TJIM QUARTERLY INSIGHT

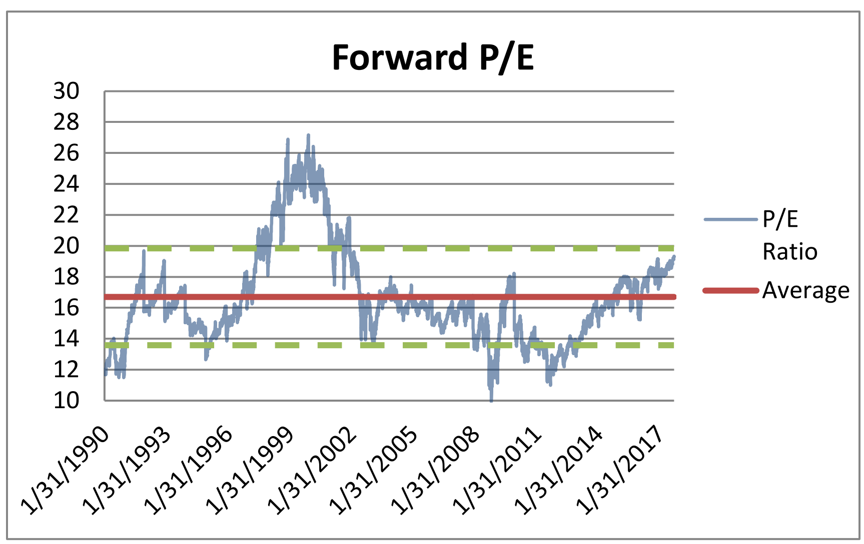
Third Quarter 2017

Tom Johnson Investment Management, LLC

Where has the volatility gone? The 3rd quarter, and really all of 2017, can be characterized as a "risk-on" market. As of late, investors have been extraordinarily sanguine regarding growth in market earnings. With such an optimistic view of earnings prospects, market conditions have become quite favorable towards more growth oriented stocks, and therefore, as compared to historical conditions, the volatility in the market has become quite muted. For the trailing 1-year period the volatility on the S&P 500 index has been 5.2% as compared to the historical volatility of roughly 15.0%. The below chart shows the relationship of the valuation and volatility for the S&P 500; going back to 1990 the S&P 500 has never been this expensive relative to the level of volatility.

A reduction in volatility makes the market more palatable to many investors. Psychologically it's much easier to remain invested when the market is stable and returns are consistent. However, with volatility comes risk, and with risk comes investing discipline, and with investing discipline comes the requirement for higher total returns.

We believe this low volatility has led to a sense of security and has likely contributed to the further run in stocks that are considered expensive by traditional metrics, and would therefore be riskier in nature. This is illuminated by the outperformance in growth, momentum, and high beta stocks; and conversely the underperformance in value, high dividend, and low volatility stocks. In fact, the aforementioned volatility on the S&P of 5.2%, is actually lower than the trailing 1-year volatility of the low volatility index. This implies that stocks that are typically deemed to be riskier, as defined by their typically higher volatility, are actually currently considered to be less risky than their low volatility counterparts.



This "risk-on" trade does seem to be rolling over, as value outperformed both growth and momentum in September, while still underperforming for the quarter. That being said, market cheer can continue for an indeterminate amount of time. Like the old short seller axiom, "the market can remain irrational a lot longer that you can stay solvent."

This is not to say that the market is in dangerous territory, given time we could certainly grow into current valuations, but there does seem to be a frenzy for growth stocks. In the midst of this, we are doing what we always do and searching for quality businesses that are currently selling at a discount. So just like you "gotta dance with the one what brung ya", at TJIM we are sticking to our value principles.

201 Robert S. Kerr, Suite 510 ✧ Oklahoma City, Oklahoma 73102
Telephone (405) 236-2111 ✧ Fax (405) 236-2008

TJIM

With historically low interest rates and tight credit spreads, the bond market also remains relatively richly valued. With the 10-year Treasury yielding around 2.35% and A rated corporates getting a little less than 1.0% over the Treasury yield, we have been maintaining a conservative position in terms of both interest rate and credit risks. In the quarter, we sold some corporate issues that have seen their credit spreads tighten to unattractive levels and reinvested the proceeds in either: 1) corporate issues with more opportunity to earn additional yield, or 2) short-term Treasury issues. With the Federal Reserve raising rates 3 times since December, the yield on the short-term Treasury is as high as it has been since the beginning of 2009. Investing in the short end of the yield curve has provided us the opportunity to take steps in moving the portfolio to a more conservative aggregate position without giving up much yield in the process. Maintaining a conservative portfolio positioning will allow us to take advantage of more attractive investment prospects as they arise. We are consistently searching for attractive themes in the corporate bond market or in the term structure of interest rates, by being conservative due to market conditions, we remain nimble enough to take advantage of these themes as they arise.

Sincerely

TJIM Investment Team

201 Robert S. Kerr, Suite 510 ✧ Oklahoma City, Oklahoma 73102
Telephone (405) 236-2111 ✧ Fax (405) 236-2008