Market Commentary

As of September 30, 2018

Economy & Market Review

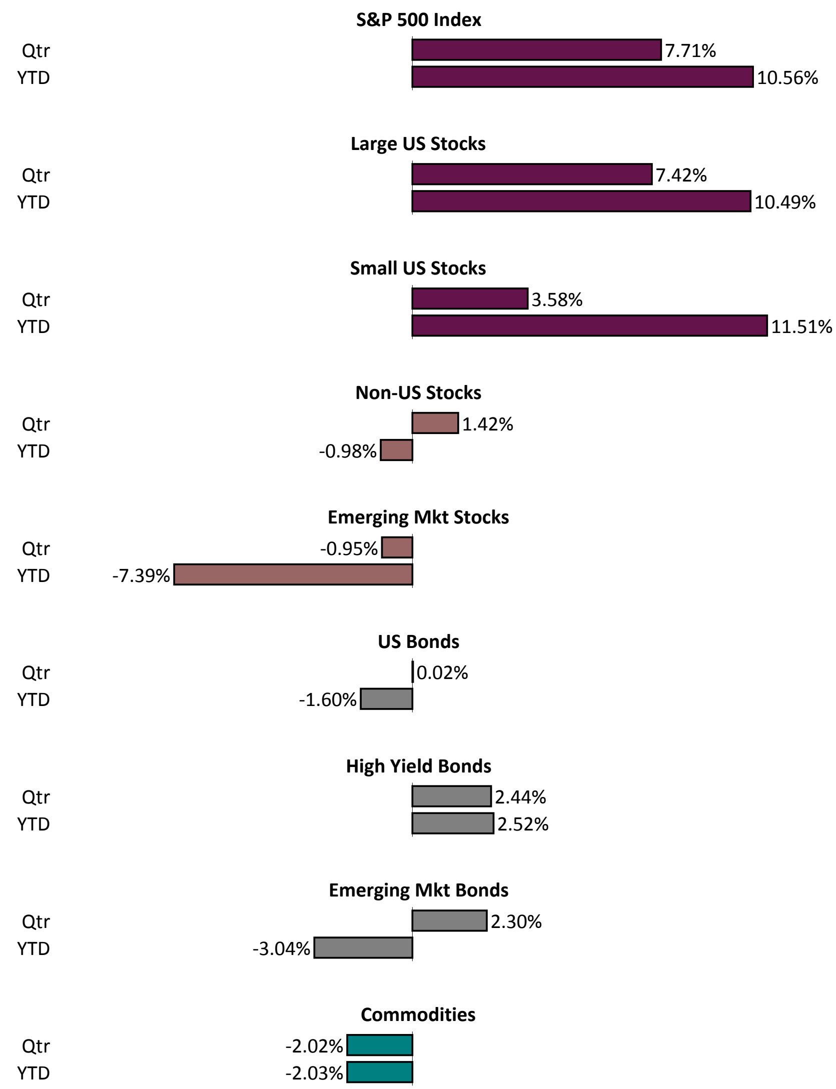
Third Quarter 2018

US equity markets registered another strong quarter and returned 7.7% as measured by the S&P 500, more than double the second quarter's 3.4% gain. After leading the charge last quarter, small cap US stocks lagged their large cap brethren, but still managed to return 3.6%. International markets, both developed and emerging, did not fare as well compared to the US market. The MSCI EAFE Index of international large cap stocks was only up 1.4% while the MSCI EAFE Small Cap Index and the MSCI Emerging Market Index were down 0.8% and 1.0%, respectively. US dollar strength, above-trend US growth, and trade challenges all had a negative impact on international stock returns relative to the US.

The US economy posted second quarter GDP growth of 4.2% due mainly to a surge in consumer spending and business investment. This is the fastest growth rate since 2014 and the third best since the last recession. Since 1900, the average economic expansion length is nearly four years, our current expansion is over nine years old - the second longest on record. In an attempt to abate inflationary pressures, the Federal Open Market Committee increased rates by 0.25% in September. The Fed also signaled an additional hike this year and three more in 2019. Further delineating their latest step in the normalization process, the FOMC statement excluded the post-recession-era language “the stance of monetary policy remains accommodative.”

