JAG CAPITAL MANAGEMENT LLC

QUARTERLY COMMENTS
4th Quarter 2017

4th Quarter 2017: Omnipresent Optimism

Norm Conley | CEO & CIO

Stocks roared into the New Year, with the S&P 500 delivering a 6.64% return in the fourth quarter of 2017. For the full year, the benchmark index returned 21.83% (both figures include the effect of dividends). It is worth noting how surprising last year's stock market performance was to most of the cognoscenti on Wall Street. When the Barron's 2017 Analyst Forecast was published on 12/19/16, the strategists' average prediction called for only a 5.4% yearly gain for the S&P 500.

Barron's 2017 Analyst Forecasts

As of 12/16/2016 >> S&P 500: 2,258 | S&P 500 Op EPS: $108.95 | 10 Year Trsy Yield: 2.60%

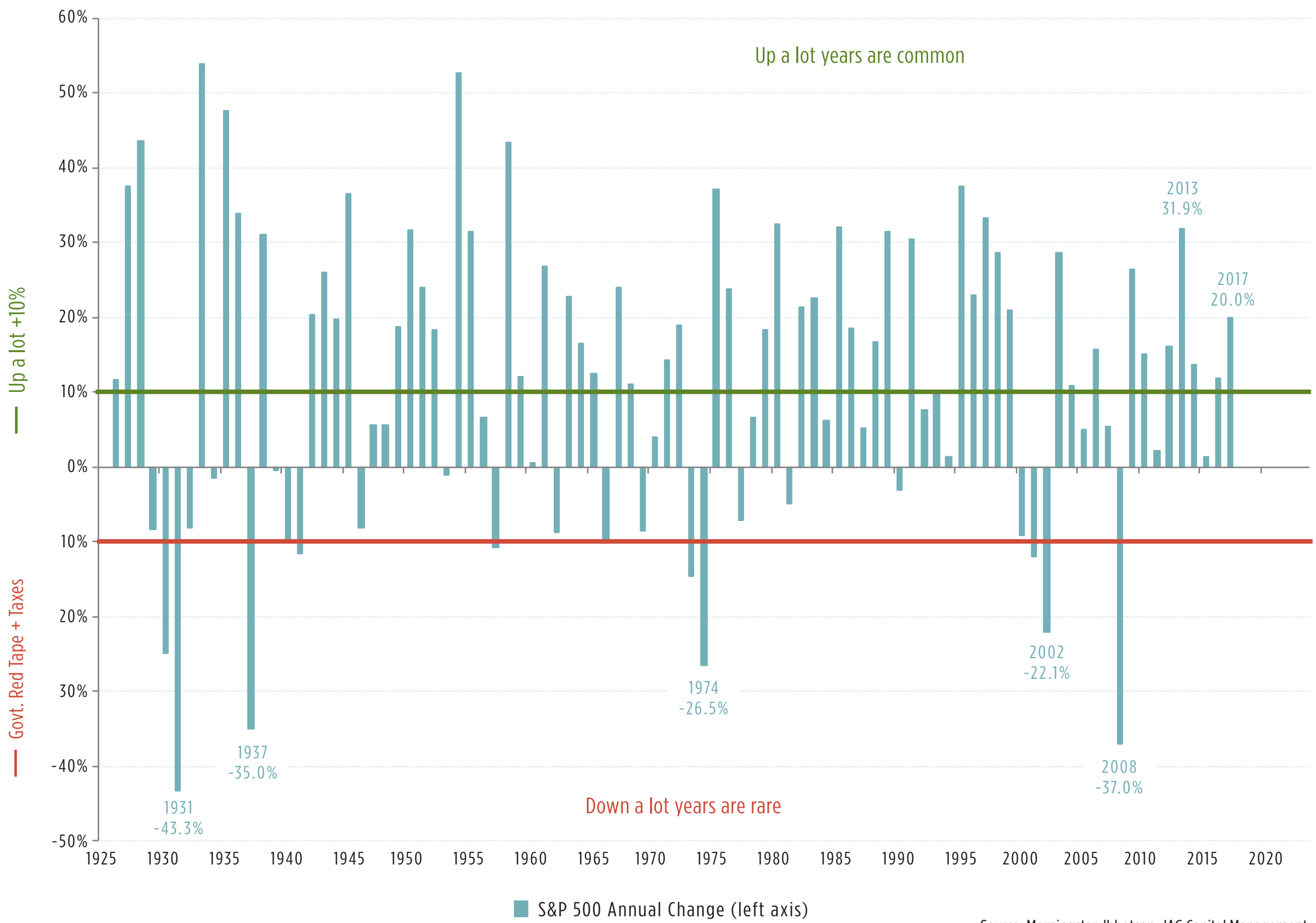
Analyst	Firm	Year-End 2017 S&P 500	Implied % Chg from 12/16/16	GDP Growth 2017	S&P EPS 2017	Implied S&P 500 Op EPS % Chg in 2017	10 Year Trsy Yield
Stephen Auth	Federated Investors	2,350	4.1%	3.00%	$130.00	19.3%	3.00%
Jonathan Glionna	Barclays Capital	2,400	6.3%	2.20%	$127.00	16.6%	2.40%
Jeffrey Knight	Columbia Mgmt	2,450	8.5%	3.00%	$135.00	23.9%	2.90%
Heidi Richardson	Blackrock	2,400	6.3%	2.40%	$127.00	16.6%	2.75%
David Kostin	Goldman Sachs	2,300	1.9%	2.20%	$116.00	6.5%	2.75%
Dubravko Lakos-Bujas	JP Morgan	2,400	6.3%	2.10%	$128.00	17.5%	2.55%
Tobias Levkovich	Citi Research	2,325	3.0%	1.80%	$129.00	18.4%	2.60%
Adam Parker	Morgan Stanley	2,300	1.9%	2.00%	$128.70	18.1%	2.50%
John Praveen	Prudential Intl.	2,575	14.0%	3.00%	$122.20	12.2%	2.75%
Savita Subramanian	BofA Merrill Lynch	2,300	1.9%	2.00%	$129.00	18.4%	2.65%
Average		2,380	5.4%	2.37%	$127.19	16.7%	2.69%
Median		2,375	5.2%	2.20%	$128.35	17.8%	2.70%

