

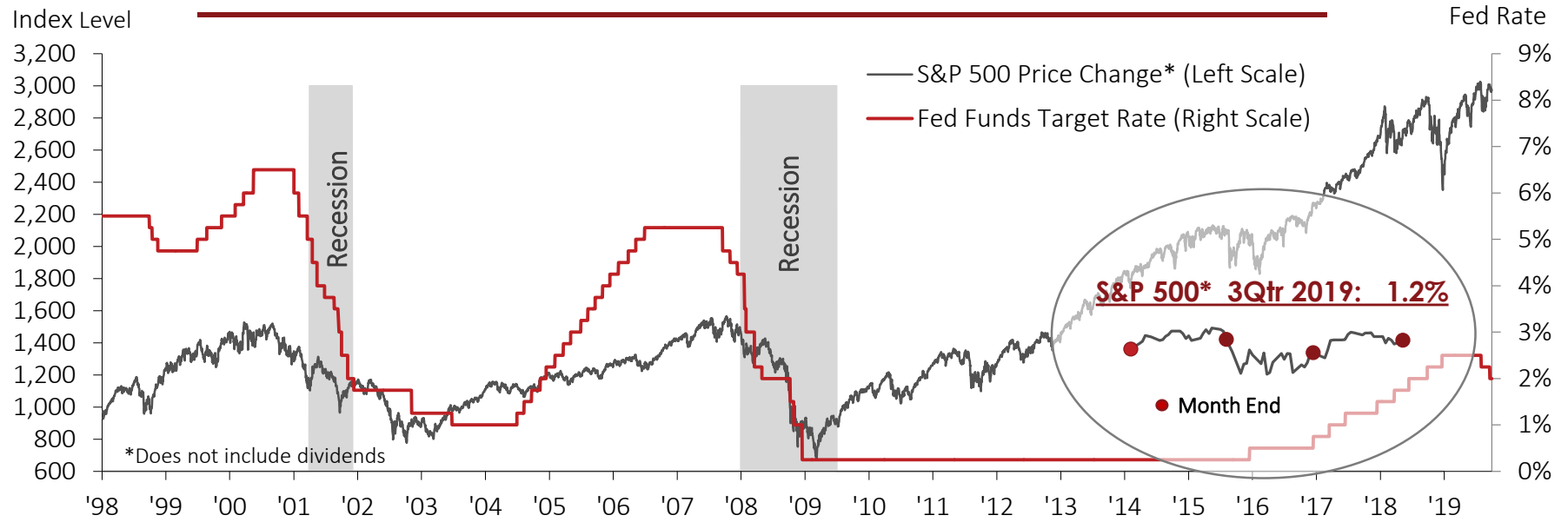
Capital Market Review

September 30, 2019

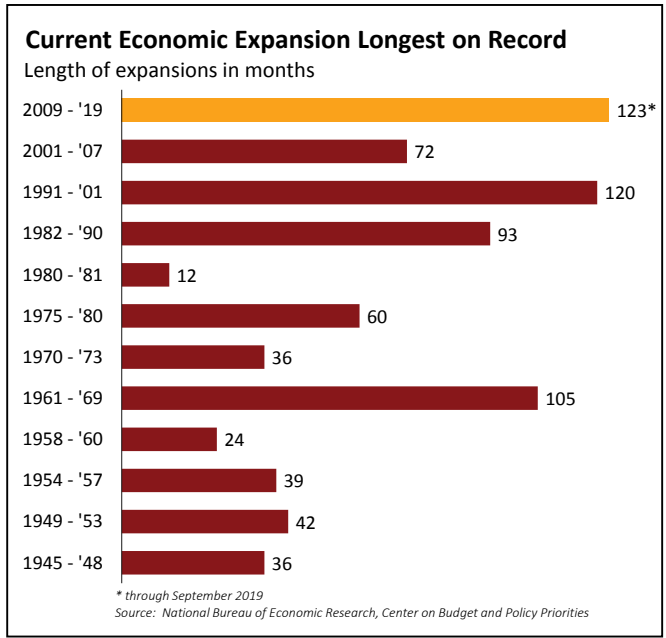


DeM^{ar}arche

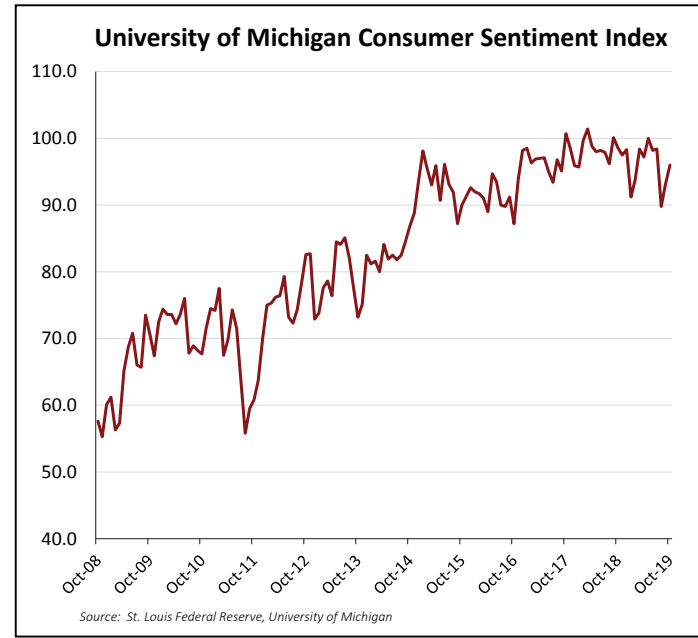
Mid-Cycle Slowdown



Source: Standard & Poor's, Federal Reserve



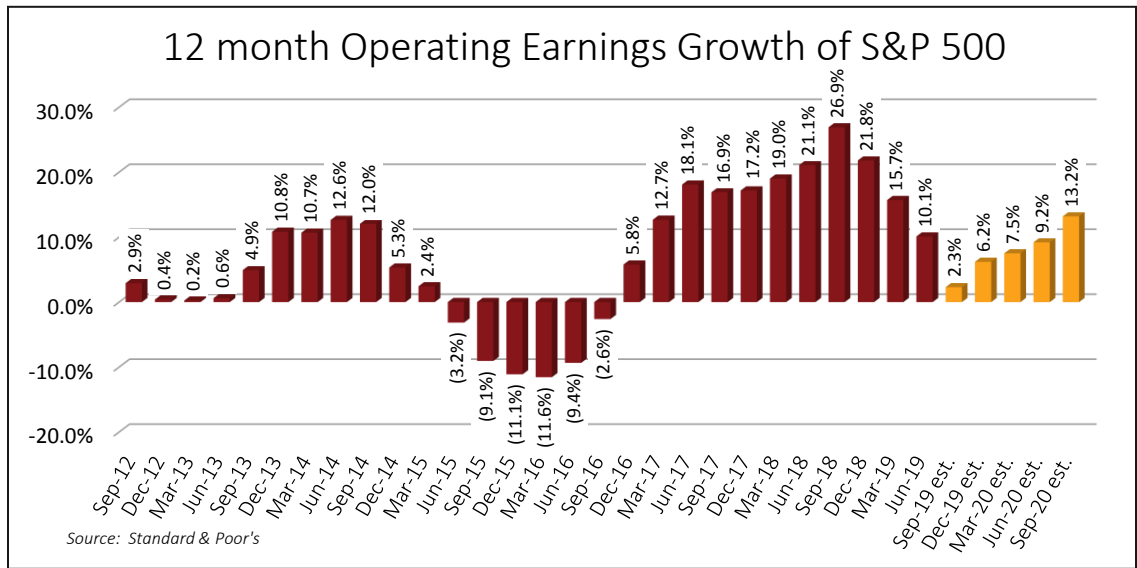
The Federal Reserve cut rates twice in response to a "mid-cycle" slowdown of economic growth. To put economic growth into perspective, the current expansion has surpassed 123 months and is the longest on record. It is also the weakest post-WWII expansion and is showing signs of cooling. One measure of consumer strength is the Consumer Sentiment Index. The consumer, which accounts for 70% of the economy, still has some confidence in the economy even though the latest gains are moderating. Unemployment is below its 50-year average of 6.2%, and wage growth is below its 50-year average of 4%. This suggests that the current cycle is in its late stages, but no downturn is imminent.



