QUARTERLY REVIEW

SECOND QUARTER 2018

If you plan to drive to your summer vacation destination, it's unlikely that you will set the cruise control at 70 mph and only decelerate upon arrival. Curves in the road, construction zones, and that slow driver that won't get out of the left lane require us to moderate our speed for a safer trip. Investing for the long term has similar analogies. Staying invested to achieve long-term goals requires moderating portfolio allocations and risk (eg: adjusting speed and travel lanes) at times when hazards emerge. Similar to alternative routes, various investment strategies and styles within asset classes may allow investors to incur less downside (and more upside) while maintaining market exposure. Parking assets in cash is like a prolonged layover and requires being right twice: when to stop and when to start. While in some instances a cash allocation is appropriate, over the longer-term it only delays reaching our respective financial destinations.

Annualized Benchmark Returns through March 2018*

	1 Quarter	YTD	1 Year	2 Years	3 Years	5 Years	10 Years
S&P 500	3.4%	2.6%	14.4%	16.1%	11.9%	13.4%	10.2%
Russell 2000	7.8%	7.7%	17.6%	21.0%	11.0%	12.5%	10.6%
MSCI World Ex. US Index	-0.5%	-2.4%	7.6%	13.7%	5.4%	6.7%	3.1%
MSCI Emerging Markets	-7.9%	-6.5%	8.6%	16.1%	6.0%	5.4%	2.6%
Bloomberg Barclays U.S. Aggregate	-0.2%	-1.6%	-0.4%	-0.4%	1.7%	2.3%	3.7%
Bloomberg Barclays Municipal Bond	0.9%	-0.2%	1.6%	0.5%	2.9%	3.5%	4.4%
Bloomberg Barclays U.S. High Yield	1.0%	0.2%	2.6%	7.5%	5.5%	5.5%	8.2%
FTSE Nareit All REITs	8.3%	1.1%	4.8%	3.1%	9.2%	9.0%	8.5%

Source: Bloomberg *Quarter and year-to-date returns are not annualized.

The Big Picture (click here for full article)

U.S. equity markets are positive year to date (YTD) and if the performance is annualized the result would be acceptable in the eyes of many investors. Yet, investors appear unsettled. For example, S&P 500 companies reported year-over-year earnings growth during the first quarter of 24%, but stock prices did not move significantly around their respective announcement dates. Potential hazards ahead such as tariffs, increasing interest rates, inflation and generally ongoing bellicose political exchanges in Washington rattle investor nerves. Some issues, such as rising interest rates, are "easier" to plan around given the Federal Reserve's communications. Others such as tariff and trade policy are highly uncertain and consequently it is even more important now for investors to know what they own and why.

Annualized U.S. real gross domestic product for the first quarter of 2018 was 2.0%, off from the 2.9% annualized growth achieved in the fourth quarter of 2017. U.S. economic growth is expected to be relatively strong through this year and 2019 based on Philadelphia Federal Reserve surveys. Most everyone we speak with is concerned about the potential for recession and we share in that longer-term concern. However, based on current data we do not think a recession is imminent. Nevertheless, we are increasing risk controls on the margin. Provided the economy continues as expected, the Federal Reserve will likely continue increasing its Fed Funds Target Rate as communicated, which means we might see rates increase 1%-2% over the next 12 months. We would also expect future inflation expectations to increase as a growing U.S. economy, in combination with sub-4% unemployment, increases wage growth-induced inflation. Each of these factors has implications on both fixed income and equity allocations.

Europe remains in growth mode with an accommodative European Central Bank. Economic growth in the European Union, according to the European Commission, is expected to be 2.4% in 2018 and to continue through 2019. Despite continued growth expectations, European equity markets are negative YTD for U.S. investors. We believe this largely reflects increased risk premiums due to tariff and trade concerns, political issues surrounding Italy and negative effects of local currencies depreciating relative to the U.S. Dollar.

Emerging markets continue to demonstrate economic growth in excess of developed markets. However, similar to non-U.S. developed markets, emerging market returns are negative YTD due to both local currency depreciation relative to the U.S. Dollar and ongoing trade talks. While we remain optimistic for non-U.S. developed and emerging markets, current data dictates a cautious approach is warranted as the set of facts surrounding the asset classes has changed.

