Dear clients and friends,

As the focus of the markets has turned to the potential for a significant increase in U.S. interest rates, we thought we would update you on our views and how we have positioned Brave's portfolios.

Although we have been expecting the end of the 35-year bull market in bonds for a couple of years now, our conviction that that time is upon us has grown significantly over the last six months as bearish forces on both the demand and supply sides of the U.S. credit markets look set to intensify.

The challenges on the horizon have been clear for some time. A near record-low level of unemployment would eventually result in workers demanding and receiving increased compensation. This higher wage growth would trigger an increase in inflation expectations which in turn would result in investors requiring higher interest rates to maintain the same level of real rates. This may finally be occurring as the employment report for January showed that year-over-year wage growth ran at 2.9%, the highest level since 2009.

Secondly, the Federal Reserve has reversed its nearly 9-year policy of quantitative easing in which it expanded its balance sheet by buying approximately $4 trillion of debt securities. This unwinding is resulting in the Fed becoming a major seller of Treasury and mortgage bonds to the tune of $420 billion this year and $600 billion in 2019.

However, developments over the last couple of months on the supply side of the U.S. government credit market have been the real surprises. Congress passed and the President signed into law a tax reform and reduction program that is estimated to add $150 billion per year to the U.S.'s budget deficit. This was followed up with a compromise spending bill last week that appears to add up to another $300 billion to the country's annual budget deficit over the next two years. These actions come at a time when the U.S. was already running a nearly $700 billion deficit which implies that the annual deficit is on its way to over $1 trillion.

We believe that the combination of this significant increase in supply of government debt and the impact of fiscal stimulus at a time of near full employment will be felt most directly in higher interest rates. A secondary impact of these developments will likely prove to be additional downward pressure on the U.S. dollar as global markets continue to price in this new reality. We expect the effect on U.S. stocks to be more nuanced. The virtually unprecedented period of low volatility over the last fifteen months is likely over. However, we expect that the combination of higher interest rates, a weaker dollar, and stronger economic growth will be a net positive for equities, although their effect on individual sectors and companies will differ.

We have been reflecting these expectations in both the equity and fixed income holdings of the firm's portfolios. This fall, we sold most of our holdings in interest rate-sensitive stocks such as utilities and real estate investment trusts. We have increased exposures to companies and sectors that should benefit from a higher level of economic growth and interest rates and a weaker dollar, such as cyclical companies and banks. In our fixed income portfolios, we have looked to limit exposure to duration by exiting our holdings of

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preferred stocks and most longer-term bonds. The 1-year Treasury bill is now one of Brave's largest holdings as we believe that getting 1.80-1.90% (which is exempt from state and local income taxes) over the next year and then looking to reinvest the proceeds at higher rates is preferable to getting 3.00-5.00% interest in a longer-term fixed income security only to see that security's price decline by 10-30% as interest rates climb. To sum up our current feelings about bonds, we are reminded of the Will Rogers quote, "I am more concerned with the return of my money than with the return on my money"!

We continue to evaluate the impact on the markets of this changing macro environment and will not hesitate to make additional changes to the firm's portfolios to attempt to best position them for both safety and growth.

As always, do not hesitate to contact us if you would like to discuss anything further.

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