Market Review

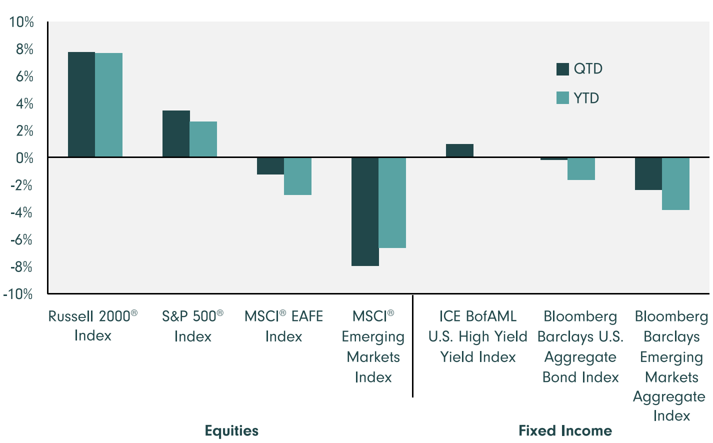
Second Quarter 2018

Domestic equities generated a positive return, with the S&P 500 Index gaining 3.43% in the second quarter, bringing its year-to-date return to 2.65%. Small stocks performed even better, with the Russell 2000 Index returning 7.75% for the quarter and 7.66% year to date. Trade-war rhetoric escalated sharply during the quarter, which caused international and emerging-market stocks to perform poorly. The MSCI EAFE Index declined 1.24% in the quarter and is now down 2.75% year to date. Emerging-market stocks got punished even more, with the MSCI Emerging Markets Index declining 7.96% for the quarter and erasing gains from earlier in the year.

U.S. Treasury yields continued to back up slightly, with the 10-year Treasury yield moving from 2.74% to 2.86%. The Bloomberg Barclays U.S. Aggregate Bond Index was basically unchanged for the quarter, at -0.16%, bringing the year-to-date return to -1.62%. High-yield bonds outperformed, gaining 1.00% for the quarter and ending the first half of the year up 0.08%. Not unlike equity returns, emerging-market debt was a weak performer, as represented by the Bloomberg Barclays Emerging Markets Aggregate Index, losing 2.40% in the quarter and 3.84% for the first half of 2018.

Index Returns

Periods ending June 30, 2018



Data is obtained from Bloomberg and is assumed to be reliable. Past performance is no guarantee of future results.

Effects of Global Trade Uncertainty

The key event that drove equity and debt markets in the second quarter was the sharply escalating talks around global trade tariffs. NAFTA negotiations appear to have gone nowhere, World Trade Organization talks appeared ineffective at best, and Chinese negotiations have stalled out with increasing threats from President Donald Trump.

It is difficult to isolate how much of a drag on business activity this is already causing abroad in developed and emerging economies, but it certainly isn't helping. Europe, after a soft first quarter due largely to weather, has not picked up materially in the second quarter, and emerging markets have slowed on the margin in terms of economic growth. (See chart: *Global Manufacturing Summary*). The global synchronized recovery is being called into question by investors in light of this uncertainty. Even in the U.S., stocks of large, multinational and more cyclical companies exposed to international trade performed poorly in the quarter. Small stocks, on the other hand, fared better, thanks to their primarily domestic focus and status as big beneficiaries of tax reform.

Global Manufacturing Summary

Developed Markets	Current Reading	Current Reading vs. 12-Month Average
Americas		
Canada	57.1	1.7
United States	60.2	1.2
Europe		
Austria	56.6	-3.1
Denmark	49.7	-9.9
France	52.5	-3.2
Germany	55.9	-3.7
Ireland	56.6	0.5
Italy	53.3	-2.7
Netherlands	60.1	-0.9
Norway	55.8	-0.4
Spain	53.4	-1.2
Switzerland	61.6	-1.3
United Kingdom	54.4	-1.1
Pacific		
Australia	57.4	0.1
Japan	53.0	-0.3
New Zealand	54.5	-1.2
Singapore	52.5	0.0
Emerging Markets		
Americas		
Brazil	49.8	-1.8
Mexico	52.1	0.3
Europe		
Czech Republic	56.8	-0.7
Greece	53.5	0.2
Hungary	53.0	-3.8
Poland	54.2	0.5
Russia	49.5	-1.7
Asia		
China (CLFP)	51.5	0.0
China (Caixin)	51.0	-0.2
India	53.1	1.5
Indonesia	50.3	-0.1
Korea	49.8	0.0
Malaysia	49.5	-0.1
Philippines	52.9	0.4
Taiwan	54.5	-0.5
Thailand	50.2	0.1

Data is obtained from Strategas and is assumed to be reliable. Past performance is no guarantee of future results.

We don't know for how long these negotiations will carry on, but we do believe even President Trump knows that a trade war would not be positive for his economic agenda or his voter base. The hope is that cooler heads will prevail over a reasonable time period.

