MARKET REVIEW & COMMENTARY

OCTOBER 2018

TELEMUS®

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MARKET REVIEW

OCTOBER

October provided the exclamation point to the ten year anniversary of the 2008 market drop! It was a real character-builder. The month reversed most of this year's hard-won gains and drove international bourses further into the red. In the U.S., high dividend paying stocks held up the best, large caps did better than small and 'value' significantly outperformed 'growth' across capitalizations as tech stocks took a beating. Bonds significantly outperformed stocks, as we would expect during a rout. Bond returns were mixed with shorter durations gaining while longer paper fell in proportion to duration. Real assets were mixed while hedge fund strategies were mostly negative.

Specifically, high dividend payers declined -4.47%, the S&P500 fell -6.84% and the tech-heavy NASDAQ, which attracted so much media attention, slumped -9.16%. Large growth dropped -8.94%, while large cap value decreased -5.18%. Mid cap growth fell -9.90% while its value counterpart lost -7.20%. Small cap growth lost -11.41% while small value stocks decreased -8.61%. International equities were also negative. Europe lost -7.63% and EAFE fell -7.96%. Emerging markets lost -8.71% but riskier frontier markets were down 'only' -3.53%.

October continued September's mostly negative fixed income returns as interest rates reversed their August slump and continued to rise. Short paper continued to outperform longer duration. Municipals underperformed on the short end, but corporates replaced Treasuries as the long duration losers; reflecting a nascent preoccupation with the topping of economic growth. Specifically, 1-5 year government/credit rose a slight +0.05% while 1-5 year municipals lost -0.07% and 3-5 year Treasuries gained +0.09%. The Bloomberg Barclays long credit index was down -3.61% while 10 year municipals lost -0.58%, and the Bloomberg Barclays long Treasury index fell -1.20%. TIPS lost -1.43% while high yielders fell -1.60%. World bonds were down -1.10% in dollar terms, and emerging market debt fell -2.10%.

Alternatives generally lost money with the HFRX Global Hedge Fund Index down -3.11%, the HFRX Absolute Return Index losing only -0.11%, and the HFRX Relative Value Arbitrage Index declining -1.04%. Real assets were mostly down as well. The Philly Stock Exchange Gold/Silver Index fell -1.38% while real estate was hit hard again as global and U.S. real estate both lost over -2.55% in the month on rising rates. Global natural resources fell -10.67%, crude oil lost -10.73%, while the Bloomberg Commodity Index declined -2.16%. However, the dollar rose +2.10%.

MARKET REVIEW

YEAR-TO-DATE

Volatility has increased, turning each market gain back to neutral this year. This choppy market action reflects the slow transformation of market and economic tailwinds into nascent headwinds. Returns on diversified portfolios are now mostly negative as markets look ahead to slowing but positive growth, and the growing adverse impact of trade wars. The disparity between the returns of 'growth' and 'value' stocks narrowed significantly in October but remains large. U.S. growth stocks are up +6.61% (large cap growth),+2.16% (mid cap growth) and +3.20% (small cap growth). U.S. value stocks have returned -1.46% (large cap value), -4.29% (mid cap value) and -3.90% (small cap value). The S&P 500 is positive year-to-date, up +3.01%, high dividend payers are up a more modest +1.16%, and the tech heavy NASDAQ remains up the most despite recent rhetoric, up +6.71%. International equities continue to underperform. For the year-to-date EAFE is down -9.29%, and Europe has fallen -9.90%. Frontier and emerging markets have experienced the deepest liquidity woes, and their market returns reflect that. Year-to-date frontier markets and emerging markets are both down over 15%.

Fixed income returns are also now mostly negative for the year as interest rates popped up over the prior 2018 highs in October. Shorter term paper remains up a bit. 1-3 year Treasuries are up +0.39%, 3 year municipals are up +0.58%, and 1-3 year corporate paper gained +0.77% year-to-date. Longer paper is down, but corporates have replaced Treasuries as the worst performers. The 10-20 year Treasury Index is down -5.29%, the Bloomberg/Barclay Municipal 10yr Index has lost only -1.23 %, and the Bloomberg Barclays long credit index has fallen -8.63%. Floating rate notes are up +2.09% while TIPS are down -2.27%. As investors stretch for yield, high yield U.S. corporate paper remains up a skinny +0.93%, mortgage backed paper is down -1.70%, world government bonds have lost -3.62%, and emerging market paper has lost -6.70% year-to-date.

