

Stocks continued their hot streak in the second quarter. The S&P 500 Index advanced 4.3% while the Russell 2000 Index gained 2.1%. Year-to-date, the S&P 500 Index and the Russell 2000 Index have posted total returns of 18.5% and 17.0%, respectively. Interestingly, the S&P 500 Index had its best first half of a year since 1997. All 11 sectors of the Index rose and Technology led the way with a gain of over 26%. Health Care was the market's laggard with a 7.1% gain in the first half. Our portfolios posted strong absolute returns and most are generally outperforming their respective benchmarks on a year-to-date basis.

While stocks finished the quarter near record highs, there was some turbulence along the way. Fears of an economic slowdown, prompted in part by the ongoing trade skirmish with China, caused a sharp selloff in May. To wit, the S&P 500 Index and Russell 2000 Index declined 6.4% and 7.8%, respectively, for the month. While our portfolios declined as well, we were pleased to see them perform better than their respective benchmarks during this swoon. Then, markets roared back in June as the Federal Reserve once again vowed to ease monetary conditions should the economic weakness become an issue. Of note, the Dow Jones Industrial Average had its best June since 1938.

For now, macroeconomic conditions remain supportive of stocks. Unemployment is at its lowest level since 1969, we have seen a record monthly streak of job gains, inflation is subdued and interest rates remain very low. Let's face it, the 10 Year U.S. Treasury's paltry yield of 2.0% makes many other asset classes look more attractive. China relations have been an obstacle of late, but most seem to believe this may only be a short-term headwind. This makes sense given we are approaching an election year.

However, the torrid pace of recent gains is unlikely to be sustained. We are relatively late in a bull market cycle and returns have been goosed a bit by fiscal and monetary stimulus. With returns over the last 10 years coming in above historical norms (the S&P 500 Index has annualized at 14.7% over the last 10 years through June), it seems logical to think we could see some reversion to the mean over the next 10 years. This doesn't mean returns won't be attractive, it just implies we may see something more subdued like mid-to-high single-digit returns. We think a more moderate return environment could favor stock pickers like us who enjoy finding diverse and value-based ideas.

We are very excited about some recent purchases and our setup going forward. On a different note, we encourage you to review our recent presentation titled Navigating Negativity, which can be accessed on our website or provided by your Account Executive. This presentation is aimed at identifying key sources of negativity in our daily lives and anticipating how the political environment may serve to intensify negative news flow. While we are respectful of the world's challenges and do not want to come off as Pollyannaish or dismissive, we point out several ways in which the world is better off than it has ever been. We then identify a few exciting developments that will improve quality of life and may also yield investment opportunities. We hope this can be a tool to help maintain a long-term perspective in what is sure to be a noisy time leading up to the 2020 election.

## Bond Market Update

The second quarter of 2019 saw stocks hit all time highs and the rate rally that started during the fourth quarter of 2018 continued. It was almost to the point that the "Goldilocks" environment was perpetual and asset prices reflected this optimism. Signs of a slowdown in non-U.S. countries, and stabilization in the discord over trade with China contributed to the Federal Reserve indicating a pause in their rate changes with commentary surfacing that indeed they could entertain a rate cut as the year progresses if "data" justified the move.

The response to this change in financial conditions led to a drop in Treasury yields during the quarter. The two-year Treasury yield fell 51 basis points to 1.76%, the five year down 47 basis points to 1.77%, the ten year down 40 basis points to 2.00%, and the thirty year down 28 basis points to 2.53%. The yield on the three-month Treasury bill stood at 2.09% at the end of the quarter causing the yield curve differential to be inverted out to ten-year maturities - historically a precursor to the US economy entering a recession. Not only were rates lower for the US markets but also many international rates were lower leading to \$13 trillion dollars' worth of international debt at negative values. It was \$10 trillion at the end of the first quarter of 2019.

Unlike the first quarter, when the government shutdown influenced economic data, the economic releases for the second quarter showed a slowing yet still expanding economy. Durable goods orders were negative for three straight months, retail sales vacillated between positive and negative readings, and the labor market averaged 183,000 hires for the quarter. The unemployment rate continues to hover at 3.6%. Unit labor costs, which should have increased as employers searched for qualified hires, were negative even with the strong labor market. Contrasting many of the negative economic releases during the quarter was the University of Michigan survey of consumers showing a positive outlook.

