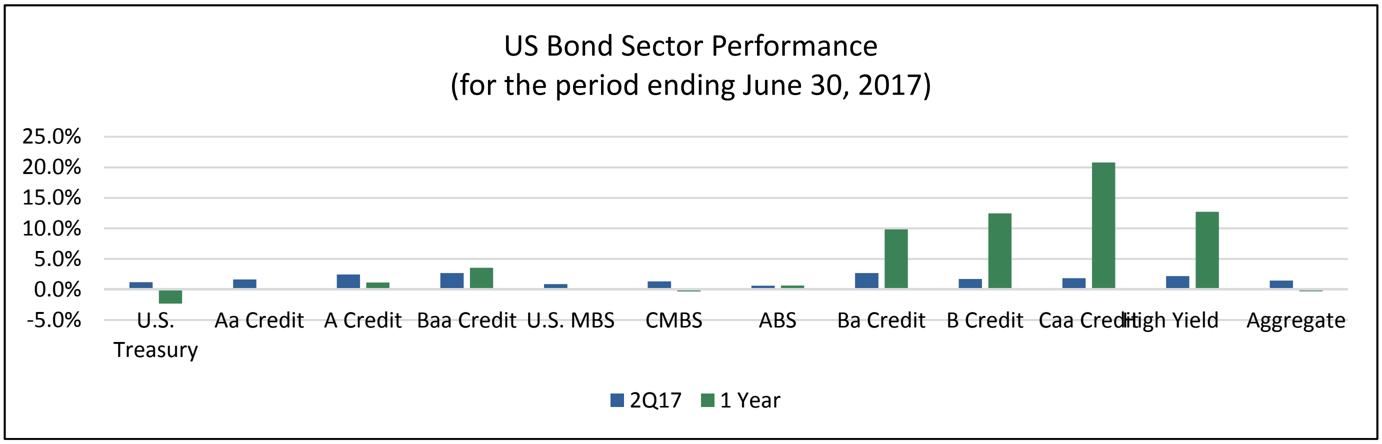
Please see "Angler" on page 4



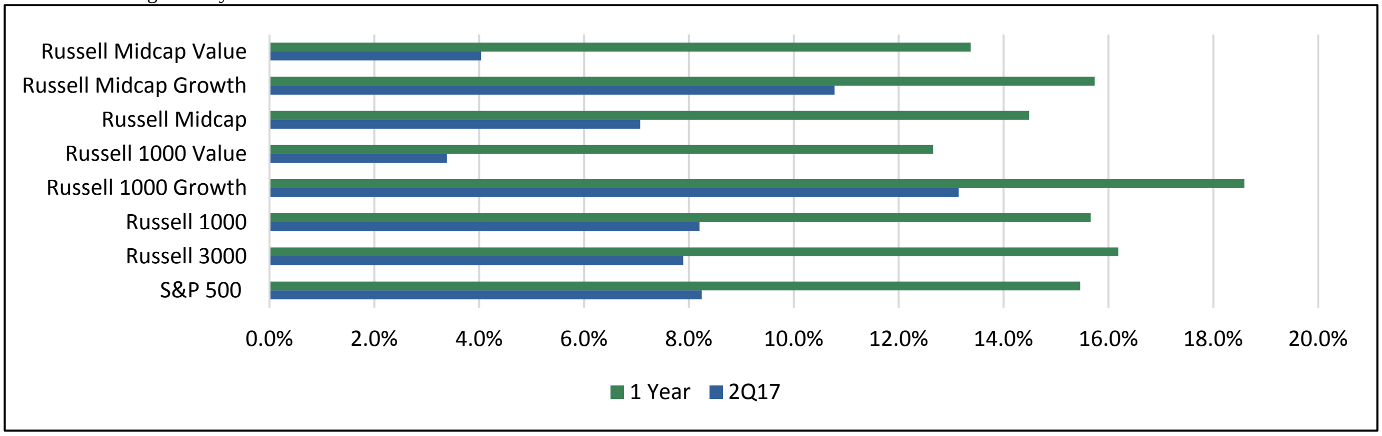
Source: Bureau of Labor Statistics



Source: FHFA



Source: Bloomberg Barclays Indices



Source: Bloomberg

Review and Outlook

The broader U.S. equity markets have made good progress so far in 2017, but haven't been able to build on these gains in the closing weeks of the second quarter. Health care, information technology and financials were the sizable S&P 500 sector winners for the period. The energy and telecommunication services sectors were the laggards for the quarter.

