DIVERSITY'S DIFFERENCES

International stocks have strongly underperformed U.S. stocks this year. Such a large gap may lead many to questioning the value of owning stocks outside the U.S. As part of our investment approach, we see the inclusion of international equities as a natural extension of the diversification we pursue in all our portfolio exposures. Indeed, we see diversification across a range of historical periods as having allowed stronger performance among particular segments of the equity universe to offset weaker returns from others. The range of differences in performance and shifts in ranks among the segments over time may surprise some readers. That surprise is chief among the rationale for our pursuit of diversity.

Rankings Roundup

So far this year, U.S. equities have outperformed stocks in every other major region around the globe, in many cases substantially so. But, while domestic equities have seen several recent years of relatively strong outperformance, that outperformance has not always been a given. Indeed, coming out of the Technology Bubble in the early part of the 2000s, U.S. stocks generally ranked among the worst performers of the group. Our point is in no way to suggest that the U.S. won't continue to outperform from here on out. Rather more frankly, the best way we know to answer that uncertainty is through diversification.

Figure 1: Annual Performance of Regional Equity Indexes, Ranked

Performance leadership has varied widely through the years

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018 YTD
United States	28.4%	10.1%	5.1%	14.7%	5.4%	-37.6%	26.3%	14.8%	1.4%	15.3%	31.8%	12.7%	0.7%	10.9%	21.2%	4.4%
EM (Latin America)	73.5%	39.4%	50.0%	43.2%	50.4%	-51.4%	103.8%	14.7%	-19.4%	8.7%	-13.4%	-12.3%	-31.0%	31.0%	23.7%	-5.8%
Japan	35.9%	15.9%	25.5%	6.2%	-4.2%	-29.2%	6.3%	15.4%	-14.3%	8.2%	27.2%	-4.0%	9.6%	2.4%	24.0%	-6.6%
Pacific ex. Japan	45.8%	28.5%	13.8%	32.0%	30.7%	-50.5%	72.8%	16.9%	-12.8%	24.6%	5.5%	-0.5%	-8.5%	7.8%	25.9%	-8.5%
Canada	54.6%	22.2%	28.3%	17.8%	29.6%	-45.5%	56.2%	20.5%	-12.7%	9.1%	5.6%	1.5%	-24.2%	24.6%	16.1%	-9.6%
Developed Europe	38.5%	20.9%	9.4%	33.7%	13.9%	-46.4%	35.8%	3.9%	-11.1%	19.1%	25.2%	-6.2%	-2.8%	-0.4%	25.5%	-10.7%
EM (Asia)	50.3%	14.8%	26.8%	32.7%	41.1%	-53.0%	73.6%	19.0%	-17.4%	20.8%	2.0%	4.9%	-9.8%	6.1%	42.8%	-12.7%
Frontier	43.5%	22.6%	72.7%	-8.9%	41.9%	-54.1%	11.6%	23.8%	-18.7%	8.9%	25.9%	6.8%	-14.5%	2.7%	31.9%	-13.9%
EM (EMEA)	56.0%	39.1%	38.4%	24.0%	28.5%	-55.7%	67.7%	23.5%	-20.4%	21.9%	-5.2%	-15.2%	-20.0%	19.9%	24.5%	-14.7%

Years (blue = best performer, grey = worst performer)

From 12.31.02 to 11.30.18. EM = Emerging Markets. 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

Matters Little How You Slice It

Some investment strategies seek to expose portfolios to international equities through a separate investment (e.g., mutual fund or exchange traded fund). For example, the equity investments in our portfolios generally are distinct by virtue of the regions they encompass, even as the strategies that define their underlying holdings generally are similar. That approach, however, tends to draw focus to the differentiation in performance between the various regions (e.g., United States, developed countries outside of the U.S. and emerging markets).

