Market Update – August 2018

Headlines during August were focused on U.S. trade talks. Stock market returns were bifurcated as U.S. stocks rose and international stocks fell. Although not a big factor last month, international stock returns for U.S. investors in 2018 have been negatively impacted by the strengthening U.S. dollar, especially in emerging markets. Bond returns were positive in the U.S. and slightly negative for international bonds. Global REITs, managed futures, and reinsurance each rose in August, while commodities dipped into negative territory.

Economy

- The second estimate of 2nd quarter real GDP growth came in at an annualized rate of 4.2%. This increase of 2% from first quarter's growth rate marks the fastest growth rate posted since the 3rd quarter of 2014.
- Inflation, measured by the Consumer Price Index for all goods, ticked up slightly to 2.9% year-over-year.
- Unemployment remains near business cycle lows at 3.9%.
- Consumer confidence continues to remain very high.

Stocks

- Gains in U.S. stocks continued this month with the S&P 500 (+3.3%) generating strong gains and U.S. small cap stocks (+4.3%) surging even more. Sector strength was driven by consumer discretionary and technology stocks.
- International developed (-1.9%) and emerging markets (-2.7%) stocks experienced another month of declines.

Bonds

- The yield curve was relatively unchanged in August, resulting in slightly positive bond returns, with short-term bonds up 0.2%, intermediate-term bonds up 0.6%, and inflation-protected bonds up 0.7%.
- International bonds (-0.2%) were slightly negative for the month.

Alternatives

- Global REITs (+1.6%), managed futures (+1.4%) and reinsurance (+0.4%) each made gains during August. However, commodities (-1.8%) fell due to weakness in the metals and grains sectors.

Sources: Bureau of Economic Analysis (BEA), Federal Reserve, Morningstar Direct, Standard and Poor's

The Weather Has No Memory

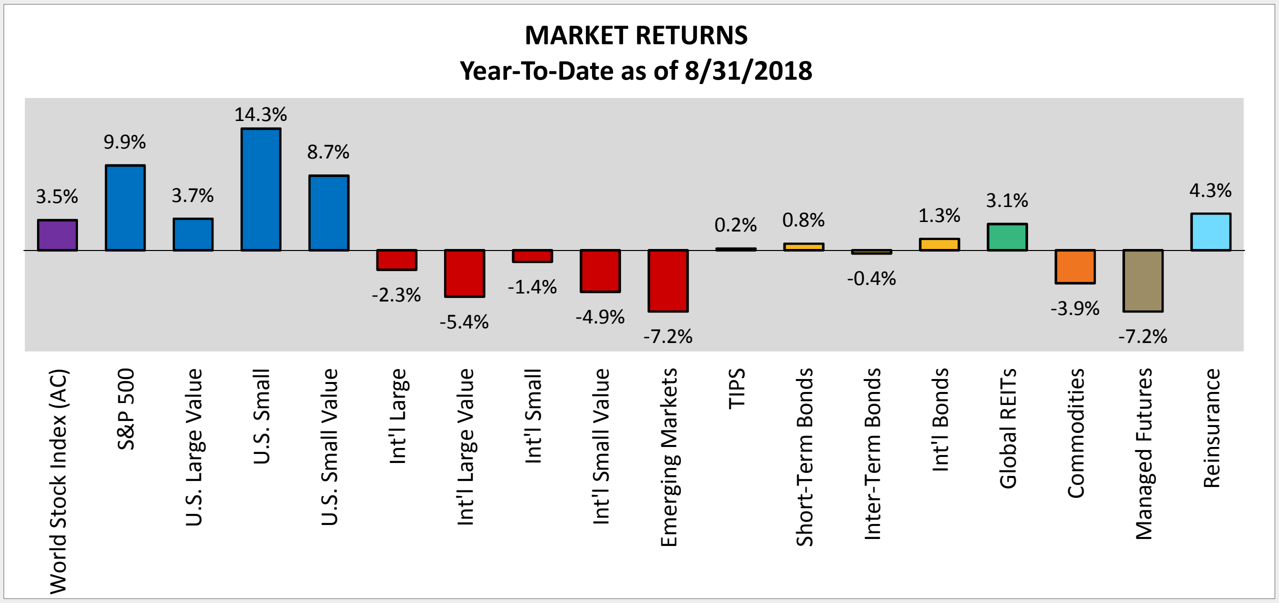
The recent threat of Hurricanes Lane (Hawaiian islands) and Florence (East Coast) brings to mind the devastating hurricane season of 2017. It also brings up questions such as, "Does last year's active hurricane season demonstrate an increasing trend of landfalling hurricanes? Does it make it more likely this year will be an active season?" Historical weather data illustrates the answer to both is "no."