The second half of 2017 could look a lot like the first half on the economic front. The low volatility rally in the first six months of the year have been driven by a benign macro backdrop. There is continued strength in business fixed investment, home sales, and consumer spending (fueled by strong stock returns, increasing real estate values, and healthy levels of consumer confidence). There is also softness in auto sales, spending at brick-and-mortar stores, and orders for durable goods. Political risk remains elevated domestically and abroad. There continues to be increased concern about policy implementation in the U.S., with a continued focus on corporate tax reform/cuts, infrastructure spending, and the repeal and replacement of the Affordable Care Act (ACA).

"The Federal Reserve hiked U.S. interest rates by another 25 basis points in June."

The Federal Reserve hiked U.S. interest rates by another 25 basis points in June. It's the Fed's third rate hike since December and is a sign that the central bank believes the U.S. economy is on solid ground.

The major domestic fixed income indices posted solid positive return numbers for 2Q2017, given the 8-basis point decrease in yield on the 10-year Treasury. The U.S. Aggregate index improved 1.45% during the quarter. High-yield bonds posted positive returns while investment-grade debt also gained during the second quarter, according to the Barclays Capital indices. The total returns from corporate high-yield were 2.17% for the quarter, while returns from investment-grade corporate debt produced total returns of 2.54%. High-yield debt is rated below Baa3 by Moody's Investors Service and lower than BBB- by S&P.

The 2-year Treasury yield climbed 13 basis points while the 10-year Treasury yield decreased 8 basis points during the quarter to yield 1.38% and 2.30% for the period, respectively. Utility and Industrial were the best performing sectors within the U.S. Aggregate index. The two sectors returned 2.96% and 2.70%, respectively, for the quarter. U.S. Treasury bonds produced total returns of 1.19%. Baa bonds were the best-performing investment-grade credit quality during the second quarter, posting a 2.68% gain. Pharmaceuticals, banking, finance companies and diversified manufacturing were the best performing industries within the high-yield corporate sector.

The Bloomberg News monthly survey of bond yields – which includes input from more than 60 economists – forecasts that U.S. Treasury 10-year yields will increase to 3.00% in 2Q2018 and then rise to 3.11% in 3Q2018. All the yields are less than the forecasted yields of the May survey. Inflation has softened again, as oil price effects fade and restrained wage growth keeps core CPI low. The European Central Bank (ECB) and Bank of Japan (BoJ) remain cautious, while the Fed signaled further policy normalization, confident that the economic recovery will push inflation towards its 2% target. This could backfire if inflation declines and growth disappoints in coming quarters.

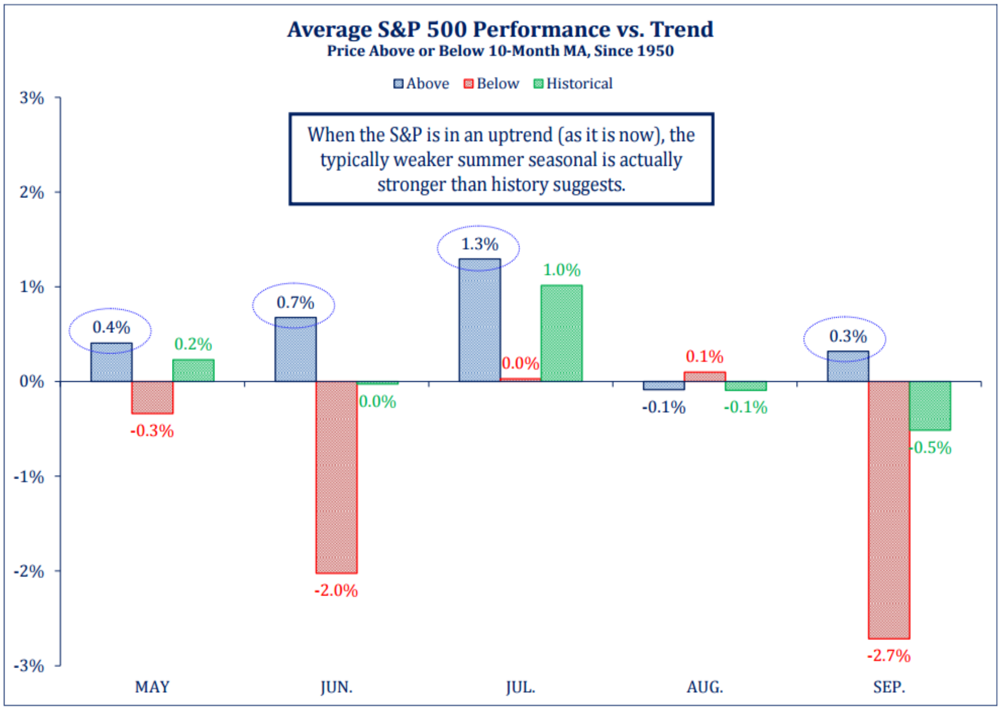
We will continue to manage portfolios that tend to exhibit less volatility than their relative index and strive to deliver attractive risk-adjusted returns. Our portfolios are designed to perform over a full market cycle with a focus on downside risk, a style we believe will succeed over the long term.