Source: Barron's Magazine; December 19th, 2016 issue

While they correctly predicted the general direction of stock prices (up), they did not come close to foreseeing the magnitude of gains experienced by the broad equity market. We are not pointing this fact out to malign investment gurus. They are almost uniformly intelligent, dedicated, and hard-working professionals. However, they have all experienced similar education and training, and they tend to rely upon almost identical datasets to inform their forecasts. Consequently, their market prognostications tend to be tightly grouped with each other. Since their consensus expectations are largely derived from widely-known information that is already discounted by the markets, their predictions tend to be wrong more often than not. Always remember that surprises are a feature of financial markets, not a bug!

Looking forward to 2018, we start with some baseline assumptions. Although some of our colleagues in the investment industry seem to enjoy making investing maximally complicating, there are only four general paths the stock market can take in any single year. To paraphrase legendary investor Ken Fisher, market outcomes can be divided into four categories: 1. stocks can be up a lot (10%+); 2. up a little (between 0% and 10%); 3. down a little (between 0% and -10%), or 4. down a lot (fall by more than 10%). Thankfully for long-term investors, "up a lot" years are relatively common. In fact, the S&P 500 experienced 10%+ gains in 52 of the last 91 calendar years, including 2017.

S&P 500 Annual Percentage Change



Source: Morningstar-Ibbotson, JAG Capital Management

Sure, there have been some brutal down years, including 2008 most recently. These sorts of big down years are as rare as they are unpleasant. On the bright side, big drawdowns have tended to create great buying opportunities for long-term investors.

When it comes to stocks in 2018, we think investors should avoid the temptation to assume that what goes up must come down. Since 1926 and including 2017, the S&P 500 has experienced 52 calendar years of double-digit (10%+) gains. Somewhat surprisingly to many, the most common outcome following a big up year has been yet another year of double-digit gains.

How Does the S&P 500 Perform in the Year Following an "Up a lot" Year?

Following Year Performance Category	# of Occurrences	% of Total
Up a lot	29	55.8%
Up a little	9	17.3%
Down a little	11	21.2%
Down a lot	3	5.8%
Total	52	100.0%

Source: Morningstar-Ibbotson, JAG Capital Management

Indeed, the S&P has been "up a lot" again in 55.8% (29) of the instances. Stocks could certainly pull back significantly in 2018 for any number of reasons, or even for no apparent reason. But it is worth noting that this would be an unusual outcome. Strong yearly gains have been followed by double-digit declines in only 5.8% (3) of such instances since 1926.

For their part, Wall Street strategists are once again only modestly bullish on the prospects for stocks. This year's Barron's Analyst Forecast projects a 7.2% gain for the S&P 500. But take this with a grain of salt, because their projection of an "up a little" year has occurred in only 17.3% of the years following double-digit gains.

