INVESTMENT REVIEW & OUTLOOK
(June 30, 2017)

This edition of the INVESTMENT REVIEW & OUTLOOK includes a summary of returns for the financial markets for the second quarter of 2017.

	Three Months Ended 6/30/17 Total Returns	Six Months Ended 6/30/17 Total Returns
S&P 500	3.09%	9.34%
Barclays Aggregate Bond Index (Bonds)	1.45%	2.27%
Alerian Total Return Index (MLPs)	-6.35%	-2.66%
Russell 2000 (Small Cap Stocks)	2.46%	4.99%
MSCI EAFE (Foreign Stocks)	6.37%	14.22%
60/40 Blend (60% S&P 500, 40% Alerian)	-0.75%	4.46%

The first half of 2017 witnessed solid returns overall for the financial markets, and NBW Capital's performance compared favorably to its respective benchmarks. Investment returns for our clients at 2017s mid-point are tracking at a double digit rate, which will have them exceed our 2017 full year high, single digit return expectations expressed at the beginning of the year. We are constructive about the second half of 2017s performance, and feel the markets should be given the benefit of doubt until we are able to anticipate time tested precursors to problems. Looking back over the last 99-months of this historic bull market, one of the more difficult actions was to stay invested, and not get overly defensive. Corrections have and will continue to occur, and we will continue to take a long-term perspective and not attempt to sidestep short-term turbulence with the hope of buying back in at lower levels. This operation requires two great decisions and is almost impossible to execute consistently well. What is more possible to do well is to get defensive at an appropriate stage of a multi-year investment cycle. We intend to do this and have a disciplined and unemotional plan, but it is simply not yet time. When will it be time? We really won't know until measurable preconditions alert us to a probable bear market. What are the preconditions we are looking for? We have a number of proprietary models and disciplines that have served us well over the years across market environments. The characteristic of all of them is that they are unemotional and measurable. They include measures pertaining to valuation, sentiment, inflation, monetary policy, and equity market price trends. At present, the majority of these factors are confirming a continued bull market.

ATTRIBUTION

NBW Capital's 2017 year-to-date performance was driven by a strong equity environment in combination with excellent stock selection. Specifically, the S&P 500 was up over nine percent during the first half. Notably, the outperforming sectors were: technology, industrial and healthcare. Individual stocks that stood out included Apple, Facebook, Tyler Technologies, Zillow, Roper Technologies, Illinois Tool Works, Blueprint Medicines, Malibu Boats, American Tower and Chegg.

Conversely, Master Limited Partnerships (MLPs), as represented by the Alerian Total Return Index, experienced their first down quarter since the MLP bull market began over 16 months ago. MLPs declined 7.6% from the end of February 2017 through June 30, 2017. We view this pullback as mild. For context sake, since February 2016 when the new bull market for MLPs began, MLPs have generated total returns of 61.5%. We were encouraged by how the second quarter ended as MLPs generated strong returns of 7.6% in the quarter's final seven trading days.

NBW Capital's MLP performance during the first six months of 2017 was enhanced by its holdings of Noble Midstream, Western Refining Logistics and EQT GP Holdings. Performance was held back by the lagging year-to-date returns for SemGroup and NGL Partners. NBW Capital's MLP portfolios outperformed the MLP benchmark, the Alerian Total Return Index, during the first half of 2017.

MASTER LIMITED PARTNERSHIPS

We remain committed to the ownership of Master Limited Partnerships as a superior generator of total returns over market cycles. We acknowledge that for the first six months of 2017, MLP performance has trailed that of the S&P 500. In fact, MLP performance is slightly below breakeven. However, in our opinion, we are experiencing a healthy "rest and refresh" portion of a market cycle for MLPs which follows an excellent 2016 where NBW's MLP gross return of 25.1% was more than double that of the S&P 500's 12.0% total return.

We would encourage long-term investors to put the short-term underperformance of the 2017 second quarter into perspective. As you can see from the table below, since the year 2000, there have only been three full calendar years that NBW's MLP investments have generated total returns below that of the S&P 500.

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
NBW Capital	30.6%	35.6%	-3.6%	40.8%	26.8%	12.7%	36.4%	13.2%	-52.4%	84.6%	35.1%	15.0%	20.4%	48.4%	11.7%	-32.8%	25.1%
S&P 500	9.1%	-11.9%	-22.1%	28.7%	10.9%	4.9%	15.8%	5.5%	-37.0%	26.5%	15.1%	2.1%	16.0%	32.4%	13.7%	1.4%	12.0%

We cannot tell you with any specificity when MLP price performance will again turn positive. However, we do believe that corrections in financial markets are normal and healthy events. They help to keep speculation in check and sentiment muted.

An important event for MLPs occurs every June as the industry association (MLPA) sponsors a three-day conference featuring many MLP management teams and scores of institutional and individual investors. Over many years of attendance, we usually leave with an overriding theme and several investment ideas. This year's conference did not disappoint. A constant throughout was the very depressed state of investor sentiment. It was as though all risks were magnified and all positive potential was minimized. More than once we heard the following paraphrased statement from an MLP management team, "Our current business, growth prospects, and balance sheet strength are being ignored." Another refrain (again paraphrased), "We don't understand the disconnect between the health of our business and the market price performance of our equity." Near the end of the conference, a presentation by several large institutional MLP investors emphasized (and again paraphrasing) "the importance of being an investor and in having a long-term investment horizon."