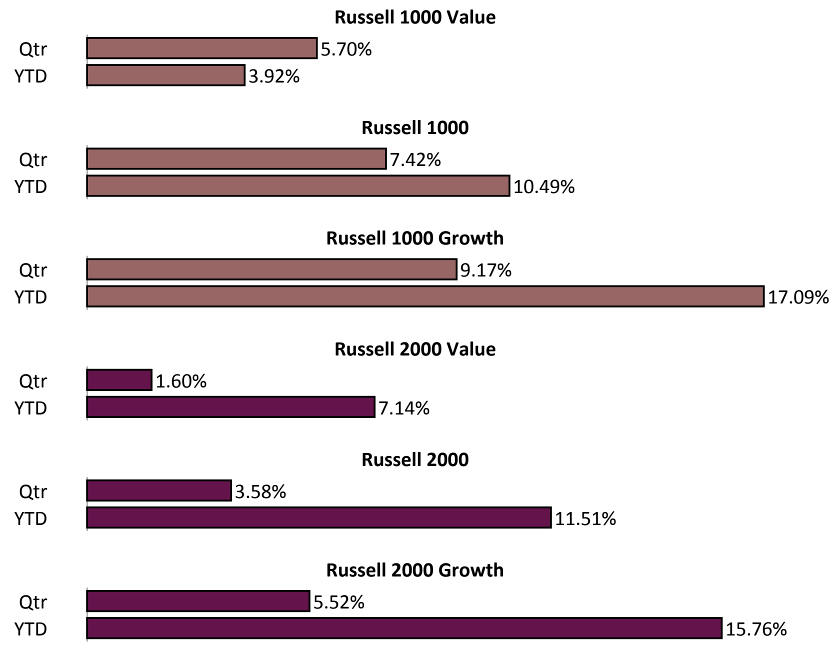
On the trade front, markets are digesting whether the tariff talk is a war or simply a tirade. In September, the US, Mexico, and Canada reached a trilateral trade deal purportedly replacing NAFTA. Although far from finalized, the plan is for the three countries to sign the arrangement in November and then submit the deal to Congress. Announcement of the pact helped alleviate some market fears about global trading disruptions, but left the elephant in the room - US/China trade relations. Discussions between the two countries currently are not progressing. The recent 10% US tariffs imposed on $200 billion in Chinese imports is set to increase to 25% beginning on January 1, 2019. Of course, China has responded with their own retaliatory tariffs ranging from meat and wheat to textiles.

Global Market Performance



U.S. Equity Markets

U.S. Equity Style Performance

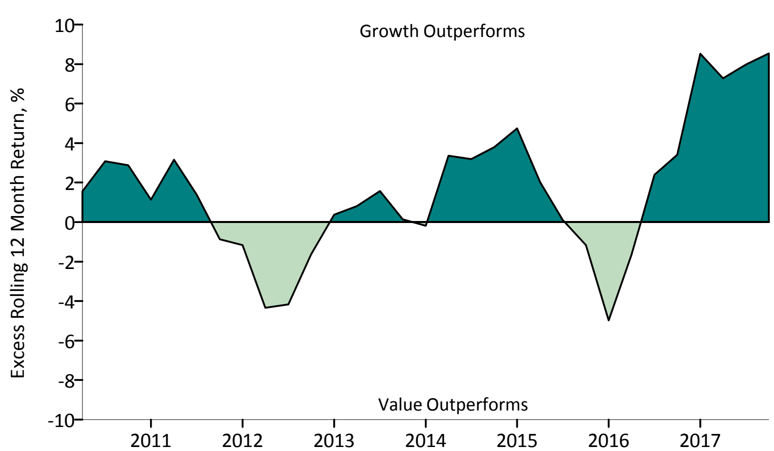


The stock market has been called a forward-looking mechanism. Investors forecast prices based on estimated earnings expectations. Currently, earnings have been strong as corporate tax cuts positively influence companies' profits, but lately possible adverse signals have appeared. Recent negative profit guidance outpaced positive guidance by the most since 2010. Historically low unemployment of 3.7%, its lowest level since December 1969, may also be a precursor of additional inflation.

