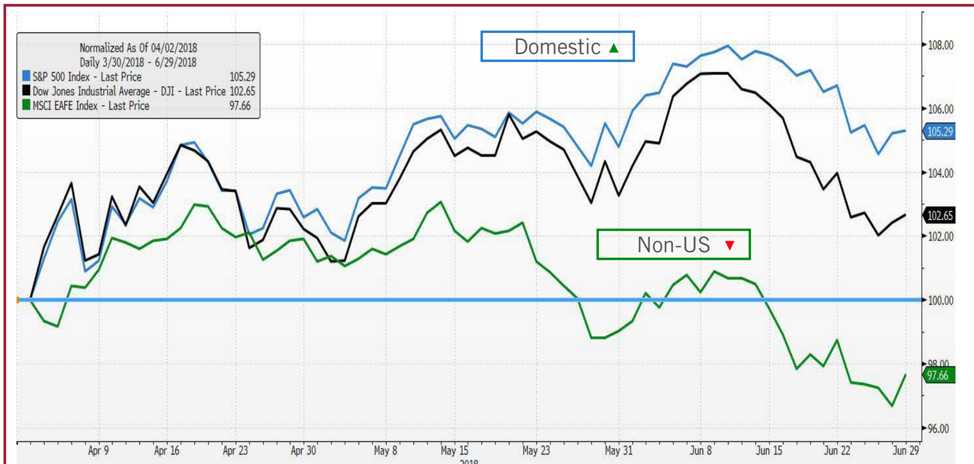
Q3 2018 Quarterly Newsletter

DO THE TAILWINDS SHIFT TO HEADWINDS?



INDEX PERFORMANCE

	Quarter Return	YTD Return
S&P 500	+3.43%	+2.65%
Dow Jones Indus. Avg	+1.26%	-0.73%
Russell 1000 Value	+1.17%	-1.69%
Russell 1000 Growth	+5.76%	+7.25%
MSCI EAFE (Non-US)	-1.06%	-2.40%
MSCI ACWI (Non-U.S)	+0.53%	-0.43%
U. S. Aggregate	-0.16%	-1.62%
U.S. Corp High Yield	+1.03%	+0.16%
Alerian MLP	+11.80%	-0.63%

[1]*Source: 2018 Bloomberg Finance L.P.*

Market activity during the second quarter of 2018 was somewhat of a rollercoaster. Yet, despite increased volatility, domestic equity markets posted positive returns, while Non-US markets declined slightly during the quarter. Indeed, during the quarter we saw investors' focus and media rhetoric shift and pivot due to a range of themes including:

- Threat of nuclear war with North Korea
- Trade wars with China
- Federal Reserve (Fed) increasing rates too fast
- Italian elections and the fears of "Italeave"
- And further developments on Brexit