Our years of investing experience has taught us the wisdom of Warren Buffet's dictum to the effect that in the short–term, the stock market is a voting machine ruled by emotion, sentiment, and popularity, but in the long run, it is a weighing machine ruled by objective and measurable information.

At quarter end, where are the measurables that we consider so important to long-term investment success? We think that we are at an "appealing" juncture for MLP investors. We say this because we currently sit at what we consider to be one of the best entry points for MLPs in over a year. Recall that MLPs bottomed in February of 2016, and appreciated so quickly and so dramatically (i.e. 19.4% in the first five trading days) that many investors could not participate. Today, there exists a confluence of low investor sentiment and significant undervaluation versus historical norms; similar to conditions in February 2016. The table summarizes the degree of MLP undervaluation.

	MLPs	S&P 500	Dow Jones Utilities	10 Year U.S. Treasury
Yield	7.13%	2.02%	3.31%	2.30%
P/E	19.8x*	25.6x**	38.4x	43.5x***

*Based upon estimated tax effected cash flow. **P/E on trailing 12 month earnings. ***Multiple of annual yield. Sources: Barron's and Wells Fargo Research.

Today, MLPs are benefiting from the resurgence in U.S. energy production. While this production upswing has created a drag to the price of oil, MLP revenues have been favorably affected by the increased volumes. Recall that MLPs have fee-based, long-term contracted revenue. These fees apply to volumes and not the prices of the energy commodity being transported, processed or stored. This dynamic helps explain the dichotomy in MLP revenue and cash flow growth and lower energy prices. The frustrating "hand in glove" correlation of MLPs to oil prices is finally starting to break down, and should return to lower historical correlation norms. The table below summarizes:

	NBW Capital MLP Total Returns	Percentage Change Crude Oil
2016	25.1%	22.2%
2017 YTD	-0.3%	-14.7%

Source: Bloomberg

It is important to note that throughout the energy downturn, MLPs did grow their distributions to investors. Coverage ratios, balance sheets, and access to capital markets are much improved from where they were sixteen months ago. We feel that estimated annual returns over the next several years are compelling. The combination of yield (7.13%), annual growth in distributions (5.0%), and reversion upward to "normal" valuations should allow for annual percentage returns in the low to mid-teens. Two important valuation measures both allude to undervaluation versus historical norms. On a price to distributable cash flow basis, and using Wells Fargo's research inputs, MLPs at quarter end are trading at a 16% discount to their five-year historical average valuation. Similarly, MLPs in comparison to Ten Year U.S. Treasuries are trading at a substantial discount to where they have historically traded.

OUTLOOK

The S&P 500 is currently priced at 19.4 times estimated 2017 earnings, and in historical absolute terms, this is an overvalued level. More importantly, the S&P 500 is currently inexpensive compared to interest rates. Ten Year U.S. Treasuries yielded 2.3% at quarter end, and pale in comparison to the S&P 500s "earnings yield" (inverse of the P/E ratio) of 5.15%. The S&P 500 is fairly valued compared to inflation. Over the last 65 years, valuations during low inflation periods have tended towards 18 times earnings. In sum, we conclude that valuation, while important, is not a threat at present to future return prospects for the S&P 500. One footnote is that 2018 estimated earnings and growth could be boosted considerably by a cut in corporate taxes as envisioned by the Trump administration. This would lower valuations and enhance the attractiveness of stocks.

Turning to inflation and FED policy, our monetary authorities are engaged in a multi-year normalization of interest rates. The great monetary infusion cycle spawned by the 2008 financial crisis has ended. Over the next several years, our FED will systematically raise interest rates to normal levels. Once that is achieved, they will embark on an unwind of a substantial amount of securities they purchased during and subsequent to the crisis. This will be done methodically, and we hope gingerly as the FED simply lets these securities mature and does not reinvest the proceeds. It is estimated that the entire operation will be completed by 2025. At NBW, we will be keen observers of this process. We think it is critical for the FED to use the level of “real” interest rates to pace this unwind. So long as real rates (i.e. federal funds rate less inflation rate), currently at -0.79%, stay under 1.5%, we feel the FED can accomplish their goals without damaging the economy or financial markets. If inflation were to slip further, we would hope the FED would temporarily halt this process until reengagement has less potential to do harm.

A final closing comment on the continuing economic backdrop: We have a slow growth economy characterized by good job creation, sluggish wage growth, low inflation, and low interest rates. It is a supportive environment for financial assets. Liquidity flows to financial investments because the economy is not growing fast enough to draw capital away from financial markets. Very strong growth and invigorated inflation would change this dynamic, and paradoxically be a negative influence on equity and bond prices.

FEATURED INVESTMENT HOLDING

This quarter’s featured stock is a company that we have owned since August 2010, Roper Technologies. Management’s laser-like focus on using free cash flow to acquire “Asset Light” business has transformed Roper from a manufacturer of pumps into a diversified technology company. Today, the company has a portfolio of leading software companies in Data Collection, Technology, SAAS Software, Sensors, Radio Frequency Identification and Healthcare that dominate their market niches. For example, should you pay a highway toll outside of the Northeastern United States, it is highly likely that you utilize Roper’s products to do so. We believe that the company’s focus on improving the operations of acquired companies, and proven track record of cash deployment into opportunistic acquisitions, will allow the company to continue to generate solid returns for our clients.

ADMINISTRATIVE NEWS

We are pleased to announce that we are increasing the number of investment strategy options available to our clients. Included in this package is a document that outlines the new portfolio offerings. We encourage you to reach out to the partner responsible for managing your account to learn more about the new selections.