2018 Capital Markets Review

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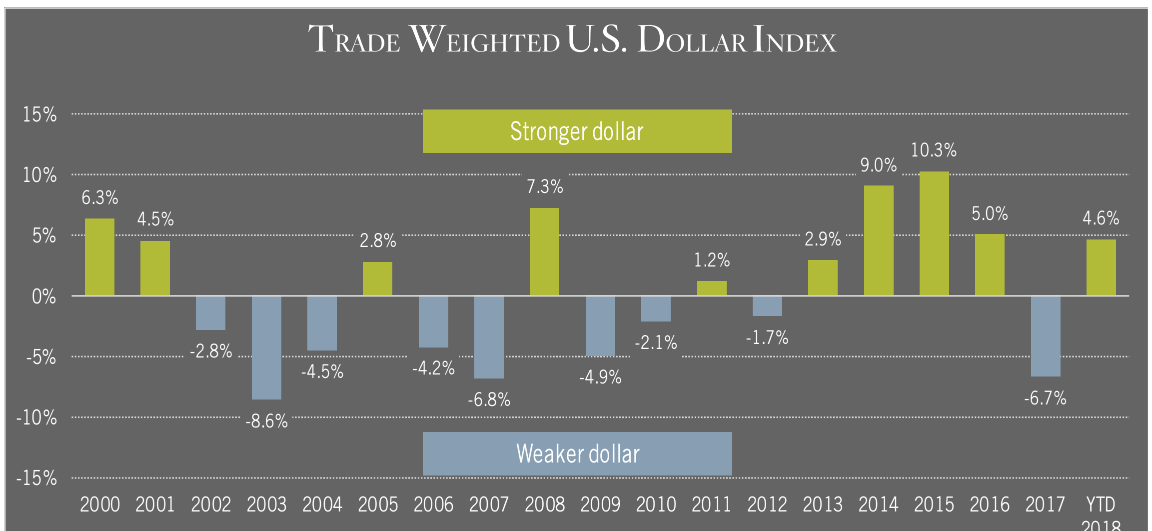
U.$. Dominance

The Trade-weighted U.S. dollar index was established to measure the value of the U.S. dollar relative to other currencies. For U.S. investors investing outside the United States, the index represents a critical macro driver of short-term results as currency moves can either contribute to (weakening U.S. dollar) or detract from (strengthening U.S. dollar) the investment results of foreign investments.



Source: St. Louis Fed, Welch Hornsby, Inc.

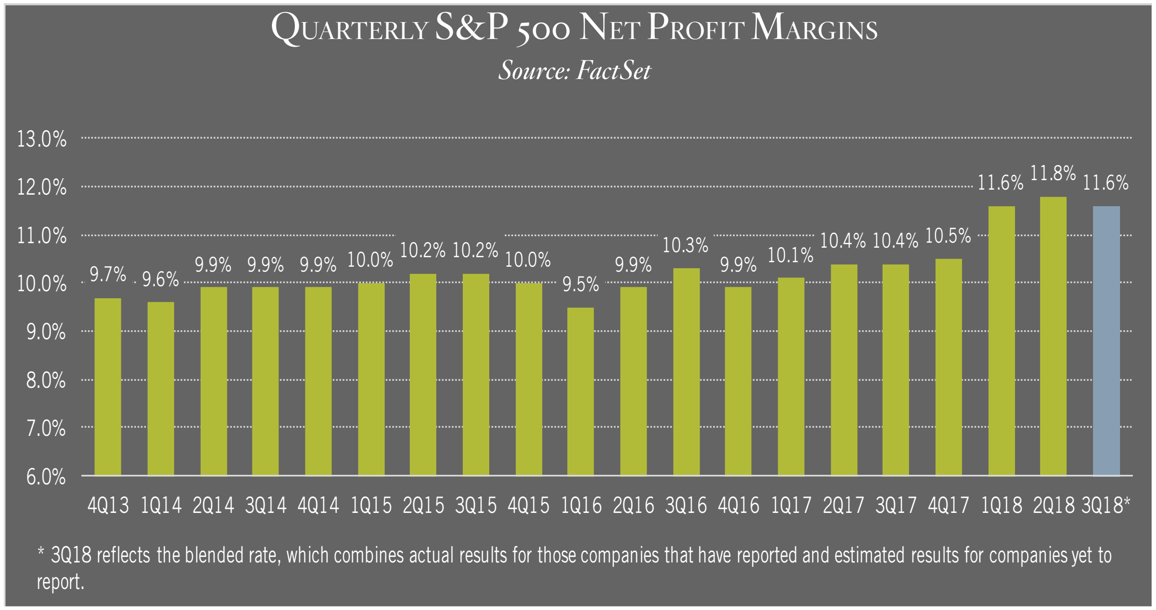
The U.S. dollar has climbed six consecutive months, gaining 4.6% year-to-date through September 30th. This currency headwind has weighed heavily on non-U.S. assets, continuing a longer-term trend which began in 2013. Over this period, the cumulative appreciation by the trade-weighted U.S. dollar index has been nearly 27%, resulting in a dollar dominated investment environment.

