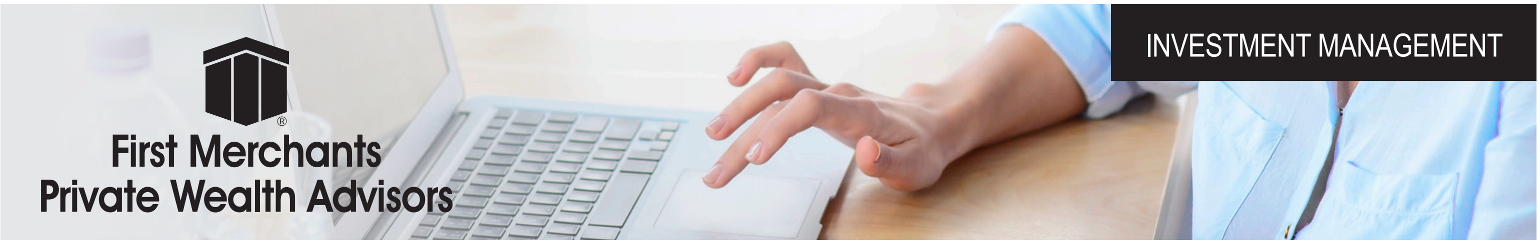

PRIVATE WEALTH *perspectives*

When Euphoria Meets an Inescapable Truth

Expectations have greatly changed since Donald Trump was elected President in early November and the Federal Reserve raised short term interest rates December 14. Equity prices and valuations have risen sharply and fixed income securities have been sold, in response to the belief that the economy might begin to grow faster than the slightly-more-than-stagnant 1.8% average of the last eight years. Many times both Ben Bernanke and Janet Yellen publicly expressed hope for some form of fiscal stimulus from the Federal Government to buttress their monetary efforts, which they believed had met limits and were increasingly distorting market prices. On November 8 they got their wish, and in one night economic forecasts for more of the same shade of gray were changed to include prospects for both personal and corporate tax reform, infrastructure spending, and a concomitant reflationary expectation. From an economic point-of-view, we are to be congratulated.

". . no matter how business savvy the incoming Administration and their picks for top governmental posts are, it will take time to realize that potential."

In a historic political and economic twist, the outgoing Administration eschewed the textbook Keynesian response to stagnant growth of easy money and government stimulus, preferring only to strong-arm the Federal Reserve. The incoming Administration promised Keynesian-like government stimulus by way of infrastructure improvements as part of their election platform, and thus far is promising to follow that up with public-private partnerships to finance those projects, leaving the Fed to respond to economic feedback as they see fit. Ironic, but this may prove to be the missing link in the GDP equation, which has lacked capital investment by businesses and government spending. While the consumer has done their part to keep the economy moving forward the last several years, the lack of government and business capital spending has undeniably kept a leash on GDP growth.

While sharing in the optimism we also remain grounded in facts, experience, market signals and feedback, and one inescapable truth rather than hyperbole in this, our investment outlook for 2017. In short, we believe equities will outperform bonds, but not by the amount reflected by investment markets the last few weeks. We still fully expect that domestic equities will outperform international and emerging market equities, even in the face of a stronger dollar, which will act as a brake for larger U.S.-domiciled companies selling their wares overseas. While Japan may be an exception due to a much weaker Yen, political issues of their own as well as a weak-and-getting-weaker banking system will continue to hinder developed Europe. A stronger dollar, the result of a widening gap between real (inflation adjusted) sovereign bond yields, will act to contain commodity prices and limit returns to emerging market equities and bonds. China will continue to be plagued by capital flight as their currency's continued weakness (seemingly tolerated by Chinese officials) leads individuals and companies to exchange the Yuan for other currencies, rather than face the possibility of another overt devaluation. Rising crude oil prices will be entirely dependent on OPEC and non-OPEC countries keeping their promise to limit production, something that is without precedent. As well, shale fracking in the United States has become technologically advanced enough to lower the cost of production to levels enjoyed by Saudi Arabia and few others. Cushing, Oklahoma, the cross-roads and repository of crude oil production in the U.S., remains swimming in oil (though rumors of homeowners renting out their pools and children their fish bowls are likely false). This will serve to keep a lid on crude oil prices long term.

That said, both infrastructure and capital investment spending takes years of planning, let alone actual construction. A property developer will tell you the process of acquiring the federal, state, and local permitting necessary to begin construction can take years. We believe the goals of the incoming Administration are right-minded as well as needed (our electrical grid is circa 1922), but the post-election market response of a quick and positive GDP contribution grossly overestimates the reality. We may not know how this even might turn out for another two years, at a minimum. It is a warm feeling though, experiencing what "hope" really can, or even might actually be. For further perspective on our views regarding Inflation, Bond Yields, Commodities, REITs, Domestic Equities, and International and Emerging Market Equities, please see the Appendix.