"Angler" from page 1

Recent analysis by Strategas Research Partners suggest that stock market trends can influence seasonal performance. Since 1950, the S&P 500 has performed even better during the summer months when it begins May in an uptrend like it has. Strategas describes an uptrend as the S&P 500 trading above its 10-month moving average. But remember that, historically, September and October can be two of the most threatening months.

"Understanding the impact to portfolios when something goes "wrong" is inherently more important than missing an opportunity on the upside."

BUT IMPORTANT TO REMEMBER… TREND CAN INFLUENCE SEASONALS



Source: Strategas Research Partners

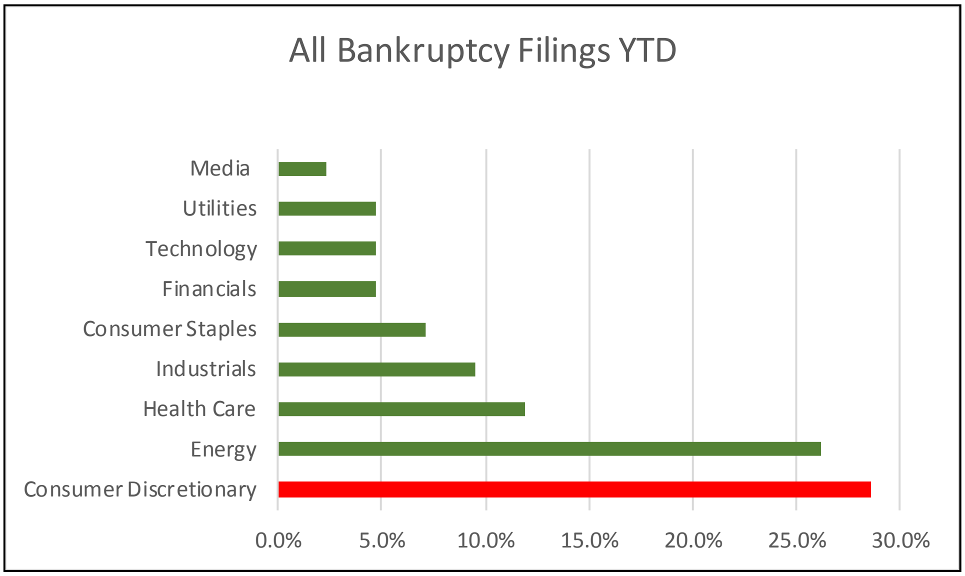
Valuations are being overextended, investors are still reaching for yield and Central Banks continue to have supportive monetary policies. Understanding the impact to portfolios when something goes "wrong" is inherently more important than missing an opportunity on the upside. What is the environmental (economic) impact of issues such as availability of fish (securities), overfishing (cash) on the sidelines to invest, and other elements of the environment, such as by-catch (ETFs). Anglers would call this overexploitation while investors would say that valuations are elevated.

Lets' go fishing! What do we need to go fishing and where do we purchase it? All we need is a small investment in a beginner's rod and reel, a hook, line and some kind of bait or lure, and we will be on our way. We can buy what is necessary from the fishing section of any retail sporting goods store. We will look at Dick's Sporting Goods (DKS), Cabela's (CAB), Hibbett Sports (HIBB) and Big 5 Sporting Goods (BGFV). Bass Pro Shop is a private company that is purchasing CAB for $5.0 billion in the third quarter of 2017. We won't consider the mass merchants or e-commerce (i.e., Wal-Mart, Costco and Amazon). Amazon is the whale shark of retailers.

