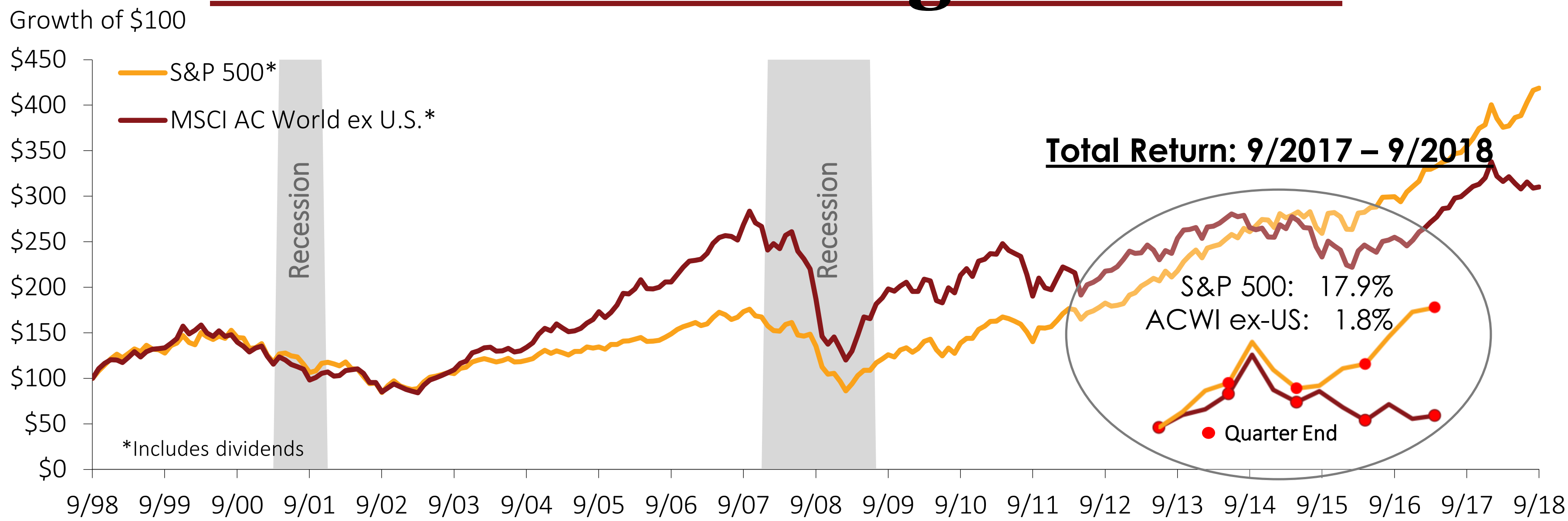
Capital Market Review

September 30, 2018

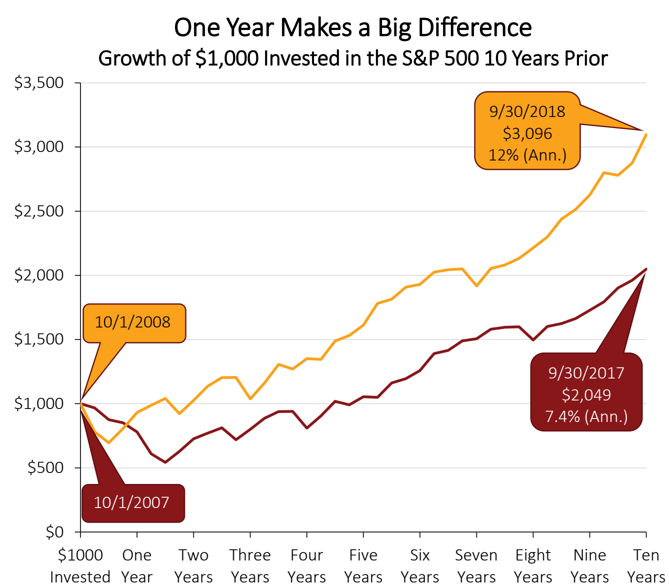



DeMarche

Global Divergence

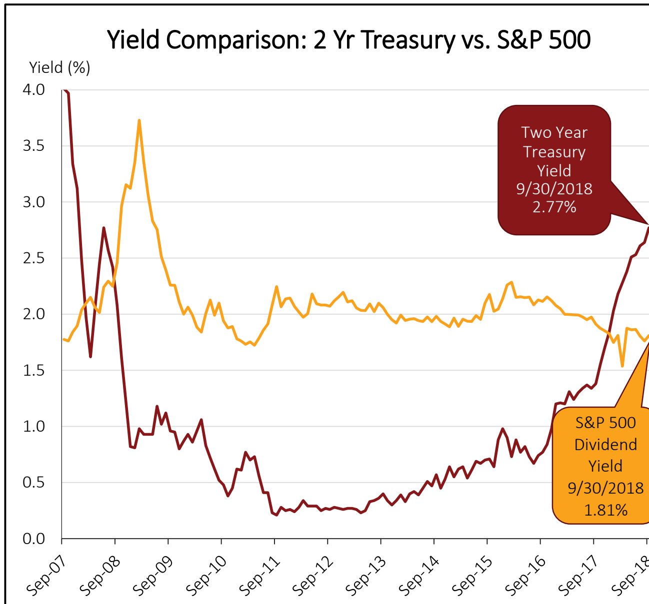


Source: Standard & Poor's, MSCI



Source: Standard & Poor's, DeMarche Associates, Inc.

The solid and growing U.S. economy fueled another strong quarter of domestic stock market returns, outpacing international returns again this quarter. Consequently, interest rates increased as expected, driving the 2-year Treasury yield above the S&P 500 dividend rate by a margin not seen since before the market crash of 2008. This event gives investors the chance to earn a rate of return without taking much risk and suggests that expected returns on domestic stocks could be constrained. Speaking of 2008, a year ago, 10-year returns were modest for the S&P 500 which posted an annualized 7.4% return from October 2007 to September 2017. Fast forward to the end of September 2018, and the 10-year S&P 500 annualized return is 12.0%.