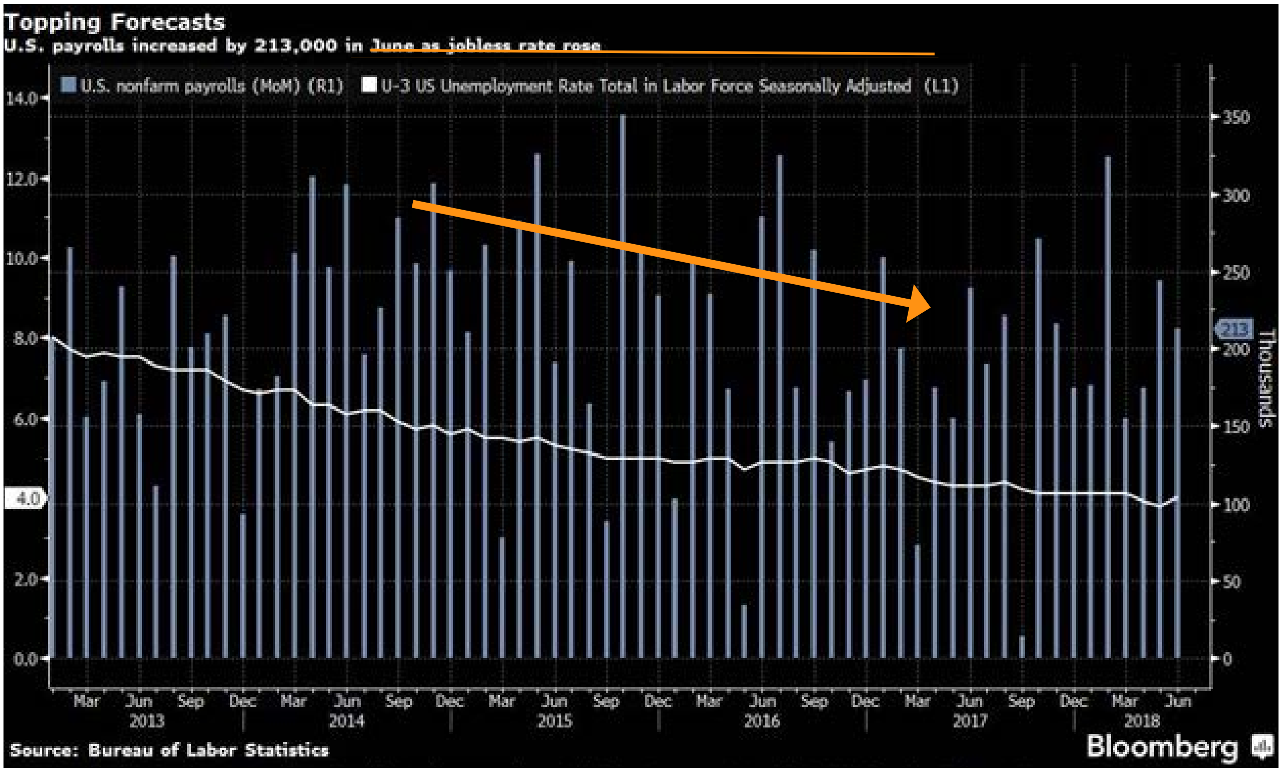
The more dominant news-headline shift was assuredly the move away from discussing market volatility due to the Fed raising rates and speculation on the speed of the hikes, to fear of a trade war as the Trump administration imposed tariffs on multiple global trade partners. At the time of this writing the prospect of the trade skirmish becoming a full-blown trade war, in our opinion, is a low probability event. That said, the threat and price action to the downside could be significant if it does in fact escalate further. We continue to see the administration's strategy of jawboning to further their policy agenda as simply a negotiating tactic, and certainly a tactic that we have seen before with President Trump.

TAILWINDS

The US equity market fundamentals remain robust for the time being. With multiple tailwinds, such as continued positive economic data, strong corporate earnings, and revamped trade deals, the US economy continues to advance.

JOBS & WAGES

The most recent jobs number (June of 2018) beat expectations and posted a headline number of 213K vs estimates of 195K. While wage increases did miss slightly, we believe there is still room for our economy to grow. The unemployment rate is forecast at 3.9% for 2018 and 3.6% for 2019 (currently at 4.0).[2] We anticipate wage increases to be the next data point to indicate that the US economy is reaching full capacity and inflation will inevitably follow, although should be mitigated by the Feds planned rate hikes. It is worth noting that wage increases will not be the only data point the Fed focuses on and may change their path of US policy normalization based on any one of the global macro narratives that pose a threat to continued US expansion.



[3]Source: 2018 Bloomberg Finance L.P.

CORPORATE EARNINGS & GDP

We believe strong corporate earnings will be the driving force behind the next move higher in markets now that other themes, as mentioned previously, have subsided. Additionally, US Real GDP growth is forecast at 2.9% and 2.4% for 2018 and 2019 respectively, and S&P 500 earnings are forecasted to be up 20% for 2018, and 10% for the next 2 years.[4]

[5] *Source: 2018 Bloomberg Finance L.P.*

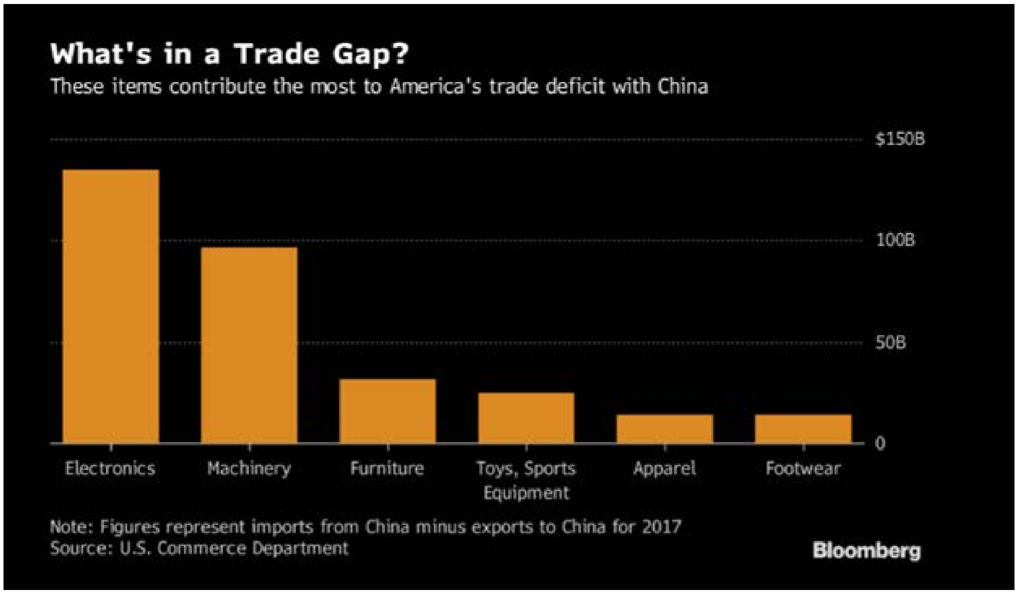
Note, Bank of America recently revised their 2019 S&P 500 earnings estimates to $170, which is slightly higher than the 10% growth expected based on average consensus (consensus is $159.78 this year). As we have addressed in previous newsletters, the Forward Operating Price to Earnings (FOPE) is currently at 16.76 vs. the 30-year average of 17.86, which is down in the last few quarters due to continued strong operating earnings growth.

