MARKET LETTER

PACIFIC PORTFOLIO CONSULTING, LLC

First Quarter 2019

WE'RE GONNA PARTY LIKE IT'S YOUR BIRTHDAY

Having closed out 2018 with one of its worst quarterly showings since the financial crisis, the ongoing bull market in stocks celebrated its 10th birthday in Q1 by posting its strongest quarter since just after the start of the recovery back in 2009 (and its best 1st quarter in over 20 years), as a 24% rally (as of this writing) off the late-December lows has left the S&P 500 less than a percent shy of a new all-time high.

Although everyone got an invitation to the birthday party, not everyone has felt like celebrating. Certainly, some investors may be feeling anxious or skeptical; the ride has been quite a bit bumpier over the past year or so and, much as we try to dissuade them of the idea, the behavior of many investors hints at a continued belief in some sort of "expiration date" fatalistically poised to bring about the bull's imminent demise. Others – specifically, those who failed to stick with their long-term game plan – may be smarting over having missed out on much of what this market has had to offer: global stocks are up more than three-fold over the past decade, while even a diversified investor holding a balanced mix of stocks and bonds has enjoyed returns north of 8% per year over that time.

Many Happy Returns! (Pun Intended)

Despite some close calls along the way, this past March marked the 10th anniversary of the start of what is now the longest equity bull market on record. Investors with the discipline to stick with their investment strategy have been well-rewarded over that time: while gains have been far from evenly distributed – the U.S. has been the clear leader and, within that, large-cap and growth-oriented names in particular –global financial markets for both stocks and bonds have turned in solid performance. Reinforcing the idea that this may well be the most-hated bull market in history, however, many investors seem to have given in to their discomfort and taken money off the table prematurely: equity mutual funds have shown a clear pattern of outflows whenever the market has corrected, including massive outflows at year-end 2018 even as a dramatic recovery was getting underway.

Unfortunately, there's no shortage of people in that whole "missing out" camp, including many who likely sold out in December and have found themselves stuck on the sidelines ever since. The fact is that individual investors have been pulling money out of stocks fairly consistently whenever the market has made even a minor misstep (once again, perhaps a side-effect of the lasting muscle memory created by the crisis), with over \$900 billion flowing out of stock funds since the March 2009 market bottom and roughly one and a half times that amount directed *into* bond funds.

Frankly, our relatively contrarian nature leaves us quite comfortable leaning against the broad consensus; as a result, this lack of love for the equity market suits us just fine, as we view it as forestalling the sorts of excesses in sentiment and positioning typically associated with the end of a bull market cycle. While cautiously optimistic, however, we would warn against any attempt to project forward the pace of gains seen year-to-date (the S&P 500 returned +13.65% in Q1 alone, which – if sustained – would imply an eye-popping full-year return of some +67%!). Our Investment Committee came

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into 2019 looking for moderately positive returns from stocks for the year and while we certainly have gotten that, it has come within a drastically shorter timeframe than anticipated. Nonetheless, we continue to see the potential for further stock market upside from current levels, as economic growth stabilizes – and even improves in some areas – while several of the key risks that have loomed large on the horizon for some time now continue to recede, buoying sentiment and, thereby, market multiples. Importantly, beyond merely new highs for the S&P 500, we believe this sets the stage for gains across a broad range of sectors, capitalization segments, and geographies within the global stock market, albeit paired with a continuation of the more "normal" market conditions we have seen over the past year, conditions characterized by the potential for periodic corrections and the inevitable spike in market volatility levels.

