CORBYN INVESTMENT MANAGEMENT, INC.

January 2018

Dear Advisors and Clients:

Strong corporate earnings reports, continued global economic growth, and the passage of U.S. corporate tax reform helped push the equity markets higher during the fourth quarter of 2017. Reacting to this backdrop of economic strengthening, the Federal Reserve ("Fed") raised short-term interest rates in December by one-quarter of one percent, the third such increase in 2017. Although the Fed's move pushed short-term rates higher, continued low inflation kept longer-term rates little changed, which further "flattened" the yield curve. We are pleased to report that Corbyn-managed accounts generated solid returns during the fourth quarter.

Equities

The equity market rally that began late in the third quarter continued for the balance of the year as it became evident that Congress would pass significant tax reform legislation. Investors understood that lower corporate tax rates would directly benefit many U.S. corporations and their shareholders as earnings and after-tax cash flow would increase, providing companies greater flexibility to reinvest back in their businesses, make acquisitions, repay debt, raise dividends or repurchase shares.

Our belief, however, is that indirect benefits of corporate tax reform, although varied, less certain and harder to track, could ultimately prove to have a greater influence on the economy. Recent announcements by many companies awarding special bonus payments to employees and higher corporate wage levels are developments that could spur additional consumer spending. Companies have also announced plans to increase capital spending as lower taxes and more generous depreciation rules make domestic capital investments more attractive. Larger paychecks, unexpected bonus payments and higher spending on capital projects all have the potential to bolster economic growth and could be the impetus to move the economy from its "two steps forward, one step back" slow growth pattern of recent years to a more robust growth trajectory.

Fixed Income

Fixed income investors have also been keenly focused on the potential implications of tax reform on the economy. After hitting historic lows in mid-2016, rates on the 10 year U.S. Treasury moved higher following the presidential election with the expectation that the Trump administration's plans would accelerate economic growth and potentially result in higher inflation. However, during much of 2017, interest rates moved in a relatively narrow range as clouds of uncertainty hung over Washington. Then, with the passage of corporate tax reform late in the year, bond prices fell, pushing interest rates to the higher end of the recent trading range with renewed anticipation of accelerated economic growth.

The slow growth, moderate inflation, low interest rate environment of the last few years has been noteworthy for its muted volatility. Every time the economy seemed to gain steam and interest rates inched higher, economic data seemed to cool and interest rates would drop back. During this period, we often warned of the significant losses that would be incurred by holders of longer-duration bonds, particularly low coupon longer-duration bonds, if interest rates were to move higher on a sustained basis.

Throughout this multi-year low interest rate environment, our focus on short-duration high yield bonds has allowed our clients to achieve solid returns while shielding the portfolios from the risk inherent in longer-duration securities. Given the current potential for an acceleration in economic growth and a corresponding increase in interest rates, we believe it is important for fixed income investors to remain alert to this risk and exercise caution by avoiding longer-duration bonds and remaining focused on short-duration securities.

Outlook

Looking forward, we are encouraged by the potential pick-up in economic growth that may result from the direct and indirect benefits of corporate tax reform and the positive implications this should have on corporate earnings and cash flow. Many of the companies represented in the equity portions of the portfolios will benefit from these developments. We have always tried to target high-quality management teams and, during periods of economic transition such as the current environment, these well-managed companies should be able to adjust more capably than many of their competitors. While interest rates on short-duration securities remain at low levels and the spread to U.S. Treasuries remains very tight, we will continue to maintain a conservative posture in the fixed income portfolios, working to deliver attractive high-yield returns without compromising our credit standards. Our focus on short-duration fixed income securities shelters the portfolios from the adverse effects of increasing interest rates and positions the portfolios to benefit from a sustained move higher in rates - a development we would welcome, unlike many fixed income investors.

We hope you had an enjoyable Holiday season and extend our best wishes for the New Year. Please feel free to call us to discuss any questions you have regarding your investment portfolio. We are off to a solid start so far in 2018 and look forward to updating our progress at the end of the first quarter.

Respectfully,

Charles vK. Carlson, CFA
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