



QUARTER IN REVIEW

Markets rose into the new year upon approval of sweeping tax reform in the U.S. Fortune turned in late January, though. Where investors once sought stronger inflation, it seems fears of too much of it saw perspectives flip. Compounding caution, increasingly contentious and sometimes erratic gestures from administrations around the globe left strategists warning of rising geopolitical tensions. Though the two forces had mixed effects on domestic bond prices, pressures from rising rates prevailed and fixed income returns were broadly negative in the quarter. Both trends lifted investor uncertainty to levels not seen in a few years, reminding many of the saw—past performance is not guaranteed—and leaving most segments of the equity universe in the red. Zooming out, equity investors may still find content in year-over-year gains easily in the double-digits, with now-higher yields potentially boosting bond returns going forward.

Tax Cut Timing Off?

Days before Christmas, President Trump signed a broad update to federal taxation that lowered absolute and effective rates for a wide swath of U.S. corporations and citizens. Investors initially applauded the changes, but commentary soon shifted to the potential for the tax cuts to overly juice the economy. With broader economic activity still humming after nearly a decade of still ongoing monetary support from the Federal Reserve, a faster path to historically more normal rates may be required to retain growth at reasonable levels. It's perhaps a bit confounding, the thought that investors now may dread too-fast growth, but such are the implications of crisis-level interventions amidst lofty equity market valuations.

Paychecks Boost Inflation Fears

Fanning inflation fears was news of faster-than-expected growth in wages. Here, again, the story may perplex, as one should like to be happy the American worker is seeing larger take-home pay. But, higher pay may well mean lower corporate profits, potentially compounding angst over equity market valuations. And rather obvious is the fact that, while the Federal Reserve sought to reduce interest rates after the Financial Crisis to bolster attraction to riskier assets, forces may reverse as rates rise. A larger cause for anxiety remains the fact that faster-than-expected growth in inflation may leave the Fed scrambling to modulate macroeconomic growth via future policy moves. History suggests a less-predictable Fed may be cause for market disruption.

Wary of a Turn

The beginning of the second quarter has furthered the late-Q1 slide. A broader reckoning with equity market returns of late perhaps prompted some portfolio rebalancing. We continue to believe investors may have caught a bit of old-fashioned risk aversion, “ills” some may have thought left the community in months past. Such turns can be seen as healthy, so long as the contagion doesn't spread. Our thoughts remain on balance optimistic, though we have the sense that the near-term future may look a bit more like the recent past than the half-decade prior.