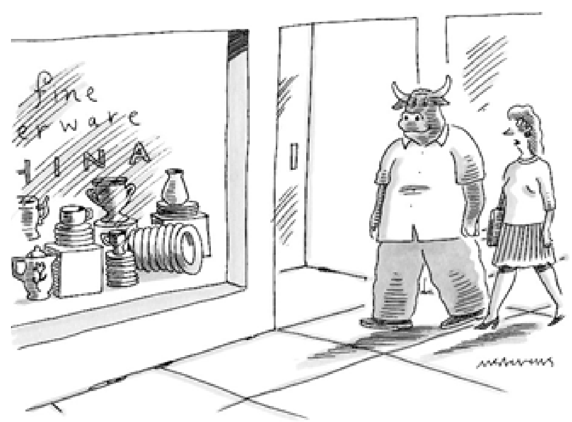
Barron's 2018 Analyst Forecasts

As of 12/11/2017 >> S&P 500: 2,652 | S&P 500 Op EPS: $118.60 | 10 Year Trsy Yield: 2.39%

Analyst	Firm	Year-End 2018 S&P 500	Implied % Chg from 12/11/17	GDP Growth 2018	S&P EPS 2018	Implied S&P 500 Op EPS % Chg in 2018	10 Year Trsy Yield
Stephen Auth	Federated Investors	3,000	13.1%	2.90%	$150.00	26.5%	2.75%
Jeffrey Knight	Columbia Threadneedle	2,750	3.7%	3.10%	$144.00	21.4%	3.10%
David Kostin	Goldman Sachs	2,850	7.5%	2.50%	$150.00	26.5%	3.00%
Dubravko Lakos-Bujas	JP Morgan	2,800	5.6%	2.30%	N/A	N/A	2.70%
Tobias Levkovich	Citi Research	2,675	0.9%	2.70%	$141.00	18.9%	2.75%
John Praveen	PGIM	2,975	10.3%	2.80%	$139.30	17.5%	3.00%
Rob Sharps	T. Rowe Price	2,775	4.6%	2.50%	$150.00	26.5%	2.75%
Savita Subramanian	BofA Merrill Lynch	2,800	5.6%	2.40%	$139.00	17.2%	2.90%
Mike Wilson	Morgan Stanley	2,750	3.7%	2.10%	$145.00	22.3%	1.95%
Ed Yardeni	Yardeni Research	3,100	16.9%	3.00%	$147.00	23.9%	2.75%
Average		2,843	7.2%	2.63%	$145.03	22.3%	2.77%
Median		2,800	5.6%	2.60%	$145.00	22.3%	2.75%