Our strategy over the last three quarters has been to upgrade the credit quality of our portfolios and extend the effective maturities. Institutional portfolios averaged AA- at the end of the quarter and had effective maturities of 4.2 years and durations of 3.4 years. Our allocation to floating rate notes stands at 25%, down from the mid-30s a year ago. We continue to be slightly shorter than our benchmark index, the Bloomberg Barclays Intermediate Government/Credit Index, and do not expect to change these profiles unless it becomes apparent that the U.S. economy is heading to a recession.

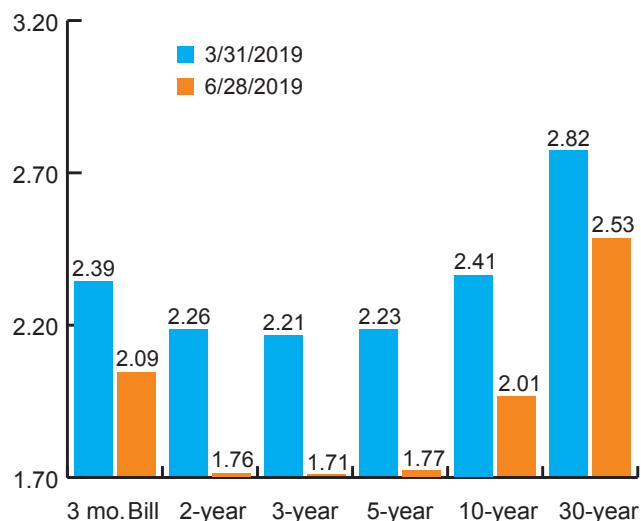
### Market Returns

	Q2 2019	YTD
U.S. Large Caps	4.3	18.5
U.S. Mid Caps	4.1	21.4
U.S. Small Caps	2.1	17.0
International Developed Markets	1.2	11.6
Emerging Markets	0.6	10.6
Intermediate Term Bonds	2.6	5.0

Source: Morningstar Direct.

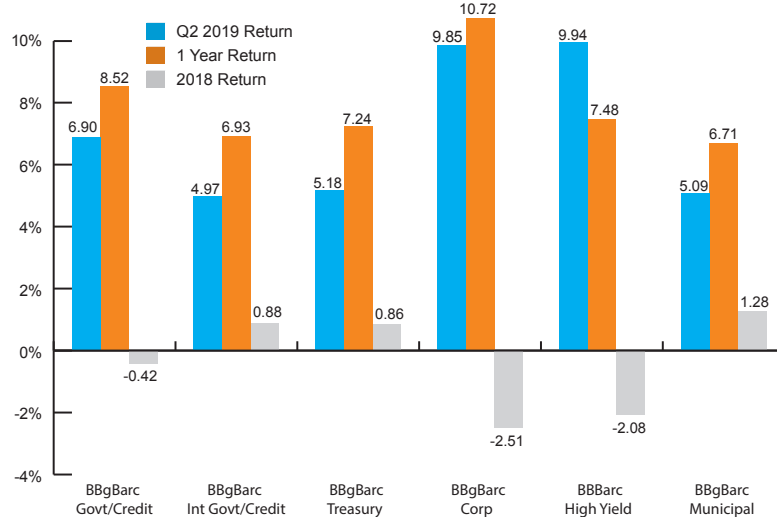
Please see last page for index definitions.

## Q2 2019 Treasury Yield Changes



Source: Bloomberg Barclays. Please see last page for index definitions.

## 2019 Index Returns



Source: Morningstar Direct. Please see last page for index definitions.

## Important Disclosures

Any opinions expressed here are statements of judgment on this date and are subject to future change without notice. This information may contain forward looking predictions that are subject to certain risks and uncertainties which could cause actual results to differ materially from those currently anticipated or projected. The information contained herein has been compiled from sources believed to be reliable; however, there is no guarantee of its accuracy or completeness. There is no guarantee that a company will continue to pay a dividend. The investment return and principal value of an investment will fluctuate. Small and mid cap company stocks may be more volatile than stocks of larger, more established companies. The portfolios may invest in foreign securities which are subject to additional risks such as currency fluctuations, political instability, differing financial standards and the potential for illiquid markets. The information provided in this letter should not be considered a recommendation to purchase or sell any particular security. U.S. Government securities are guaranteed as to timely payment of principal and interest only. Bonds are subject to market and interest risk; values are expected to decline as interest rates rise. Bonds may not be suitable for all investors.

Performance shown is historical and is no guarantee of future results. Investing in securities carries risk including the possible loss of principal.

