SIGNATURE RESOURCES
CAPITAL MANAGEMENT

Second Quarter 2018

QUARTER IN REVIEW

The second quarter proved mostly unexceptional. Sure, we could point to headlines and such, intimating at some connection between how markets reacted and reflecting on our portfolios performance amidst those reactions. But, as we often note, such comments would be more conjecture than conviction. Besides, there really wasn't much in the way of highlights (aside from one we'll soon review). Although market volatility has risen, we might concede that markets are beginning to "work" in a manner more like that expressed in their pre-Financial Crisis past, a welcome return to ordinary.

Micro Draws Focus

When it comes to investing, it's easy to find distraction in daily market moves and the headlines ascribed to them. Most are lost with time. But, a bit of shaking can turn into a quake. A few overpriced tech stocks became many, inflating the Tech Bubble. A few ill-advised investments became many, prompting the Financial Crisis. While we'd like as an industry to be able to predict market upsets, such science doesn't yet exist. Still, many are on the lookout for the next big one, a cottage industry that's sprung up since the 2008-09 downturn. That group's attention more recently has grown to include global trade policy.

Tariff Talk Tortures Traders

The expansion in global trade over the second half of the 20th century bolstered growth in the global economy. But, while that positive impact can be seen at the macro level, governments have struggled with negative impacts at the micro level, the most obvious being the loss of employment in those local industries displaced by trade. Given the strong connection between jobs and votes, a focus on reversing those effects is understandable. As U.S. policy, or at least the ramblings thereof, portend a far more protectionist stance, investors are left to work out what impact any near-term moves might have on the global economy. More uncertain, of course, is the path of trade policy going forward. With dominos tipping at multiple points (while we battle with Canada, Mexico, the European Union and China, the UK is struggling to chart its own course of future trade, while a new order in Asia may prove just as disruptive), executives, economists and investors, alike, are left to rework spreadsheets full of interdependent flows of monies and goods.

Macro Matters More

Perhaps the most obvious impact has been the rapid decline in emerging market shares this year, their outperformance over the past two years having been the talk of the town. While we might wish the matter of tariffs resolved without grander disturbance, one must consider the potential for an expanding zone of impact. How to respond, though? Instead of seeking to time the market's eventual reaction to any specific potential outcome, we'll suggest the better route is to focus on our abilities to withstand any potential negative impact—both mentally and in the context of our financial goals—and seek to modulate exposure to the market based on that understanding.

Figure 1: Quarter Summary

Overall Take			
↗	→	Equity: Though the two parts mostly matched movements through the first half of the second quarter, domestic equity gains strongly outpaced global peers as U.S. dollar strength weighted international equity returns. Global markets altogether ended the quarter barely above breakeven	
	→	Fixed Income: Another wild ride for yields in the second quarter, but some easing in rates from a mid-quarter peak left room for now higher income to support in a late-quarter rebound	
Equity			
↑	Domestic A robust Q1 earnings season and generally still favorable levels of macroeconomic activity were offset by increasing fears of a global trade war. A reasonably strong single-quarter return, nonetheless	↓	International A fine start to the quarter was lost amidst growing concerns over the impact of heightened U.S. protectionism and a stronger U.S. dollar

Directions and colors of arrows are indicative of the Investment Team's subjective interpretation of the quarter's market events and performance; green upward (red downward) and orange angled-upward (downward) arrows indicate relatively favorable (unfavorable) reviews in the aggregate. They are not indicative of any specific underlying data. SOURCE: SRCM

Equity Market Review

After a rather disappointing Q1, global equity markets climbed mostly in sync through late April. But, a strengthening U.S. dollar, supported by heightened U.S. protectionist trade rhetoric and still more favorable domestic fixed income yields, left international equity markets flailing through quarter end in USD terms. The broad-based Russell 3000 Index gained 3.9% on a total return basis for Q2, capping a 14.8% rise over the trailing 12-month period. Contrarily, the MSCI All Country World ex. U.S. Index fell 2.6% in USD terms during the quarter, though the trailing 4-quarter tally remained well in positive territory at 7.7%. Emerging market stocks, which had outpaced the global equity benchmark for the trailing four years or so through late January (in USD), sank nearly 8% on the thinking that they might be the worst hit from tariffs related to America's increasingly inward perspective.