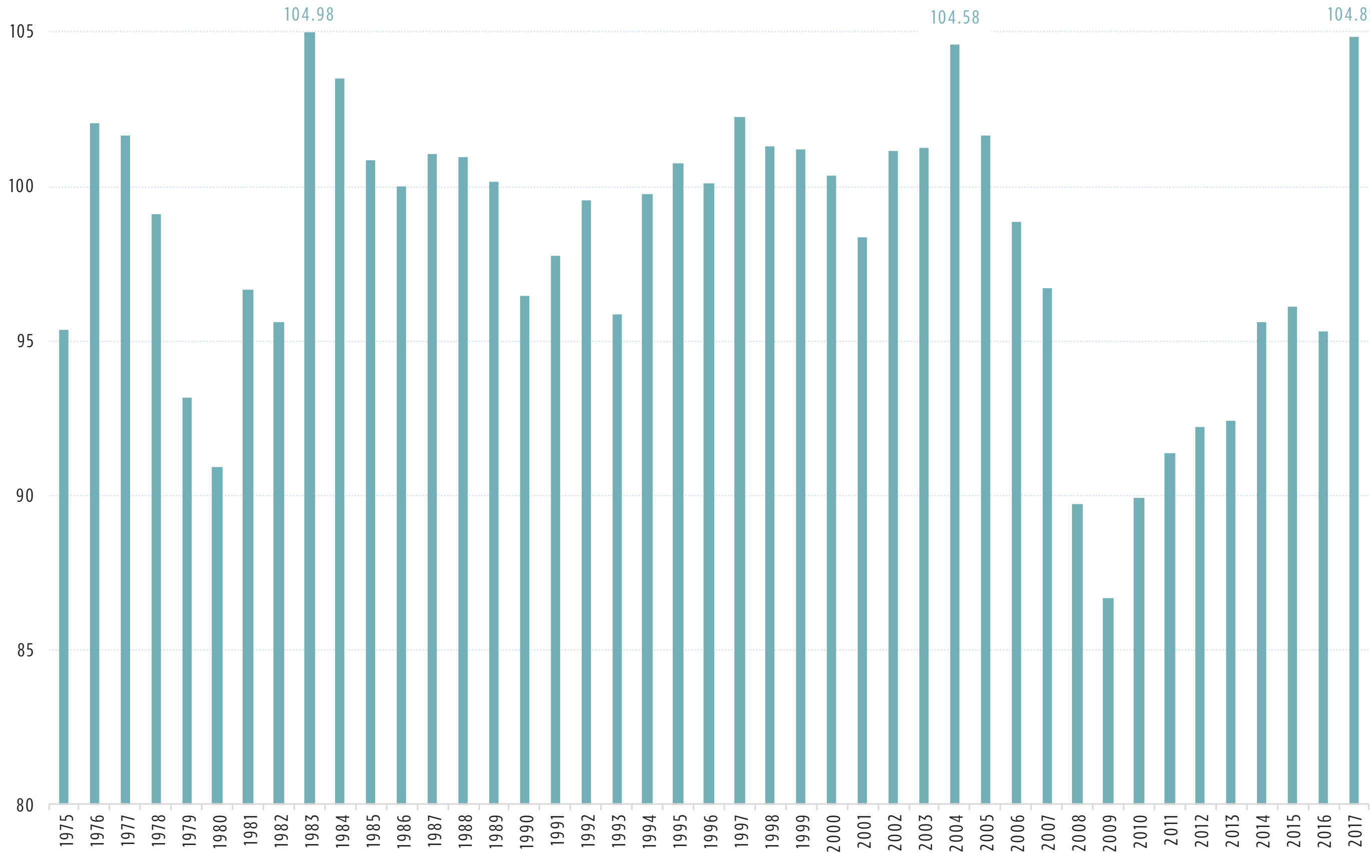
Source: Barron's Magazine; December 11th, 2017 issue

Moving from Wall Street to Main Street, we note that small business owners are increasingly enthusiastic about the economy and their own business prospects. The NFIB (National Federation of Independent Business) Small Business Optimism Index recently ramped to its highest level since 1983, outstripping the pre-Great Recession high that was set in 2004.



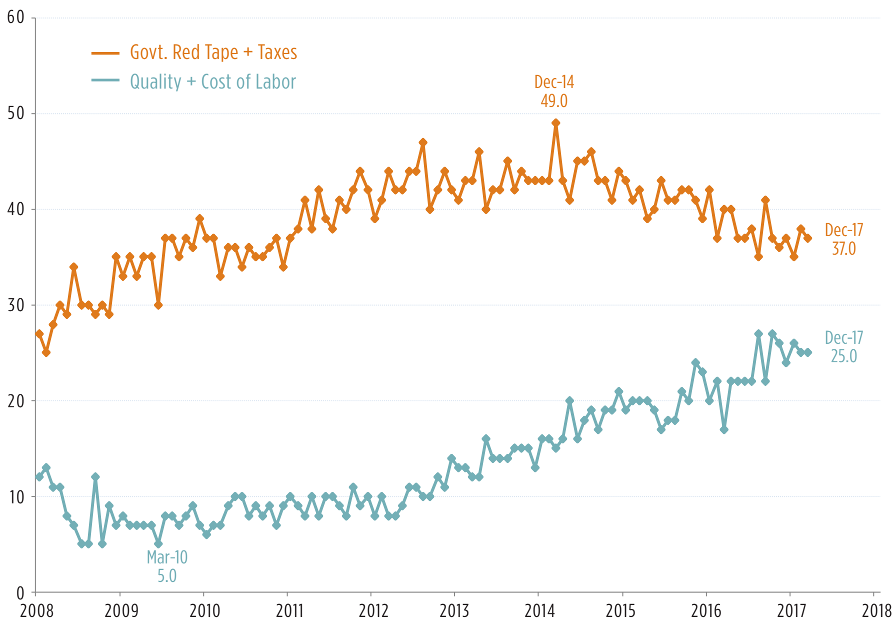
"Don't even think about it."