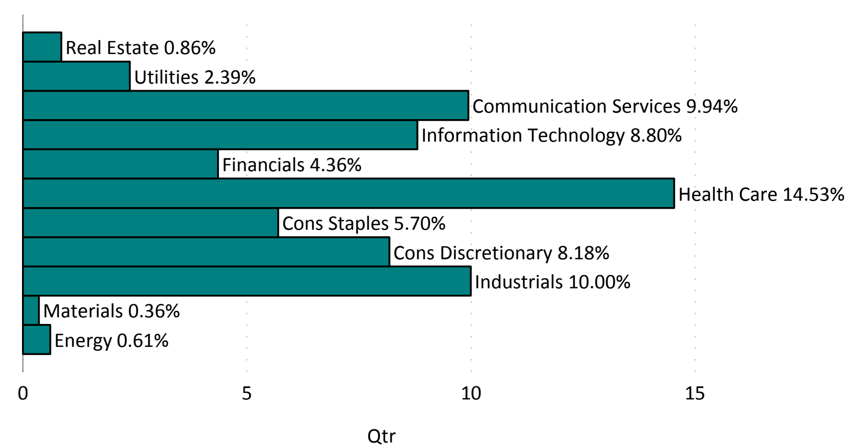
The Russell 1000 Index of large cap stocks returned 7.4%. During the quarter, the momentum trade resumed with growth outperforming value at all market caps. Historically, small cap stocks, as measured by the Russell 2000, have performed best after a business cycle trough. In this case, as the economy is likely late-cycle, small cap performance has benefited from a domestic focus that functioned as a refuge from trade challenges.

During the quarter, major changes in the MSCI and S&P Dow Jones equity sectors occurred with the launch of a new communication services sector constructed from telecom, technology, and consumer discretionary sectors. Numerous companies, including Facebook and Alphabet (Google), moved to the new sector. Health care, industrials, and communication services were the best performing sectors during the three month period while commodities and energy were the worst performers.

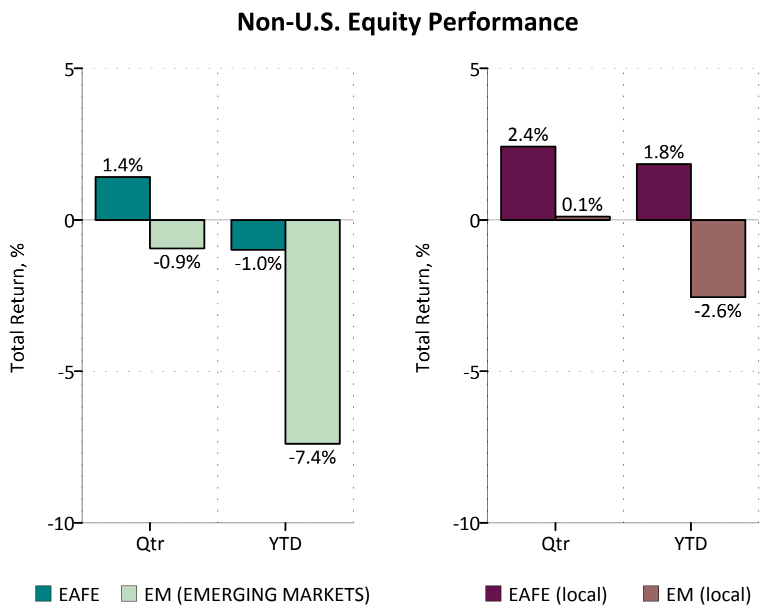
Growth Relative to Value (Russell 1000)



U.S. Equity Sector Performance (S&P 500)