Domestically, small-cap stocks strongly outperformed, with Small-Value seeing even greater returns relative to the broader market. Small-caps turned in a comparatively weak run in 2017, with the Value portion especially dismal when compared to the rest of the market. While not entirely back to even over the nearer term, second-quarter gains made up a good portion of that lost ground for the broader small-cap group, at least. The Value component has a bit of a ways to go. Value underperformed more generally in the quarter in the U.S., however, and did so abroad as well. Outside the U.S., performance differentials were larger across the valuation spectrum than they were across size, with small caps only marginally outperforming large-cap stocks, though mid-cap international equities had a better showing. For the past year, small-cap stocks have outperformed quite handsomely outside the U.S.

Figure 2: Trailing Equity-Market Performance

The tables below display the relative performance of different segments of the U.S. and international stock markets. Broad market performance is shown in the upper left of each group (3-month and 1-year periods). The remainder of the table displays the performance of various segments, including large-, mid- and small-cap stocks, Value and Growth stocks, and combinations of each. Segments that outperform (underperform) the broader market are shaded in blue (grey) in depth according to their respective relative performance.

U.S. Stocks

3-Month Period ended 06.30.18

		Value	Growth
All Stocks	3.9%	1.7%	5.9%
Large	3.4%	1.4%	5.2%
Mid	4.3%	5.4%	3.3%
Small	7.8%	8.3%	7.2%

1-Year Period ended 06.30.18

		Value	Growth
All Stocks	14.8%	7.3%	22.5%
Large	14.4%	7.6%	20.6%
Mid	13.5%	11.2%	15.7%
Small	17.6%	13.1%	21.9%

International Stocks

3-Month Period ended 06.30.18

		Value	Growth
All Stocks	-2.6%	-3.8%	-1.5%
Large	-2.8%	-4.0%	-1.5%
Mid	-1.8%	-3.1%	-1.1%
Small	-2.6%	-3.6%	-1.7%

1-Year Period ended 06.30.18

		Value	Growth
All Stocks	7.7%	5.0%	10.4%
Large	6.9%	4.4%	9.6%
Mid	9.0%	5.8%	10.9%
Small	10.6%	7.5%	13.7%

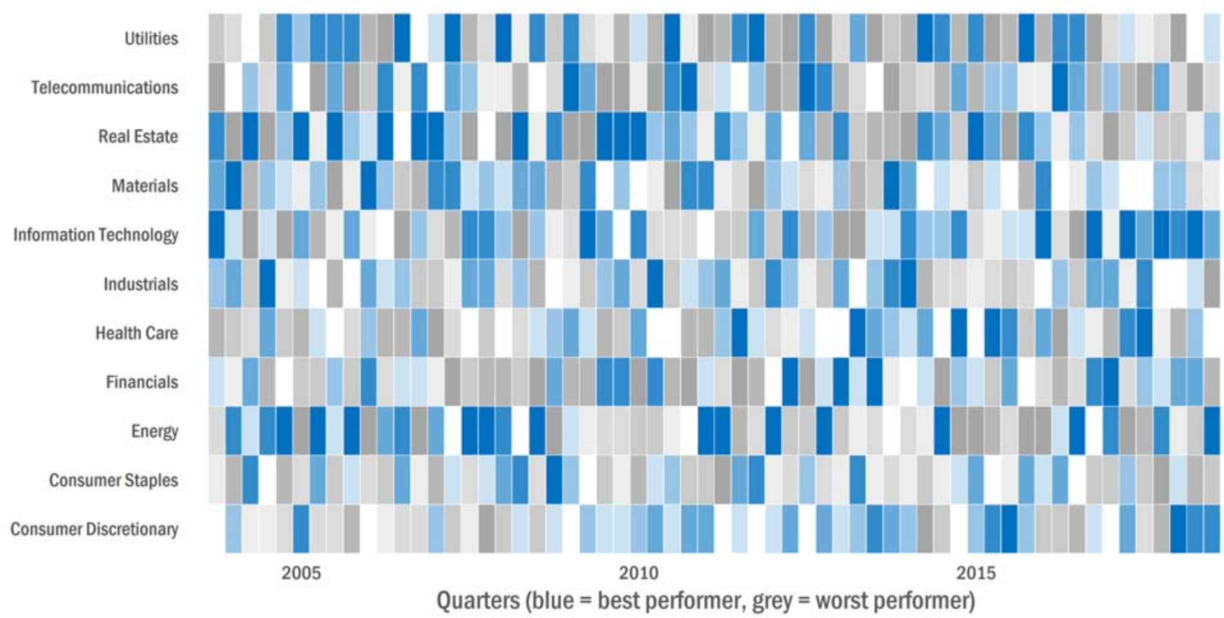
From 06.30.17 to 06.30.18. Data are total returns for the period shown. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report.
SOURCE: SRCM using data from Bloomberg