The Inescapable Truth

There is an inverse to the human notion of instant gratification, or the desire to experience pleasure or fulfillment without delay or deferment. That is, if we expect something adverse, or an occurrence that will detract from our current position, and it doesn't happen either immediately or within some self-perceived period of time, it probably never will. The passage of time in-between reinforces this view in a non-linear fashion. If the adversity hasn't happened in two weeks, it likely never will.

Demographics, as we've written previously, define the word "inexorable." If you've ever pondered a glacier, watched an approaching storm, or waited for your father to get home from work and discuss your latest report card with your mother, you might understand. There is no prayer, incantation or supplication that will stop the inevitable. As Einstein theorized, mass becomes energy as it approaches the speed of light. It takes on a self-perpetuating, inescapable life of its own.

We are getting older; all of us, on average, especially in developed countries that maintain the vast majority of wealth, whether stored in a vault, invested in a portfolio, or as equipment on a factory floor. We ache more, eat less (but still gain weight), share favorite stretching techniques with friends instead of favorite fishing or watering holes, and tailgating consumes thirty minutes and the cost of a Subway pre-game instead of all night and enough beer to float a medium-sized boat. We buy and consume less; we work and produce less but expect the same number of options for our lives, and protections from our governments. This aging process, and the drop in productivity the last few years, dictates a lower potential growth rate of non-inflationary GDP. Simply put, less working-age people and lower productivity results in lower potential growth rates.

So, while we love a good rally as well as anyone, we also recognize a couple of things: One, no matter how business savvy the incoming Administration and their picks for top governmental posts are, it will take time to realize that potential. Two, the rise in the price-to-earnings and enterprise value-to-EBITDA graphs for the S&P 500 are now steep enough to be classified as a double black diamond at any ski resort in the Tetons. Either the economy quickly improves, which would increase earnings at a faster pace, or we will have a correction as rising bond yields, a rising dollar, and a less-accommodative Fed serve as a brake to the economy, however slightly.

As always, we will monitor the confluence of market euphoria and the inescapable truth of demographics as we look to build tailored portfolios focused on our clients success.

Thank you for your business. David Forbes, Terry Blaker, and their respective crews work hard eight days a week to maintain your trust and confidence. If we can provide anything else, please let us know. On behalf of First Merchants Private Wealth Advisors I wish you and yours the very best for the New Year.

First Merchants Private Wealth Advisors

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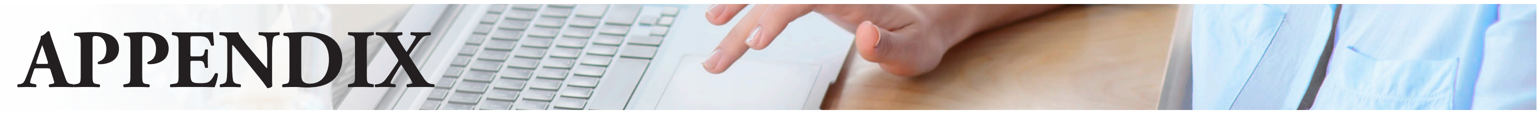


APPENDIX

There are several ingredients in the economic and investment pie. What follows are summaries of our thoughts on each as we head into 2017:

Inflation

Inflation will be a non-event. Commodity price inflation should be kept in check by a strong dollar, as well as continued oversupply. Part of the reason commodity prices fell so precipitously a few years ago was that new supply came on-line just in time for the global economic downturn, causing a massive supply/demand imbalance. Slow global growth (especially in China) since then hasn't done much to soak up the excess supply. As far as wage inflation goes, the fact that there currently are few groups of employees that can demand wage hikes is only a reflection of how poor the underpinnings of our employment picture are, and not that the unemployment rate of less than 5% is any barometer of economic well-offness. In other words, there are less machinists making a decent living working at Caterpillar and more people flipping burgers at McDonalds. The people flipping burgers have no innate pricing power; perhaps that the previous Administration saw fit to fiddle with minimum wage laws was a copout to their inability, or lack of imagination, in creating family-supporting rather than menial jobs.

We also note that while elevated, 2-year (1.53%), 5-year (1.88%), and 10-year (1.99%) breakeven yields (an indication of expected future inflation rates) were much higher as recently as the spring of 2013 and 2014. In addition, prices for various mutual funds holding TIPS have fallen, almost substantially, over the last few weeks. At the end of this update we'll provide a further insight to our inflation expectations.