This is shaping up to be the year of retail bankruptcies. The number of retailer casualties is piling up. In fact, through the first six months of 2017, eleven large retailers pursued bankruptcy protection. Sporting goods stores have fared a little better than the larger retailers and apparel players. Its challenges have been relatively consistent with those of the broader retail industry (e.g., reduced in-store traffic, lower transaction volume, rise of e-commerce, etc.). See Chart 1.

"The retail fishing hole is not a good place to attract strong returns now."

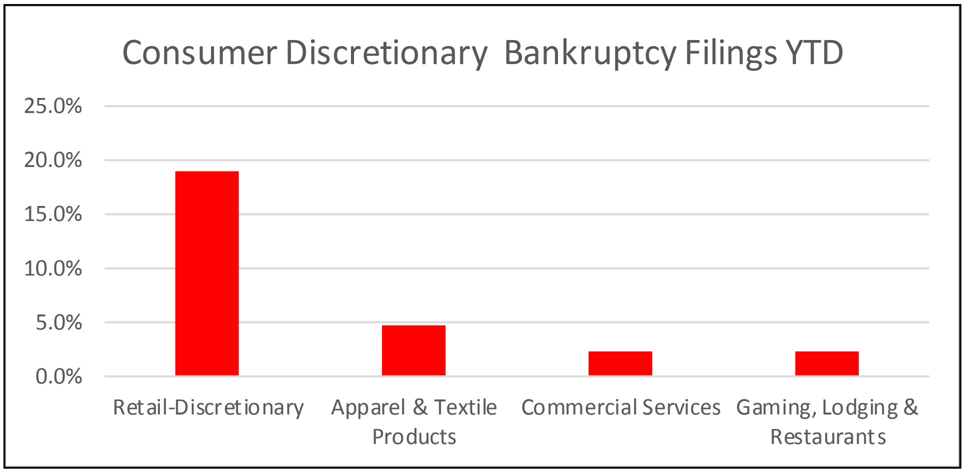
Chart 1



Source: Bloomberg and PIA

The consumer discretionary sector includes businesses that tend to be sensitive to economic cycles. The retail fishing hole is not a good place to attract strong returns now. See Chart 2. The recent retail sales report by the Census Bureau showed that department store sales fell 5.2% over the year ago period, while non-store retailers (online) rose a healthy 10.7%. Personal observation and recent news reports show an increasing number of "traditional" retailers either having slowing sales growth, falling sales, or shutting down business altogether.

Chart 2



Source: Bloomberg and PIA

The crucial plan to hook shoppers and survive is to offer something that e-commerce can't. Physical store retailers can work to create an emotional response in their shoppers. Experiences can help to build connection and community by offering free in-store classes, training, demos and supporting local Little Leagues and Scout Troops.

The connection with your fish is strongest when you catch it yourself. Second would be the local fish market, then the grocery store. Last would be the frozen section in a mass merchant store. Being a good angler means being comfortable not knowing when you are going to catch a fish, while remaining confident you are on the right path. The same can be said about managing money.

"Being a good angler means being comfortable not knowing when you are going to catch a fish, while remaining confident you are on the right path."

We need to spend more time thinking and less time doing. We need to spend more time sharpening the tools to be ready. To allow our minds to make those connections only made in a "resting" state. We should try not to confuse lack of activity with lack of accomplishment. Investors are inherently wired to search for an explanation when the market makes a move. In short time frames the reason is generally noise. Some say that noise can scare fish. Probably not above the water, but the vibrations below the surface can send them scattering. It is the below surface financial market tremors that we must pay attention to in order to get a true read on the trend and direction of the markets.

We all would like to catch that hard-fought game fish. That is what keeps fishermen and investors driven…the art of the pursuit.

Q: What kind of money do fishermen make?

A: Net profits!

DISCLOSURE STATEMENTS

Additional Disclosure - A copy of Piedmont Investment Advisors, LLC Form ADV Part 2A, which describes our investment advisory services, fees and operations in more detail, is available upon request.

Investment Risk Disclosure - Fixed income securities are subject to the following investment risks:

Interest rate risk. Interest rate risk is the risk that debt securities will decline in value because of changes in market interest rates. Generally, when market interest rates rise, the value of debt securities declines, and vice versa. An account's investment in such securities means that the value of the account will tend to decline if market interest rates rise. The prices of long-term debt obligations generally fluctuate more than prices of short-term debt obligations as interest rates change.