INDEX	3rd Qtr	YTD	1-Year	3-Year	5-Year	10-Year
MSCI World	0.5	17.6	1.8	10.2	7.2	9.0
DeMarche World*	-1.4	14.3	-0.7	8.8	6.2	7.8
DeMarche 3000	-0.6	16.6	0.6	10.5	8.0	10.2
Russell 3000	1.2	20.1	2.9	12.8	10.4	13.1
S&P 500	1.7	20.6	4.3	13.4	10.8	13.2
DeMarche International	-2.3	11.4	-2.2	6.6	3.6	4.8
MSCI EAFE USD	-1.1	12.8	-1.3	6.5	3.3	4.9
BlmBarc Aggregate	2.3	8.5	10.3	2.9	3.4	3.7
FTSE Non-US Gov't Bond	-0.1	5.4	6.8	0.6	1.3	1.1
BlmBarc Global Aggregate	0.7	6.3	7.6	1.6	2.0	2.3
NCREIF (Private RE)	1.4	4.8	6.2	6.8	8.6	9.8
Bloomberg Commodity	-1.8	3.1	-6.6	-1.5	-7.2	-4.3

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	2019	2018	2017	2016	50-Year Average
GDP Annual Growth Rate	2.0	3.1	2.4	1.5	2.8
Unemployment	3.5	3.7	4.2	4.9	6.2
Inflation (CPI)	1.7	2.3	2.2	1.5	4.0
10-Year Interest Rates	1.7	3.1	2.3	1.6	6.3



- Markets continued on their roller coaster ride in the quarter. The S&P 500 advanced 1.7%, despite volatility in the quarter. The Federal Reserve cut interest rates on July 31st, and the market fell in response. Chairman Powell characterized the rate cut as a “mid-cycle adjustment.” Then the market struggled in August on trade headlines before rebounding in September on more positive trade news. Remember that the year started out with a low point after a negative 4th quarter 2018, resulting in exceptional year-to-date returns.
- International stocks declined 1.1% in the quarter on fears of slowing global growth and uncertainty. Due to negative interest rates in their local markets and mounting macro concerns, international investors sought relative safety in the U.S. market, resulting in the U.S. dollar strengthening against other currencies in the quarter. A stronger dollar provides a headwind to international returns for U.S. investors.
- Bond returns, as measured by the BlmBarc Aggregate, posted a strong quarter and year as interest rates fell on slowdown concerns. The Federal Reserve cut interest rates a couple of times this quarter in response. Despite the Fed’s rate cuts, the yield curve remained inverted, with the 10-year yield closing the quarter at 1.68%.
- The chart to the left shows that the strong earnings growth of 2017 and 2018 have waned. Stock prices discount future expectations; therefore, the below-trend earnings expectations are being reflected in current prices. This explains the recent volatility and modest returns.

DeFact

True to form, the Federal Reserve cut interest rates twice in the quarter, once on July 31st and again on September 18th. While Chairman Powell stated that the July cut was a “mid-cycle adjustment, he has since stated that risks exist in the favorable jobs and inflation picture, principally from global developments. According to the CME FedWatch tool, the futures market is pricing in an 86% probability of another cut at the end of October 2019.