Summary of Allocation Recommendations

Asset Class	Recommendation	Comment	Asset Class Summary Link
U.S. Large Cap	Neutral/Underweight	Earnings remain strong, but relative valuations remain elevated, especially in growth sector	U.S. Large Cap Review
U.S. Small & Mid Cap	Neutral	Small and microcap stocks driving market; investments favoring tax reform beneficiaries and domestic focus	U.S. Small Cap Review
Non-U.S. Developed	Neutral/Overweight	Fundamentals intact but tariff and trade concerns escalating	International Equity Review
Emerging Markets	Neutral	Strong economic growth yet tariff, trade and currency concerns impacting asset class	International Equity Review
Fixed Income	Underweight/Neutral	Short-term bonds capture large percentage of longer-term yields; floating rate remains a favored allocation	Fixed Income Market Review
Tactical	Neutral	Robotics and cybersecurity	Tactical Investments Review
Alternative	Hedge Funds & Private Equity	For appropriate allocations	Contact your Wealth Advisor

The Outlook

We continue to recommend a neutral/underweight allocation to U.S. Large Cap Equities, as upside is likely modest in the near-term. S&P 500 aggregated earnings growth for 2Q2018 is projected to be 19% and approximately 19.8% for the year.[1] Growth stocks continue to outperform value stocks, driven in part by higher valuations. Despite strong earnings in value stocks, they remain ignored by the market. We believe maintaining and marginally increasing exposure to value should position portfolios well for an eventual style rotation. For passive investors please note that concentration risk within equity indices is increasing. For example, the S&P 500's YTD return of 2.6% was driven by only 10 stocks, without which the Index would have been negative. (Amazon was 1/3rd of the S&P's YTD return!) The technology sector, the best performing sector in the S&P 500, comprises about 27% of the index, a level only exceeded during the period leading up to the 2000 "Tech Crash". We remain critical of these metrics and advocate diversification.

Similar to last quarter, we are recommending a neutral allocation to U.S. SMID Cap Equities. SMID cap outperformed large cap this quarter and YTD due in part to less exposure to tariff risks and greater positive impact from corporate tax reform. Similar to large cap, growth stocks within the SMID cap sector have materially outperformed value stocks. Market cap was also a factor with the smallest capitalization stocks performing the best.

In light of the negative developments related to tariffs and trade, our positioning in non-U.S. developed markets is modified marginally to a neutral/overweight allocation. Despite the YTD performance of developed market equities, economic growth remains intact. We would expect positive price momentum should tariff discussions become more constructive. However, at the margin, recent developments are negative and we reconcile this higher risk by modifying our recommended allocation slightly lower. We are modifying our emerging market allocation to a neutral weighting for similar reasons. Emerging markets continue to generate economic growth driven by export market demand. That said, the clear concern is the tariff and trade dispute with China that, depending on the ultimate outcome, could raise the risk premium for emerging markets broadly.

We continue to recommend an underweight/neutral allocation to fixed income. We have shifted a portion of fixed income allocations to short-term bond funds as investors are able to capture nearly all the yield of longer-term bonds with less duration risk. We maintain our recommendation to invest in floating rate loans given favorable corporate fundamentals and their alleviation of interest rate risk. Floating rate loans are up about 2.4% YTD while the Barclays U.S. Aggregate Bond Index is down 1.6%.

Our Tactical recommendations continue to include investments in a robotics ETF and a cybersecurity ETF. The latter has performed well YTD while the former is slightly negative. The performance differential between the two ETFs has not curtailed our view that robotics and cybersecurity will play a larger future role in corporate America and the world.

[1] Factset: Earnings Insight

Tax and Financial Planning News

Facebook's sharing of user data with Cambridge Analytica has rightfully raised concerns in Washington and the general public. Concentrated stock positions tend to develop over time as a given stock performs well and the investor continues to hold the position. However, at some point, the stock's allocation becomes outsized relative to other portfolio holdings, increasing portfolio risk along the way. What is an investor to do? Selling the stock is likely to generate meaningful taxes and holding the stock elevates portfolio risk. We address a few ideas in the following link. As always, each investor has their own unique set of financial circumstances so please speak with your financial advisor to learn what strategy might work for you.

Firm News

We are excited to announce the opening of Round Table Wealth Management offices in Boca Raton, FL and Bend, OR! Staffed locally, we are pleased to continue to deliver consistent high-quality advice and service to families across the country and globally.

Respectfully submitted,
Round Table Wealth Management