TAX CUTS

Another tailwind that we believe has been greatly understated is the recent tax cuts. The revamped US tax code was a significant win for corporate cash flows and valuations, and this alone in our opinion could offset the negative effects of a potential trade war. Furthermore, President Trump shows no sings of slowing down when it comes to his campaign promises. The administration will also look to push other policies during the coming quarters, such as a major infrastructure spending package and possibly additional tax cuts focused on helping individual taxpayers, each of which could further advance the economy in the near term.

HEADWINDS

As stated on page 1, we believe a full-blown trade war, in our opinion, is a low probability event. That said, we believe the possibility of a trade war is an important issue that should not be ignored and one that we continue to monitor very closely. Potential trade issues have already begun to have effects. The Federal Open Market Committee (FOMC) June meeting minutes indicated that some businesses have already scaled back or postponed planned capital spending due to uncertainty over trade policy.[6] Yet, according to Brian Westbury, Chief Economist at First Trust Advisors L.P., the US administration's trade deal agenda is valid and needed. As evidence, Chinese tariffs on global imports averaged 9.9%, while the US averaged a mere 3.5%.[7] China has retaliated against the US imposed tariffs, however the fallout to date even among the most exposed sectors (Technology, Consumer Discretionary, Energy, and Materials) has been limited. In fact, technology companies that rely heavily on Chinese plants to manufacture their products, have traded sideways since reaching new highs in June, and data suggests the sector will probably show a 31% earnings growth rate in the 2Q.[8]



[8] *Source: 2018 Bloomberg Finance L.P.*

Access to the largest economy in the world will provide the Trump administration with leverage to halt unfair trade practices, including currency manipulation, product dumping, intellectual property theft and economic espionage. Furthermore, if economic leverage helps bring parties to the table and diffuses critical geopolitical tensions, a contained and temporary tariff skirmish could prove worthy of the economic cost.

The best case is that this skirmish remains just that, a skirmish, and does not escalate to a full global trade war between two or three of the world's largest economies (US, China and Europe). But again, we must look at the worst case scenario and position ourselves accordingly, as well as, be prepared for any scenario that may come about. If the administration continues to push its agenda heavily on other economies of scale, and the US raises import costs by 10% thereby leading the rest of the world to retaliate and raise tariffs on US exports, the cost by 2020 could be 0.5% of global GDP according to Bloomberg economists. This would push global aggregate GDP to about 2.7% (based on estimates) which would be the lowest global GDP on record since 2001.[9] A .5% hit to global GDP could, in our opinion, cause global markets to enter a recession. Keep in mind, we have seen global trade wars worse than the current scenario discussed. This worst case scenario would however, most likely result in a deeper US stock market correction than "normal."

INTERNATIONAL

International equity markets lagged US markets during the second quarter. Despite the underperformance, we reiterate our positive outlook on the space. In the short term, contributing to the underperformance was volatility from geopolitical events, paired with disappointing and weaker economic data from the Eurozone political and trade war concerns. We recently started to see a pick-up in Eurozone economic data, and while the trajectory of the regions stocks will depend on developments in trade, politics and corporate earnings, this will remove at least one major overhang weighing on sentiment. With European Central Bank (ECB) President, Mario Draghi, announcing in mid-June that the ECB will end their Bond Buying Program by January of 2019 (originally tapering from €30 billion a month through September and then reducing to €15 billion a month through the end of December if data is in line with inflation outlook) and furthermore saying the ECB will not raise rates through at least Summer of 2019 will ultimately lead to the start of policy normalization[10]. We anticipate the ECB to follow the path of the US Fed and evaluate economic data on a go-forward basis, while taking into account any macro-economic developments. While current ambiguity and uncertainty surround their rate hike plan, we believe this will dissipate in time and they will follow the framework of the US (given the positive outcome) and lay out exactly what datapoints need to be met in order to raise rates.

