



QUARTER IN REVIEW

The third quarter was tense in manners similar to the thrilling, but otherwise inconsequential subplots forced into the hurtling-toward-a-super-bad-outcome narrative of a typical disaster movie. This year's trade scrap is just one round of many past and likely future struggles that the U.S. will experience as it seeks to come to terms with an ever-surging China. It seems obvious from the market data that investors have eyed the contest closely. But global growth was slowing anyway. As nations seek to deal with a range of long-term growth-sapping pressures, the third quarter presented a fresh reminder to stay observant of the underlying plot, even as exciting side stories may draw attention elsewhere. In the same way, we wish to remind readers that the "plot" on which to focus when it comes to investing revolves around short- and long-term financial goals. Best to leave the otherwise weakly relevant subplots on the cutting room floor.

Trading Twitter Barbs

Trade tensions have proved more durable than earlier thought, with equity markets both pressured and more volatile as a result. Each inflection point seemingly marked by a tweet, the banality of the discourse belies the breadth and depth of the underlying strain. Unrest in Hong Kong raises weighty questions, such as America's role in ensuring regional stability and the manners in which U.S. sports organizations represent (or, in the recent NBA/China case, seek to foment) American ideals abroad.

Flexibility Matters

China may be seen as having more to lose, but that nation has proved well capable of handling such pressures, at least in manners visible to the outside world. China's economy-by-command may have that certain benefit, but that design isn't the only national characteristic that might see this battle prove a lasting one. A cultural perspective that tends to focus on the horizon also may find Chinese nationals balancing the nearer-term costs with longer-term goals. Helps that the bills for such work have a highly beneficent donor.

A Future Borrowed

The lack of progress in resolving the trade standoff between China and the U. S. may have served as more immediate cause for market instability during Q3. But, the slowdown in trade very likely has caused more enduring harm to the global economy, visible perhaps most starkly in Germany's very heavily export-reliant official figures. Negative in the second quarter, Germany's economic output may have dropped again in the quarter just ended. That weakness is contagious and has been cause for the European Central Bank to offer further monetary support. As rates fell further there, pressures increased for the Federal Reserve to follow suit. Though falling interest rates fostered strong gains among fixed income exposures, we cannot help but be concerned about the potentially weaker future income that such historically low yields present, let alone the corollary weakness in expected total returns among riskier exposures.

Figure 1: Quarter Summary

Overall Take			
↗	↗	Equity: Just a tick or two over flat for all the fuss. Near-term trade uncertainty set against a backdrop of broader macro and political concerns kept enthusiasm in check	
	↕	Fixed Income: Bond prices seemed to benefit from stock markets' heightened volatility and lack of direction, with relatively light income bolstered by gains wrought from falling rates	
Equity			
↗	Domestic First up, then down, then up, focus was on the U.S. market's volatility, despite the end-of-quarter gain	↘	International Dollar strength sapped otherwise okay results among int'l equity markets

Directions and colors of arrows reflect a subjective interpretation of the quarter's market events and performance; upward (downward) and 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

The third quarter saw equity markets beset with investor worries regarding the ongoing slowdown in global macroeconomic growth, further weighted by the roiling trade dispute between the United States and China. Between the hints at potential breakthroughs and further duress, news regarding global trade whipsawed markets, which meantime expressed a range of emotions over existing and potential future central bank policies. With the dollar generally strengthening during the quarter, and with sentiment regarding prospects for international economies broadly underperforming the U.S., the domestic stock market furthered its advance against the rest of the world, with trade-sensitive emerging market stocks left far behind.