Bond Yields

We may have seen the greatest extent of rising bond yields for this cycle. Treasury yields are the sum of the Fed-set short term rate (the Federal Funds Rate) plus an inflation premium. The inflation premium rises over time because the ability to accurately make predictions lessens in relation to the lengthening of time. In the corporate and municipal bond world, you would add a premium on top of that for at least the possibility of a credit default. While the leveraging of corporate America since 2008 is a fact, causing the credit premium to rise, the inflation premium will be held in check by both the already-experienced rise in rates, a strong dollar, and the fact that corporate America's capacity to borrow and remain of investment-grade has narrowed. As we discussed at length in our last portfolio managers meeting, interest rates in July of this year were at Fed-induced all-time lows – the 10-year Treasury yielding roughly 1.30% was the result of Fed sugar cubes, not Mr. Market's price discovery. The rise in yields we've experienced the last few weeks is not much more than a normalization of interest rates. If one wanted to build a laddered-bond portfolio, this would be a good time to start.

Commodities

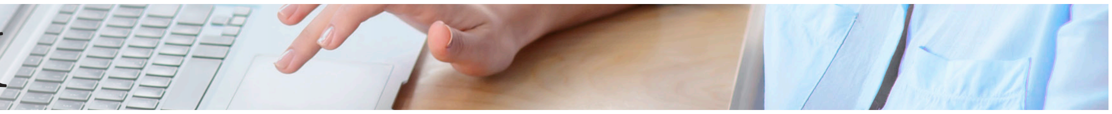
Commodity prices dance to so many different tunes that sometimes blanket recommendations or predictions are bound to fail. Supply and demand forces ebb and flow, but production capabilities are so capital-intensive and take such long lead times that an investor in commodities in general is always faced with a classic investment tension – the mismatch of duration. While the demand side can change overnight, changes in supply that is running at or near maximum capacity takes years to respond to those changes in demand, hence the centuries-old cycle of commodity-price boom and bust. China's continued economic slowing, a strong dollar, sluggish growth in most of the developed world's economies (President-elect Trump notwithstanding), and the aforementioned overcapacity should serve to keep a lid on commodity prices.

Domestic Equities

For the tenth straight year we will remain domestic-centric in the risk-taking, or equity portions of our investment portfolios. Much has to do with the fact that Congress and the new Administration have a majority and will be far more business friendly. Two, if the economy does pick up, even slightly, earnings may again begin to increase, rather that decrease as they had for several quarters, though we recognize that a stronger dollar will remain a significant headwind for larger companies. Far more importantly, however, is that we remain the most flexible, adaptable, and creative people on the face of this earth, a distinct advantage in tough times that will last as long as we continue providing a ladder for everyone willing to climb it. Stop that and we become Russia or worse; a soulless, faithless people dependent on redistributed government largesse. As long as we continue to make wise choices we will maintain this distinct competitive advantage.

We'd like to say that small and mid caps will outperform large caps, but their astonishing rebound since the election makes that a

APPENDIX



difficult prediction. They should outperform, because they sell less of their wares overseas, and the stronger dollar will be less of an accounting and earnings burden. As well, they both underperformed for several quarters, one of the rare occasions where one paid a price for diversifying away from large caps. We have upped, slightly, our allocation to both of these subclasses, believing that they will continue to outperform large caps through 2017.

We also recognize that domestic equity markets are greatly overvalued. We will continue to carefully pick our spots for entry, and take every opportunity to pick individual companies, where we can, so we can better gauge valuation in what we're buying.

International and Emerging Market Equities

We will continue, in 2017, to maintain a nominal allocation to international equities and none to emerging markets. We maintain a nominal allocation for the simple reason that we could be wrong. But we see nothing changing from the social, political, or economic status quo that would change our minds. And every time we look at emerging markets we come away with the same conclusion – this risk subclass is like holding a handful of hornets. Low commodity prices, elevated dollar-indebtedness in the face of a rising dollar, and almost never-ending political turmoil leaves us believing pork bellies would be a steadier investment.

Real Estate Investment Trusts (REITs)

REITS tend to be interest rate sensitive; when rates rise, REIT prices tend to fall. Specifically, REITs respond as well to their industry-specific (enclosed malls, office space, cold storage, health care etc.) characteristics. The building cycle, retail trends, the financial health of tenants, the ebb and flow of capitalization rates all contribute to price and valuation changes. REITs have been the highest-returning domestic equity subclass for fifteen years, and there are valid reasons why – they generate positive investor cash flow due to their tax status, they can appreciate, they can be good inflation hedges as many leases contain inflation escalators, and their esoteric nature makes tremendous barriers-to-entry in almost all industries, even in an industry as mundane as self-storage.

We are maintaining our allocation to REITs. We are not yet convinced interest rates are set for any cyclical rise as much as they're climbing back from a false inducement from the Federal Reserve. We will also remind our clients that REITs are esoteric enough, from an accounting point-of-view, that we are much more comfortable maintaining our exposure via mutual funds than purchasing them individually. We believe we own, on your behalf, two outstanding mutual funds which management provides a great deal of expertise in this subclass.

These are the Investment Group's thoughts as we head into what we believe will be an eventful 2017. More optimistic than we have been in some time, but also cautious that equity markets have come a long way in a short period of time. As always we look forward to working with you in a New Year.