With Chinese companies coming under fire for most of the year due to the ongoing trade dispute with the US, slowing economic growth and the weakening Yuan, valuations have recently touched lows not seen since 2015 and 2016. While investors may have been reluctant to jump in head first in 2015 and 2016, the Chinese benchmark index has rallied from bear market levels. Additionally, while many have been concerned about a devaluation of the Yuan (part of their tactic concerning the trade war) Chinese officials have insisted they are in favor of a "basically" stable Yuan and that the recent move lower is market driven and not that of the central bank. Slowing growth continues to be a point of concern, as well as the ongoing trade dispute. Given the attractiveness of company valuations, however we believe there are pockets of value in the emerging market space.

OUTLOOK

Although there have been rare instances of market corrections without a recession, most major corrections are caused by recession, price bubbles or structural/debt problems. We do not expect a major correction at this time, but we are watching events closely. We remain confident and positive on equity markets, both domestic and non-US moving forward. The investment committee is monitoring global economic developments closely to assess the risks and rewards of each situation in relation to our investment process. As we stated earlier this year, we anticipate that there will be volatility spikes from time to time, however from a fundamental standpoint the investment landscape remains favorable and we remain optimistic given the current data.

THANK YOU!

Investment Committee

IMPORTANT INFORMATION

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. The economic forecasts set forth above may not develop as predicted and there can be no guarantee that strategies promoted will be successful. All performance referenced is historical and is no guarantee of future results. No strategy including asset allocation assures success or protects against loss. All indices are unmanaged and may not be invested into directly.

Stock investing involves risk including loss of principal. Value investments can perform differently from the markets as a whole. They can remain undervalued by the market for long periods of time.

International and emerging market investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

The Standard & Poor's 500 index is a market capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

The MSCI World ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries--excluding the United States. With over 1,000 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. The CBOE Volatility Index® (VIX®) is meant to be forward looking, showing the market's expectation of 30-day volatility in either direction, and is considered by many to be a barometer of investor sentiment and market volatility, commonly referred to as "Investor Fear Gauge".

The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the Nasdaq. Price-weighted means stocks with higher share prices are given a greater weight in the index. The DJIA is a stock market index that shows how 30 large, publicly owned companies based in the United States have traded during a standard trading session in the stock market. The value of the Dow is not a weighted arithmetic mean and does not represent its component companies' market capitalization, but rather the sum of the price of one share of stock for each component company.

The Russell 1000 Index is a market capitalization weighted stock market index that tracks the highest-ranking 1,000 stocks in the Russell 3000 Index, which represent about 90% of the total market capitalization of that index. The Russell 1000 is a subset of the Russell 3000 Index. It represents the top companies by market capitalization. The Russell 1000 typically comprises approximately 90% of the total market capitalization of all listed U.S. stocks. The Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Index consists of the following developed country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the UK.

The Bloomberg Barclays U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds.

The Bloomberg Barclays U.S Corporate High-Yield Bond Index is an unmanaged market value weighted index composed of fixed-rate, publicly issued, non-investment grade debt.

The Alerian MLP Index is the leading gauge of energy Master Limited Partnerships (MLPs). The capped, float-adjusted, capitalization-weighted index, whose constituents represent approximately 85% of total float-adjusted market capitalization, is disseminated real-time on a price-return basis (AMZ) and on a total-return basis (AMZX).

IMPORTANT INFORMATION

[1] 2018 Bloomberg Finance L.P.

[2] 2018 Bloomberg Bureau of Labor Statistics

[3] 2018 Bloomberg Finance L.P.

[4] 2018 Bloomberg Finance L.P.

[5] 2018 Bloomberg Finance L.P.

[6] FOMC Meeting Notes – June, 2018

[7] World Trade Organization (WTO) First Trust Monday Morning Outlook, “No More Kid Gloves”, June 25, 2018

[8] 2018 Bloomberg Finance L.P.

[9] 2018 Bloomberg Finance L.P., Bloomberg Economics, “How bad could it get?-Counting the cost of global trade war”

[10] 2018 Bloomberg Finance L.P.