Figure 2: Trailing Broad Equity-Market Performance

Best-performing index for each period is shaded in blue; worst-performing in grey. See index details at the end of this report

	3 Month	1 Year	3 Year	5 Year	10 Year
Global	-0.18	0.48	9.36	6.61	8.45
World ex. U.S.	-1.72	-1.84	6.10	3.05	4.66
World ex. U.S. Large-Cap	-1.82	-0.64	6.57	2.69	4.26
World ex. U.S. Mid-Cap	-1.69	-3.64	5.35	3.83	5.34
World ex. U.S. Small-Cap	-1.19	-5.63	4.64	3.98	6.13
U.S.	1.24	2.97	12.84	10.52	12.93
U.S. Large-Cap	1.73	4.35	13.69	10.94	12.98
U.S. Mid-Cap	0.52	2.88	11.59	9.98	13.45
U.S. Small-Cap	-1.59	-6.93	8.46	8.22	11.95
Developed Markets	-0.98	-2.02	6.40	3.63	5.22
Emerging Markets	-4.28	-2.41	5.41	2.03	3.36

From 09.30.09 to 09.30.19. Total return data 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

Figure 4: Trailing Equity-Market Performance

The tables below display the relative performance of different indexes representing 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 indexes, including large-, mid- and small-cap stocks, Value and Growth stocks, and combinations of each. Indexes 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 09.30.19				1-Year Period ended 09.30.19			
			Value	Growth			Value	Growth
	All Stocks	1.2%	1.8%	0.7%	3.0%	3.4%	2.7%	
Large	1.7%	1.9%	1.6%	4.4%	5.0%	3.8%		
Mid	0.5%	2.3%	-1.2%	2.9%	2.2%	3.5%		
Small	-1.6%	0.1%	-3.2%	-6.9%	-6.6%	-7.2%		

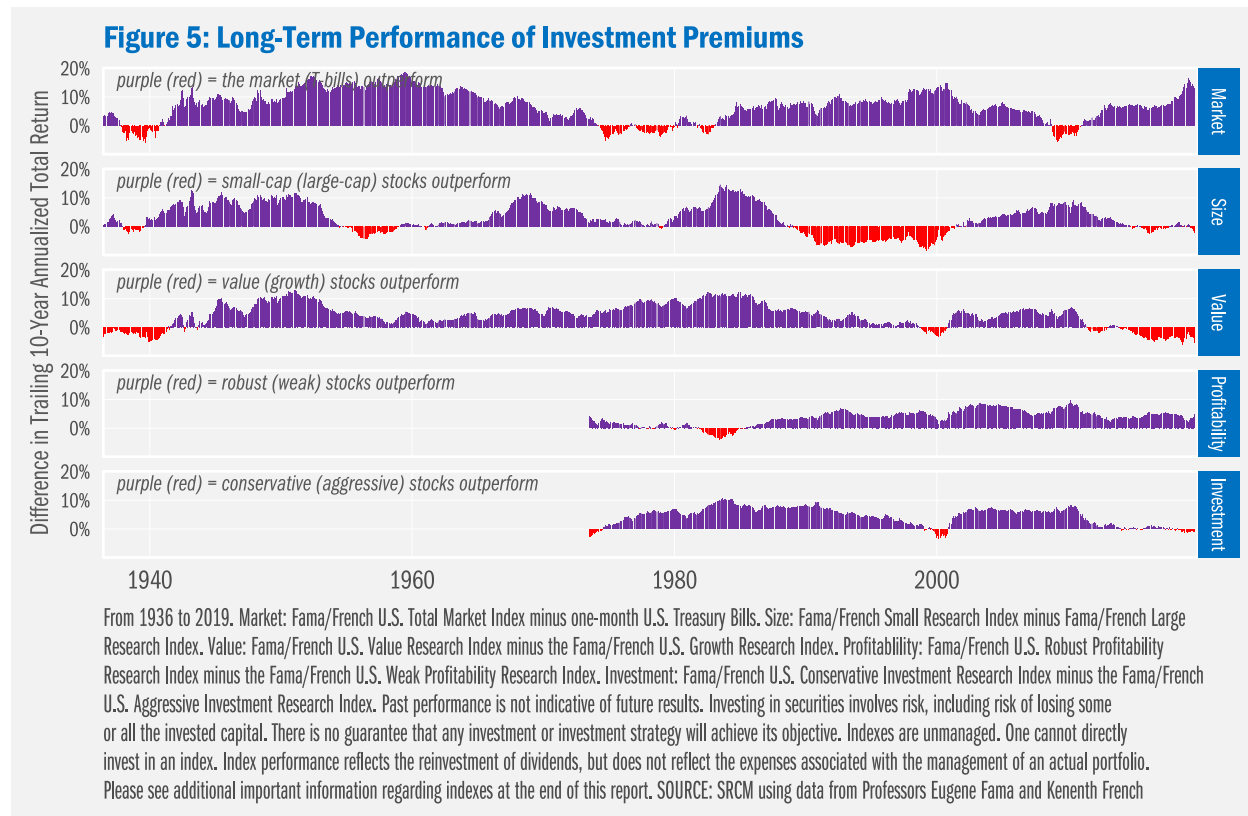
International Stocks	3-Month Period ended 09.30.19				1-Year Period ended 09.30.19			
			Value	Growth			Value	Growth
	All Stocks	-1.7%	-2.6%	-0.9%	-1.8%	-4.7%	1.0%	
Large	-1.8%	-2.9%	-0.7%	-0.6%	-4.5%	3.7%		
Mid	-1.7%	-2.1%	-1.5%	-3.6%	-4.7%	-2.9%		
Small	-1.2%	-1.0%	-1.3%	-5.6%	-5.6%	-5.6%		