Source: Standard & Poor's, Federal Reserve

Broad Market Overview

September 30, 2018

INDEX	3rd Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
MSCI World	5.0	5.4	11.2	13.5	9.3	8.6
DeMarche World*	4.0	3.5	8.6	13.1	8.4	8.2
DeMarche 3000	5.9	7.6	13.9	15.3	10.9	9.8
Russell 3000	7.1	10.6	17.6	17.1	13.5	12.0
S&P 500	7.7	10.6	17.9	17.3	13.9	12.0
DeMarche International	1.6	-1.6	2.2	9.6	5.6	6.3
MSCI EAFE USD	1.4	-1.4	2.7	9.2	4.4	5.4
BlmBarc Aggregate	0.0	-1.6	-1.2	1.3	2.2	3.8
FTSE Non-US Gov't Bond	-2.2	-3.1	-1.6	2.4	-0.2	2.0
BlmBarc Global Aggregate	-0.9	-2.4	-1.3	2.0	0.8	2.9
NCREIF (Private RE)	1.7	5.3	7.2	7.8	9.6	6.4
Bloomberg Commodity	-2.0	-2.0	2.6	-0.1	-7.2	-6.2

*Notes: Data are presented as percent returns. All 3, 5 and 10-year returns are annualized. *Does not include Canada or Brazil.*

Indicator Year Ending 9/30	2018	2017	2016	2015	50 Year Average
GDP Annual Growth Rate	3.0	2.3	1.5	2.4	2.8
Unemployment	3.7	4.2	4.9	5.1	6.2
Inflation (CPI)	2.3	2.2	1.5	0.0	4.1
10-Year Interest Rates	3.1	2.3	1.6	2.1	6.4