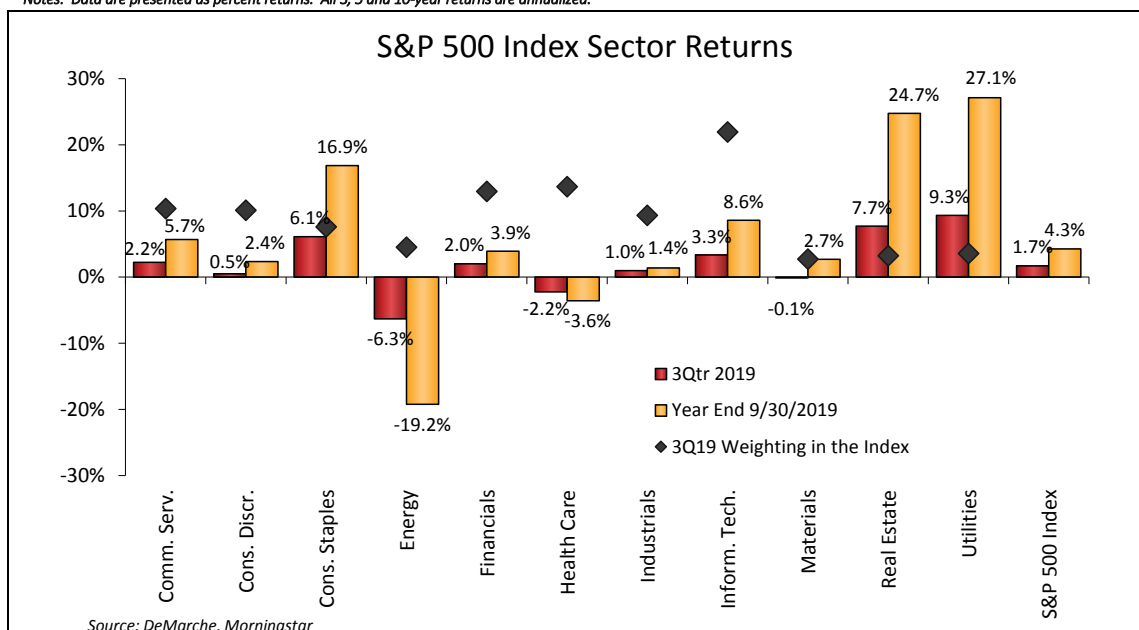
~ CME, Federal Reserve

Domestic Equities

September 30, 2019

INDEX	3rd Qtr	YTD	1-Year	3-Year	5-Year	10-Year
DeMarche Growth	-0.5	18.8	1.8	13.9	11.0	12.1
DeMarche Value	-0.9	13.1	-1.3	6.2	4.1	7.5
DeMarche Aggressive	-5.3	12.2	-9.5	5.7	2.4	7.1
DeMarche Defensive	-0.2	17.0	1.6	11.0	8.5	10.4
DeMarche Large Cap	-0.3	16.5	1.4	11.0	8.2	9.8
Large Cap Growth	-0.4	18.4	1.9	14.7	11.6	12.0
Large Cap Value	-0.2	13.6	0.5	6.5	4.0	6.9
DeMarche Small Cap	-2.9	8.6	-14.1	5.3	5.6	10.0
Small Cap Growth	-3.5	10.6	-10.4	7.1	6.2	9.9
Small Cap Value	-2.5	7.2	-16.8	4.0	5.0	10.0
S&P 500	1.7	20.6	4.3	13.4	10.8	13.2
S&P Mid-Cap 400	-0.1	17.9	-2.5	9.4	8.9	12.6
S&P Small-Cap 600	-0.2	13.5	-9.3	9.3	9.9	13.0
Russell 1000	1.4	20.5	3.9	13.2	10.6	13.2
Russell 1000 Growth	1.5	23.3	3.7	16.9	13.4	14.9
Russell 1000 Value	1.4	17.8	4.0	9.4	7.8	11.5
Russell 2000	-2.4	14.2	-8.9	8.2	8.2	11.2
Russell 2000 Growth	-4.2	15.3	-9.6	9.8	9.1	12.2
Russell 2000 Value	-0.6	12.8	-8.2	6.5	7.2	10.1

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



Source: DeMarche, Morningstar

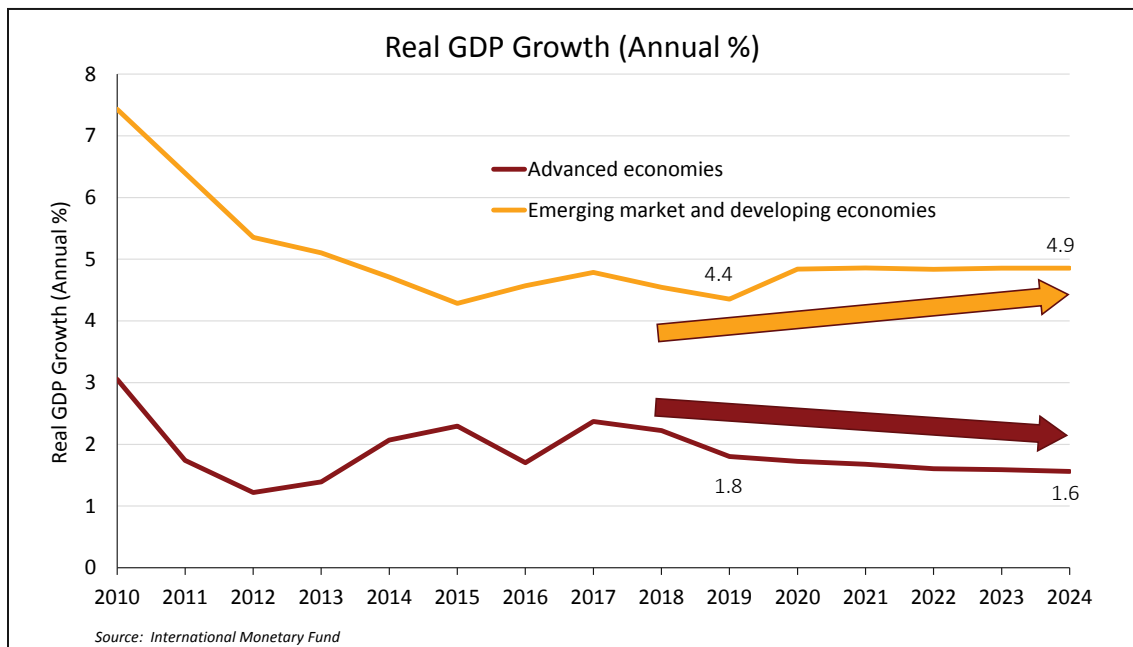
- Large cap growth and value paced together during the quarter but below the surface, the market was volatile. Through the middle of September, growth was in the lead; however, value stocks caught up later in the month in response to positive trade talk news. The leading sectors in the value space for the quarter were utilities, real estate and consumer staples. Each of these sectors outperformed the largest sectors in the growth index, such as technology, healthcare and consumer discretionary.
- Interestingly, value stocks have led growth over the trailing 12 months, which is one of the few times value has led growth over the last decade. Growth stocks have swamped value stocks over the 3-, 5- and 10-year time frames.
- Small cap stocks continued their underperformance versus large cap, with the Russell 2000 trailing the large cap Russell 1000 by 3.8% in the quarter, and 12.8% over the trailing 12 months. Small cap stocks lagged large caps by 4.6% through the end of August, but leadership changed in September with small cap outperforming large by 0.8% in the month.
- Small cap growth struggled as healthcare stocks underperformed the broader index due to concerns about earnings growth. The small cap healthcare sector makes up 27% of the growth index and posted a negative return of 19% for the trailing 12 months.
- The chart to the left shows the great recent returns for utilities and real estate, which have been unloved parts of the market throughout most of the S&P's bull run the past few years. Traditionally, those sectors do well when rates fall. Technology also did well, but the second largest sector, healthcare, has struggled for the past year.