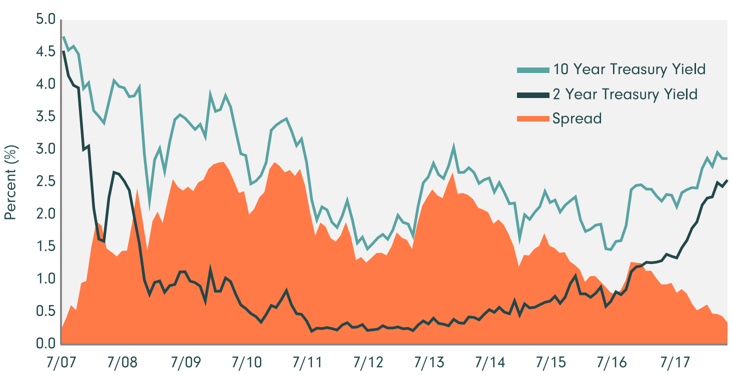
A silver lining in this situation is that equity and debt markets are priced in a way—e.g. weakness in emerging markets, U.S. industrials and Europe—that a favorable resolution over time should result in improved stock prices in these particular areas.

Continued on Page 2

Yield Curve on Watch

The Federal Reserve raised short-term interest rates during the quarter, and investors fully expect two more rate increases before year end. Rising U.S. short-term rates relative to those of the rest of the world have caused upward pressure on the dollar. Dollar strength and tariff talks have combined to put pressure on many emerging markets. The U.S. yield curve has continued to flatten, however, (See chart: *Treasury Yields Compress*), with the difference between the 10-year and 2-year rates reaching the lowest since July 2007. It will be interesting to see how new Fed Chairman Jerome Powell reacts if long rates continue to be stable or even decline when he pushes up the short end. We are watching the yield curve closely, particularly for a point of inversion, which typically has signaled an impending recession. It is worth noting, though, that the yield curve remained fairly flat for four years from 1994 to 1998, and stocks performed well with no recession taking place.

Treasury Yields Compress



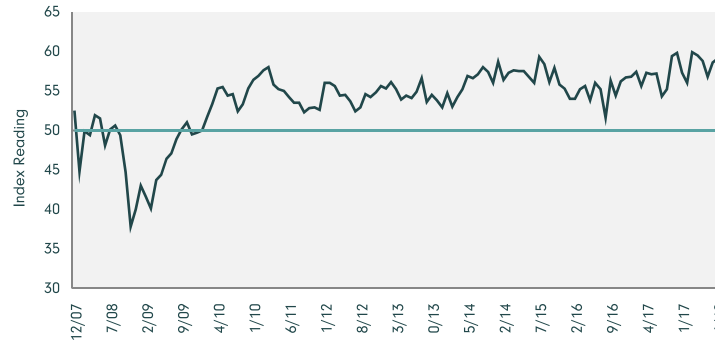
Data is obtained from The Federal Reserve Bank of St. Louis and is assumed to be reliable. Past performance is no guarantee of future results. Data is through June 30, 2018.

Solid U.S. Business Growth

Business and economic activity in the U.S. still appears to be fairly strong across the board. For one, the Institute for Supply Management recently reported its non-manufacturing index rose to 59.1 in June (See chart: *Non-Manufacturing Activity Expands*). The index tracks a broad range of U.S. industries including finance, health care and wholesale trade. A reading above 50 suggests a general expansion.

Moreover, the Federal Reserve Bank of Atlanta recently estimated second-quarter GDP growth could come in above 4%. Labor markets also continue to tighten, with more job openings posted than job seekers overall, the first time this has happened since the Department of Labor started tracking these numbers in 2000. Fortunately, domestic companies have enough business momentum and economic growth to overcome all the background noise coming out of Washington. Corporate earnings were extremely good in the first quarter, and second-quarter releases that will start shortly should be strong as well.

Non-Manufacturing Activity Expands



Data is obtained from the Institute for Supply Management and is assumed to be reliable. Past performance is no guarantee of future results.

As always, we will stay focused on investing in high-quality companies with a sustainable competitive edge. We believe this is the best long-term protection we can provide in this period of heightened uncertainty. We thank you for your trust and confidence.

Douglas S. Foreman, CFA
Chief Investment Officer
Douglas S. Foreman, CFA is Chief Investment Officer, Portfolio Manager, and a member of the Executive Management Committee. He has approximately 32 years of investment experience.

The S&P 500® Index is a market capitalization weighted index which includes 500 of the largest companies in leading industries of the U.S. economy. The Russell 2000® Index is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The MSCI® EAFE Index is a free float-adjusted market capitalization index that measures developed foreign market equity performance, excluding the U.S. and Canada. The MSCI® Emerging Markets (EM) Index is a free-float adjusted market capitalization index tracking the equity performance of global emerging markets. The Bloomberg Barclays U.S. Aggregate Bond Index is a market value weighted index that tracks the daily price, coupon, pay downs and total return performance of fixed-rate, publicly placed, dollar-denominated and non-convertible investment grade debt issues with at least $250 million par amount outstanding with at least one year to final maturity. Performance is calculated on a total return basis with dividends reinvested. The Bloomberg Barclays Emerging Markets Aggregate Index is a flagship hard currency Emerging Markets debt benchmark that includes fixed and floating-rate U.S. dollar-denominated debt issued from sovereign, quasi-sovereign, and corporate emerging market issuers. Country eligibility and classification as Emerging Markets is rules-based and reviewed annually using World Bank income group and International Monetary Fund (IMF) country classifications. The ICE BofAML U.S. High Yield Index tracks the performance of U.S. dollar denominated below-investment-grade corporate debt publicly issued in the U.S. domestic market.