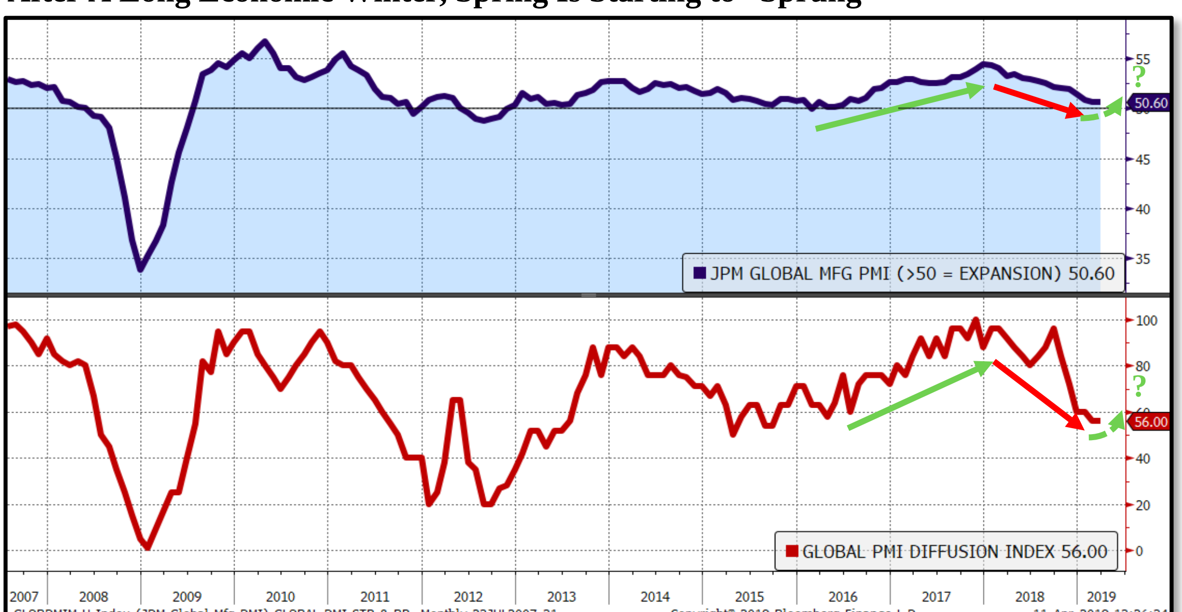
IT'S NOT A PARTY WITHOUT PUNCH (CUE THE FED!)

Perhaps counter-intuitively, the market's sharp advance during the 1st quarter took place against the backdrop of the broad-based slowdown in global economic activity that has been unfolding over roughly the past year. Here in the U.S., GDP growth for 4Q 2018 was revised lower to a rather underwhelming +2.2% (in spite of which the year-over-year growth rate remained a solid +3.0%); meanwhile, although most measures of consumer confidence have held up relatively well, business confidence recently has seen a sharp retrenchment (granted, from an extremely elevated level). Finally, even the labor market has given the market a hiccup or two in recent months (although we believe those will most likely turn out to be red herrings rather than red flags).

Certainly, some deceleration in the pace of U.S. activity really should not come as a surprise, as the GDP-juicing effects of the 2017 fiscal stimulus continue their inexorable fade. The U.S. is not alone, however: in particular, China – the second-largest economy behind the U.S. – has shown clear signs of slowing as well. Once again, this can hardly be deemed a "spoiler", as the pace of Chinese economic growth has been edging steadily lower for most of the past decade. For the past several years, the Chinese government's attempts to re-orient the economy away from investment and towards consumption have exacerbated this trend, as likely has the ongoing trade conflict with the U.S. more recently.

