ROUND TABLE
WEALTH MANAGEMENT

QUARTERLY REVIEW

THIRD QUARTER 2018

Here's a party we can all agree on…U.S. equity markets had a fantastic quarter, with the S&P 500 rising 7.7%, nearly tripling the return of the index's first half return of 2.6%! Driven by year-over-year quarterly earnings growth between 20%-25%, the market embraced equities and pushed the index to historical highs.

Developed non-U.S. equities were modestly positive for the quarter, while emerging markets were modestly negative for the same period. U.S. bond market performance remains subdued, primarily due to the current rising interest rate cycle.

We are maintaining a cautiously optimistic outlook as several developing stories deserve close monitoring: U.S. mid-term elections, trade negotiations, Federal Reserve rate increases (and their impact on non-U.S. investments), and U.S. and global synchronous economic growth.

Annualized Benchmark Returns through September 2018*

	QTD	YTD	1 Year	2 Years	3 Years	5 Years	10 Years
S&P 500	7.7%	10.6%	17.9%	18.3%	17.3%	13.9%	12.0%
Russell 2000	3.6%	11.5%	15.2%	18.0%	17.1%	11.1%	11.1%
MSCI World Ex. US Index	1.4%	-1.0%	3.2%	11.0%	9.9%	4.8%	5.7%
MSCI Emerging Markets	-0.9%	-7.4%	-0.4%	10.6%	12.8%	4.0%	5.8%
Bloomberg Barclays U.S. Aggregate	0.0%	-1.6%	-1.2%	-0.6%	1.3%	2.2%	3.8%
Bloomberg Barclays Municipal Bond	-0.2%	-0.4%	0.3%	0.6%	2.2%	3.5%	4.8%
Bloomberg Barclays U.S. High Yield	2.4%	2.6%	3.0%	5.9%	8.1%	5.5%	9.5%
FTSE Nareit All REITs	0.7%	1.8%	4.2%	3.9%	9.2%	9.7%	8.1%

Source: Bloomberg *Periods greater than one year are annualized.

The Big Picture (click here for full article)

U.S. real gross domestic product growth increased 4.2% in the second quarter of 2018, representing the best quarterly growth since the third quarter of 2014. The Survey of Professional Forecasters by the Philadelphia Federal Reserve indicates continued economic growth in the U.S. of 2.8% for the full year of 2018 and 2019, with a meaningful decline to 1.8% in 2020. Based on that outlook, the probability of a near-term U.S. recession appears low. Other forward looking data sets, such as the Conference Board's Index of Leading Economic Indicators, support continued U.S. economic growth. The most recent August reading reflects a continuing upwards trajectory and positive momentum. Historical declines in the index have generally preceded economic recessions by several months to years.

Provided the U.S. economy continues on a positive growth path, it is anticipated the Federal Reserve will continue to increase the Federal Funds Rate. The Fed most recently increased the rate by 0.25% to a reference range of 2.0% to 2.25%. The Fed “Dot Plot,” representing rate outlooks by individual members of the Federal Reserve Open Market Committee (that decides on rate increases), depicts a Fed Funds Rate range of between 3.0% to 3.5% by year-end 2019.

Rising U.S. rates can have both positive and negative impacts on various assets classes. Within U.S. equities, rising rates can be positive as the catalyst for higher rates is likely an improving and expanding economy. On the negative side, rising rates increase the discount rate used in valuing future company cash flows and therefore reduce their net present value reflected in share prices. With regard to non-U.S. equities, rising U.S. rates can propel the relative value of the U.S. Dollar higher versus other currencies, which detracts from the performance of those non-U.S. investments. This dynamic clearly unfolded in both non-U.S. developed and emerging market investments during 2018. Forward looking market indicators suggest modest changes in the relative value of the U.S. Dollar over the next year. Fixed income investments have an inverse relationship to interest rates: as rates increase, the prices of bonds fall. The longer the maturity of a given bond, the larger the potential price decline. For this reason, we continue to recommend relatively shorter duration fixed income exposure within client portfolios.