Asset Class Performance in Times of Rising Interest Rates

Period (End of Month)	10-Year Treasury Rate	All Returns are Cumulative (Not Annualized) S&P 500	MSCI EAFE	MSCI Emerging Markets	BofAML US High Yield	Bloomberg Barclays Aggregate	Bloomberg Commodities	MSCI US REIT
8/2005 – 6/2006	4.0 – 5.2	5.7	19.8	25.5	2.7	-1.2	5.1	16.1
12/2008 – 5/2009	2.3 – 3.5	3.0	8.6	37.9	25.3	1.3	6.6	-9.5
9/2010 – 1/2011	2.5 – 3.4	13.4	9.1	4.4	5.1	-1.2	17.0	11.0
4/2013 – 8/2013	1.7 – 2.8	3.0	-2.2	-9.4	-2.0	-3.7	-2.4	-13.4
6/2016 – 12/2016	1.5 – 2.5	7.8	5.7	4.5	7.5	-2.5	-1.3	-3.9
8/2017 – 9/2018	2.1 – 3.1	11.0	5.2	4.2	1.0	-1.6	8.3	3.6
	Average	5.6	6.5	13.3	5.5	-1.8	5.1	2.9

Source: DeMarche Associates, Inc. Data are presented as percent.

- The markets continued to exhibit a divergence in the third quarter. U.S. stocks surged as trade concerns waned and economic growth powered on. Large cap stocks responded positively on the U.S.-Mexico NAFTA trade negotiation at the end of August.
- International stocks posted positive returns (reversing the second quarter) but lagged domestic stock returns as concerns about overseas economic growth continued. International growth had been expected to be above 2.5% at end of 2017, but has posted closer to 2.0% growth so far this year and is now expected to trend at the 2.0% rate for the coming year, per the Organisation for Economic Co-operation and Development.
- Bonds continue their struggle against rising interest rates. The 10-year Treasury closed the quarter above 3% and the Fed raised interest rates once again. Bonds, as measured by the Bloomberg Barclays Aggregate, generated a small positive return of 2 basis points in the face of rising rates, breaking a run of two negative quarters. Only one time in its history has the index been negative three quarters in a row, from July 1979 through March 1980.
- Bloomberg Commodity declined on falling prices for precious metals and agricultural goods. However, oil and natural gas prices increased in the quarter on stronger demand from global growth and on concerns about Venezuela's economic collapse and OPEC supply cuts.
- Interestingly, rising rates are not a death knell for stock markets. Traditionally, rising rates signal strong economic growth. Investment grade bonds suffer (and to some extent high yield bonds also) as interest rates hurt bond prices.

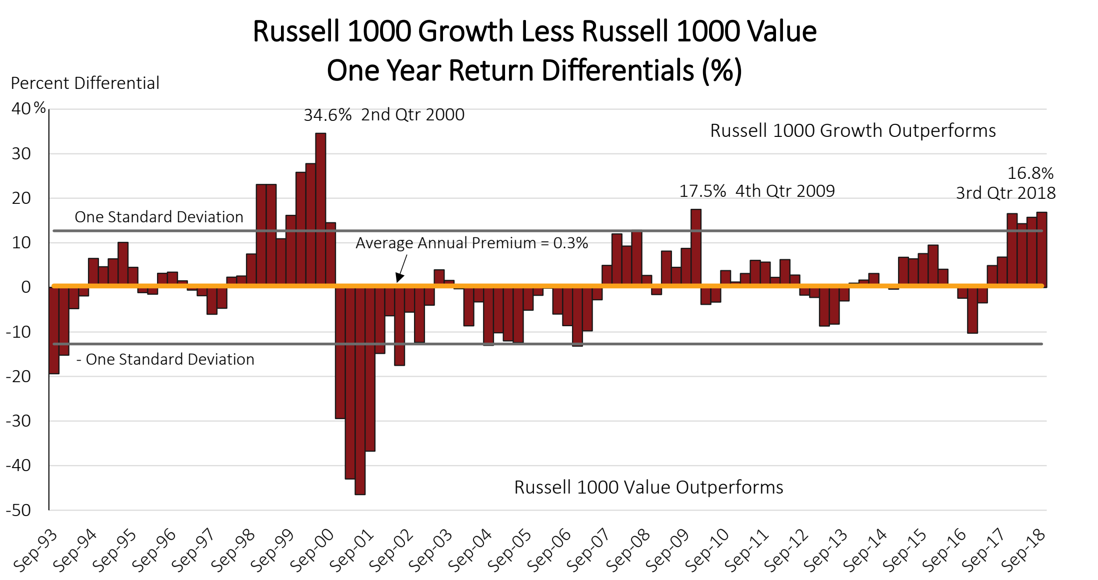
DeFact

Ten years ago in September 2008, the collapse of the investment bank Lehman Brothers traumatized Wall Street. With heavy investments in subprime mortgages triggering billions in losses, Lehman filed bankruptcy on September 15, 2008, at that point the largest such filing in U.S. history. Soon, Merrill Lynch was forced to sell itself, and FNMA and FHLMC were placed into conservatorship.