After experiencing a bout of weakness in 2017 fueled by a global growth recovery, many experts predicted the dollar would decline further in 2018. However, as foreign economies have softened in 2018, the U.S. economy has strengthened, enabling the Federal Reserve to continue their rate normalization process, further widening the monetary policy gap between the U.S. and other developed markets. The diverging growth and policy paths, combined with global trade tensions, have been, and will likely continue to be, supportive for the dollar, but concerns are growing louder. An overly strong dollar could eventually hurt U.S. companies as exports become prohibitively expensive and/or earnings come under pressure as foreign revenues are worth less when translated back into dollars.

Notwithstanding these headwinds and ongoing concerns, the only pressure on U.S. earnings in 2018 has been upward pressure, providing a strong catalyst for U.S. stock market gains, especially during the third quarter. A closer look at the third quarter capital market environment follows:

Developed Equity Market Review

The S&P 500 posted its best quarterly result since the final quarter of 2013, climbing 7.7%. According to FactSet, the year-over-year earnings



Quarterly S&P 500 Net Profit Margins

Source: FactSet

* 3Q18 reflects the blended rate, which combines actual results for those companies that have reported and estimated results for companies yet to report.

growth rate for second quarter earnings was 25% (99% of the companies reporting). Of those reporting, 80% of companies exceeded estimates, marking the highest percentage of positive surprises since FactSet began tracking this metric in Q3 2008. Looking forward, third quarter earnings growth estimates are modestly lower, but expectations are high that the S&P will post its third straight quarter of 20%+ year-over-year earnings growth.

Contributing to the positive earnings results has been rising profit margins, propelled by many factors, including corporate tax reform. Net profit margins have exceeded 11% each quarter during 2018 marking the highest levels in over a decade.

Reviewing sector results, all eleven sectors advanced during the quarter. Leading the way was the Health Care sector, which gained 14.5% as shares of pharmaceutical companies soared. Another strong performer was the newly created Communication Services sector. The new sector represents approximately 10% of the S&P 500 and includes names such as Facebook, Alphabet, Twitter, Netflix and Walt Disney. For the quarter, the sector climbed 9.9% with every company in the sector reporting a positive earnings-per-share surprise. On the opposite end of the spectrum, the Real Estate, Energy and Materials sectors lagged, advancing less than 1% during the period.

From a style and capitalization standpoint, the growth style continued its momentum during the quarter, outpacing its value counterparts by more than 3.5% across the capitalization spectrum. Year-to-date, the growth advantage has been dramatic, exceeding 13% within the large cap space.

Outside of the U.S., developed equity markets climbed 2.4%; however, the currency headwind negated a portion of this return, netting U.S. dollar investors 1.4%, as measured by the MSCI EAFE Index ($). Results were strongest in Japan as economic activity has strengthened. Banks across Japan continued to expand credit and employment metrics approached historic levels. According to a recent release from JP Morgan, the current level of jobs available per applicant has not been this high since 1974.