Data as of 06/30/2019 ©2019 Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

\*The **Goldilocks Economy** term describes an ideal state for an economic system. In this perfect state, there is full employment, economic stability, and stable growth. The economy is not expanding or contracting by a large margin. A Goldilocks economy is warm enough with steady economic growth to prevent a recession.

**Index Definitions:** U.S. Large Caps represented by the **S&P 500 Index**. U.S. Mid Caps represented by the **Russell Midcap Index**. U.S. Small Caps represented by the **Russell 2000 Index**. International Developed Markets represented by the **MSCI EAFE Index**. Emerging Markets represented by the **MSCI EM Index**. Intermediate Term Bonds represented by the **Bloomberg Barclays Intermediate Government/Credit Index**.

The **S&P 500 Index** is comprised of 500 U.S. stocks and is an indicator of the performance of the overall U.S. stock market. The **Russell 2000® Index** measures the performance of the 2000 smallest companies in the Russell 3000 Index, representing approximately 8% of the total market capitalization of the Russell 3000. The **Russell 1000® Value Index** measures the performance of the Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The **Russell Midcap® Index** measures the performance of the 800 smallest companies in the Russell 1000, which represent approximately 25% of the total market capitalization of the Russell 1000. The Russell 2000® Index, Russell 1000® Index and Russell Midcap® Index are trademark/service marks of the Frank Russell Co. Russell® is a trademark of the Frank Russell Co. The **Morgan Stanley Capital International Europe, Australia and Far East (MSCI EAFE) Index** is an unmanaged index composed of the stocks of approximately 1,000 companies traded on 20 stock exchanges from around the world, excluding the U.S., Canada, and Latin America. The **Morgan Stanley Capital International Emerging Markets (MSCI EM) Index** is a capitalization-weighted index of stocks from 26 emerging markets that only includes issues that may be traded by foreign investors. The reported returns reflect equities priced in US dollars and do not include the effects of reinvested dividends. The **Bloomberg Barclays U.S. Corporate High Yield Index** measures the U.S. dollar-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. The **Bloomberg Barclays Intermediate Government/Credit Index** is an unmanaged index composed of debt securities with maturities from one to ten years issued or guaranteed by the U.S. Treasury, U.S. Government agencies, quasi-federal corporations and fixed rate dollar denominated SEC-registered corporate debt that are rated investment grade or higher by Moody's Investors Service and Standard and Poor's Corporation or Fitch Investor's Service, in that order. The **Bloomberg Barclays Municipal Index** covers the U.S. dollar-denominated long-term tax exempt bond market. The **Bloomberg Barclays U.S. Government/Credit Bond Index** measures the non-securitized component of the U.S. Aggregate Index. It includes investment grade, U.S. dollar-denominated, fixed-rate Treasuries, government-related and corporate securities. The **Bloomberg Barclays U.S. 1-3 Year Government/Credit Index** includes all medium and larger issues of U.S. government, investment-grade corporate, and investment-grade international dollar-denominated bonds that have maturities of between 1 and 3 years and are publicly issued. The **Bloomberg Barclays U.S. 1-5 Year Government/Credit Index** measures the performance of U.S. dollar-denominated U.S. Treasury bonds, government related bonds (i.e., U.S. and non-U.S. agencies, sovereign, quasi-sovereign, supranational and local authority debt) and investment grade U.S. corporate bonds that have a remaining maturity of greater than or equal to one year and less than five years. The **Bloomberg Barclays Intermediate Corporate Index** The Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers. The **Dow Jones Industrial Average® Index** is a price-weighted measure of 30 U.S. blue-chip companies. The index covers all industries except transportation and utilities. A **Municipal Security's Credit Rating** is the grade a rating agency assigns to indicate the risk of default and, in some cases, takes into consideration the potential loss to investors in the event of default. Further information and a more extensive discussion credit ratings can be found in the MSRB Education Center. EMMA users should refer to the specific rating definitions provided by each rating agency to gain a more complete understanding of the meanings of ratings assigned by the rating agencies. Users are cautioned that rating agencies may assign different meanings to similar terms. <http://emma.msrb.org/emmahelp/UnderstandingCreditRatings.aspx>. For a portfolio of bonds, average **effective maturity** is the weighted average of the maturities of the underlying bonds. A **duration** is a measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates.

An investor cannot invest in these indices and their returns are not indicative of the performance of any specific investment.