NFIB Small Business Optimism Index



Source: Bloomberg, JAG Capital Management

Top Concern for Small Business: Quality + Cost of Labor (blue line) vs. Govt. Red Tape + Taxes (orange line)



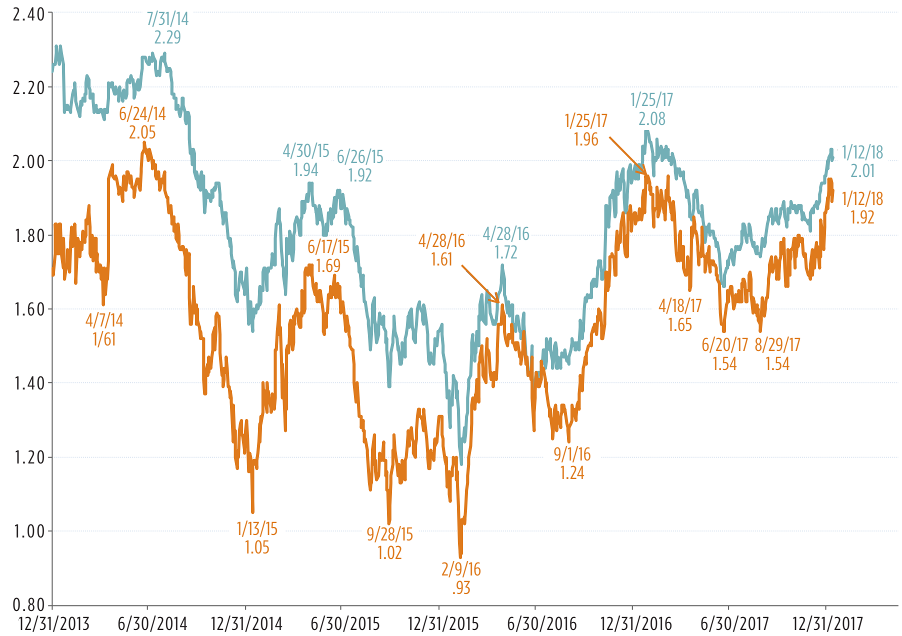
Source: NFIB, JAG Capital Management

When asked to note their top concerns, 37% of small business owners cite Government Red Tape and Taxes, but this figure is down significantly from late 2014. On the other hand, 25% of business owners note that the quality and cost of labor are their biggest challenges, up from only 5% in early 2010. This evolution of small business owner sentiment is probably a good thing for middle-class workers. Businesses hungry for talent will probably have to raise wages to attract qualified employees. It follows that wage growth could tick up in 2018 after years of stagnation. Moreover, to the extent that business people feel less burdened by taxes and/or government regulations, we could also see an improvement in overall economic growth over the next year.

One simple way to track the markets' view of inflation is by tracking the "spread" (i.e. break-even rate) for Treasury Inflation Protected Securities (TIPS). When the lines are rising, inflation expectations are building. The reverse is true when the lines are falling. Financial markets now expect the Consumer Price Index (CPI) to rise 2.0% per year over the next 10 years. While markets still expect relatively tame inflation in the coming years, we note that current expectations are nearing multi-year highs. We think inflation could actually rise faster than expectations in 2018. Drivers could include burgeoning commodity prices (especially in industrial metals and oil), strengthening global economic growth, and whiffs of wage inflation from tight labor markets.

On balance, we are optimistic about stocks in 2018. The global economy is growing, business owners are in a great mood, interest rates and inflation are ticking up but remain low in absolute terms, and corporate earnings growth should strengthen over the next several quarters.

10 Year TIPS Spread (blue line) **vs. 5 Year TIPS Spread** (orange line)

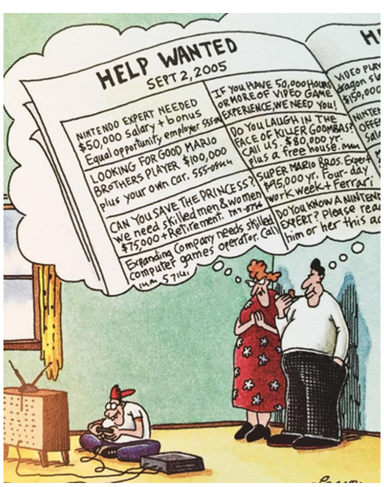


Source: Federal Reserve H.15 Release, JAG Capital Management

In Closing: what was once fantasy is now reality

The Far Side cartoon showing hopeful parents watching their son play videogames was originally published in 2000. The Wall Street Journal article discussing highly-paid professional videogame players was published in early January 2018. Sometimes truth turns out to be stranger than fiction!

Norm Conley
CEO & CIO



Source: Gary Larson's The Far Side, 2000

Source: Wall Street Journal article, 1/4/18

Disclosures

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JAG
CAPITAL MANAGEMENT LLC

9841 Clayton Road | St. Louis, MO 63124
800.966.4596 **www.jagcapm.com**