From 09.30.18 to 09.30.19. 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

Focusing on investment factors, the disparity in performance between U.S. small- and large-cap stocks widened during the quarter, with the former falling about as much as the latter gained. Small stocks outside the U.S., though, outperformed large stocks by a bit. Value stocks saw relative gains in America, outpacing growth issues in the third quarter and now showing a positive gap over the trailing 1-year period.

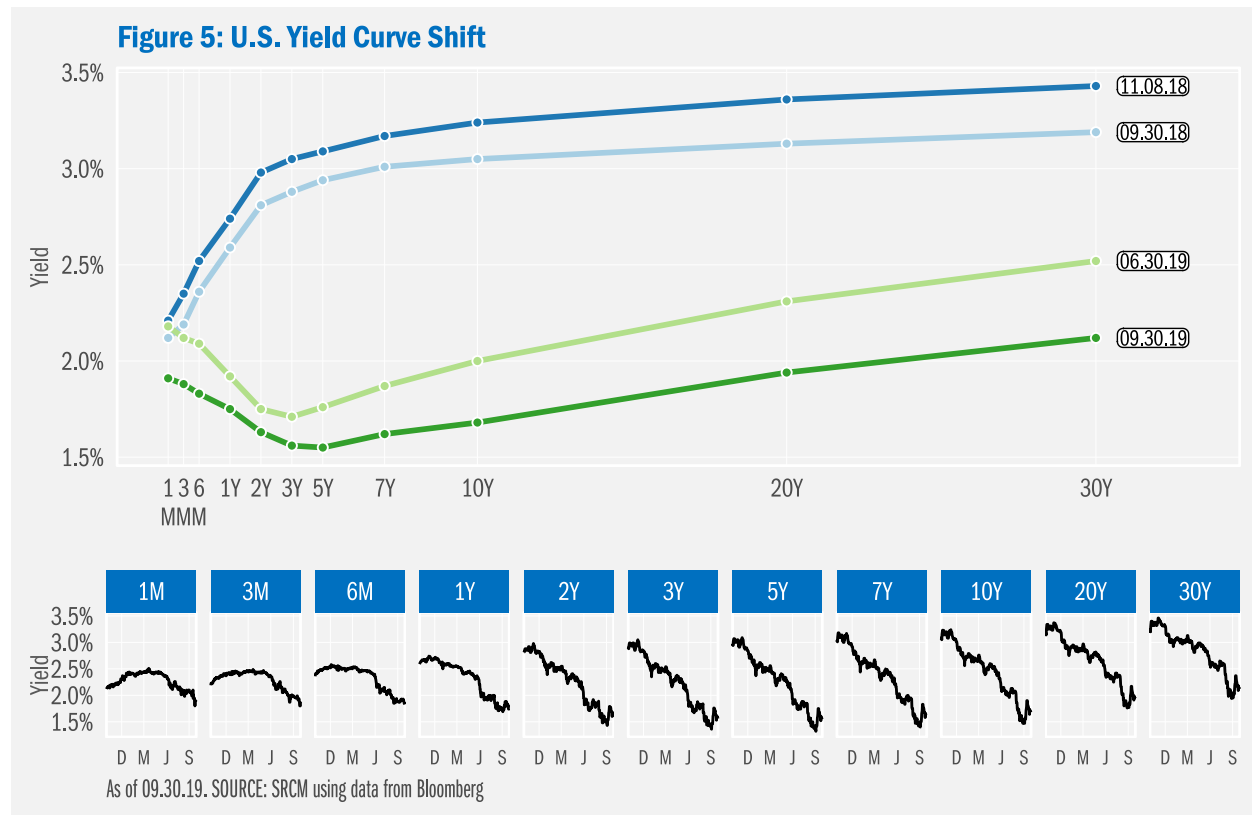
It's not rare that shifts in the performance of investment premiums happen quickly and without an immediately (or ever) identifiable cause. In September, the gap between the performance of expensive (growth) stocks and undervalued (value) stocks, which had been widening for some time, quickly reversed course. This latest reversal has lost steam, but the quick turnaround, coming on the heels of a long period of underperformance, is a reminder that factor investing generally requires no minor amount of patience in order to realize the premiums targeted in the approach. After all, as with all manners of investing, we should expect the potential to outperform over longer-term periods to come with a reasonable expectation to underperform over short- and medium-term timeframes.