DeFact

Mega-cap stocks currently dominate the market. To get a sense of their strength and size, the two biggest stocks in the U.S.—Microsoft and Apple—had a combined market cap of more than \$2 trillion at the end of September. The entire Russell 2000 Index, on the other hand, had a combined market cap of \$2.2 trillion. Historically over the last 20 years, the two biggest names by market cap in the U.S. averaged roughly 57% of the total market cap of small-cap stocks.

INDEX	3rd Qtr	YTD	1-Year	3-Year	5-Year	10-Year
DeMarche Int'l	-2.3	11.4	-2.2	6.6	3.6	4.8
Growth	-2.9	13.1	-0.4	5.9	4.5	5.8
Value	-2.0	8.3	-5.3	6.8	2.8	4.0
DeMarche Int'l Small Cap	-1.9	16.8	0.7	6.0	4.4	5.5
DeMarche EM	-7.3	4.1	-4.6	4.0	1.9	3.3
MSCI EAFE Local	1.8	15.7	1.6	8.3	6.0	7.0
MSCI EAFE USD	-1.1	12.8	-1.3	6.5	3.3	4.9
Growth	-0.4	17.9	2.2	7.8	5.5	6.5
Value	-1.7	7.7	-4.9	5.1	1.0	3.2
MSCI Japan	3.1	11.1	-4.7	6.2	5.6	5.5
MSCI AC Asia-ex Japan	-4.5	5.7	-3.4	6.3	4.2	5.5
MSCI Germany	-4.0	9.9	-7.1	3.5	1.9	4.4
MSCI France	-1.7	15.9	-1.6	10.2	5.1	4.4
MSCI UK	-2.5	10.1	-2.9	4.6	0.4	4.8
MSCI EAFE Small Cap	-0.4	12.1	-5.9	5.9	6.0	7.5
MSCI EM	-4.2	5.9	-2.0	6.0	2.3	3.4
MSCI All Country-ex US	-1.8	11.6	-1.2	6.3	2.9	4.5