~ Fox Business

INDEX	3rd Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
DeMarche Growth	7.2	12.1	19.7	18.0	14.0	11.6
DeMarche Value	4.0	1.6	6.3	11.8	6.9	7.5
DeMarche Aggressive	2.7	7.6	12.8	13.4	6.7	9.2
DeMarche Defensive	6.2	7.7	14.0	15.5	11.3	9.7
DeMarche Large Cap	6.8	8.3	14.7	15.3	11.1	9.2
Large Cap Growth	8.2	13.7	21.8	18.9	14.9	11.4
Large Cap Value	4.7	1.4	5.7	11.0	6.5	6.4
DeMarche Small Cap	-0.8	7.7	10.2	17.8	10.0	11.6
Small Cap Growth	-0.6	8.1	9.1	16.0	9.8	10.8
Small Cap Value	-0.9	7.4	11.1	19.1	10.1	12.1
S&P 500	7.7	10.6	17.9	17.3	13.9	12.0
S&P Mid-Cap 400	3.9	7.5	14.2	15.7	11.9	12.5
S&P Small-Cap 600	4.7	14.5	19.1	19.4	13.3	12.9
Russell 1000	7.4	10.5	17.8	17.1	13.7	12.1
Russell 1000 Growth	9.2	17.1	26.3	20.6	16.6	14.3
Russell 1000 Value	5.7	3.9	9.5	13.6	10.7	9.8
Russell 2000	3.6	11.5	15.2	17.1	11.1	11.1
Russell 2000 Growth	5.5	15.8	21.1	18.0	12.1	12.7
Russell 2000 Value	1.6	7.1	9.3	16.1	9.9	9.5

Notes: Data are presented as percent returns. All 3, 5 and 10-year returns are annualized.



Source: DeMarche Associates, Inc.

- Large cap growth stocks continued to outperform large cap value during the quarter. The one-year 16.8% dispersion between growth and value, as measured by the Russell 1000, is as wide as it has been since 2009. This quarter the leading sector in the index was not technology but healthcare (primarily healthcare providers and medical device makers).

- Small cap trailed large cap for the quarter and now trails for the past year. The dispersion between the Russell 2000 growth and value, while notable, is not as wide as the growth/value dispersion in large cap stocks. The primary driver in small cap stocks has been biotech, in addition to medical devices. Small cap value stocks were weighed down by financials, a 28% weight in the index.

- Aggressive stocks, which are characterized as more highly levered and cyclical, had been outperforming defensive stocks during the year. That trend changed in the third quarter as larger, more stable, quality stocks rebounded due to concerns about interest rates and inflation.

- The 25 year chart to the left shows the extent to which growth stocks and value stocks trade leadership. Since the technology crash of the early 2000's to the global financial crisis of 2008, value stocks held their own and in many time periods significantly led growth stocks. Since then, growth has led the way. Interestingly, over the entire time period of wide swings and long periods of outperformance by growth or by value, the average premium of growth has been only 30 basis points.