Capitalization and Style Performance

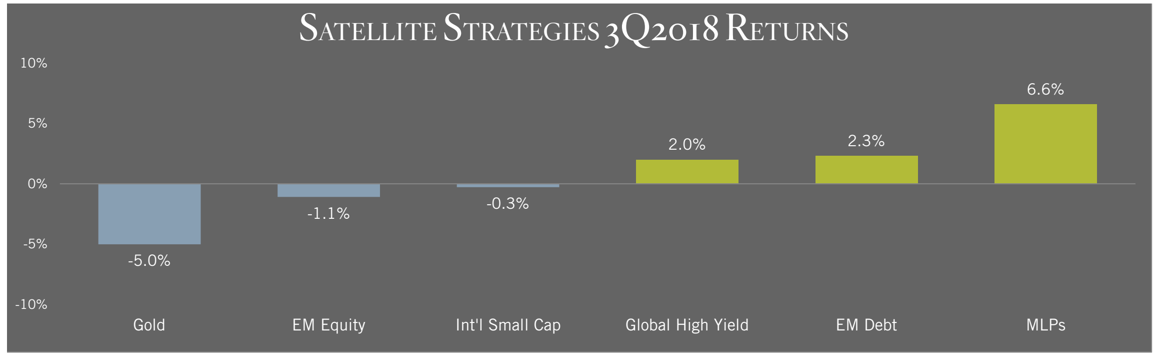
		Value	Core	Growth
Large	3Q 2018	5.7%	7.4%	9.2%
	2018 YTD	3.9%	10.5%	17.1%
Mid	3Q 2018	3.3%	5.0%	7.6%
	2018 YTD	3.1%	7.5%	13.4%
Small	3Q 2018	1.6%	3.6%	5.5%
	2018 YTD	7.1%	11.5%	15.8%

Source: Morningstar Direct, Russell Indices

Across Europe, results were mixed as economic data continued to trend downward. European Central Bank president Mario Draghi points to trade uncertainty as the primary contributor to slowing Eurozone economic activity, but feels it is only a temporary setback.

Fixed Income Review

The Federal Reserve continued to follow-through with its rate normalization program, raising the benchmark overnight lending rate by 0.25% to a range of 2.00% - 2.25%. This marked the third increase in 2018 and expectations continue to rise of an additional hike in December. The yield curve shifted higher as rates climbed across all maturities, putting downward pressure on Treasury prices. Economic strength, the catalyst behind higher interest rates, lifted other areas of the investment grade bond market, resulting in narrowing credit spreads. The cumulative impact of rising Treasury yields and narrowing credit spreads was an investment-grade bond market that ended the quarter basically flat, as measured by the Barclays Bloomberg Aggregate Bond Index. Outside the taxable bond market, tax-exempt bonds were also pressured by rising interest rates, resulting in increasing losses as you moved out on the maturity spectrum.



Source: Morningstar Direct, Welch Hornsby, Inc. - Emerging Mkt Equity: MSCI EM Index ($); Global High Yield: Barclays Global High Yield TR ($); MLPs - Alerian MLP TR ($); Emerging Market Debt - JPM EMBI Global Diversified TR ($); Int'l Small Cap: S&P Developed Ex US Small TR ($); Gold - S&P GSCI Gold ($)

Satellite Strategies

As the dollar has climbed, Gold prices have fallen. For the quarter, the S&P GSCI Gold index declined 5%, bringing its year-to-date return down to -9.4%. Emerging markets have also been under pressure as currency and trade concerns have raised questions about potential structural vulnerabilities. China continues to be the headline concern as many EM countries depend on Chinese demand for growth. For the quarter, Emerging equity markets were down 1.1%. On the positive side, MLPs had another strong quarter, buoyed by solid operating results.

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