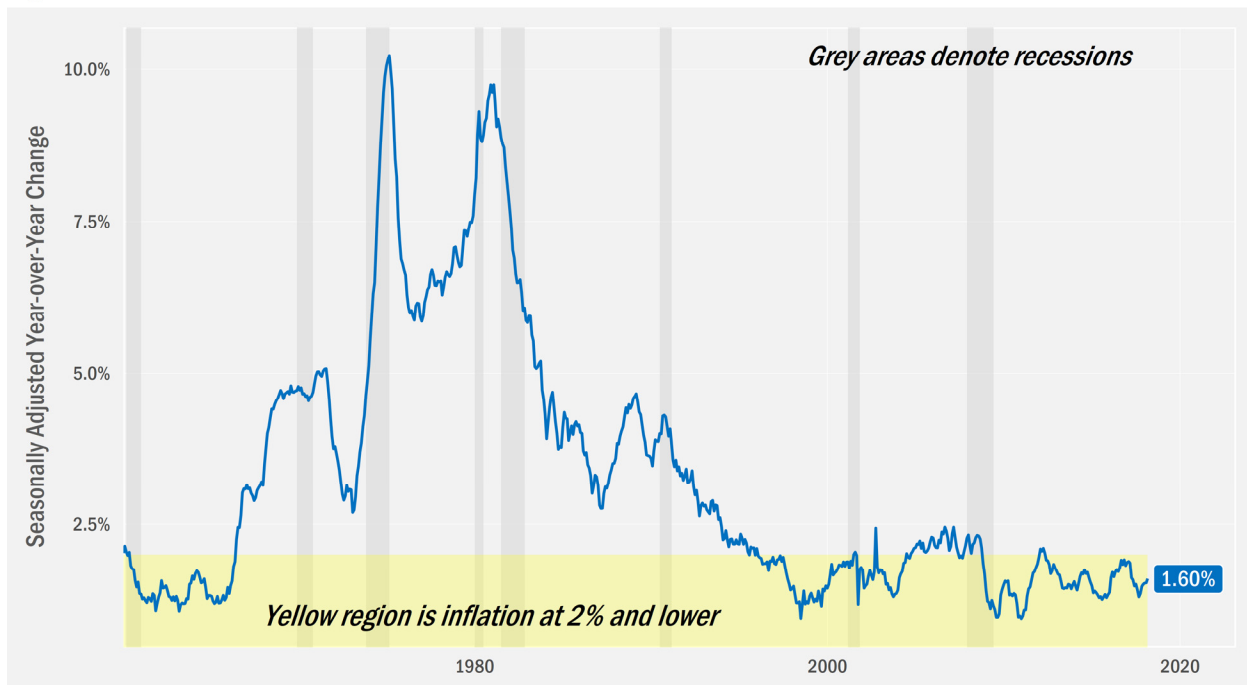
Figure 1: Year Summary

Overall Take	
↓	<p>Equity: A broadly weak, but mixed result reflected benefits of global and factor diversification, but the underperformance of Value weighed heavily on total returns</p> <p>Fixed Income: Rising rates have wrought welcome higher yields, but have left a bit of red in their wake</p>
Equity	
↓	<p>Domestic A late-quarter plunge erased a large-cap rebound, though small stocks just about broke even over the three months. Value's falter was substantial</p>
↓	<p>International While emerging markets held firmer footing, developed international stocks sank</p>

Macro Focus

The Federal Reserve is charged in part with fostering stable prices as part of its “dual mandate”, which also includes the objective of maximum employment. For the Fed, “stable” means prices that grow (inflation) at about 2% per year. In practical terms, targeting a positive level of inflation might seem misguided. Why force folks to pay more in the future for items they may need or would like to purchase?

Figure 2: U.S. Inflation



From 01.31.60 to 02.28.18. Year-over-year change in the seasonally adjusted U.S. Personal Consumption Expenditure Core Price Index. SOURCE: U.S. Bureau of Economic Analysis via Bloomberg

In conceptual terms, however, some manner of modest, but positive inflation is broadly considered a good thing. The Fed actually sees inflation at the root of its policy effectiveness, declaring in the FAQ section of its Web site, “Communicating this inflation goal clearly helps keep longer-term inflation expectations firmly anchored, thereby fostering price stability and moderate long-term interest rates and enhancing the FOMC’s

ability to promote maximum employment.” To the Fed, “stable” is a state of mind, not a statistical feature. Stable is a measure of concerns regarding long-term prices. When consumers and businesses can be reasonably certain of longer-term price shifts, inflation can be seen as stable. What’s quite interesting about the approach is that it assumes a manner of circularity. In the supporting theory, the more the Fed speaks to a long-run target of 2% per-year inflation, the more likely market participants will believe that target will be achieved, and the more likely that target may actually be achieved.

Why not target no change in prices? The thinking is that the closer one gets to no inflation, the more likely one might be to experience deflation, which generally is considered a harmful phenomenon. With deflation, not only would one see prices for goods fall, but also even wages drop (the price of labor). Such periods thus are not considered healthy from a macroeconomic standpoint and as such are to be avoided. Indeed, fears of deflation were a primary driver of some of the Fed’s more grandiose moves first to stabilize then to boost the economy after the Financial Crisis. Inflation much higher than 2%, however, might create undue stress in terms of projecting future expenditures, thereby constraining growth as decision-making becomes more risk averse. Targeting a level higher than but not too far from zero is thought to alleviate the potential for more extreme consequences on either side.

As we see in Figure 2, however, we have yet to break through that magic 2% level on a consistent basis. What are the implications of this failure to achieve two? Perhaps none negative. What’s more interesting to us is the presumptuous¹ attention given to inflation as the cause of this year’s increase in market instability. Perhaps so long as the Fed manages to maintain inflation at a level of 2%², it might be that equity markets will maintain a reasonable level of stability. That is, if the Fed does not offer any proof that it has become more desperate in its policy moves, and if the actual level of inflation doesn’t diverge greatly from 2%, investible markets may regain a reasonable calm. Point being, both features...actual inflation and Fed responses to it...will retain top-of-mind importance to market participants as we move further into 2018.