DeFact

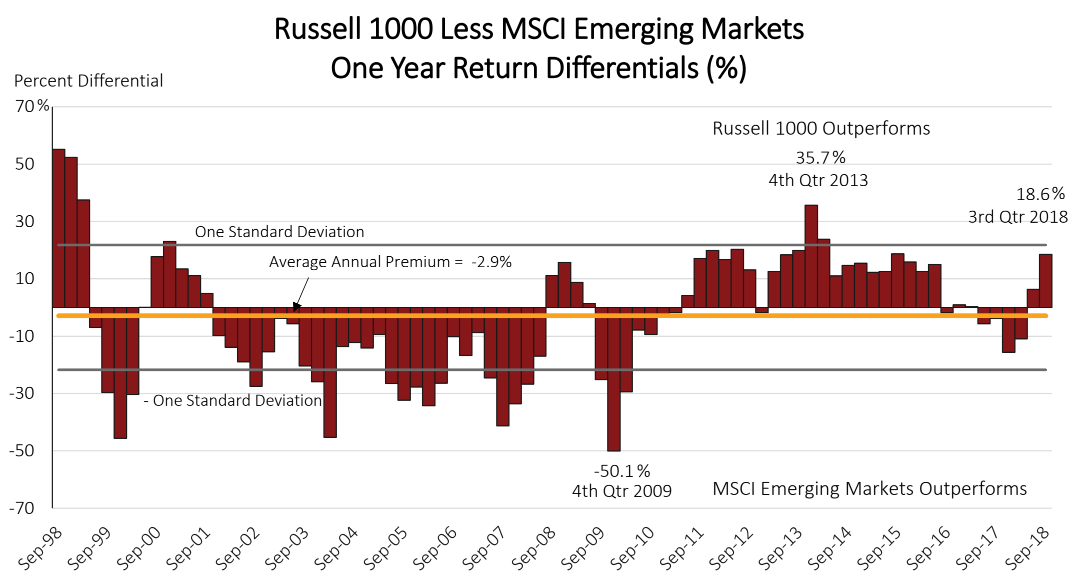
The S&P 500 Global Industry Classification Standard (GICS) replaced the Telecom sector with the more robust Communication Services sector, effective September 28. Notable names that changed sectors and moved to Communication Services are Alphabet and Facebook (from technology) and Netflix, Comcast and Disney (from consumer discretionary). The weight of the new Communication Services sector in the S&P 500 is about 10%, up from Telecom's weight of 1.9% at the end of August. Roughly $1.9 trillion in market cap changed classifications overnight.

~ Bespoke Investment Group

International Equities

INDEX	3rd Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
DeMarche Int'l	1.6	-1.6	2.2	9.6	5.6	6.3
Growth	0.4	-1.8	1.6	8.6	5.2	6.3
Value	3.0	-0.8	3.7	11.2	5.3	5.9
DeMarche Int'l Small Cap	-1.6	-6.2	-3.7	9.1	5.4	9.3
DeMarche EM	-1.5	-10.7	-3.5	7.8	4.3	5.3
MSCI EAFE Local	2.4	1.4	5.1	9.4	7.9	6.7
MSCI EAFE USD	1.4	-1.4	2.7	9.2	4.4	5.4
Growth	1.5	0.6	5.8	10.3	5.6	6.2
Value	1.2	-3.5	-0.4	8.1	3.1	4.5
MSCI Japan	3.7	1.6	10.2	12.1	6.8	6.0
MSCI AC Asia-ex Japan	-1.6	-6.3	1.5	13.3	6.6	8.4
MSCI Germany	-0.6	-7.9	-5.4	9.2	3.8	4.9
MSCI France	2.8	2.7	4.2	12.1	5.8	4.8
MSCI UK	-1.7	-2.7	2.9	6.2	2.2	4.9
MSCI EAFE Small Cap	-0.9	-2.2	3.7	12.4	8.0	9.7
MSCI EM	-1.1	-7.7	-0.8	12.4	3.6	5.4
MSCI All Country-ex US	0.7	-3.1	1.8	10.0	4.1	5.2

Notes: Data are presented as percent returns. All 3, 5 and 10-year returns are annualized.



Source: DeMarche Associates, Inc.

- The dollar strengthened during the quarter, negatively impacting international returns when expressed in dollars. It appears that slower growth in Europe has taken root this year, and stocks are struggling to gain a foothold. Over the past three years, the dollar has traded within a range against other developed market currencies, gaining and losing strength. The result is that three-year returns in U.S. dollars are very close to returns expressed in local currencies.

- Emerging market stocks also suffered a negative quarter and are now negative for the trailing 12 months. While trade concerns moderated with Mexico, whose market rebounded significantly during the quarter, trade concerns with China have been front and center. Chinese stocks, the largest weight in the index at about 30%, fell over 7% during the quarter. Korean, Taiwanese and Indian stocks, which together make up about 35% of the MSCI Emerging Markets index, all outperformed Chinese stocks in the same period.