The fact is, though, that there really has been no shortage of mixed economic data across the global economy over the past couple of quarters, notably in Europe – where many countries are big exporters to China – as well as in a number of emerging market economies, many of which live within the "China supply chain" and, thus, tend to catch a cold whenever China sneezes. As a result, the global manufacturing PMI index (a broad, global survey of business activity and conditions) has declined steadily for the past eleven months. While (from an alarmist perspective) this matches in duration a record set back in – you guessed it – 2008, there are a couple of key differences to note in order to interpret this within the proper context. First of all, this time around, the index has declined less than 3 points, whereas it cratered a massive 18 points during the

After A Long Economic Winter, Spring Is Starting to "Sprung"

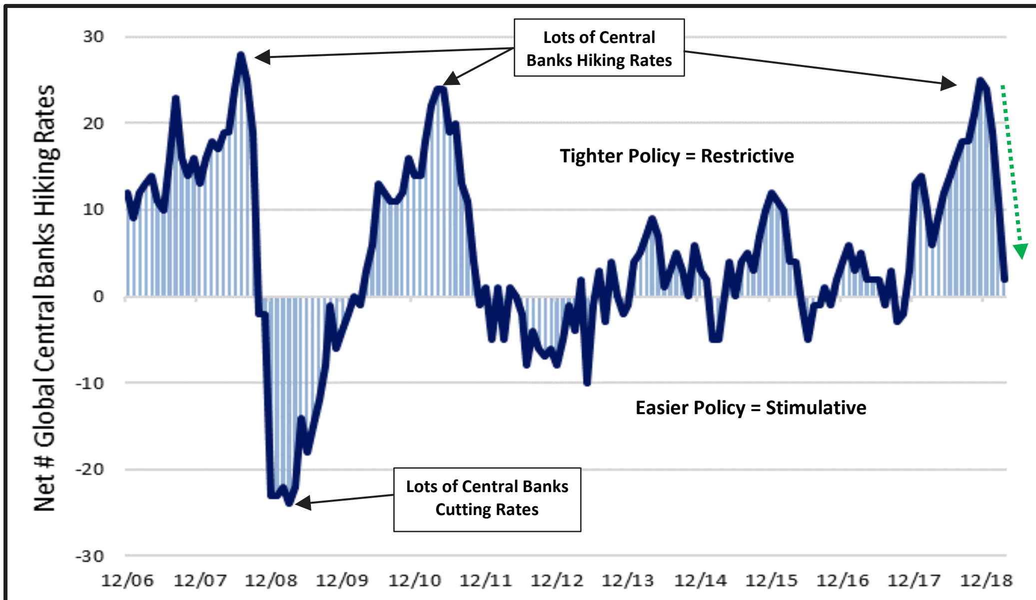


The slowdown in global growth over the past year is clear, with both a weaker – if still expansionary – reading for activity levels as well as a sharp narrowing of the scope of the global expansion, as weakness in some European and emerging market economies has driven the percentage of countries in expansion down rapidly in recent months. Nonetheless, at this stage, we believe the worst is behind us and look for global growth to inflect higher from here, as monetary policy tilts back towards accommodation on a global scale, Chinese stimulus measures continue to gain greater traction, and stagnant European economic data troughs out.

Great Recession. In addition, the current level of the index – at 50.6 – is still indicative of expansion (and, based on its historical relationship with global GDP, consistent with a rate of global growth of around +3.5%), a stark contrast to the massively-contractionary reading of 33 registered back in December 2008. Thus, while it is, indeed, clear indication of a slowdown, one should not infer that the ground is falling out from under the feet of the global economy.

Even so, this distinctly lackluster tone resonating from much of the recent U.S. and global economic data no doubt caught the attention of the Federal Reserve, likely figuring heavily into its decision to engineer one of the most profound reversals in monetary policy history (although it's also likely that investors' distress signals – by way of swooning financial markets late last year – were finally starting to get through to them). While a sturdy if unimpressive U.S. economy and seemingly bull-headed Fed had led us to look for one or perhaps even two quarter-point rate hikes this year, Fed guidance around the definition of their newfound "patience" appears to have all but taken the prospect for any 2019 rate hikes off the table. In addition, the Fed recently provided some welcome (and very market-friendly) guidance around its process for shrinking – or, more precisely, for stopping the shrinking of – its balance sheet. While the Fed has been using the "right-sizing" of its balance sheet – bloated by years of Quantitative Easing (QE) – as an additional means of removing accommodation in its efforts to normalize U.S. monetary conditions, it announced that it would begin tapering and, by September of this year, end the shrinking process, much sooner and at a higher level of assets than markets previously had anticipated.