On Sector Performance

With the present tariff skirmish threatening to turn into a multi-lateral war, we've been asked which sectors will be the winners/losers at the end of it all. The answer, like those to many similar questions, is hard to determine. And that's not least because the nature of the battle, including the fronts and weapons to be chosen are, too, yet unknown. Still, even if we had greater confidence in the nature and course of tariff-related measures, we should be humble in our confidence regarding the outcomes. Regardless of their basis in empirical evidence, most efforts to predict market situations in advance are based far more on informed hypotheses than in widely accepted science.

Lifting the discussion a bit, our own experience and the historical record of the broader investment industry suggest that a focus on picking winners among individual stocks (and/or sectors, countries, etc.) tends to lead to less-than-optimal outcomes and underperformance relative to client expectations. The diversity of outcomes for sector performance in any quarter or year, shown in Figures 3 and 4, supports that basic belief. While some would see the great variability as opportunity, we think that with such unpredictable inconsistency in outcomes over time, the chances of providing regular outperformance seem pretty low.

Figure 3: Quarterly Performance of S&P 500 Sector Indexes, Ranked



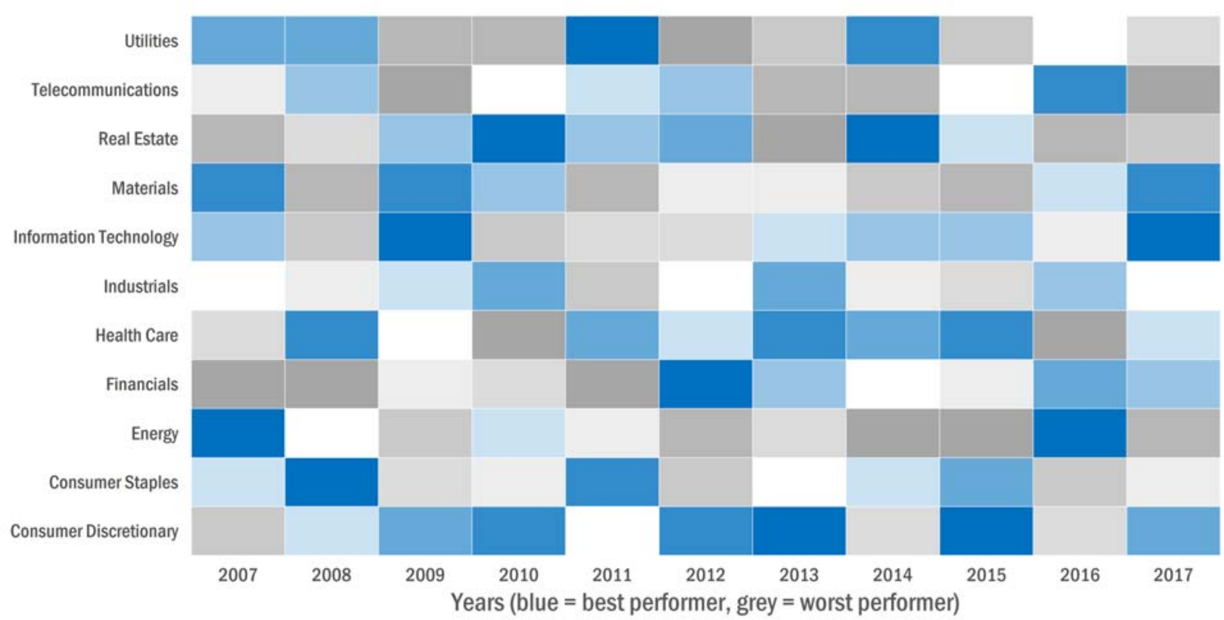
From 06.30.03 to 06.30.18. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