- Asian stocks (ex-Japan) show underperformance compared to emerging markets in total during the quarter. Chinese stocks have underperformed broader Asian stocks in the short term. However, over longer time periods, Asian stocks have outperformed broader emerging markets.

- The chart to the left shows the relative performance of emerging market stocks versus domestic stocks over the past 20 years. In 2008, the U.S. was the first market to get hit by the financial crisis but was also the first to start recovering, ahead of other nations. Coupled with a stronger dollar (and strong U.S. growth) and trade tensions, the divergence of returns between the U.S. and emerging countries has exacerbated. However, over the longer history, emerging markets on average outperform by 2.9% annually. This suggests a period of emerging markets outperformance in the future, normalizing the recent dispersion between the two.

DeFact

The world's middle class now totals 3.7 billion people or about 48% of the world's population. More than half of the global population should be in the middle class by 2020. The growth in the middle class will be centered in China and India, which expect their middle class to grow to over 70% of their population over the next decade.

~ JP Morgan, Brookings Institution

INDEX	3rd Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
BlmBarc 1-3 Gov Credit	0.3	0.4	0.2	0.7	0.8	1.7
BlmBarc Aggregate	0.0	-1.6	-1.2	1.3	2.2	3.8
BlmBarc Gov Credit Long	-0.5	-5.4	-2.7	3.4	5.2	7.1
BlmBarc US TIPS	-0.8	-0.8	0.4	2.0	1.4	3.3
Merrill Lynch High Yield	2.4	2.5	2.9	8.2	5.5	9.3
CSFB Leveraged Loan (bank loans)	1.9	4.4	5.6	5.4	4.4	5.8
BlmBarc Global Aggregate	-0.9	-2.4	-1.3	2.0	0.8	2.9
JPM EmgMkt Bd Glbl Dvrsfd (hard)	2.3	-3.0	-1.9	6.0	5.4	7.5

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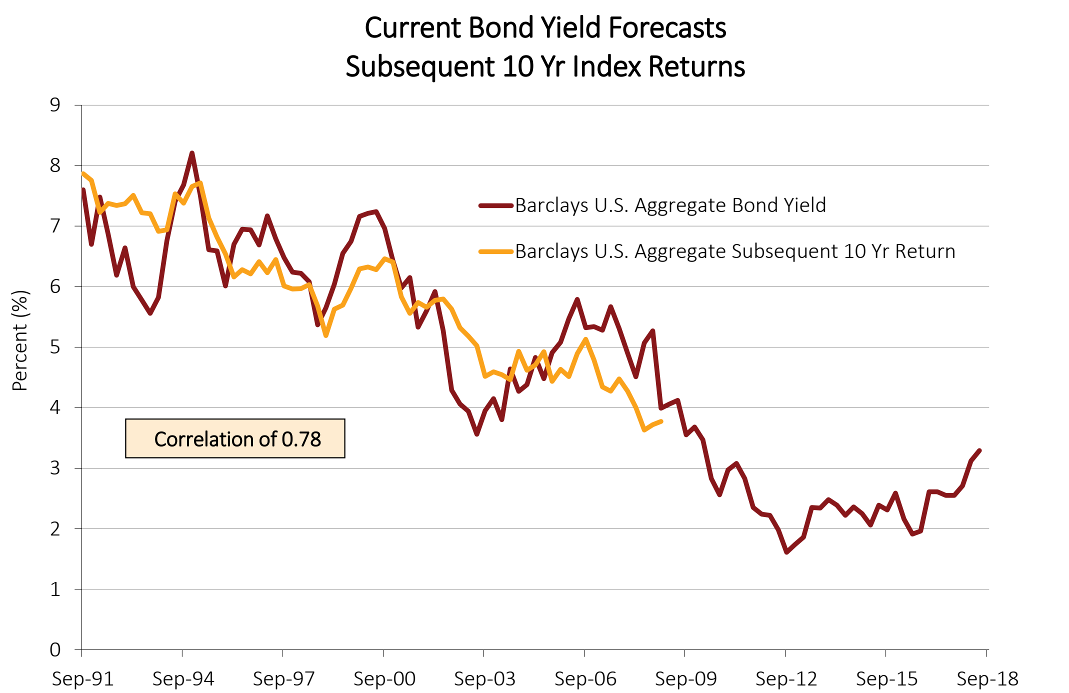


Source: DeMarche Associates, Inc.