We also are reminded of what we consider the virtue of a multi-factor approach. As we show in Figure 5, the relative performance of some of the factors that we target in our investment approach is generally uncoordinated, with each seeing periods of strong under- or outperformance that do not generally coincide with those of the other factors. This diversification can help to dampen the effects of nearer-term underperformance of any particular factor, while still incorporating the potential for a portfolio to capture a meaningful level of any eventual outperformance.

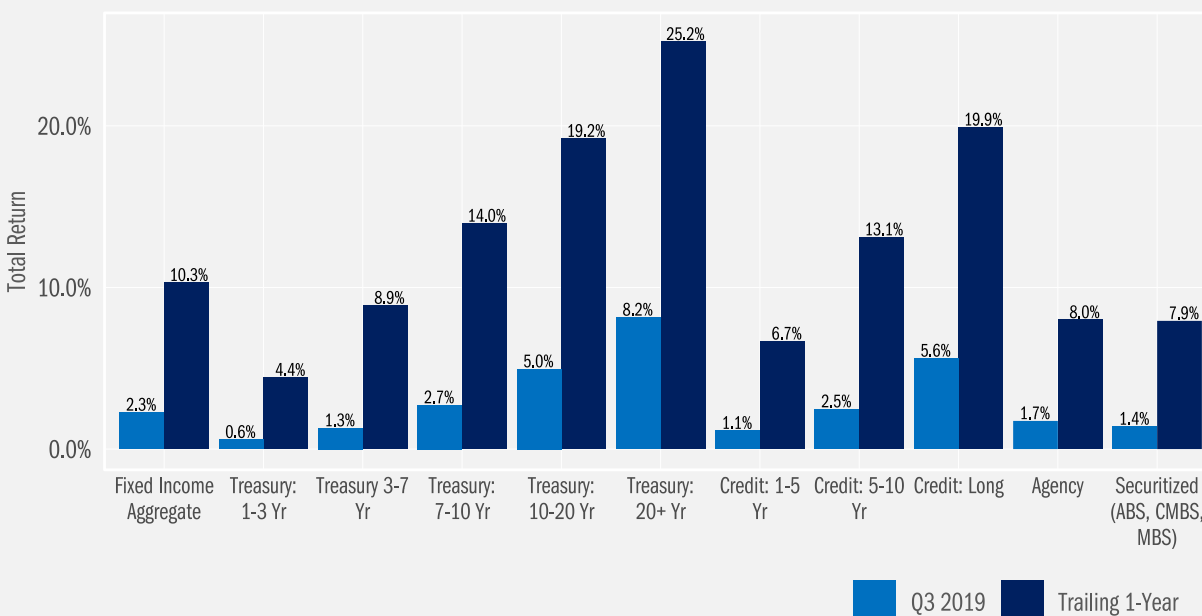


Fixed Income Market Review

After dropping during the first part of the quarter, Treasury yields surged in September, likely on account of improving confidence in the U.S. economy and a bit of an easing on the trade conflict front. Only took a few converse headlines to erase most of those increases, however, leaving the Treasury yield curve broadly lower quarter-over-quarter. Despite the rate volatility, some may welcome the nearer-term price gains. Still, we must consider the potential longer-term implications of persistently low yields. With most of the U.S. yield curve resting below 2%, and with approximately a quarter of the international bond market (\$13.7 trillion) offering negative yields, we lament the still relatively meager income bonds presently provide, versus their historically far more generous coupons.



