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LARGE CAP CORE GROWTH COMMENTARY

The rally in equities that began after the November 2016 election continued its upward charge in the second quarter with the S&P 500 gaining another 3.09%. The Russell 1000 Growth Index, our benchmark, added 4.67%. For the year-to-date, the indexes were up 9.34% and 13.99%, respectively. The Russell index was aided by strong technology performance for most of the quarter. For the second quarter, our Large Cap Core Growth model handily beat the S&P 500 while lagging the Russell 1000 Growth by a few basis points. For the period, our best performing sectors were Consumer Discretionary, Industrials and Healthcare, so it was a mixed bag of cyclicals and defensive sectors. Lagging sectors were Telecom, Energy and Consumer Staples. Energy is also cyclical but performed poorly as the price of oil declined from the mid-$50's to the mid-$40's. Telecom and Consumer Staples also trailed as slow growers were shunned. Adjustments to the LCCG model for the three-month period included the purchase of Rockwell Collins, maker of communications equipment, Charles River Labs, provider of research tools for drug development, and Microchip Technology, which develops, manufactures, and sells semiconductor products for various embedded control applications. Sales included General Mills and TJX Companies.

Investors are still expecting stronger growth going forward due to the administration's pro-growth agenda, but the time frame has been stretched from 2017 to 2018. A lot of questions remain as to just how much of the agenda will make it through the House and Senate gauntlets. Health care and tax reform seem to be having the most difficulty at this point. At the least, a significant reduction in regulations that impact corporate earnings should continue, and that alone could be a significant driver of profits and perhaps stock prices as well.

Recent economic statistics presented investors with a mixed picture as far as the economy, with strong results from such "soft" indicators as consumer confidence but weaker results from "hard" indicators such as gross domestic product. Automobile sales also slipped recently. One piece of hard data, the just-released ISM Manufacturing Index, posted quite a strong result with a reading of 57.8 for June. This was well above the consensus of 55.3 (readings above 50 indicate economic expansion). Especially of

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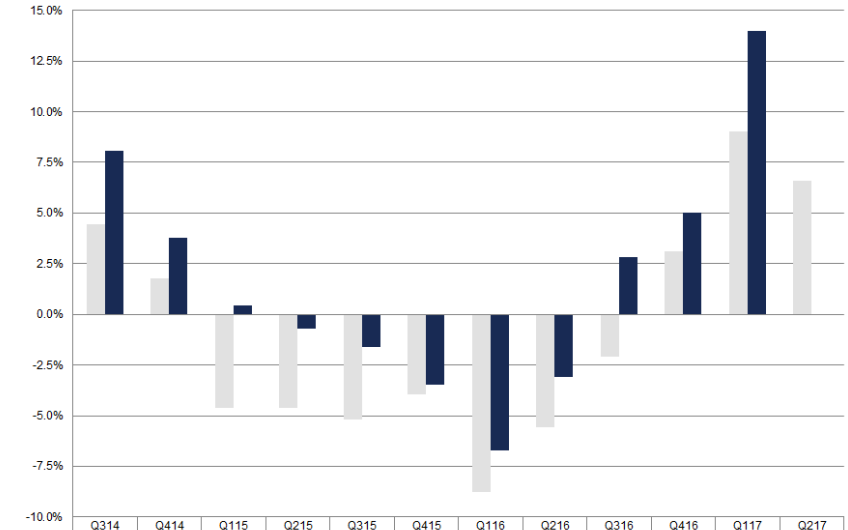
- Investors are still looking for stronger growth going forward from the administration's pro-growth agenda but the time frame has been stretched from 2017 to 2018.
- A significant reduction in regulations that impact corporate earnings should continue and that alone could be significant driver of profits and perhaps stock prices as well.
- Employment statistics continue to look strong.
- The corporate profits outlook for the second quarter now looks promising based on early reporting companies .

note, the manufacturing improvement was broad based. Fifteen of eighteen industries reported growth, and major measures of activity stayed above the key 50 level while new orders and production posted the largest gains for June. The new orders index this year has averaged the highest start to a year since 2004. Another report, the June ISM for non-manufacturing companies, was also released and posted a solid 57.4, up 0.5 from May and ahead of the expectations of 57.1. This provides another good data point to confirm the economy is improving. Employment statistics continue to look strong. The June unemployment rate came in at 4.4%, up 0.1% from May. May was a 16-year low and essentially indicated full employment. The labor market appears to be tight, and the JOLTS job openings report just hit 6.04 million, the highest level since the JOLTS report has been published. Such a high level indicates employers are having trouble finding qualified applicants which has been an issue for some time. As for the Federal Reserve, it raised its target range for the federal funds rate to 1.00%-1.25% and currently expects inflation to hit its target of 2% in 2018 and 2019.

