ASTOR INVESTMENT MANAGEMENT | FUNDAMENTALLY DRIVEN.

COMMENTS ON RECENT EQUITY MARKET PULLBACK

AS OF 2/6/2018

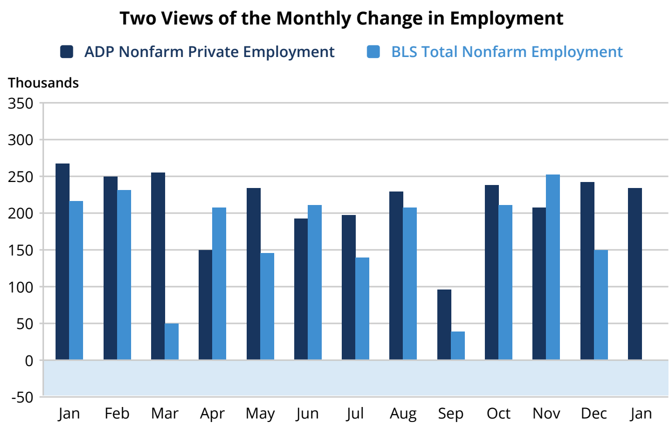
It's been a very long time since the stock market was the lead news story. That changed quickly as the stock market declined almost 10% (from intraday high to intraday lows) in the course of two days (2/2 - 2/5/2018)—a big move, no matter how you slice it. The question everyone is asking is, "What's going on?"

Given the recent move in financial markets, I want to provide you with my thoughts and comments on the situation. Recently, Bryan Novak, Sr. Managing Director at Astor Investment Management wrote an article (which is currently up on the Astor blog) concerning some data on the issue at hand. My comments expand on Bryan's statement.

CURRENT PLACEMENT IN THE ASTOR ECONOMIC INDEX®

As I often say, the stock market can move 10% or more in any direction on any day for any reason. That's the price investors pay for the returns offered by stocks.

At Astor we look at fundamentals using the Astor Economic Index (AEI), our proprietary measure of the state of the economy. The AEI is currently at very high levels, with readings that are associated with economic expansions. In fact, the and the ISM Manufacturing Index released just days ago both displayed positive numbers, which we see as supportive of the health of the economy.



Source: Advisor Perspectives. dshort.com
** BLS Total Nonfarm Employment data was not available for the month of January at the time of reporting*

Equity markets are experiencing a substantial increase in volatility of late, which comes as no surprise. While bull markets don't look at the calendar to judge the length of a run-up, they do react to changes in factors that can influence how we view valuations. Interest rates, inflation, and uncertainty all play a role in valuations that our philosophy monitors. With less emphasis on P/E ratios, earnings reports, and balance sheets. Our view is: **if the economy is above trend and expanding equites will have a positive expected return.**

POINTS OF INTEREST

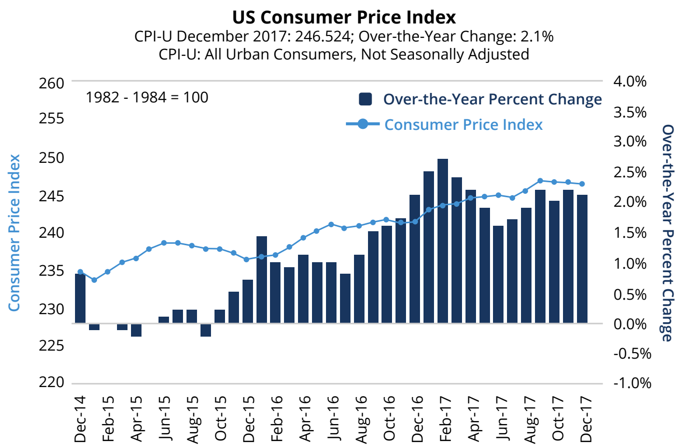
As for the recent moves, I see several things that capture my attention. Interest rates have moved higher sooner than anticipated, inflation is picking up, political uncertainty continues, and a new Fed Chairman has taken over—all culminating at once to impact volatility.

Another market mechanism not often highlighted is the discount and premium on stock futures (this is one of my themes for 2018). I foresee increased volatility this year as the cost of hedging (read: selling) is much less than in past years. The result is more trading at different price levels, which exacerbates market moves. In contrast, in the last few years low interest rates compared to dividend yields resulted in a relatively high cost to carry a short position. If markets declined, traders would bid to buy back short positions to avoid additional costs of carrying the hedge.