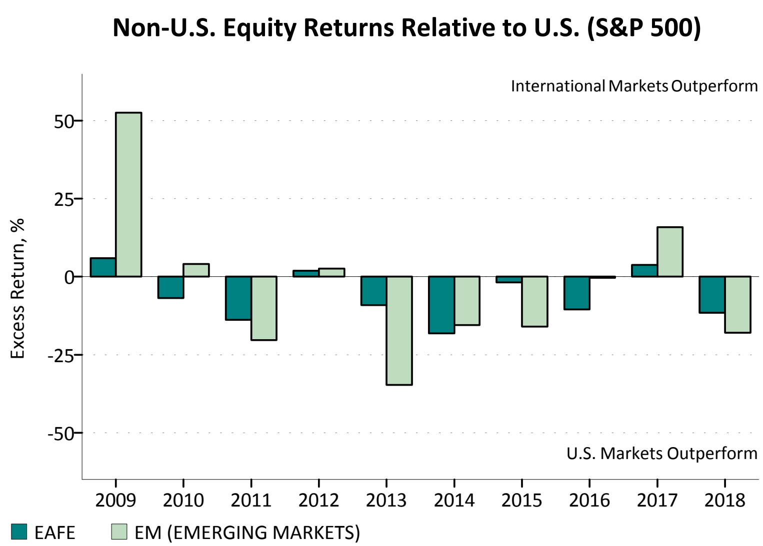


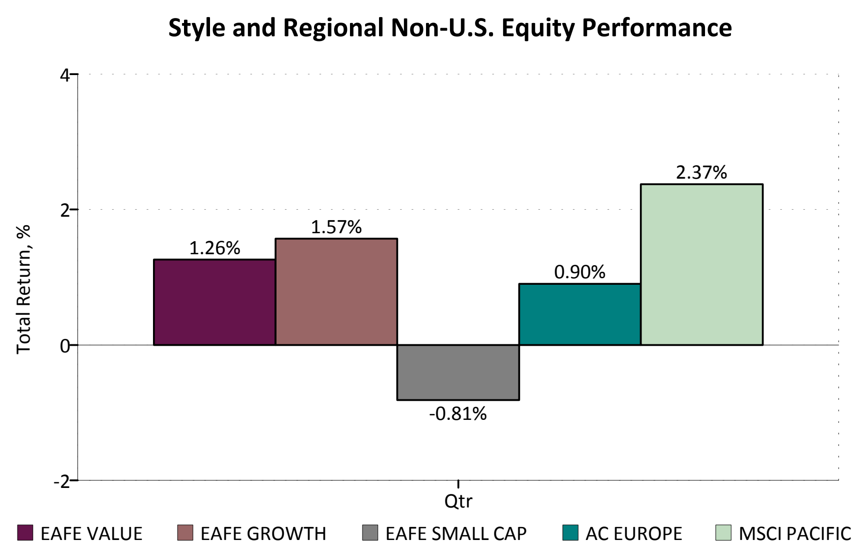
International Equity Markets



Overseas markets were mixed as foreign economic growth remains challenged and trade tariffs have increased uncertainty. Developed international markets had positive quarterly returns, but the EAFE Index was still down 1% year-to-date. As the US continues to increase interest rates, the European Central Bank (ECB) signaled few changes. The bank's September announcement included plans to end bond purchases at year end, but also keeping interest rates at low levels through at least mid-2019. This has been a very gradual removal of crisis-fighting stimulus. ECB officials stated that the path of inflation, the primary consideration for monetary policy, is largely unchanged.