We can slice markets into thematic buckets in myriad ways, however, generally speaking with similar result in terms of the range of performance between the groups. Dissecting broader-market performance by sector is an often-seen example. In Figure 2 we show historical performance of the S&P 1200 Global Index by sectors from 2003 onward. Readers may note the wide gap in 2018 between the best- and worst-performing sectors, Health Care and Materials, respectively. Last year, however, Materials turned in second-best performance, while Health Care was in the middle of the pack. And the latter was the worst-performer in 2016.

Figure 2: Annual Performance of S&P 1200 Global Sector Indexes, Ranked

Performance leadership has varied widely through the years

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018 YTD
Health Care	17.9%	4.7%	8.2%	10.4%	4.0%	-21.7%	18.3%	2.3%	10.6%	17.5%	36.2%	17.9%	6.1%	-6.3%	20.6%	11.9%
Utilities	28.6%	28.0%	13.8%	37.2%	22.8%	-30.2%	7.6%	-2.0%	-3.3%	1.7%	12.4%	15.5%	-7.0%	5.6%	14.5%	4.2%
Information Technology	47.2%	3.6%	4.7%	10.0%	13.9%	-43.9%	54.5%	11.4%	-2.9%	15.9%	25.2%	15.6%	4.4%	13.7%	41.1%	3.0%
Consumer Discretionary	37.2%	14.4%	0.6%	22.3%	-3.5%	-40.4%	40.1%	23.1%	-4.2%	24.3%	37.5%	3.5%	6.0%	2.9%	22.9%	0.5%
Consumer Staples	14.5%	11.2%	5.9%	20.6%	18.6%	-22.4%	22.1%	13.1%	9.2%	13.5%	19.9%	6.8%	6.1%	1.1%	17.5%	-4.0%
Energy	27.2%	27.8%	28.9%	20.5%	30.5%	-37.1%	25.4%	11.2%	0.6%	2.7%	16.2%	-11.7%	-22.3%	27.9%	5.3%	-5.7%
Industrials	36.8%	18.2%	10.3%	17.2%	15.8%	-42.2%	25.7%	23.8%	-8.3%	15.5%	32.1%	1.6%	-2.3%	12.8%	24.9%	-6.5%
Telecommunications	25.7%	19.0%	-6.2%	33.3%	26.0%	-32.7%	13.1%	11.0%	1.1%	7.1%	24.3%	-0.9%	-0.4%	5.2%	6.2%	-7.7%
Financials	37.9%	16.5%	12.3%	23.8%	-8.3%	-54.7%	34.4%	3.4%	-19.6%	29.5%	27.2%	3.6%	-4.4%	12.3%	23.6%	-8.0%
Materials	44.9%	18.3%	19.1%	31.2%	38.0%	-49.5%	63.6%	20.5%	-20.3%	11.4%	3.0%	-7.5%	-16.7%	23.5%	29.7%	-12.5%

Years (blue = best performer, grey = worst performer)