Credit risk. Credit risk refers to an issuer's ability to make payments of principal and interest when they are due. Bond prices typically decline if the issuer's credit quality deteriorates. Lower grade securities may experience high default rates, which could mean that an account may lose some or all of its investments in such securities. If this occurs, the account's value would be adversely affected.

Investment grade bond risk. Investment grade bonds are considered less risky than bonds whose ratings are below investment grade; however, ratings are no guarantee of quality. The credit quality of these bonds can decline which would normally cause the prices of these bonds to decline.

Below investment grade bond risk. These bonds, commonly known as "junk bonds", involve a higher degree of credit risk.in the event of an unanticipated default, an account would experience a reduction in its income, a decline in the market value of the securities so affected and a decline in the account's value. During an economic downturn or period of rising interest rates, highly leveraged and other below investment grade issuers may experience financial stress that could adversely affect their ability to service principal and interest payment obligations, to meet projected business goals and to obtain additional financing. The market prices of below investment grade bonds are generally less sensitive to interest rate changes than higher-rated investments but are more sensitive to adverse economic or political changes or individual developments specific to the issuer. Periods of economic or political uncertainty and change can be expected to result in volatility of prices of these securities. NRSROs consider these bonds to be speculative in nature.

Equity Market Risk – Overall stock market risks may affect the value of the investments in equity strategies. Factors such as U.S. economic growth and market conditions, interest rates, and political events affect the equity markets.

Sector Focus Risk - The portfolios may be heavily invested in certain sectors, which may cause the value of its shares to be especially sensitive to factors and economic risks. These risk specifically affect those sectors and may cause the value of the portfolio to fluctuate more widely than a more broadly diversified benchmark.

Mortgage-backed securities risk. Mortgage-backed and securities are subject to prepayment risk. When interest rates decline, unscheduled prepayments can be expected to accelerate, and an account would have to reinvest the proceeds of the prepayments at the lower interest rates then available. Unscheduled prepayments would also limit the potential for capital appreciation on mortgage-backed securities. Conversely, when interest rates rise, the values of mortgage-backed securities generally fall. Since rising interest rates typically result in the decreased prepayments, this could lengthen the average lives of such securities, and cause their value to decline more than traditional fixed-income securities.

Performance Disclosure - Past performance is no guarantee of future results. Therefore, no prospective or existing client should assume that the future performance of any specific investment, investment strategy recommended and/or purchased by Piedmont Investment Advisors, LLC will be profitable or equal to corresponding indicated performance levels. Historical performance results do not reflect the deduction of transaction charges, investment advisory fees and/or other expenses, which, if included, would decrease the historical performance results. The collection of fees produces a compounding effect on the total rate of return net of management fees. As an example, the effect of investment management fees on the total value of a client's portfolio assuming (a) quarterly fee assessment, (b) $1,000,000 investment, (c) portfolio return of 8% a year, and (d) 1.00% annual investment advisory fee would be $10,416 in the first year, and cumulative effects of $59,816 over five years and $143,430 over ten years.

Index Comparison - Barclays Capital indices have been used as comparative benchmarks because the goals are to provide fixed income like returns. These indices are some the world's most recognized indices by investors and the investment industry for fixed income markets. These indices, however, are not managed portfolios and are not subject to advisory fees or trading costs. Investors cannot invest directly in these indices. These indices' returns also reflect the reinvestment of interest. Piedmont Investment Advisors, LLC is aware of the benchmark comparison guidelines set forward in the SEC Clover No-Action Letter (1986) and compares clients' performance results to a benchmark or a combination of benchmarks most closely resembling clients' actual portfolio holdings. However, investors should be aware that the referenced benchmark funds may have a different composition, volatility, risk, investment philosophy, holding times, and/or other investment-related factors that may affect the benchmark funds' ultimate performance results. Therefore, an investor's individual results may vary significantly from the benchmark's performance.

Forward Looking Statements - This newsletter may include forward-looking statements. All statements other than statements of historical fact are forward-looking statements (including words such as "believe," "estimate," "anticipate," "may," "will," "should," and "expect"). Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct.

Past Performance - Past performance is not indicative of any specific investment or future results. Views regarding the economy, securities markets or other specialized areas, like all predictors of future events, cannot be guaranteed to be accurate and may result in economic loss to the investor.

Risk - Investment in securities, including fixed income instruments, involves the risk of loss.

Strategas Research Partners is a global institutional brokerage and advisory firm that provides macro research, capital market and corporate advisory services, and financial products to institutional investors and corporate executives.