Mid-term elections will likely prove to be hotly contested. Historically, the party occupying the Oval Office tends to lose majority in the House of Representatives and the Senate. This year, forecasters predict the House could cede control to the Democratic Party while the outcome of the Senate is less certain. Markets tend to perform generally well during these same periods with a median U.S. equity market gain of 8.0% from one month pre-election to two months post-election.

Summary of Allocation Recommendations

Asset Class	Recommendation	Comment	Asset Class Summary Link
U.S. Large Cap	Neutral/Underweight	Earnings growth rates decline in 2019; valuations remain in focus	U.S. Large Cap Review
U.S. Small & Mid Cap	Neutral	Small and microcap stocks driving market; investors 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. After a strong quarter, investors are likely to begin focusing on 2019 data, which currently reflects lower earnings growth rates. We have stated previously that investors (the market) presently are willing to pay 18x for an equity market that has experienced 20%+ earnings growth. As we transition to 2019, year-over-year earnings growth is anticipated to be 7.5% on average for the first and second quarter. Our concern is that the market may experience valuation contraction in light of lower, albeit positive, growth rates.

Similar to last quarter, we are recommending a neutral allocation to U.S. SMID Cap Equities. While we continue to anticipate domestic growth, small cap optimism may be fading as tax-reform benefits play out and expectations revert back to a lower earnings growth environment. We therefore hold a neutral allocation for the small and mid cap allocation, with a bias towards mid cap stocks over small cap stocks.

We continue to maintain a neutral to overweight allocation to non-U.S. developed markets. Our investment committee spent considerable time debating the merits of this allocation. Our view is that currency, which accounted for a fair amount of this year's negative performance, is likely to have only a marginal impact in the near term based on futures market pricing. Developed market valuations and earnings growth continue to appear favorable. Similarly, we continue to maintain a neutral weight recommendation for emerging markets as valuations remain highly discounted to developed markets and projected 2019 earnings growth remains strong.

We continue to recommend an underweight/neutral allocation to fixed income. Barring a large stock correction or economic recession, we do not anticipate the Fed to deviate from their projected rate increases given inflation and economic growth; we therefore we maintain our defensive duration positioning. Current fixed income positioning does not forgo any meaningful yield due to the narrow yield difference between longer dated bonds and shorter dated bonds. We will revisit this positioning as we see longer dated bond yields rise (the bond yield curve steepens), which should allow portfolios to capture higher yields.

Our Tactical recommendations continue to include investments in robotics and cybersecurity. We remain committed to these investments for the intermediate term.

Tax and Financial Planning News

With the new 2018 tax law, fewer taxpayers will have the opportunity to itemize deductions as they have in the past. The new standard deduction amount is $12,000 for single filers and $24,000 for joint filers, which is significantly higher than it was in 2017 ($6,350 for individual filers and $12,700 for joint filers). For those who are concerned about losing valuable deductions, one strategy includes "bunching" annual tax deductions into one year while limiting deductions in other years. As one example, if your average annual charitable contribution is $5,000, consider making a larger contribution of $10,000 or more before year-end in order to exceed your 2018 standard deduction. The intent of this strategy is to create tax deductions in excess of the standard deduction in the "bunching" year, and therefore create additional tax savings. This can also apply for various expenses, but requires coordination with your CPA to review all eligible deductions and to ensure that you will exceed the standard deduction.

Our Wealth Advisor, Richard Freeman, has written two timely posts that describe various ways to give and what the best assets are to give to a charity. Please visit our website through the following link **Guide To Giving**.

Firm News

Please join us in welcoming Lee Whetstone to Round Table Wealth!

Congratulations to Theodore Schneider on his marriage to longtime girlfriend and now wife, Julia!

Respectfully submitted,
Round Table Wealth Management