The corporate profits outlook for the second quarter now looks promising based on early reporting companies. The current estimate for second quarter earnings growth per share is for an increase of 6.6%. As the chart below illustrates, these early estimates are often on the low side, so we could be in for something closer to double digit growth.

Of course, the direction of equity prices is quite correlated with the direction of earnings. Revenue growth is also projected to increase, and already reported revenues for Q2 bolster that conviction. Nick Raich of the"Earnings Scout" publication notes that early reporters have posted revenue growth of 8.5%, so earnings are no longer just a cost-cutting story but also a growth story. Raich is quite encouraged by what he has seen thus far in Q2, and we share that sentiment. Second and third quarter earnings may set quarterly records. It, therefore, looks as if we are transitioning from a Federal Reserve-driven market to an earnings-driven market at just the right time.

S&P 500: Estimated Earnings Growth at End of Qtr. vs Actual Growth



	Q314	Q414	Q115	Q215	Q315	Q415	Q116	Q216	Q316	Q416	Q117	Q217
End of Qtr.	4.5%	1.8%	-4.6%	-4.6%	-5.2%	-3.9%	-8.8%	-5.6%	-2.1%	3.1%	9.0%	6.6%
Actual	8.1%	3.8%	0.4%	-0.7%	-1.6%	-3.5%	-6.7%	-3.1%	2.8%	5.0%	14.0%	

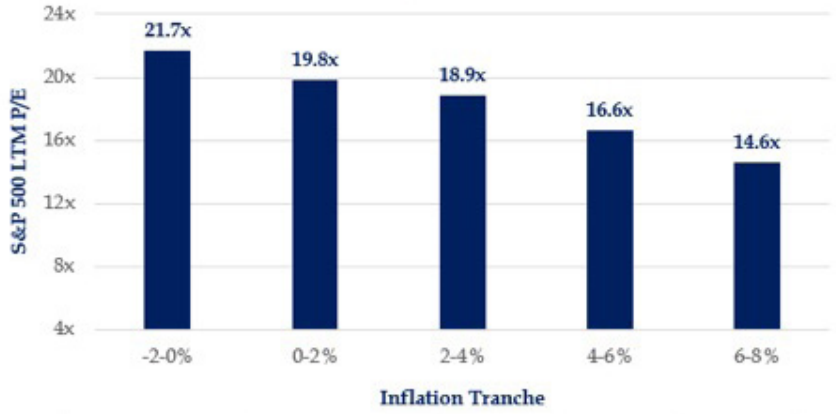
Source: FactSet

For the quarter, the stock market moved upwards through early June and then settled into a trading range of between about 2400-2450 to close out the quarter. We remain constructive on equities for 2017, but the market has gone a long way without a significant pullback so it would not be a surprise to see the market sell off between 5%-10% at some point in the next few months. That said, the indexes seem to be in a very positive position currently. The key indexes are "in gear," meaning they are moving up together and hitting new highs, a very bullish sign. The S&P 500, Dow Industrials, NASDAQ, and the Advance/Line all hit new highs in June. Even the Dow Transports went on to hit a new high in early July. This is considered a very bullish occurrence by followers of "Dow Theory." The theory postulates that when the Industrials and Transports both make new highs, indicating that both sectors of the economy are growing, then that should be positive for stocks. Actually, we would view a pullback as a "healthy" development as it would allow earnings to catch up to stocks prices and improve the valuation numbers. As it stands, the S&P 500 is currently trading at a PE of around 18.5x, so it is a bit stretched by historical standards. However, we are in a period of unusually low interest rates and inflation

which we refer to as a valuation "sweet spot". As the chart below indicates, markets can reach significantly higher levels during these periods so we have a bit of a cushion as long as inflation remains tepid.

Additionally, the yield curve is still sending an encouraging message with a positive slope and spreads that have widened a bit recently, as well. Now, if only Washington can get its act together and pass some growth-inducing legislation such as tax reform (including repatriation of overseas profits), we could possibly begin a new leg up on this bull market.

Average S&P 500 LTM P/E by CPI Y/Y Tranche
(1990 - Current)



Source: Strategas

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About Crossmark's 30 Year History
Crossmark, previously Capstone Asset Management Company, is an independent investment advisor headquartered in Houston, Texas. Founded in 1987, Crossmark is in its 30th year of providing portfolio solutions for financial advisors and institutional investors with values-based, SRI and ESG values and factor-based strategies. Additionally, Crossmark is the exclusive manager of the Crossmark Steward Funds, which is a fund family that applies an overarching values-based screening methodology to its suite of equity and fixed income funds, including its award-winning Global Equity Income Fund- named Lipper's "Best Global Equity Income Fund" for the last three consecutive years. Crossmark manages approximately $5 billion in assets with clients nationwide.

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