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



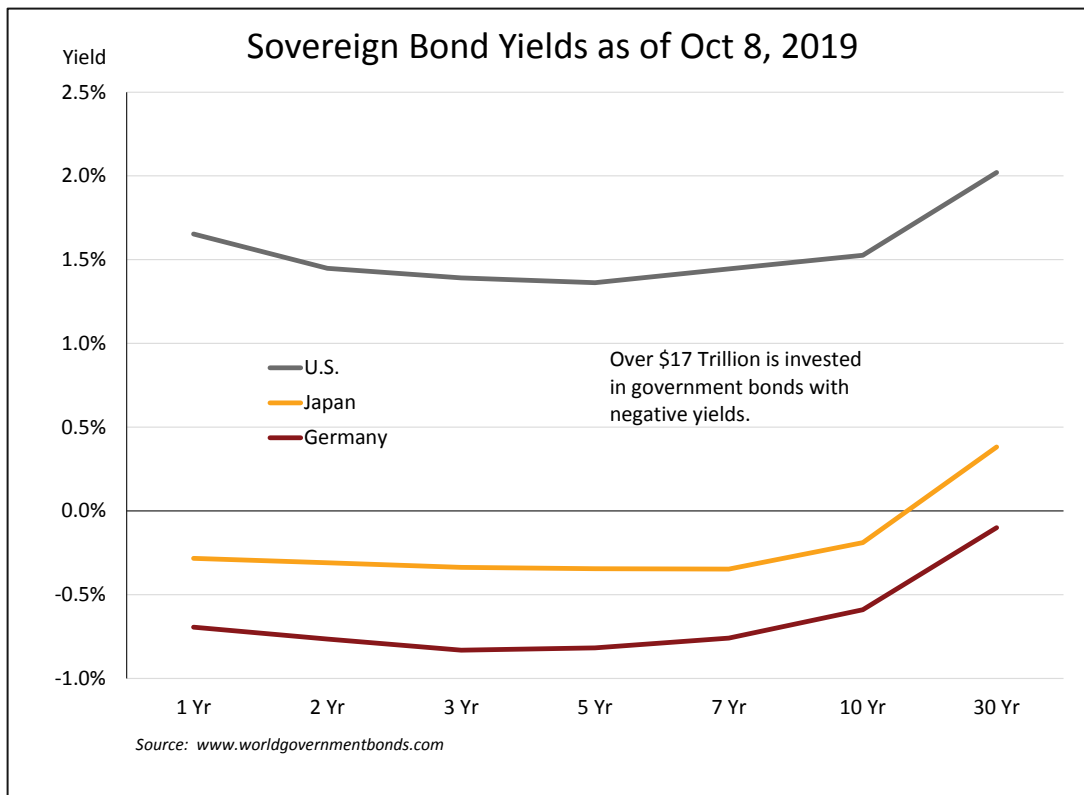
- The dollar resumed its strengthening trend against a trade-weighted basket of currencies in the quarter. Higher relative GDP growth and interest rates in the U.S. have attracted foreign capital. Over the longer term, the stronger dollar has been a headwind for international returns as the EAFE Index, reported in local currency, has been higher than in U.S. dollar terms.
- While markets around the globe have rebounded from the 4th quarter 2018, the trailing 12-month returns in international developed and emerging countries are negative. The concern of slowing growth and trade wars weigh on more recent returns, and emerging market stocks have lagged large cap U.S. stocks by 9.8% per annum for 10 years. This divergence partly reflects the much bigger presence of faster growth technology companies in the U.S. market.
- Japanese stocks showed some signs of life in the quarter, posting a 3.1% return in response to the BOJ further considering easing measures. The ECB resumed its quantitative easing programs, cutting interest rates further into negative territory, but Japan did not follow suit. Japanese rates are also negative along the curve and have been so since 2016, making it debatable how much more negative Japanese interest rates can go.
- GDP growth in developed countries is expected to slow over the next five years. Emerging markets, which have readjusted growth downward for the past decade, are now expected to rebound slightly in the near term. This could bode well for emerging market stocks, which have lagged U.S. stocks for a decade.

DeFact

Given the underperformance of the EAFE Index to the U.S. large cap, it is beneficial to place the index composition into context. The U.S. stock market's weight in technology and communication services is 32%, while the EAFE's weight is 12%. Conversely, EAFE's weight in financial stocks is 19% vs. 12% for the U.S. Additionally, of the top 10 stocks in the EAFE, there is one technology stock, SAP, with a weight of less than 1%. In the Russell 1000 Index, there are six technology/communication services stocks with a combined weight of over 13%.