In a recurring theme, alternative investment returns have been broadly negative. The HFRX Global Hedge Fund Index is down -4.30%. HFRX Equity Hedge strategies are down -4.81%; HFRX Event Driven strategies have lost -9.83%, while Macro strategies have lost -3.80%. Real asset returns have been broadly mixed and volatile. Year-to-date the Bloomberg Commodity Index has lost -4.14%, precious metals are down -21.79%, and global real estate has lost -5.35%. The U.S. dollar has been volatile, but remains up +5.43% for the year-to-date.

INDEX RETURNS AS OF 10/31/2018

BASIC INDEX RETURNS	MONTH TO DATE RETURN	QUARTER TO DATE RETURN	YEAR TO DATE RETURN	LATEST 3 YEARS RETURN	LATEST 5 YEARS RETURN	LATEST 10 YEARS RETURN
BALANCED INDEX (50% ACWI, 35% US Gov. Cr 1-5, 5% HFRX, 5% commodity, 5% bill)	-4.01%	-4.01%	-2.23%	13.32%	16.98%	75.10%
HFRX GLOBAL HEDGE FUND INDEX	-3.65%	-3.65%	-4.84%	1.28%	0.16%	13.92%
CPI - SEASONALLY ADJUSTED	0.00%	0.00%	1.65%	5.90%	7.79%	16.15%
S&P 500 COMPOSITE	-6.84%	-6.84%	3.01%	38.70%	71.11%	246.68%
LIPPER LARGE - CAP CORE	-6.88%	-6.88%	1.80%	35.75%	60.66%	214.37%
WISDOM TREE LARGE CAP DIVIDEND	-4.47%	-4.47%	1.16%	37.09%	64.38%	217.81%
MSCI ALL COUNTRY WORLD INDEX NET	-7.49%	-7.49%	-3.96%	25.07%	34.75%	153.44%
MSCI EAFE NET	-7.96%	-7.96%	-9.28%	11.27%	10.52%	94.73%
BLOOMBERG BARCLAYS MUNICIPAL BOND 5Y (4 - 6)	-0.19%	-0.19%	-0.09%	2.74%	8.26%	38.98%
BLOOMBERG BARCLAYS US AGGREGATE	-0.79%	-0.79%	-2.37%	3.15%	9.52%	47.15%
BANK OF AMERICA / MERRILL LYNCH US T - BILL 3MONTH	0.18%	0.18%	1.48%	2.72%	2.79%	3.52%