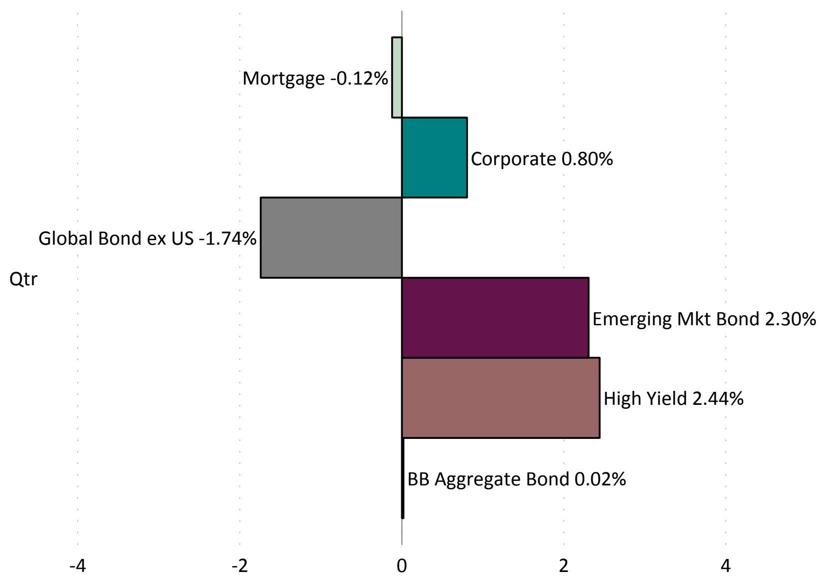
Emerging markets, China in particular, produced negative returns during the quarter. The MSCI All China Index was down 7.3% in the quarter and 17.4% year-to-date. The broader MSCI Emerging Market Index was down 0.9% and 7.4%, respectively. Sentiment on emerging markets is quite negative, but fundamentals seem pretty good. With the lowest valuations of any major asset class and growth expected to be in the high single to low double digits, emerging markets continue to be a reasonable investment from a long-term perspective. As with any asset class, recognition of possible challenges are important. Trade protectionism remains a real risk and election outcomes could change the economic landscape rather quickly.





Fixed-Income Markets

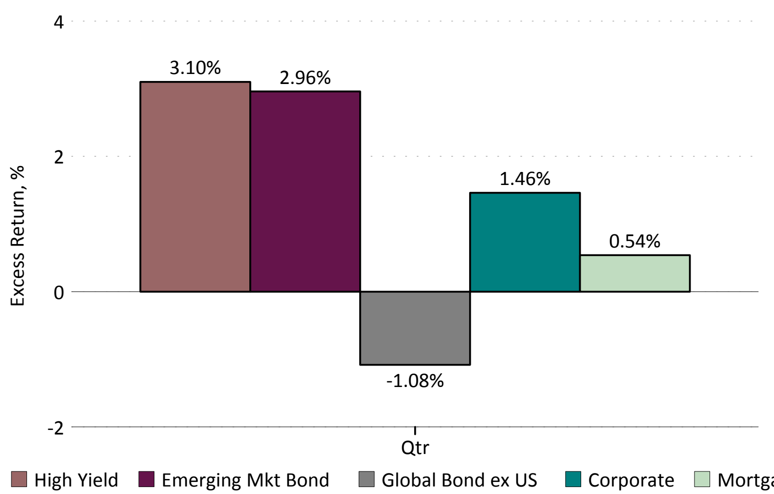
Fixed Income Performance



Fixed income returns remain under pressure as rates continue to rise. The US 10-Year Treasury yield rose from 2.46% at the beginning of the year to 3.23% on October 5th. More than half of that increase actually occurred in the last 30 days when the 10-Year yield rose 0.40% (a swift and sizable yield move historically). A bond's maturity and coupon rate generally determine how much its price will change due to interest rate changes. This means bonds with shorter maturities and/or higher coupons (i.e. those yielding enough to offset any decrease in price) often perform the best in a rising interest rate environment. As a result, high yield bonds were the best performers as credit defaults remain low and higher coupon rates more than offset any price decline. The Bloomberg Barclays US Aggregate Bond Index, a broad measure of the bond market, was basically flat for the quarter, but down 1.6% year-to-date.

The quarter-over-quarter yield curve change was slightly different than recent history. Rather than continuing to flatten, the yield curve made more of a parallel shift across the entire curve. A parallel shift is when interest rates on short-term, intermediate, and long-term maturities increase or decrease by roughly the same amount. The FOMC is expected to raise rates again in December, but if strong economic data continues, investors may expect an even more aggressive Fed in 2019.

Excess Performance to Treasuries



Yield Curve