- As interest rates increased across the yield curve during the quarter, bond prices fell. The incremental yield provided from the credit spread cushioned returns of corporate bonds against interest rate increases. Higher quality bonds have tighter spreads to Treasuries, so their coupon return was not enough to cushion against price declines. The Aggregate Index posted a flat return for the quarter as the price decline offset the approximate 3.5% yield on the index.
- High yield bonds posted a positive quarter, as the yield on the index is about 6.2%. Credit spreads versus the Treasury curve are historically tight at about 350 basis points, the narrowest point since before the Great Recession. The long-term average is closer to 580 basis points. High yield bonds typically have a shorter duration than higher quality bonds in the Aggregate index and will be less negatively impacted by increasing interest rates. Defaults also ticked down (per JP Morgan) to 1.8% for the trailing 12 months.
- Bank loans, which possess floating rate coupons, posted another positive quarter and strong annual returns, outpacing all other bond sectors as shown on the table. Defaults also remain low and are expected to remain low for the near future (per JP Morgan).
- The chart to the left shows how closely 10-year bond returns track current yields. If the trend holds, 10-year bond returns, as measured by the Bloomberg Barclays Aggregate, will be about 3% annualized. The upward movement in interest rates the past two years suggests that the lower returns of 2% through 2012 to 2016 are behind us.

DeFact

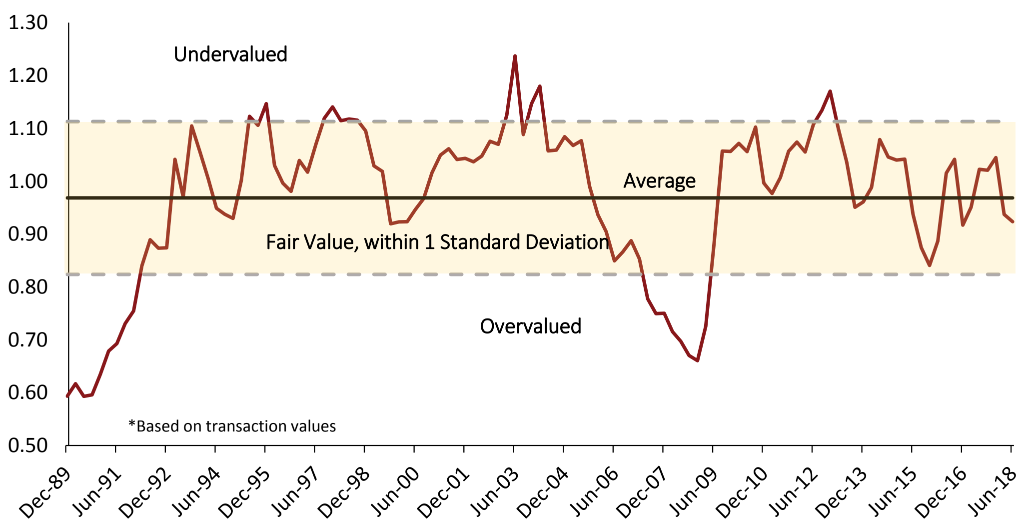
In the U.S., almost 40% of all nonfinancial corporate bonds are now rated BBB, up from 31% in 2000. The face amount of those outstanding bonds is $1.9 trillion, more than twice that of the high yield market. Including financial companies, the amount jumps up to almost $3 trillion. The reasoning behind this increase is that companies have found it advantageous to issue debt in this low interest rate environment to finance share repurchase programs and, more recently, pay for mergers.