Catch the Wave: Global Monetary Policy Tides Are Shifting



As economic growth slows around the world, global central banks – their hands in no small way forced by the abrupt and dramatic dovish pivot by the U.S. Federal Reserve – are leaning increasingly towards taking "the pause that refreshes," delaying additional interest rate hikes (or, in some cases, even an initial hike!) in an effort to avoid tipping their economies into recession. This has boosted markets in the short run and should help support economic activity as well. Given signs of any serious inflationary pressures remain conspicuously absent, policy makers – including the Fed – appear to enjoy plenty of leeway to err on the side of caution and remain accommodative for much longer than previously thought.

This abrupt policy U-turn by the Fed has had global ramifications, setting off a global wave of easier monetary policy, as the rest of the world's central banks – many already uneasy in light of current economic and financial conditions – now find themselves extremely hard-pressed to tighten policy as the Fed remains accommodative, slowing their respective economies and boosting the value of their home currencies (and, thereby, likely slowing their economies even further!)

This shift in the Fed's game plan has been a key catalyst driving markets sharply higher these past several months, as it essentially eliminated the market's fear of a Fed policy error prematurely killing off the economic expansion. At this point, however, it would be difficult – though not impossible – for the Fed to produce any more dovish surprises; further, given the economy appears to remain in relatively decent shape and markets are buoyant, current conditions don't appear to give the Fed any incentive to do so. As a result, monetary policy risk now actually has a slightly hawkish bias, given the interest rate *cuts* markets have begun to price in. As a result, the potential for a continuation of the market advance will likely now be more reliant on an improvement in the fundamentals.

WHAT'S NEXT: A HANGOVER OR THE AFTERPARTY?

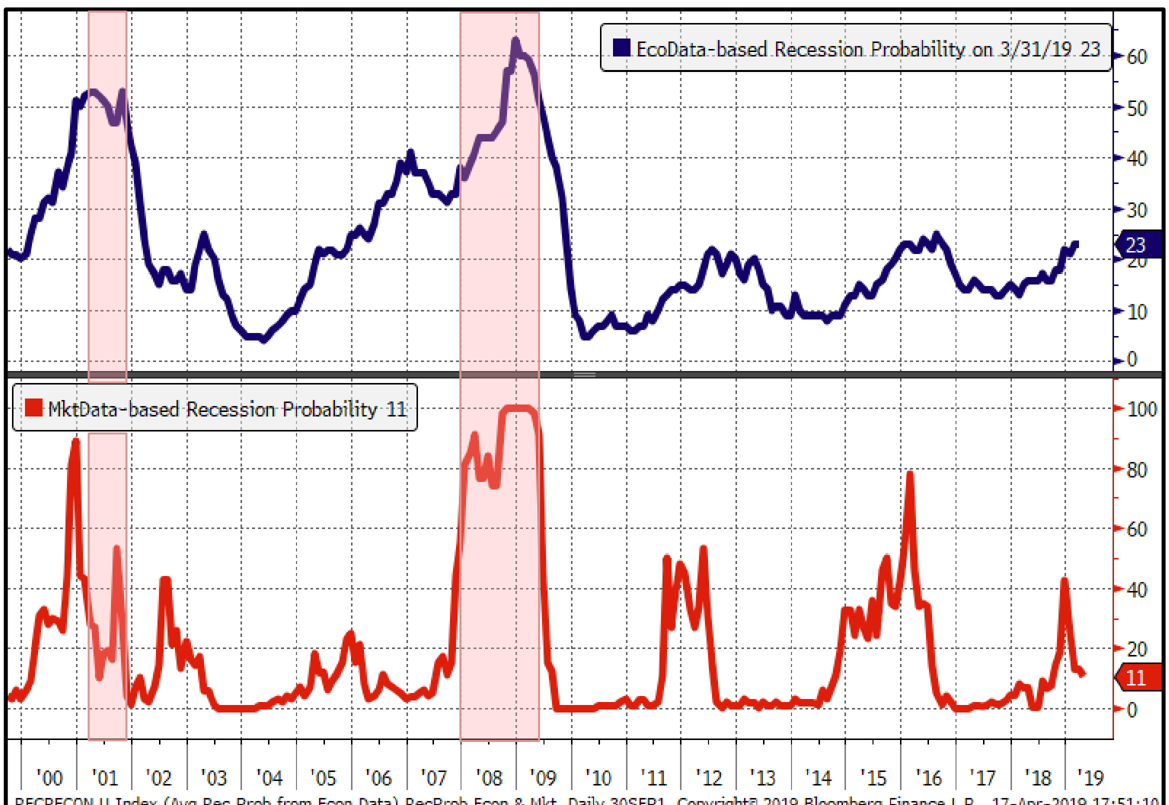
Barring some sort unexpected shock to the system, we don't expect economic conditions to deteriorate to anything near a level needed to justify the Fed fulfilling investors' radically-dovish interest rate expectations this cycle. In fact, we believe we are likely to see global growth begin to inflect upwards, as the benefits of the last six months of Chinese monetary and fiscal stimulus become more evident, boosting the outlook for a broad swathe of global economies reliant on China as the key driver of global growth. Further benefitting both China and the U.S., the potential for a near-term resolution to the ongoing trade war between the two countries appears to be growing, as positive comments from the leaders of both countries increasingly favor the forging of at least a partial deal to allow both parties to save face.