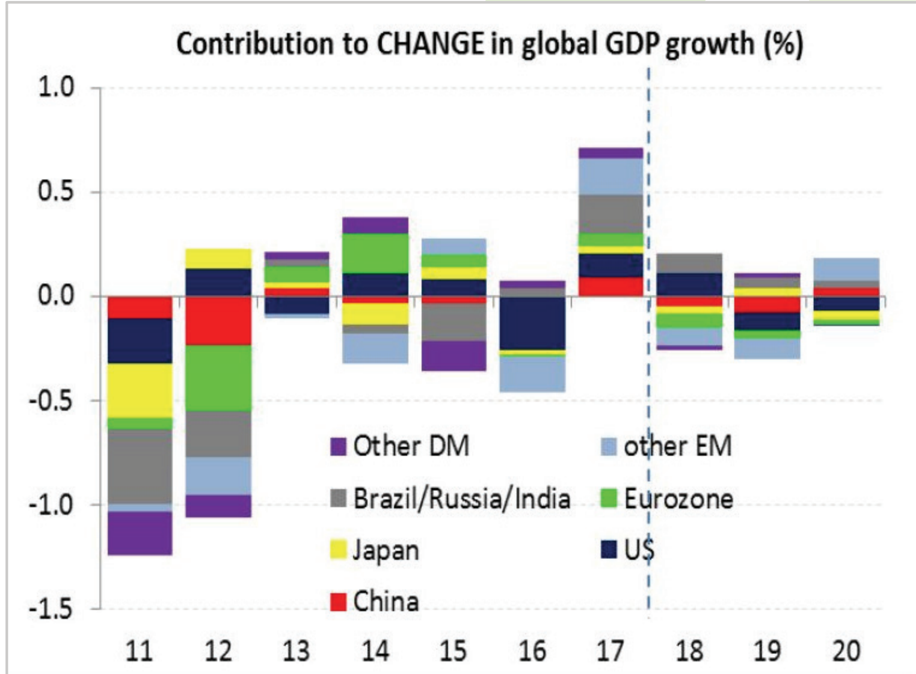
EXTENDED INDEX RETURNS	MONTH TO DATE RETURN	QUARTER TO DATE RETURN	YEAR TO DATE RETURN	LATEST 3 YEARS RETURN	LATEST 5 YEARS RETURN	LATEST 10 YEARS RETURN
RUSSELL 1000 GROWTH	-8.94%	-8.94%	6.61%	46.87%	87.79%	320.78%
RUSSELL 1000 VALUE	-5.18%	-5.18%	-1.46%	29.09%	51.11%	191.67%
RUSSELL MIDCAP GROWTH	-9.90%	-9.90%	2.16%	34.54%	61.77%	307.98%
RUSSELL MIDCAP VALUE	-7.20%	-7.20%	-4.29%	26.52%	47.67%	250.10%
RUSSELL SMALL CAP COMP GROWTH	-11.41%	11.41%	3.20%	40.42%	61.36%	330.85%
RUSSELL SMALL CAP COMP VALUE	-8.61%	-8.61%	-3.90%	28.14%	39.56%	208.04%
MSCI EM (EMERGING MARKETS) NET	-8.71%	-8.71%	-15.72%	20.88%	3.97%	112.74%
BLOOMBERG BARCLAYS US TREASURY BILL 6 MONTH	0.19%	0.19%	1.50%	3.23%	3.61%	5.82%
BLOOMBERG BARCLAYS US AGENCY	-0.15%	-0.15%	-0.69%	2.22%	6.90%	28.80%
JP MORGAN EMERGING MARKET BOND INDEX(EMBI) + COMPOSITE	-2.10%	-2.10%	-6.70%	8.93%	17.31%	120.08%
CITI GROUP WORLD GOVERNMENT BOND	-1.10%	-1.10%	-3.62%	4.01%	-1.04%	25.59%
BLOOMBERG COMMODITY	-2.16%	-2.16%	-4.14%	-2.06%	-31.57%	-34.73%
ALERIAN ENERGY MLP	-7.99%	-7.99%	-2.57%	-4.48%	-21.95%	121.78%
PHILADELPHIA STOCK EXCHANGE GOLD / SILVER	-1.38%	-1.38%	-24.62%	24.94%	-32.39%	-20.70%
LIPPER GLOBL NAT RES	-10.67%	10.67%	-11.41%	14.60%	-17.61%	33.26%
LIPPER PRECIOUS METAL FUND	-1.19%	-1.19%	-21.79%	17.02%	-22.73%	15.45%
MSCI WORLD REAL ESTATE	-3.63%	-3.63%	-5.35%	10.01%	23.81%	135.15%
LIPPER REAL ESTATE FUND	-3.72%	-3.72%	-2.43%	12.23%	38.45%	138.11%

Note: The data is cumulative not annualized. All data in U.S. dollars.

MACRO REVIEW

We are near the peak of the cycle and can see ahead to the end. The rate of global growth continues to lessen almost imperceptibly, and QT is replacing QE globally, at only a slightly faster pace. However, in the U.S., unemployment remains near historical lows, consumers are still confident, and the trade wars are hurting everyone else more than us.

Global growth remains positive, but the downside risks we have highlighted have begun to materialize. We believe that the best times are now in the rear-view mirror. The International Monetary Fund (IMF), in its World Economic Outlook Update (WEOU) of October 2018 projects still comfortable global growth of 3.7% for the 2018-2019 period, albeit 0.2% lower than its April projections. The U.S. is expected to slow somewhat in 2019 from its strong performance in 2018, however, growth in many places has become wobbly. A chart reflecting contributors to the change in global growth appears to the right.



Source: UBS, Haver

MACRO REVIEW

The Eurozone and U.K. growth rates are expected to slow somewhat also following the third consecutive drop in euro area investor morale. Trade tensions, banking sector weakness, Brexit and, Italy's budget issues are all to blame. Projections for Argentina, Brazil, Iran and Turkey have all decreased while emerging energy exporters' prospects have brightened. Trade issues are expected to dent growth in China and many Asian economies for, as we pointed out in our August letter, those countries rely much more heavily on exports than does the U.S. Finally both Germany and Japan are expected to log negative growth in this quarter. The IMF's map of world growth appears to the right.