~ The Economist, McKinsey Global Institute

INDEX	3rd Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
NCREIF Property (Private RE)	1.7	5.3	7.2	7.8	9.6	6.4
Apartment	1.6	4.7	6.4	7.0	8.6	6.4
Industrial	3.4	10.5	14.2	13.1	13.5	8.0
Office	1.7	5.1	6.8	6.7	8.7	5.2
Retail	0.6	2.6	3.9	7.0	9.6	7.6
NAREIT (Public RE)*	0.7	1.8	4.2	9.2	9.7	8.1
NCREIF Timberland	1.0	2.4	4.0	3.5	6.0	4.0
HFR FOF Composite	0.3	1.0	3.1	3.3	3.2	2.6
Conservative	0.9	2.6	3.8	2.9	3.0	2.2
Diversified	0.6	1.4	3.5	3.0	3.2	2.6
Strategic	-0.4	-0.1	2.4	4.1	3.4	2.9
Bloomberg Commodity	-2.0	-2.0	2.6	-0.1	-7.2	-6.2

Notes: Data are presented as percent returns. All 3, 5 and 10-year returns are annualized.
**Public RE is not a less liquid strategy. It is listed for comparative purposes.*

Ratio of Real Estate Capitalization Rates* to Baa Corporate Bonds



Sources: National Council of Real Estate Fiduciaries (NCREIF), St. Louis Federal Reserve, Prudential, DeMarche Associates, Inc.

- Commodity prices headed lower during the quarter, primarily on precious metals and agricultural goods. Soybean exports to China dropped by $1 billion or 28% during the quarter (due to tariffs) causing prices to fall to a 10-year low. Both gold and silver fell during the quarter as the dollar strengthened. The price of precious metals are denominated in dollars and as the dollar strengthens, they become more expensive for international purchasers.

- For REITs, rising rates have been a headwind much of the past year. The recent surge of the 10-year Treasury yield to above 3% sent REITs lower during the last days of the third quarter.

- Hedge funds posted divergent returns for the quarter. Global markets were mixed due to interest rate and trade concerns. Conservative strategies came out ahead, while directional or strategic strategies were held back by stock exposure in emerging markets.

- Even with an increase in interest rates, real estate cap rates have only nominally been impacted. A cap rate is the measure of income a property generates compared to its market value. An investor seeks a return on real estate that is comparable to bonds as a yield alternative. Currently real estate looks to be fairly priced when compared to the yield of Baa bonds.

DeFact

U.S. crude oil prices rose to their first multiyear high since November 2014. West Texas Intermediate climbed to over $75 a barrel. Brent also reached a four-year high at almost $85 a barrel. The $10 gap between the two benchmarks is due to U.S. infrastructure bottlenecks in getting crude to market. Oil prices have been impacted by a decline in Iranian crude exports, and with other large producers such as Saudi Arabia struggling to fill the supply void, prices have increased by more than 25% for the year. Some analysts expect that the recent rally in prices will lead to a surge in U.S. exports to meet global demand. That means higher prices at the pump for U.S. consumers.

~ WSJ

Directions Please

Navigating Crucial Decisions to Reach Your Investment Goals

The Path Forward – An Institutional Investors Checklist

The 2018 DeMarche Client Conference, *Directions Please: Navigating Crucial Decisions to Reach Your Investment Goals*, addressed how investors can safely maneuver through current and future challenges such as rising interest rates, demographic shifts, troubled bond markets, and emerging market risks. Here's a checklist to help you stay on course.

☑ Review Asset Allocation Annually

Markets change over time and so do your investment needs. These changes may expose areas of unintended risk in your portfolio, meaning you need to review your asset allocation. **Look for efficiency in risk and return.** Your asset allocation must meet your long- and short-term goals as well as your spending needs. **Seek opportunities to benefit from the diversity in your portfolio,** especially if your cash flow needs change.

☑ Consider New Asset Categories

Look at asset classes that you are not currently using. Ask whether new classes will fit your portfolio in terms of **Diversification** and **Correlation**. Look at asset classes, sectors, and geographic areas where growth is expected and consider if you can harness those benefits.

☑ Reconsider Previous Paradigms

Embrace new ideas. Changes to the Bloomberg Barclays Aggregate and its components present an opportunity to review your Investment Policy Statement. Reconsider the risk component of your fixed income portfolio. Take advantage of the financial and fiduciary education that DeMarche provides each year.

☑ Work with the Right Partner

DeMarche has helped guide clients toward reaching their investment goals for 45 years. Our customer service is grounded in being an active listener, promptly responding to your needs, and proactively assisting and challenging you to find areas of growth.