Now, we might allow that one need only bat better than average in terms of choosing which sectors will outperform in order to beat the market. Still, the mere suggestion that such "picking" decisions determine portfolio holdings leaves the review of any outcome open to the shoulda-woulda-coulda conviction that a better course might have been taken in hindsight. Of course, we'd first have to define a defensibly reliable methodology that could result in a better-than-breakeven batting average…

For the relatively meager incremental gain that might be achieved, even under optimistic scenarios, we think market timing is more likely to hinder progress toward long-term financial goals. Instead, we seek to pave a smoother path toward establishing and satisfying client investment expectations. Our starting point is a diversified portfolio of domestic and international stocks that's much like the broader market in terms of numbers of individual stocks owned. In turn, our approach focuses on characteristics that over the course of market history have shown to lead to more favorable outcomes. This additional focus results in tilts away from the composition of the broader market in our portfolios.

But what about those tilts? Aren't they "picks" just the same? Candidly, they are, but ones for which we can find support in the forms of a diversity of evidence, review and oversight. Even so, any manner of outperformance derived from these tilts is not guaranteed. And there's the kicker…the characteristics we choose to emphasize in our portfolios are naturally volatile in terms of relative performance. For this reason, we choose to incorporate stronger tilts into the more risk-tolerant portfolios. To quote our friends at Dimensional Fund Advisors, "While never guaranteed, the value premium has historically had a greater chance of being positive the longer the time horizon observed. Periods of underperformance can happen, but a consistent approach that maintains emphasis on value stocks in all market environments may allow investors to more reliably capture the premium over the long run."[1] Through our Global Target Risk Series, we seek to offer that consistent approach.

Figure 4: Annual Performance of S&P 500 Sector Indexes, Ranked



From 2007 to 2017. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

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[1] Dimensional Fund Advisors, *Where's the Value?* (07.02.18). The *Issue Brief* is available upon request at info@srcmadvisors.com.

Figure 5: Trailing Broad Equity-Market Performance

Broad Equity-Market Indexes

	3 Month	1 Year	3 Year	5 Year	10 Year
Global	0.53	10.73	8.19	9.41	5.80
World ex. U.S.	-2.61	7.75	5.46	6.39	2.93
World ex. U.S. Small-Cap	-2.60	10.57	7.94	8.98	5.77
U.S.	3.89	14.78	11.58	13.29	10.23
U.S. Large-Cap	3.43	14.37	11.93	13.42	10.17
U.S. Mid-Cap	4.29	13.50	10.89	12.69	10.78
U.S. Small-Cap	7.75	17.57	10.96	12.46	10.60
Developed Markets	-1.24	6.84	4.90	6.44	2.84
Emerging Markets	-7.96	8.20	5.60	5.01	2.26

Value Component of Equity Indexes

	3 Month	1 Year	3 Year	5 Year	10 Year
Global	-1.29	5.40	6.09	7.22	4.74
World ex. U.S.	-3.80	5.04	4.02	5.21	2.53
World ex. U.S. Small-Cap	-3.55	7.48	7.26	8.19	6.10
U.S.	1.71	7.25	8.48	10.40	8.60
U.S. Large-Cap	1.40	7.58	8.82	10.45	8.44
U.S. Mid-Cap	5.35	11.17	10.08	11.96	10.44
U.S. Small-Cap	8.30	13.10	11.22	11.18	9.88
Developed Markets	-2.64	4.25	3.30	5.37	2.17
Emerging Markets	-8.94	4.28	2.76	2.77	1.14