Now that a short position has a positive carry, there are fewer buyers when the market falls, and that creates more volatility on the downside. **That should not affect the longer-term direction of the markets—only how we get there.**

The Fed has telegraphed at least 3 rate hikes this year and I see no change in this forecast as we move from Janet Yellen to Jerome Powell as Fed headmaster at the Federal Reserve. Powell is widely regarded as a continuation of previous policies. However, it appears the market was not fully convinced that the Fed's telegraph would turn into reality. That changed with the recent movement in long-term rates, which helped convince folks that the Fed is serious.

Additionally, inflation has begun to accelerate, but more noteworthy is the increase in wages and average hourly earnings. I believe increases in wages and hourly earnings are the most important input to inflation because, simply stated, the only way for the prices of all goods to rise is for people to make more money.



Source: Bureau of Labor Statistics 12-Jan-18

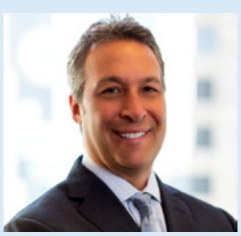
So, with lower hedging costs increasing volatility, higher interest rates changing valuations, and increased inflation expectations changing rate hike expectations, along with uncertainty at the Fed and White House, a 10% correction should not be a surprise. However, with economic fundamentals improving, economic data above long-term trends, and cash on the sidelines, in our view, the positive expected returns for stocks remains unchanged. And since Astor philosophy focuses on direction, risk and beta weighting—not magnitude or return forecasting—we feel comfortable with the current risk and beta in our strategies.

To that end, it's possible that the conditions described above could change the magnitude of the returns, and perhaps the highs and soon the lows will be in for the year. However, nothing has occurred thus far that would change my expectation for the direction of equity markets. The forecast for a positive expected return of stocks remains—that is, unless the economic data deteriorates along with equity prices.

SUMMARY OF COMMENTS:

- Equity market can move 10% in any direction on any day for any reason. That's the price investors pay for the returns offered by stocks.
- The Astor Economic Index; is at very high levels—with readings that are associated with economic expansions. Astor does not see any "cracks" in economic data that would indicate an economic recession was imminent.
- As for the recent moves, I see several things that capture my attention. Interest rates have moved higher sooner than anticipated, inflation is picking up, political uncertainty continues, and a new Fed Chairman has taken over—all culminating at once to impact volatility.
- Nothing has occurred thus far that would change my expectation for the direction of equity markets. The forecast for a positive expected return of stocks remains—that is, unless the economic data deteriorates along with equity prices. As it stands right now, economic fundamentals are above trend and supportive of rising equity prices.

ABOUT ROB STEIN



Mr. Robert Stein began his career as a project analyst for the Federal Reserve under former Chairman Paul Volcker and later went on to hold senior trading or portfolio management positions with large money-center Wall Street banks.

Returning to Chicago in 1994, he formed Astor Financial, Inc., the parent company of Astor Asset Management LLC ("AAM") a registered investment adviser and the predecessor firm to Astor Investment Management, LLC. Knight Capital Group (NYSE: KCG) acquired AAM in 2010 and Mr. Stein was appointed to the Executive Committee reporting to the Board of Directors and directly to the Chairman. In a management restructuring, Mr. Stein re-organized AAM as an independent firm (Astor Investment Management LLC). Mr. Stein is the co-creator of the Astor Economic Index (AEI), the firm's proprietary method used to create what we believe is a smoother, more accurate "live read" on the economy.

He is also the author of several books, including Inside Greenspan's Briefcase (McGraw-Hill) and Finding the Bull inside the Bear (John Wiley & Sons). Mr. Stein is the founder of the i-CARE Foundation, an organization that provides an annual grant to Northwestern Hospital to enhance patient experience and is Vice Chairman of the Board of Advisors to GlenKirk, an organization that supports people with special needs. Mr. Stein holds a Bachelor of Science from the University of Michigan.

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Please refer to Astor's Form ADV Part 2A Brochure for additional information regarding fees, risks and services.

The Astor Economic Index® is a proprietary index created by Astor Investment Management LLC. It represents an aggregation of various economic data points: including output and employment indicators. The Astor Economic Index® is designed to track the varying levels of growth within the U.S. economy by analyzing current trends against historical data. The Astor Economic Index® is not an investable product. When investing, there are multiple factors to consider. The Astor Economic Index® should not be used as the sole determining factor for your investment decisions. The Index is based on retroactive data points and may be subject to hindsight bias. There is no guarantee the Index will produce the same results in the future. The Astor Economic Index® is a tool created and used by Astor. All conclusions are those of Astor and are subject to change.

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