Activity in the U.S., meanwhile, appears gradually to be firming. GDP forecasts for the 1Q 2019 – which, as recently as mid-March, had been pointing to a flat quarter – are now projecting economic growth to come in at an annualized pace of between +1.5% and +2% for the quarter. The labor market – despite giving investors an occasional scare – appears to remain robust, with March's strong payroll number reassuring investors spooked by the wide miss in February, while wages continue to rise gradually. Paired with rising stock markets and home prices – which help drive the wealth effect – this continues to drive high levels of confidence among U.S. consumers (which, as we often note, continue to account for nearly 70% of U.S. economic activity) as well as a reasonably healthy level of activity.

Of course, this begs the question: if weak data were key drivers of the Fed's newly-dovish stance, do we need to worry about another policy flip-flop as things start to get better? While Jay Powell has, in his still short tenure, shown himself to be somewhat more unpredictable than his predecessors, we think the Fed is unlikely to reverse course and abandon its current "patient" approach any time soon. On the one hand, policy makers are increasingly referencing their "symmetrical" view of inflation and goal of reaching their long-term inflation target of 2% "on average". Given that – other than a very brief period in mid-2018 – inflation has not been anywhere near the Fed's 2% target since the early days of 2012, the Fed would seem to have quite a bit of leeway at its disposal to let inflation run "hot" for a time before feeling the need to tighten again. In fact, even if inflation were to jump to +2.5% tomorrow – an extreme and utterly unrealistic scenario at this point, used here strictly to illustrate a point – the three-year average rate of inflation would still not reach the Fed's 2% target until early 2020; similarly, it would be 2021 before a longer-looking five-year average reached such levels.