Value Component Vs. Aggregate Equity Indexes

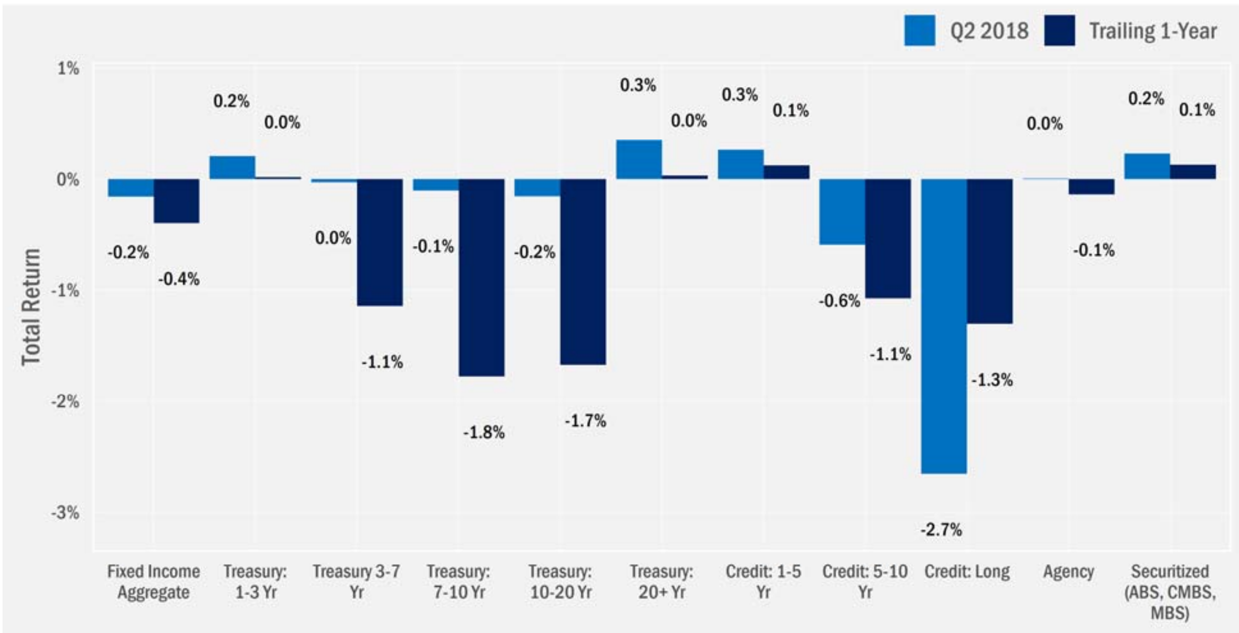
	3 Month	1 Year	3 Year	5 Year	10 Year
Global	-1.82	-5.33	-2.09	-2.19	-1.06
World ex. U.S.	-1.19	-2.70	-1.44	-1.18	-0.41
World ex. U.S. Small-Cap	-0.96	-3.09	-0.68	-0.79	0.33
U.S.	-2.18	-7.53	-3.11	-2.89	-1.63
U.S. Large-Cap	-2.03	-6.79	-3.11	-2.97	-1.73
U.S. Mid-Cap	1.06	-2.33	-0.81	-0.73	-0.34
U.S. Small-Cap	0.55	-4.47	0.25	-1.28	-0.72
Developed Markets	-1.40	-2.59	-1.61	-1.07	-0.67
Emerging Markets	-0.98	-3.93	-2.84	-2.24	-1.12

From 06.30.08 to 06.30.18. Total return data for are annualized for periods greater than 1 year. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

Fixed Income Market Review

The second quarter offered some respite from rising-rate-related woes pressuring fixed income markets since the end of Q3 2017. Though volatile over the three months and still broadly higher, interest rates fell from mid-quarter peaks. And the income generated from yields that now are in territory friendlier to savers offset a good bit of that shift upward in rates.