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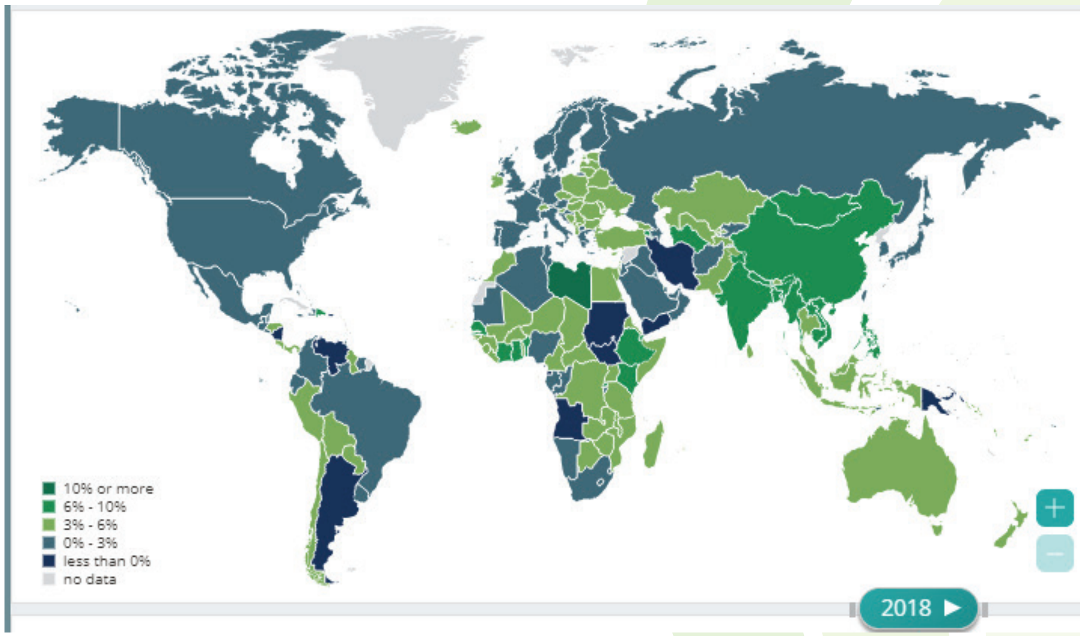
WORLD MAP OF GROWTH IN COLORS ATTRIBUTION, REAL GDP GROWTH ANNUAL PERCENT CHANGE