INDEX	3rd Qtr	YTD	1-Year	3-Year	5-Year	10-Year
BlmBarc 1-3 Gov Credit	0.7	3.4	4.6	1.8	1.6	1.5
BlmBarc Aggregate	2.3	8.5	10.3	2.9	3.4	3.7
BlmBarc Gov Credit Long	6.6	20.9	21.9	5.6	6.8	7.4
BlmBarc US TIPS	1.3	7.6	7.1	2.2	2.4	3.5
ICE BofA Merrill Lynch High Yield	1.2	11.5	6.3	6.1	5.4	7.8
Cred. Suisse Lev. Loan (bank loans)	0.9	6.4	3.1	4.7	4.1	5.4
BlmBarc Global Aggregate	0.7	6.3	7.6	1.6	2.0	2.3
JPM EmgMkt Bd Gbl Dvrsfd (hard)	1.5	13.0	11.6	4.6	5.7	6.9

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



- Interest rates have fallen so far this year and continued to drop during the quarter. The Fed cut rates twice in the quarter, keeping pace with falling longer-term rates. When interest rates fall, bond prices rise. Therefore, the BlmBarc Aggregate posted a very strong double-digit return of 10.3% for the year. The 10-year Treasury yield fell from 2.00% to 1.68% in the 3rd quarter. The yield curve has remained inverted during most of the quarter, averaging a negative 23 basis points between the 3-month T-bill and the 10-year Treasury.
- Emerging market debt has proven to be resilient during the quarter, even though the dollar broadly strengthened. The longer duration of the emerging market bond index has boosted performance as interest rates have fallen. In addition, falling U.S. rates provide a more accommodating backdrop for emerging market debt.
- Credit spreads on riskier debt, such as high yield and bank loans, remain tight to Treasuries. With spreads holding steady, the coupon yield becomes most of the total return, and quarterly and yearly returns reflect that fact. In addition, the shorter duration typical of lower rated debt constrained their ability to participate in the interest rate-driven rally.
- The chart to the left shows the dramatic differences in the government bond yields among the U.S., Japan, and Germany. The entire German yield curve is under water. One may ask, “Why own negative yielding bonds?” The answer is complicated, but the primary reason is that they are viewed as safe assets in times of distress.

DeFact

The global supply of debt continues to grow. The world is now awash in about \$113 trillion in debt (\$17 trillion of which have negative rates). In 1989, the amount was about \$12 trillion. At that time, the U.S. was over 61% of the global market, but now makes up about 37% as emerging market countries have grown from 1% to 22% of the global market and developed countries have grown from 38% to about 41%.

