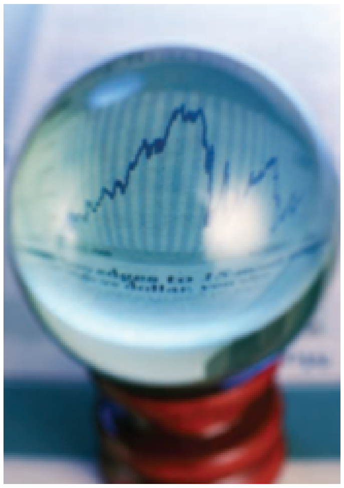
Investment Update

3rd Quarter 2018



It has been said that "The stock market climbs a wall of worry." This has been the case over the past 10 years. While global fears associated with the Japanese earthquake, the downgrade of U.S. debt and Ebola contagion are now long forgotten, at the time they caused significant angst and volatility. The markets dealt with these and many other "crises" and continued climbing the "wall of worry." All along the way, there were obstacles and setbacks. Asset classes often reversed leadership. Despite all of these issues, the S&P 500 had a total return of 436% since the financial crisis lows. Those who were able to practice patience and resolve have been amply rewarded.

2018 has followed a similar theme. After rising strongly in January, the markets fell roughly 10% on fears of slowing Asian economies. As markets stabilized, attention turned to sabre rattling over North Korean provocations as well as trade issues and tariffs. Of course, wrangling and polarization around political issues continued throughout the year.

Markets have mostly taken the worries of 2018 in stride. Through the third quarter, world markets have been choppy and mixed by region. While the U.S. has seen positive equity returns, other asset classes like international stocks and bonds have not done as well. This variation of returns is not uncommon. Last year, developed international stocks were strong outperformers. Coping with periodic underperformance and outperformance of asset classes is part of managing a diversified portfolio.

Domestic Equity

U.S. companies had their share of challenges in the quarter. In the end, strong corporate earnings fueled by a powerful economy and lower tax rates won the day. The S&P 500 jumped to a 7.7% return for the quarter. Smaller companies rose a more modest 4.7%. For the year, both large- and small-capitalization indices have produced a return of more than 10%.

International Equities

After leading the market last year, international equities recently struggled in the third quarter. The combination of a strong dollar and the threat of high-profile trade tensions weighed on returns. Given these headwinds, developed international markets took the challenges reasonably well. The MSCI EAFE, a measure of equities in developed markets, managed a modest 1.4% gain. For the year, the index edged down 1.4%. Emerging markets had a similar story. While trade tensions eased a bit with many other regions, China (up to this point) is apparently taking a more confrontational stance. Faced with this uncertainty, emerging markets lagged. The emerging markets index slipped 1.1% for the quarter and has dropped 7.7% for the year. Before investors give up on this asset class, it is important to remember that even with this year's losses, the emerging markets index still produced a compound annual return of 12.4% over the past three years.

Fixed-Income

The Department of Labor recently reported that the jobless rate fell to 3.7%. This is the lowest unemployment rate in 49 years. In response to this growth, the Federal Reserve recently raised interest rates. This is the third increase of 2018, and the eighth in this cycle. With the rate increase, one might expect there would be significant losses in bonds. So far, this has not been the case. The Barclays Aggregate, an index of the total domestic bond market, was unchanged for the quarter. For the year, in the face of the multiple increases, the index is down only 1.6%.

PERCENT RETURN AS OF 9/30/18

EQUITY INDEXES	3RD Q	YTD	3 YR
S&P 500	7.7	10.6	17.3
Russell 2500	4.7	10.4	16.1
MSCI EAFE	1.4	-1.4	9.2
Emerging Market	-1.1	-7.7	12.4
Wilshire REIT	0.7	2.2	7.1
BOND INDEXES			
TIPS	-0.8	-0.8	2.0
Aggregate	0.0	-1.6	1.3
Governments	-0.6	-1.6	0.3
Mortgages	-0.1	-1.1	1.0
Investment Corporate	1.0	-2.3	3.1
Long Corporate	1.3	-5.5	5.2
Corporate High Yield	2.4	2.6	8.1
Municipals	-0.2	-0.4	2.2
CASH EQUIVALENTS			
3-Month T-Bill	0.5	1.4	0.8
CONSUMER PRICE INDEX	**0.5**	**1.6**	**1.9**

Guided by enduring principles

As the fourth quarter begins, market volatility has returned. As interest rates have risen, markets have been under pressure. Some believe that higher rates could bring lower equity returns as inflation and credit costs rise. Equity prices have been moving down as the recent gains are digested. Though investing is often an uneven ride, we have taken these movements into account while managing your portfolio.

Through the previous 10 years, we have come through the "great recession" together and have prospered. This success is due to the principles we have in common with you. As an advocate of your wealth, we think this excerpt from a client letter 10 years ago summarized these principles well:

"During times of extreme uncertainty, it is tempting to listen to those with extreme positions and shrill voices. Our commitment is instead to use prudence and mathematical principles to help build your future. Our response to this crisis is not to shrink away and hope for the best. Instead, we will confront these challenges with discipline and strength. This, we believe, is the only way back."

We certainly are back. We will be here, whatever the next 10 years may bring, to help with your goals. Our advice is crafted to last decades, not days. That is our commitment to you.

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Whether the market is up or down, we are here for you

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