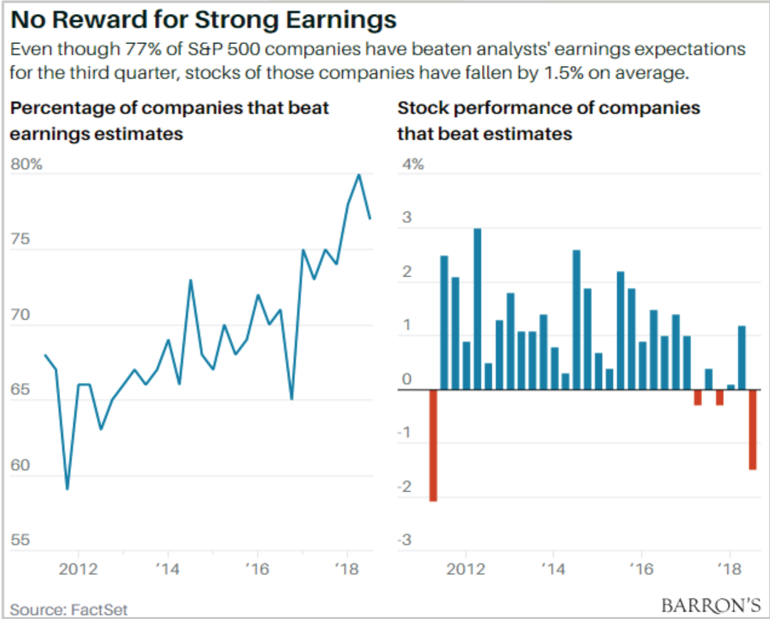


Source: IMF DataMapper, WEOU October 2018

MACRO REVIEW

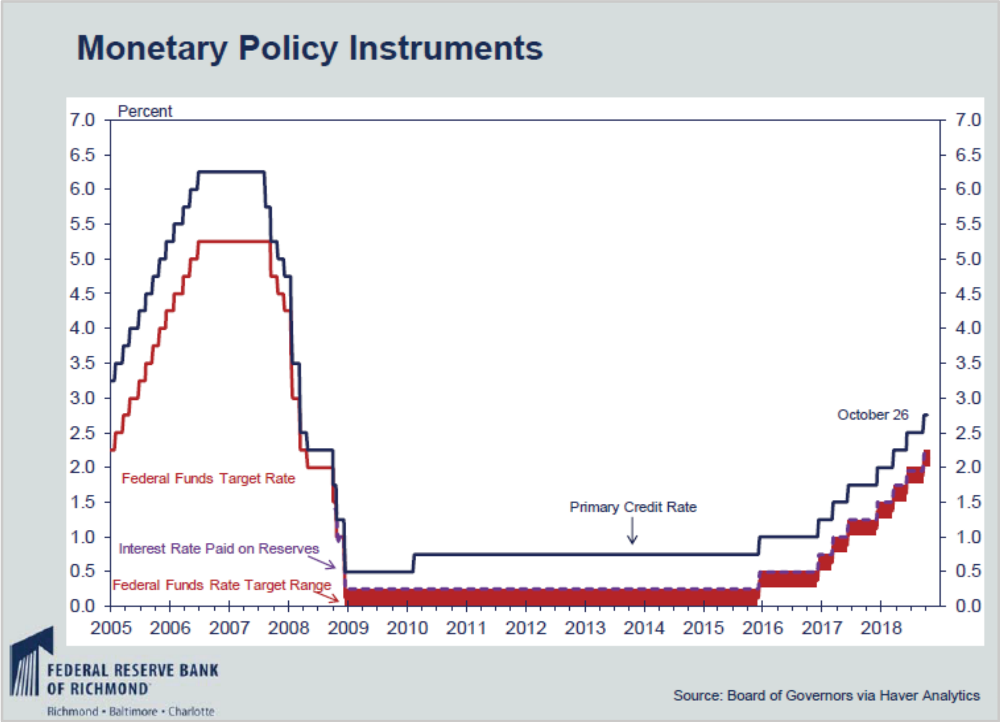
Here at home, deficit spending and tax cuts have replaced QE and zero percent interest rates as growth drivers. GDP growth is expected to come in at about 2.9% for all of 2018 but moderate to about 2.5% next year. Household net worth continues to exceed the 2006-2007 peak, the ISM manufacturing, and service indices continue near ten year highs, and corporate earnings are strong. However, household net worth will falter with any drop in stocks or real estate. U.S. manufacturing is likely to be hit harder should tariff tiffs persist, and corporate earnings growth has topped and will likely level off slowly.

In recognition of the headwinds impacting earnings, companies beating estimates actually underperformed for the first time since 2011.



MACRO REVIEW

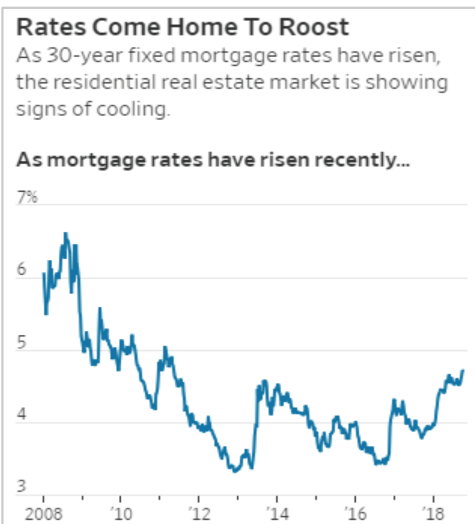
The U.S. continues to repatriate debt it purchased as part of QE and to raise rates. Since our economy is so strong we have been able to withstand the tightening and keep growing. However, the impact of our rising rates has been felt the world over, and our current discipline will continue to roil other countries not similarly situated.

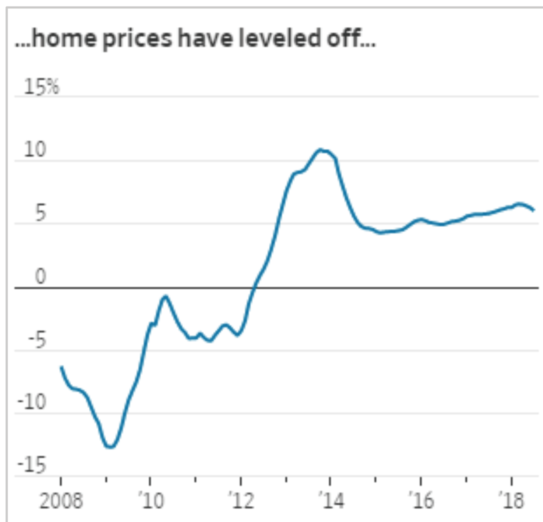


MACRO REVIEW

Rising rates have also almost imperceptibly begun to impact the U.S. economy. Short rates have risen at a much faster pace than long rates but long rates are still up. Mortgage rates bottomed around 3.6% in 2016 but now hover around 4.75%. Historically, these rates remain low but the impact on the market has been that home prices have leveled off, in general.

“The housing market has a momentum problem” according to the eponymous Roger Shiller, co-creator of the CoreLogic Case Shiller housing indices.





Sources: Freddie Mac (rates); S&P CoreLogic Case-Shiller National Home Price Index (prices); National Association of Realtors (sales)

CONCLUSION

Soon, market valuations will not be so easily justified by high but falling profits. The transition from QE to QT further removes the cushion from beneath our markets. So it is important to pay attention to valuations versus future growth and to maintain allocations which are appropriate for your risk tolerance.

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