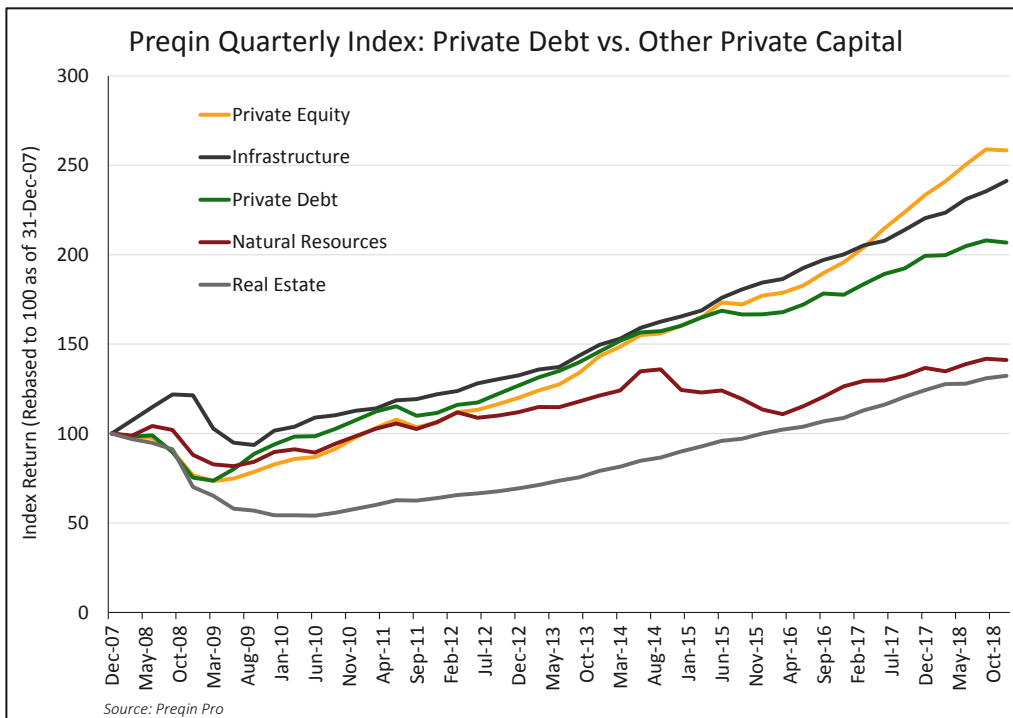
~ JP Morgan

INDEX	3rd Qtr	YTD	1-Year	3-Year	5-Year	10-Year
NCREIF Property (Private RE)	1.4	4.8	6.2	6.8	8.6	9.8
Apartment	1.2	4.0	5.4	6.0	7.7	9.8
Industrial	3.2	9.9	13.6	13.5	13.7	12.2
Office	1.5	4.8	6.5	6.4	7.9	8.9
Retail	0.2	1.9	1.4	3.8	7.3	9.6
NAREIT (Public RE)*	7.2	27.4	19.6	9.0	10.9	13.3
NCREIF Timberland	0.2	1.3	2.1	3.1	4.4	4.0
NCREIF Farmland	1.0	2.4	5.3	6.1	7.9	11.0
HFR FOF Composite	-0.9	5.2	0.0	3.2	1.9	2.7
Conservative	-0.3	4.4	1.0	3.1	2.0	2.7
Diversified	-0.6	5.4	0.6	3.3	2.0	2.8
Strategic	-1.7	5.7	-1.1	3.2	1.9	2.8
Bloomberg Commodity	-1.8	3.1	-6.6	-1.5	-7.2	-4.3

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.

- Commodity prices fell for the quarter and year, led downward by energy prices. Over the past year, precious metals have been the lone exception and have appreciated in price. Gold tends to increase in value during times of economic uncertainty and falling interest rates.
- REITs have performed very well in all time frames. REITs tend to do well when interest rates are falling, as the dividend paid becomes more attractive to investors.
- Hedge fund returns were broadly negative for the quarter. Trend-following and quantitative strategies declined in September upon the reversal in the equity market. Some more conservative strategies that focused on credit and equity exposure did slightly better. The one-year return for the broad composite is 0%.
- The chart to the left shows the returns on capital that are allocated to private market alternatives. Private debt returns are in relation to other private asset classes. Typically, private debt is floating rate so the return earned is primarily from credit spread. In this current environment of very low interest rates on traditional fixed income investments, private debt may be an attractive alternative.



DeFact

Facing declining foot traffic and rising online competition, retailers from Payless ShoeSource to Toys “R” Us to Barneys New York have filed for bankruptcy in recent years. Now, Forever 21’s announcement of bankruptcy will close up to 350 stores worldwide. And these store closings won’t be the last. Retail experts say that up to another 12,000 retail stores of all stripes are at risk of closing before the end of 2019. ~ Time

Reality Check

Change, Challenges and Opportunities

An Institutional Investor Reality Checklist

The 2019 DeMarche Client Conference, Reality Check: Change, Challenges and Opportunities, addressed how investors can position their portfolios for the next market cycle. Asset class behavior and correlations are changing, risk is being repriced, asset quality matters once again and diversification strategies require reevaluation. Here's a checklist to help you assess your situation and prepare for the changes, challenges and opportunities ahead.

Examine the Economic Outlook

Expect periods of volatility driven by headlines. That volatility will weigh upon the market's ability to move higher. The Fed may drop interest rates over the next 1-2 years, and this could eventually lead to more stability in stocks and bonds. In such a scenario, bond returns may continue to lag their historical average for years. Subsequent bond returns may be low for years if not decades. Stock returns may struggle to meet historical averages should earnings not increase at a faster pace. **Is your portfolio ready for the next few years?**

Assess Your Retirement Plan Readiness

For Defined Benefit plans, retirement readiness means maximizing the potential that pension obligations are met, minimizing surplus volatility, implementing de-risking strategies, and considering Pension Risk Transfer. For Defined Contribution plans, it means broadening your retirement solutions, considering all facets of Outcomes and Decumulation, and understanding current trends in Target Date Funds. **What are your next steps?**

Consider Alternative Investments

Alternative investments can have a high alpha generation potential, be less correlated to other assets, and operate in less efficient markets. But wide performance dispersion between peers, limited transparency, and unique risks suggest great care must be taken when investing. **What resonates to improve your plan's future reality?**

Don't Forget Traditional Assets

While alternative assets have many attractive characteristics, traditional assets continue to provide the foundation for building a comprehensive investment policy. Risks within traditional assets classes are readily understood and defined, allowing for better risk budgeting across all assets in the portfolio. **What realities beset your traditional asset portfolio?**

Build Your Plan for Sustainable, Responsible Investing

Reflect on your values and mission before taking action. Then map out a plan, educate yourself on terminology and trends, and seek expert advice. Document and communicate your plan, and review your policy to see if you're meeting its stated goals. **What is your sustainable responsible reality?**