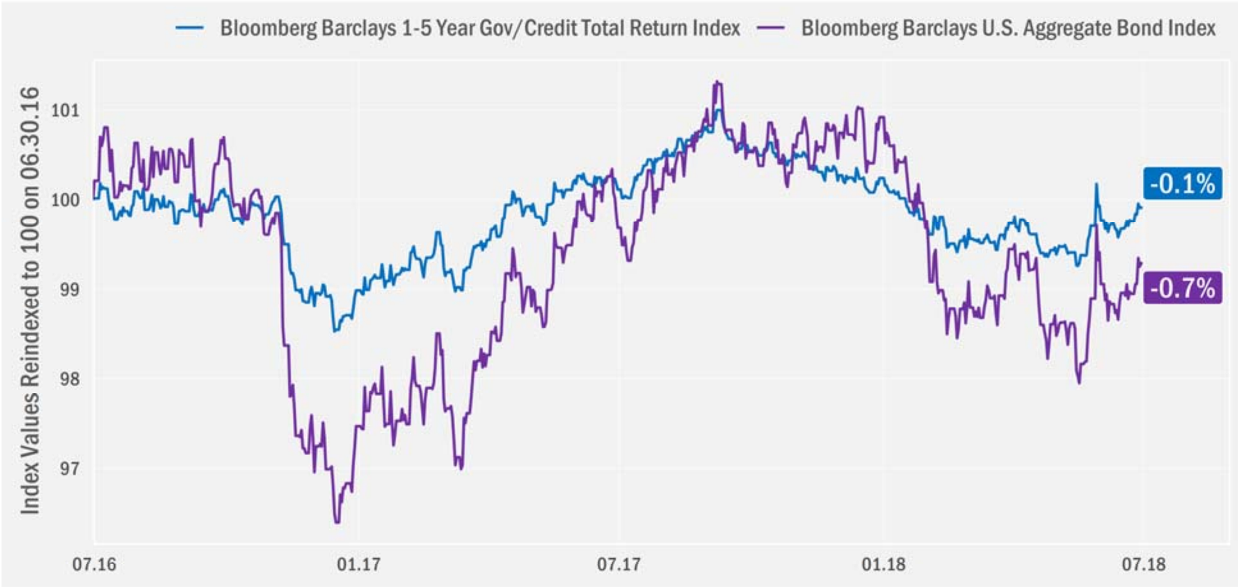
Figure 6: Bloomberg Barclays U.S. Aggregate and Sub-Index Performance



From 03.31.18 to 06.30.18. The Bloomberg Barclays U.S Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. Compone bonds. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfo indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

Nonetheless, the extra volatility of the prior two years, visualized in Figure 7, has left the broader fixed income market still in the red on a total-return basis. The chart also shows our preferred benchmark, which reflects the performance of the U.S. shorter-term investment-grade bond market, versus the broader U.S. investment-grade fixed income market. The relatively lighter volatility and drawdown of the former expresses the relative focus of our preferred approach to fixed income investing.

Figure 7: Fixed Income Benchmark Returns



From 06.30.16 to 06.30.18. The Bloomberg Barclays U.S Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. Components of the index include Treasury, Corporate, Agency and Securitized bonds. The Bloomberg Barclays U.S. 1-5 Year Government/Credit Bond Index, which is a broad-based benchmark that includes investment grade, U.S. dollar-denominated, fixed-rate Treasuries, government-related and corporate securities with maturities between 1 and 5 years. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

SRCM Portfolio Context

Broadly speaking, the gross-of-fee performance of our models, versus their respective benchmarks, ranged from positive to in-line as one moved up the risk spectrum (models with lower overall allocations to fixed income). Within fixed income, less-aggressive models benefitted on a relative basis from decisions to include inflation protection. The portfolios generally also benefited from less-substantial exposure to interest rate risk. Further up the risk spectrum, the increasing exposure to duration reduced the positive performance gap of the fixed income allocation relative to the fixed income benchmark.

Within equity, less-aggressive models benefitted on a relative basis from stronger tilts toward domestic equities and weaker tilts toward Value. These relative benefits were offset somewhat by lower tilts toward smaller-capitalization stocks (which tended to have outperformed in the second quarter). As we move up the models toward those with higher exposures to equity, the generally positive performance gap between the overall equity exposure and that of the equity benchmark narrowed toward a similar result.

Additional composite performance details are available upon request.

Trade-ing Barbs

When the investing environment turns sourer, much as it seems to have over the course of 2018, we find it valuable to refocus our thinking on the longer term. We should revisit the answers to those questions that relate to the long-term intentions for invested savings and one's general comfort with exposure to market risk. Readers might think they've heard such recommendations before. We hope so. In just about every monthly commentary and quarterly market update, the SRCM Investment Team offers the sometime subtle, sometimes not-so subtle reminder that, while no manner of performance can be guaranteed, our focus on the relationship between risk and return in the context of our investment time horizon and tolerance for market volatility can exert powerful influence on our path toward our financial goals.