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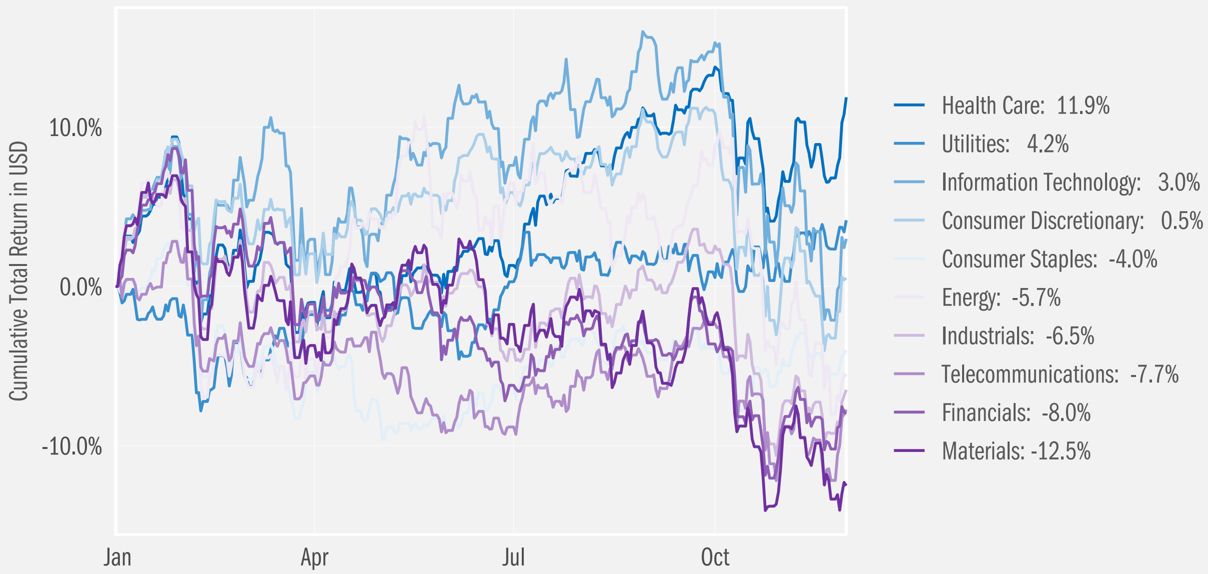
Jump Around! Jump Around?

Perverse to our intent in showing them, these sorts of images sometimes lead folks to believe that we might easily find far more handsome profit from jumping about the sectors through the years. In hindsight, of course, that seems true. But in real time, we believe such attempts at market timing are far more likely to prove less successful. As we see in Figure 3, the choice to be in the Materials sector looked pretty smart at the beginning of the year. Not so much now.

The greater challenge with sector timing—and this thinking applies to timing investments in the broader market as well—is determining when to get in and get out, in our view. Nothing much less comfortable than sitting on a position with a loss, aside from selling one with a gain, of course. But it's precisely those discomforts that we believe are among the primary barriers to success in market timing.

Figure 3: Year-to-Date Performance of S&P Global 1200 Sector Indexes

Year-to-date sector performance rankings have changed substantially through the year



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Proceed at Random

The sheer randomness of it all lies at the heart of our desire for portfolio diversity. The truth is, in our view, no one knows sufficiently more than anyone else that might enable them to add return in excess of the incremental risks being absorbed. Most of the success to be had from investing come from being invested, we think. And we have found both through experience and continued research that our clients are best served with an approach that seeks to ensure they are able to maintain exposure to investable markets despite the randomness and oftentimes challenging near- and medium-term results they may present.

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The S&P Global 1200 provides exposure to the global equity market, capturing approximately 70% of global market capitalization. The 10 S&P Global 1200 sector indexes consist of all members of the S&P Global 1200 that are classified within the respective GICS® sector.

The MSCI USA Index is designed to measure the performance of the large- and mid-cap segments of the US market. The MSCI Canada Index is designed to measure the performance of the large- and mid-cap segments of the Canada market. The MSCI Europe Index captures large- and mid-cap representation across 15 Developed Markets countries in Europe. The MSCI Pacific ex. Japan Index captures large- and mid-cap representation across four of five Developed Markets countries in the Pacific. The MSCI Japan Index is designed to measure the performance of the large- and mid-cap segments of the Japanese market. The MSCI Emerging Markets Latin America Index captures large- and mid-cap representation across five Emerging Markets countries. The MSCI Emerging Markets Asia Index captures large- and mid-cap representation across nine Emerging Markets countries. The MSCI Emerging Markets EMEA Index captures large- and mid-cap representation across 10 Emerging Markets countries in Europe, the Middle East and Africa (EMEA). These indexes reflect net dividends reinvested using dividend minus-tax-credit calculations, but subtract withholding taxes retained at the source for foreigners who do not benefit from a double taxation treaty.

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

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