Viewed from a different angle, recent rate volatility, which we show in the lower part of Figure 5, may have created opportunity to profit for those inclined to wager against such reversals of trends. Much as is the case with our approach to equity investing, though, we find such tactical activity to work against our longer-term investment stance, which includes our belief that fixed income exposures should be held as ballast against the generally far more volatile equity markets. Nonetheless, we have purposely chosen the exposures within many of our portfolios to be adaptable to the broader rate environment, potentially seeking additional income when risk-conscious metrics so warrant. Importantly, even these decisions are made in the context of multi-year perspectives, rather than in-the-moment impulses.

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

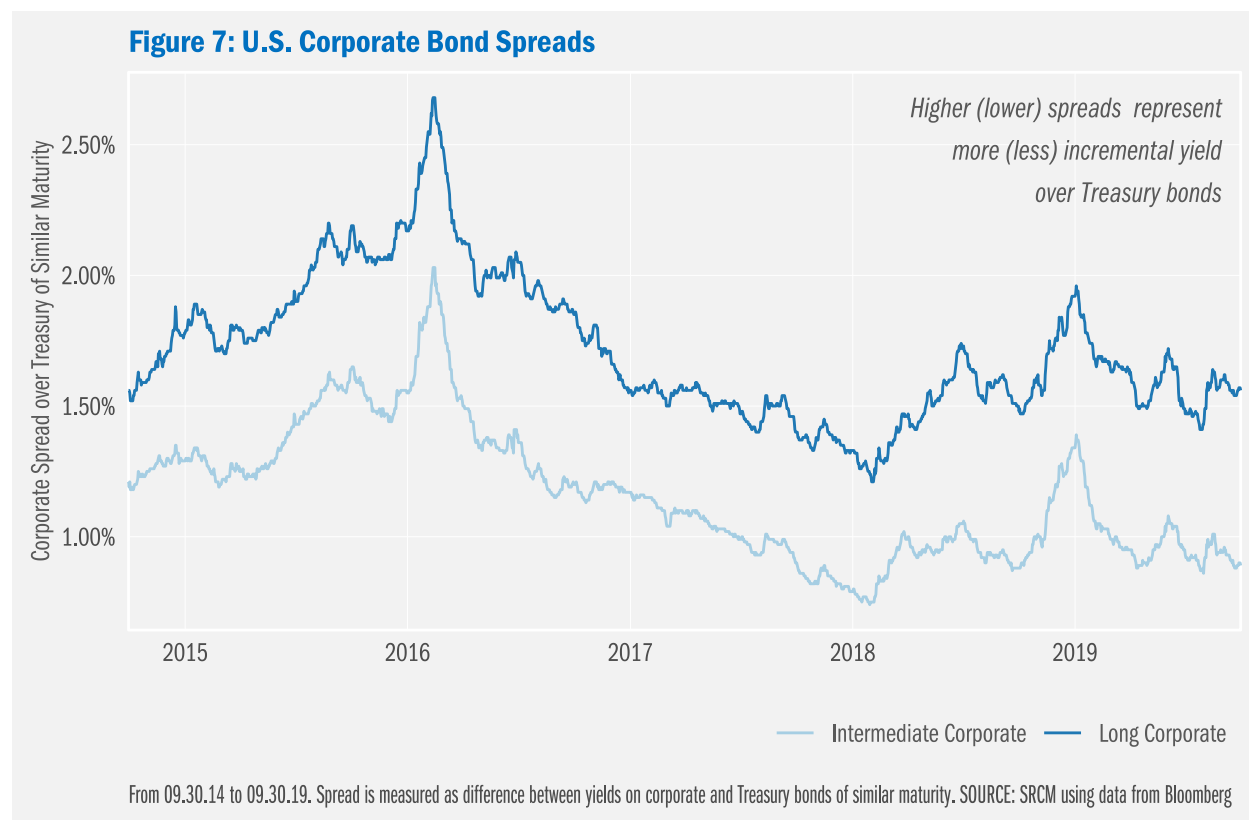
From 09.30.18 to 09.30.19. The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. Components of the index include Treasury, Corporate, Agency and Securitized bonds. Indexes are unmanaged. 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