First, hurricane data going back to 1851 for those that made landfall shows the long-term average is 1.8 per year. Furthermore, the long-term average of more powerful Category 3+ hurricanes making landfall each year is 0.6. While some may claim that climate change has created more consistent, stronger storms, the 10-year moving average of the data for both series has no discernable trend, as it has bounced around just above and below the long-term averages *(source: Stone Ridge Asset Management, National Oceanic and Atmospheric Administration)*.

Second, hurricane data for the past 167 years shows there have been 75 major hurricane years (at least one Category 3+ hurricane). Only 34 times did a major hurricane year follow a major hurricane year. In other words, there is a 45% probability of at least one major hurricane in any year (75/167) and a 45% probability of a major hurricane year following a major hurricane year (34/75).

What does this have to do with investing? Investors with holdings in the reinsurance asset class have exposure to natural catastrophe risk. For example, loss claims following hurricane damage can result in the reduction of the return premium that a reinsurance investor receives as part of an insurance-linked security because it has to pay out on losses based on the underlying contract terms. With the recent headlines and peak hurricane season upon us (August-November), these questions are relevant for such investors, but the normal variability in weather means each year begins with a clean slate!

In the context of a portfolio, the reinsurance asset class has no correlation with any of the traditional asset classes such as stocks and bonds and is independent of financial market activity. Therefore, we believe the asset class can be a good piece of the puzzle when building a globally diversified portfolio. The combination of various risk premiums can reduce the overall level of volatility and help improve expected returns of a portfolio over the long run.



MARKET RETURNS - Longer Term Annualized as of 8/31/2018

	1 Month	YTD	1 Year	3 Years	5 Years	10 Years	15 Years
STOCKS							
S&P 500	3.3%	9.9%	19.7%	16.1%	14.5%	10.9%	9.5%
U.S. Large Value	1.5%	3.7%	13.0%	13.8%	11.9%	9.3%	9.0%
U.S. Small	4.3%	14.3%	25.4%	16.1%	13.0%	10.5%	10.2%
U.S. Small Value	2.6%	8.7%	18.4%	14.9%	12.1%	10.4%	10.4%
Int'l Large	-1.9%	-2.3%	4.4%	7.0%	5.7%	3.7%	7.0%
Int'l Large Value	-3.6%	-5.4%	0.6%	5.1%	4.3%	2.7%	6.4%
Int'l Small	-0.2%	-1.4%	7.8%	11.3%	10.3%	7.5%	10.5%
Int'l Small Value	-1.2%	-4.9%	3.3%	10.0%	9.7%	7.2%	10.6%
Emerging Mkts	-2.7%	-7.2%	-0.7%	11.4%	5.0%	3.5%	9.7%
World Stock Index (AC)	0.9%	3.5%	11.8%	12.0%	9.8%	7.0%	8.5%
BONDS							
TIPS	0.7%	0.2%	0.8%	2.2%	1.9%	3.0%	4.2%
Short-Term Bonds	0.2%	0.8%	0.8%	0.5%	0.3%	0.5%	1.4%
Interm-Term Bonds	0.6%	-0.4%	-1.0%	1.3%	1.8%	3.0%	3.4%
International Bonds	-0.2%	1.3%	1.9%	3.5%	4.3%	4.3%	4.3%
ALTERNATIVES							
Global REITs	1.6%	3.1%	6.2%	8.7%	9.1%	6.8%	9.0%
Commodities	-1.8%	-3.9%	0.5%	-1.9%	-8.0%	-7.6%	-1.2%
Managed Futures	1.4%	-7.2%	-6.9%	-2.0%	3.2%	2.8%	5.7%
Reinsurance	0.4%	4.3%	1.5%	4.4%	5.0%	6.7%	7.4%