Overall, these conditions are broadly consistent with our continued view that – while the level of U.S. economic growth will, indeed, moderate relative to last year – a recession remains unlikely near-term. In fact, a gradual reversion to the more modest pace of economic growth the U.S. exhibited prior to the introduction of fiscal stimulus back in late-2017 paired with fairly modest inflation pressures (and a Fed willing to tolerate some overshoot) set the

Slower Growth + Lower Inflation & Rates = Longer Cycle: Recession Risk Is Low



Although the steep decline in financial markets in 4Q 2018 revealed a sharp spike in investors' recession fears, the economic data continued to provide a more sanguine message, one of rising but still relatively modest risk of recession over the coming twelve months. Since that time, markets have breathed a deep sigh of relief, sending the implied probability of recession back down rapidly, such that the market-implied risk is now lower than that implied by the economic data. Even that measure, however, continues to point to just a 23% probability of recession, well below the level that historically has been seen prior to entering an economic contraction – and even that measure currently is being driven primarily by the extremely shallow slope of the yield curve, without which the implied probability drops back to just 16%.

stage for an even more gradual removal of monetary accommodation than previously expected, all of which creates conditions in which the current economy expansion – soon to be the longest on record – is likely to continue longer than previously thought.

As recession is kept at bay and global growth stabilizes, the backdrop for return-seeking assets looks relatively favorable, though the need to digest considerable year-to-date gains can't be ignored. Nonetheless, stocks are now only reaching valuation levels in-line with their long-term averages, while better economic growth is likely to provide support – if not an outright boost – to earnings estimates, broadly consistent with our Investment Committee's outlook for further equity market upside going forward. While markets have retained somewhat of the defensive bias evident in recent years – during which investors piled into large-cap U.S. growth stocks at the expense of pretty much everything else – participation has been somewhat broader recently. Non-U.S. markets displayed solid upside in Q1, even if they did not quite keep pace with the U.S., with developed large-cap, small-cap, and emerging foreign equity markets gaining around +10%; in spite of this, all remain in negative territory for the full year. Although foreign stocks had begun to outperform their U.S. counterparts by a sizable margin during last December's decline, investors' belief in the superior economic and earnings growth available in the U.S. has – other than an occasional respite – driven the fairly steady and often sizable outperformance of U.S. stocks over much of the post-crisis period. This was most certainly the case once again in 2018, driving wide divergence between U.S. and foreign stock market performance, a situation that, we believe, may begin to resolve itself as U.S. growth cools and foreign growth improves, but also one that has worked squarely against globally-diversified strategies like those we construct for our clients over the past year.

While much the same could be said about small- and mid-cap stocks, which have often played second fiddle to the largest-capitalization stocks in recent years, roles have reversed thus far in 2019, with the smaller – and more cyclical – market segments leading the pack. Similarly, although much of the past several years has been all about growth stocks – specifically, Tech, Consumer Discretionary, and Health Care – a number of the more cyclically-sensitive sectors have managed to work their way up the performance food chain recently, not only benefitting diversified investors but also creating what we view as a broader and healthier foundation for this market to stand on.

On the fixed income front, the outlook for the remainder of 2019 continues to look fairly benign – in fact, even more so than we had anticipated coming into the year. With little poised to drive either short- or longer-term interest rates meaningfully higher near-term, there is likely to be considerably less benefit to be derived from a shorter-duration bias within core fixed income; meanwhile, although we continue to believe tighter credit spreads will limit capital appreciation potential going forward, the credit space remains relatively attractive against our favorable economic backdrop, which should keep defaults at bay.

Within Alternatives, meanwhile, despite mixed recent results, our Investment Committee continues to believe an allocation to this space presents a valuable tool for diversified investors; although traditional assets of all type have done extremely well lately, forward returns in these areas are likely to be quite a bit more modest than that to which investors have become accustomed in recent years. Thus, while we have been tweaking the make-up of the exposure in our clients' portfolios, we continue to hold a meaningful sleeve of exposure to non-traditional assets and strategies as a means of hedging against market risk within equities and interest rate and default risk within fixed income, an approach we believe will prove particularly valuable if traditional asset markets become volatile once again, as we expect they may.