Surely an understatement to call them merely generous, fixed income gains for the quarter and for the trailing year were outstanding. Returns for the broader U.S. investment grade bond market were thrice that of the U.S. equity market over the last four quarters, yet another example that factor premiums (in this case the equity risk premium) are occasionally negative over shorter-term time frames. Clear from the relative performance of the various fixed income sectors shown in Figure 6, longer-term bonds substantially outperformed shorter-term bonds. We thus would observe that duration played an outsized role in contributing to gains as the “spread” between longer-term bonds and shorter-term bonds fell.

A yield spread is the gap between two bonds otherwise similar but for a specific characteristic of risk. We like to look at two types of risk-based spreads: duration and credit. Duration is a measure of bond’s sensitivity to interest rates; longer-term (shorter-term) bonds tend to be more (less) sensitive to interest rate changes. With credit, the primary difference is potential for default. Higher (lower) exposure to credit suggests greater (lesser) potential for default. The spreads between yields for two bonds of different specific risk, but otherwise similar characteristics, reflects the relative prices investors are willing to accept in order to take on that additional risk.

During the past quarter and year, as rates fell, the yield curve flattened as longer-term yields fell more quickly than shorter-term yields (see Figure 5). Since bond prices move in the opposite direction of interest rates, as rates fell, bond prices rose, with prices of longer-term bonds rising more quickly than shorter-term bonds due to their different durations.

Seen in Figure 7, credit spreads were volatile, too, but ultimately settled to quarter-ago and year-ago levels. That spreads have been volatile, but otherwise remained relatively tight (low), suggests investors may be having a hard time determining how to react to changing expectations of interest rate and credit risk, while at the same time attempting to bolster portfolio income.



SRCM Portfolio Context

As noted earlier, fixed income returns more broadly may have been boosted in the third quarter by increased exposure to duration. Our portfolios generally are lighter in duration than the broader fixed income market, with exposure to both duration and credit increasing along with overall exposure to investment risk (generally driven by increased exposure to equity). Thus, as we move up the risk spectrum, the fixed income sides of our portfolios tended to outperform by an increasing margin. That is, exposure to duration boosted portfolios on a relative basis, while credit exposure was otherwise neutral except for the additional income that credit exposure provided.

Conversely, while value had a better go of it in Q3, small-cap stocks generally underperformed. As we move up the risk spectrum, we generally increase the tilts to both those factors (and others). On balance, equity risk factor exposures detracted from performance relative to the broader equity market. Meantime, as international stocks underperformed domestic stocks, our bias toward U.S. stocks (which decreases as we move up the risk spectrum), added to benchmark-relative performance.

Past performance is not indicative of future results. Individual client portfolios may maintain exposures different from, sometimes materially so, the models for which performance is discussed above. Actual portfolio performance thus may differ from that discussion.

Sounds Familiar, No?

The tail end of 2019 is shaping up from a news flow perspective much as did the final three months of 2018. But that's mainly because the news beat reads mostly similar. Geopolitical tensions are high. Trade battles remain at the top of macroeconomic-related U.S. policy initiatives. Investors remain intensely sensitive to central bank policy shifts and speculation thereabout. The manner of the United Kingdom's departure from the European Union remains undecided, with another deadline fast approaching. This time, though, the deadline may be real. And, just like last year at this time, there's potential for a year-end government shutdown. Meantime, the global economy slows further as a result of all the above.