Source: Morningstar Direct. Indices used in above graphs: S&P 500 Index, U.S. Large Value-MSCI U.S. Prime Market Value Index, U.S. Small-Russell 2000 Index, U.S. Small Value-MSCI U.S. Small Value Index, Int'l Large-MSCI EAFE Index, Int'l Large Value-MSCI EAFE Value Index, Int'l Small-S&P EPAC Small Index, Int'l Small Value-S&P EPAC Small Value Index, Emerging Mkts-MSCI Emerging Markets Index, World Stock Index-MSCI All Country World IMI Index, TIPS-Barclays Gbl Infl Linked US TIPS Index, Short-Term Bonds-Ibbotson 1 Yr Treasury Const Mty Index, Interm-Term Bonds-Barclays Interm-Term Govt/Credit Index, International Bonds-JPM GBI Global Ex US Hdg, Global REITs-S&P Global REIT Index, Commodities-Bloomberg Commodity Index, Managed Futures-Credit Suisse Mgd Futures Liquid Index, Reinsurance-SwissRe Global Cat Bond Index.

Past performance is historical and does not guarantee or indicate future results. Index returns assume reinvestment of all distributions and unlike mutual funds, do not reflect fees or expenses. It is not possible to invest directly in an index. This report is not intended to provide personalized investment advice. Some information has been produced by unaffiliated third parties, and while it is deemed reliable, the advisor does not guarantee its accuracy or completeness.

SAVANT®

Economic Indicators

Leading Economic Index Year over Year Change (%)

(+0.4) — Low: -20.2 — Current: 6.3 — High: 14.4

Unemployment (%)

(+0.0) — Low: 2.5 — Current: 3.9 — High: 10.8

Inflation CPI (YOY %)

(+0.1) — Low: -3.0 — Current: 2.9 — High: 14.6

Real GDP Growth (%)

(+2.0) — Low: -10.0 — Current: 4.2 — High: 16.7

Consumer Confidence

(+5.5) — Low: 25.3 — Current: 133.4 — High: 144.7

VIX - Market Volatility

(-0.6) — Low: 10.1 — Current: 12.6 — High: 62.6

Housing Starts (000s)

(+10) — Low: 478 — Current: 1168 — High: 2494

10-year Treasury Yield (%)

(+0.00) — Low: 1.5 — Current: 2.89 — High: 15.3

Typical range (within 1 standard deviation of the median)

Current Value

Historical Range

Change in value since last month

*See appendix for sources and data ranges

SAVANT

Appendix

Leading Economic Index Year over Year Change (%)

The Leading Economic Index is composed of 10 indicators used to forecast the direction of the economy. A fall in the index over three consecutive months is seen as a sign of a recession. The value shown represents the 12-month change in the index level. *(Data Source: The Conference Board. Monthly data since 1/1/1959)*

Unemployment

The unemployment rate measures the percentage of workers that are out of work in the U.S. labor force. *(Data Source: U.S. Bureau of Labor Statistics. Monthly data since 1/1/1948)*

Inflation CPI (YOY)

The Consumer Price Index (CPI) measures the change in the price level for a broad basket of goods in the U.S. economy. The value shown represents the percent change in the index from a year ago. *(Data Source: U.S. Bureau of Labor Statistics. Monthly data since 1/1/1948)*

Real GDP Growth

Real GDP Growth represents the change in the market value of all output in the U.S. economy. It is an annualized quarterly measure. *(Data Source: U.S. Bureau of Economic Analysis. Quarterly data since 4/1/1947)*

Consumer Confidence

The Consumer Confidence Index measures the level of optimism among U.S. consumers on the economy and their overall financial situation. *(Data Source: The Conference Board. Monthly data since 1/31/1991)*

VIX

The CBOE Volatility Index (VIX) measures the volatility of the S&P 500 index. An increase in the index level represents a spike in market volatility. Conversely, a decrease in the index represents a move towards stability. *(Data Source: Chicago Board Options Exchange. Daily data since 1/2/1990)*

Housing Starts

The number of housing starts (new construction) in the U.S. each year. *(Data Source: U.S. Bureau of the Census. Monthly data since 1/1/1959)*

10-year Treasury

The annualized return that would be realized for holding a 10-year Treasury bond to maturity. The 10-year Treasury yield is the primary benchmark for measuring interest rate movements. *(Data Source: U.S. Board of Governors of the Federal Reserve System. Daily data since 1/2/1962)*

Disclosure

SAVANT®