Finally, we continue to note the importance of a risk management mindset to temper our reasonably favorable current economic and market outlooks, through use of a long-term, strategic, globally-diversified asset allocation suited to each client's return objectives and tolerance for risk. Much as market volatility and periodic corrections may be a normal and healthy part of any market cycle, they are by no means comfortable for investors; nonetheless, as the current cycle has made abundantly clear, the discipline to stick with a game plan represents an essential component of any successful endeavor to accumulate or preserve wealth over the long-run. As such, we encourage you to consult with your Advisor should you be contemplating any significant changes in strategy; meanwhile, we invite you to reach out to Jim Ayres, our company's Chief Investment Officer, or your Advisor with any questions you may have with regard to your portfolio or the market.

1ST QUARTER 2019 CAPITAL MARKET PERFORMANCE

Index (as of 3/31/2019)[1]	1 Qtr	1 Year	3 Year	5 Year	10 Years
FTSE 3-month T-Bills	0.60%	2.11%	1.17%	0.72%	0.41%
Bloomberg Barclays Gov't/Credit Int.	2.32%	4.24%	1.66%	2.12%	3.14%
ICE BofAML US High Yield	7.40%	5.96%	8.65%	4.68%	11.12%
Bloomberg Barclays Multiverse	2.39%	-0.29%	1.85%	1.19%	3.33%
S&P 500	13.65%	9.50%	13.51%	10.91%	15.92%
Russell 1000 Value	11.93%	5.67%	10.45%	7.72%	14.52%
Russell 1000 Growth	16.10%	12.75%	16.53%	13.50%	17.52%
Russell Mid Cap	16.54%	6.47%	11.82%	8.81%	16.88%
Russell 2000	14.58%	2.05%	12.92%	7.05%	15.36%
Russell 2000 Value	11.93%	0.17%	10.86%	5.59%	14.12%
Russell 2000 Growth	17.14%	3.85%	14.87%	8.41%	16.52%
MSCI EAFE	10.13%	-3.22%	7.80%	2.81%	9.47%
MSCI EAFE Small Cap	10.76%	-9.01%	7.90%	4.84%	13.14%
MSCI Emerging Markets	9.97%	-7.06%	11.09%	4.06%	9.31%
MSCI Frontier Markets	6.90%	-14.81%	7.20%	0.93%	7.87%
Wilshire US REIT	16.02%	19.34%	5.45%	9.00%	18.69%
DJ Global Select RESI	13.92%	13.14%	5.05%	7.03%	15.62%
Bloomberg Commodity Index	6.32%	-5.25%	2.22%	-8.92%	-2.56%
Credit Suisse Liquid Alts	4.31%	1.18%	3.06%	2.19%	4.02%
60-40 Balanced EQ/FI – US Only	9.05%	7.69%	8.79%	7.48%	10.87%
60-40 Balanced EQ/FI – Global	8.28%	3.84%	7.47%	5.20%	8.97%

[1] The Bloomberg Barclays U.S. Government Credit Intermediate and Multiverse indices are registered service marks of Bloomberg Finance LP. Barclays is a service mark of Barclays Bank Plc, used under license; the ICE BofAML US High Yield index is a registered service mark of Intercontinental Exchange; BofAML is a service mark of BofA Merrill Lynch, used under license; the S&P 500 Index is a registered trademark of the McGraw-Hill Companies, Inc.; the Russell 1000, Russell 1000 Value, Russell 1000 Growth, Russell Mid Cap, Russell 2000, Russell 2000 Value, and Russell 2000 Growth indices are registered trademarks of the Frank Russell Company; the MSCI EAFE and MSCI Emerging Markets indices are registered trademarks of MSCI or its subsidiaries; the Wilshire REIT index is a registered trademark of Wilshire Associates Incorporated; the DJ global Select RESI index is a registered trademark of Dow Jones Trademark Holdings LLC; the Bloomberg Commodity Index is a service mark of Bloomberg Finance L.P.; the Credit Suisse Liquid Alternative index is a trademark of Credit Suisse Group AG.

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