We do not highlight these global concerns so that readers focus on them and react somehow "accordingly". Rather, we wish the list to serve as an intro to a reminder that there may be few instances in history when one could not develop a similar list of weighty fears for investors to digest. We invite discussions regarding investor comfort with potential market instability related to these and other issues they may find disconcerting. And we are happy to place those discussions into the context both of history and of their personal long-term financial plans. In turn, we welcome the opportunity to address any mismatches that may exist.

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:

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. The Bloomberg Barclays U.S. 1-5 Year Government/Credit Bond Index 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.

Global equity (stocks): The MSCI ACWI Investable Market Index (IMI) captures large-, mid- and small-cap representation across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries. The index is comprehensive, covering approximately 99% of the global equity investment opportunity set. May be referred to as “global”, “global equity” and/or “global stocks”. “Value” and “Growth” versions of this index are constructed as described in the “MSCI Value and Growth Indexes” note below.

International equity (stocks): The MSCI ACWI ex USA Investable Market Index (IMI) captures large-, mid- and small-cap representation across 22 of 23 Developed Markets countries (excluding the United States) and 24 Emerging Markets countries. The index covers approximately 99% of the global equity opportunity set outside the U.S. May be referred to as “World ex. U.S.”, “international equity”, “international stocks” and/or “All Stocks” in a section specifically describing only international stocks. “Value” and “Growth” versions of this index are constructed as described in the “MSCI Value and Growth Indexes” note below.

International large-cap equity (stocks): The MSCI ACWI ex USA Large Cap Index captures large-cap representation across 22 of 23 Developed Markets countries (excluding the United States) and 24 Emerging Markets countries. The index covers approximately 70% of the free float-adjusted market capitalization in each country. May be referred to as international large-cap stocks, “World ex. U.S. Large-Cap”, and/or “Large” in a section specifically describing only international stocks. “Value” and “Growth” versions of this index are constructed as described in the “MSCI Value and Growth Indexes” note below.

International mid-cap equity (stocks): The MSCI ACWI ex USA Mid Cap Index captures mid-cap representation across 22 of 23 Developed Markets (excluding the United States) and 24 Emerging Markets countries. The index covers approximately 15% of the free float-adjusted market capitalization in each country. May be referred to as international mid-cap stocks, “World ex. U.S. Mid-Cap”, and/or “Mid” in a section specifically describing only international stocks. “Value” and “Growth” versions of this index are constructed as described in the “MSCI Value and Growth Indexes” note below.

International small-cap equity (stocks): The MSCI ACWI ex. USA Small Cap Index captures small-cap representation across 22 of 23 Developed Markets countries (excluding the United States) and 23 Emerging Markets countries. The index covers approximately 14% of the global equity opportunity set outside the U.S. May be referred to as international small-cap stocks, “World ex. U.S. Small-Cap”, and/or “Small” in a section specifically describing only international stocks. “Value” and “Growth” versions of this index are constructed as described in the “MSCI Value and Growth Indexes” note below.

Developed markets equity (stocks): The MSCI EAFE Investable Market Index (IMI), is an equity index which captures large-, mid- and small-cap representation across Developed Markets countries around the world, excluding the United States and Canada. The index covers approximately 99% of the free float-adjusted market capitalization in each country. May be referred to as “Developed Markets”. “Value” and “Growth” versions of this index are constructed as described in the “MSCI Value and Growth Indexes” note below.

Emerging markets (EM) equity (stocks): The MSCI Emerging Markets Investable Market Index captures large, mid and small cap representation across 24 Emerging Markets countries. The index covers approximately 99% of the free float-adjusted market capitalization in each country. May be referred to as “Emerging Markets”. “Value” and “Growth” versions of this index are constructed as described in the “MSCI Value and Growth Indexes” note below.

Domestic (U.S.) equity: The MSCI U.S. Investable Market 2500 Index is designed to measure the performance of the large-, mid- and small-cap segment of the U.S. equity market. The index represents approximately 99% of the free float-adjusted market capitalization in the U.S. equity market. “Value” and “Growth” versions of this index are constructed as described in the “MSCI Value and Growth Indexes” note below. May be referred to as “All Stocks” in a section specifically describing only U.S. stocks.