Accepting that we have no control over how markets behave, we should acknowledge our ability to modulate our exposure to investible markets and our reactions to the various moves that they will make. We continue to believe that advisors can serve as valuable coaches in such efforts, providing both the initiative and information to address how we think about investing, while seeking to tune invested assets in a manner that may provide a more comfortable investing experience. We invite readers to reach out to their advisors to revisit these and other matters core to financial well-being.

Important Information

Investing involves risks including the possible loss of principal. Past performance is not indicative of future results.

One cannot invest directly in an index. Index performance does not reflect the expenses associated with the management of an actual portfolio.

Asset classes and their respective indexes mentioned in this report include the following:

International (global non-U.S. dollar-denominated) fixed income: The Bloomberg Barclays Global Aggregate Index is a multi-currency benchmark that measures global investment grade debt and includes fixed-rate treasury, government-related, corporate and securitized bonds from developed and emerging markets issuers while excluding U.S. dollar-denominated debt.

Domestic (U.S.) fixed income (Fixed Income Aggregate): The Bloomberg Barclays U.S Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. Components of the index include Treasury, Corporate, Agency and Securitized bonds.

Global equity: The MSCI All Country World Index (ACWI) captures large- and mid-cap representation across 23 Developed Markets and 23 Emerging Markets countries. The index covers approximately 85% of the global investable equity opportunity set.

International equity: The MSCI ACWI ex. USA Investable Market (IMI) Index captures large- and mid-cap representation across 22 Developed Markets countries and 24 Emerging Markets countries. The index covers approximately 99% of the global equity opportunity set outside the U.S.

International small-cap equity: The MSCI ACWI ex. USA Small Cap Index captures small-cap representation across 22 Developed Markets countries (excluding the U.S.) and 23 Emerging Markets countries. The index covers approximately 14% of the global equity opportunity set outside the U.S.

International small-cap value equity: The MSCI ACWI ex. USA Small Cap Value Index captures small-cap securities exhibiting overall value style characteristics across 23 Developed Markets countries and 23 Emerging Markets countries.

Developed markets equity: The MSCI EAFE Index captures large- and mid-cap representation across Developed Markets countries around the world, excluding the United States and Canada. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

Emerging markets (EM) equity: The MSCI Emerging Markets Index captures large- and mid-cap representation across 23 Emerging Markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

The value investment style characteristics for MSCI index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield.

Domestic (U.S.) equity: The Russell 3000 Index represents approximately 98% of the investable U.S. equity market. The Russell 3000 Value Index measures the performance of those Russell 3000 Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell 3000 Growth Index measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values.

Domestic (U.S.) large-cap equity: The S&P 500 Index measures the performance of the large-cap segment of the U.S. equity market. The S&P 500 Value Index is composed of those stocks exhibiting relatively stronger Value characteristics among the constituents of the S&P 500 Index. The S&P 500 Growth Index is composed of those stocks exhibiting relatively stronger Growth characteristics among the constituents of the S&P 500 Index.

Domestic (U.S.) mid-cap equity: The S&P MidCap 400 Index measures the performance of the mid-cap segment of the U.S. equity market. The S&P MidCap 400 Value Index is composed of those stocks exhibiting relatively stronger Value characteristics among the constituents of the S&P MidCap 400 Index. The S&P MidCap 400 Growth Index is composed of those stocks exhibiting relatively stronger Growth characteristics among the constituents of the S&P MidCap 400 Index.

Domestic (U.S.) small-cap equity: The Russell 2000 Index tracks the performance of U.S. small-capitalization stocks and is composed of the smallest 2000 companies in the Russell 3000 Index. The Russell 2000 Value Index measures the performance of those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell 2000 Growth Index measures the performance of those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values.

The S&P Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Utilities, Telecommunications and Real Estate Indexes comprise those members of the S&P 500 Index that below to the respective GICS® sectors.

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