Domestic (U.S.) large-cap equity: The MSCI U.S. Large Cap 300 Index is designed to measure the performance of the large-cap segment of the U.S. equity market. The index represents approximately 71% of the free float-adjusted market capitalization in the U.S. equity market. "Value" and "Growth" versions of this index are constructed as described in the "MSCI Value and Growth Indexes" note below. May be referred to as "Large" in a section specifically describing only U.S. stocks.

Domestic (U.S.) mid-cap equity: The MSCI U.S. Mid Cap 450 Index is comprised of the next largest 450 companies in terms of market capitalization of the U.S. equity market and designed to measure the performance of the mid-cap segment. The index represents approximately 16% of the free float-adjusted market capitalization of the U.S. equity market. "Value" and "Growth" versions of this index are constructed as described in the "MSCI Value and Growth Indexes" note below. May be referred to as "Mid" in a section specifically describing only U.S. stocks.

Domestic (U.S.) small-cap equity: The MSCI U.S. Small Cap 1750 Index is comprised of the remaining smallest 1,750 companies in the U.S. Investable Market 2500 Index of the U.S. equity market and designed to measure the performance of the small-cap segment. The index represents approximately 11.5% of the free float-adjusted market capitalization of the U.S. equity market. "Value" and "Growth" versions of this index are constructed as described in the "MSCI Value and Growth Indexes" note below. May be referred to as "Small" in a section specifically describing only U.S. stocks.

MSCI Value and Growth Indexes: The value investment style characteristics for MSCI index construction are defined using the following variables: book value to price, 12-month forward earnings to price and dividend yield. The growth investment style characteristics are defined using the following variables: long-term forward earnings per share (EPS) growth rate, short-term forward EPS growth rate, current internal growth rate, long-term historical EPS growth trend and long-term historical sales per share growth trend. The objective of the MSCI Value and Growth Indexes design is to divide constituents of an underlying market capitalization index into a value index and a growth index, each targeting 50% of the free float-adjusted market capitalization of the underlying index. The market capitalization of each constituent should be fully represented in the combination of the value index and the growth index, and, at the same time, should not be double-counted. One security may, however, be represented in both the value index and the growth index at a partial weight.

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Fama/French U.S. Size Research Indexes: Provided by Professors Eugene Fama and Kenneth French. Index constituents are formed at the end of each June using June market equity and NYSE breakpoints. The reconstitution considers for July of year t to June of t+1 include all NYSE, AMEX, and NASDAQ stocks for which are available market equity data for June of t. The Fama/French U.S. Small Research Index includes the lower 30% in market capitalization. The Fama/French U.S. Large Research Index includes the higher 30% in market capitalization.

Fama/French U.S. Profitability Research Indexes: Provided by Professors Eugene Fama and Kenneth French. Index constituents are formed on profitability (OP) at the end of each June using NYSE breakpoints. OP for June of year t is annual revenue minus cost of goods sold, interest expense, and selling, general and administrative expenses divided by book equity for the last fiscal year end in t-1. The reconstitution considers all NYSE, AMEX and NASDAQ stocks for which are available market equity data for June of t, (positive) book equity data for t-1, non-missing revenues data for t-1, and non-missing data for at least one of the following: cost of goods sold, selling, general and administrative expenses, or interest expense for t-1. The Fama/French U.S. Robust Profitability Research Index includes the higher 30% of stocks by profitability. The Fama/French U.S. Weak Profitability Research Index includes the lower 30% of stocks by profitability.

Fama/French U.S. Investment Research Indexes: Provided by Professors Eugene Fama and Kenneth French. Index constituents are formed on the change in total assets from the fiscal year ending in year t-2 to the fiscal year ending in t-1, divided by t-2 total assets at the end of each June using NYSE breakpoints. The reconstitution considers all NYSE, AMEX and NASDAQ stocks for which we have market equity data for June of t and total assets data for t-2 and t-1. The Fama/French U.S. Conservative Investment Research Index includes the lower 30% of stocks by profitability. The Fama/French U.S. Aggressive Investment Research Index includes the higher 30% of stocks by profitability.

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