Equity Market Review

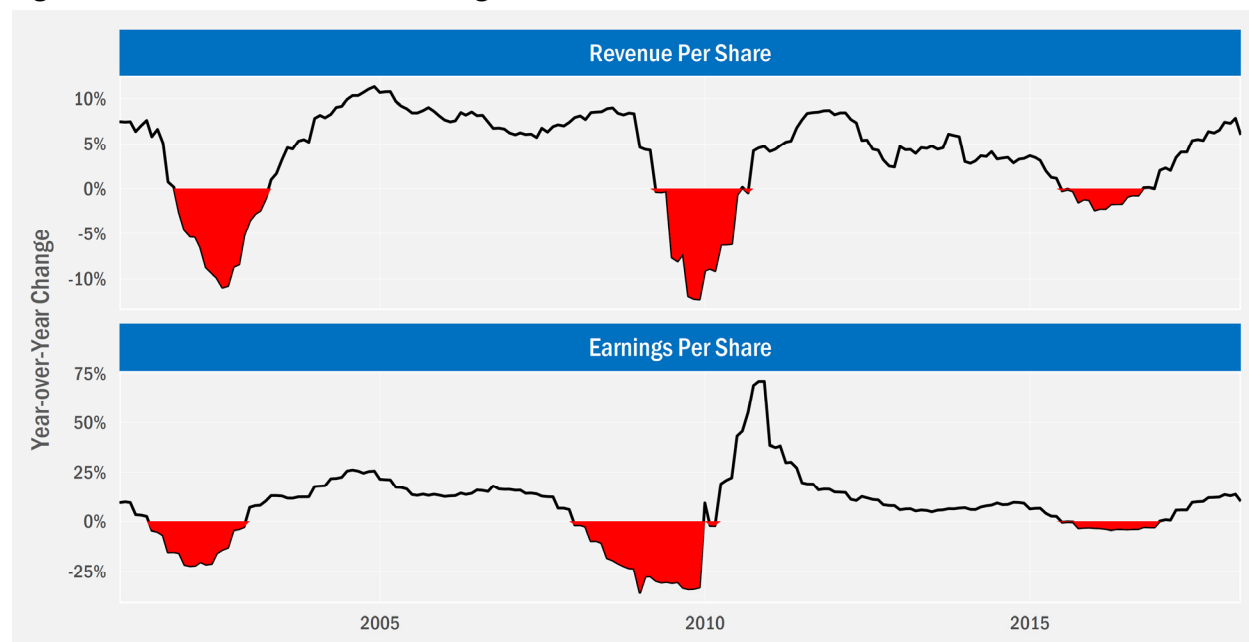
The subject of an upcoming commentary, domestic equity markets remain valued at or near (depending on the variable used) historic heights. Such levels portend relatively lighter returns going forward (since we’ve now paid a higher price for profits yet to be earned), and, after the inflation excuse, remain a focus for commentators seeking explanations for market shifts. Of course, it always will be difficult to ordain any explanation as substantive, given no firm rules regarding market valuation may be found to affirm any present or future state of market prices. Put differently, valuations effectively tell us little about future absolute states. And while they may provide reasonable suggestions as to future *relative* states, no such evaluations should be read as definitive. Intuition and history suggest equity market returns might be lower than those seen in the recent past and even the long-term average. But, they might not.

¹ We cannot be sure that fears of stronger-than-expected inflation and the Fed’s inability to manage against it were driving this year’s enhanced volatility. We may only note that such presumption dominated headline statements of cause and effect.

² Or, Fed’s powers notwithstanding, inflation manages to stay within the realm of 2%.

Such pronouncements we know rarely are kindly received, as most will want to know what we believe will happen in the future. We only seek to be honest in our ability...anyone's ability...to provide a defensible prognosis. A rather more appropriate focus, in our view, remains, individual tolerance for that uncertainty.

Figure 3: Per-Share Revenue and Earnings Growth of the S&P 500 Index



From 12.29.00 to 03.30.18. 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. 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

That idea in mind, we lament the fact that corporate fundamentals (revenue and profits) seem not to matter as much as they perhaps should. As we show in Figure 3, trends are pretty good here in the U.S. Year-over-year growth in revenue remains in the high single-digits, while earnings growth continues to be robust. With equity prices taking a breather from the post-Financial Crisis uphill trek, market valuations actually have eased a bit. Took a bit of macro-fear-mongering and some tariff-saber-rattling to provide the respite, but it's welcome, to be honest.

The path of domestic equity markets in Q1 looked a bit like a roller coaster. No loops, thankfully, but after a steady rise through the last week of January, the aforementioned investor anxieties (or something else altogether...again, one never can be sure) saw the broad-market Russell 3000 dive nearly 10% through early February, before a few leaps and dips and a final plunge left the train a wee bit below where it started. The index lost 0.64% for the three-month period. The large-cap-focused S&P 500 traced a similar course but fell by a slightly more substantial 0.76% through the end of March. Small-caps fared better, coming in just below flat for the quarter. The picture outside the U.S. was mostly similar, with small-cap stocks outperforming large caps, but with all showing a negative tilt. The one bright light to be seen was powered by the continued strength in emerging market equities. On the whole, Value underperformed strongly during the quarter across all capitalizations, both in the U.S. and abroad.

Figure 3: 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 03.31.18				1-Year Period ended 03.31.18			
			Value	Growth			Value	Growth
All Stocks	-0.6%	-2.8%	1.5%	All Stocks	13.8%	6.8%	21.1%	
Large	-0.8%	-3.6%	1.9%	Large	14.0%	7.7%	19.7%	
Mid	-0.8%	-3.0%	1.4%	Mid	11.0%	6.1%	15.7%	
Small	-0.1%	-2.6%	2.3%	Small	11.8%	5.1%	18.6%	

International Stocks	3-Month Period ended 03.31.18				1-Year Period ended 03.31.18			
			Value	Growth			Value	Growth
All Stocks	-1.1%	-1.5%	-0.6%	All Stocks	17.1%	13.9%	20.4%	
Large	-1.2%	-1.5%	-0.9%	Large	16.1%	12.8%	19.9%	
Mid	-1.1%	-1.6%	-0.7%	Mid	18.1%	15.5%	19.9%	
Small	-0.4%	-1.6%	0.8%	Small	20.6%	17.6%	23.6%	

From 03.31.17 to 03.31.18. 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. 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 Broad Equity-Market Performance

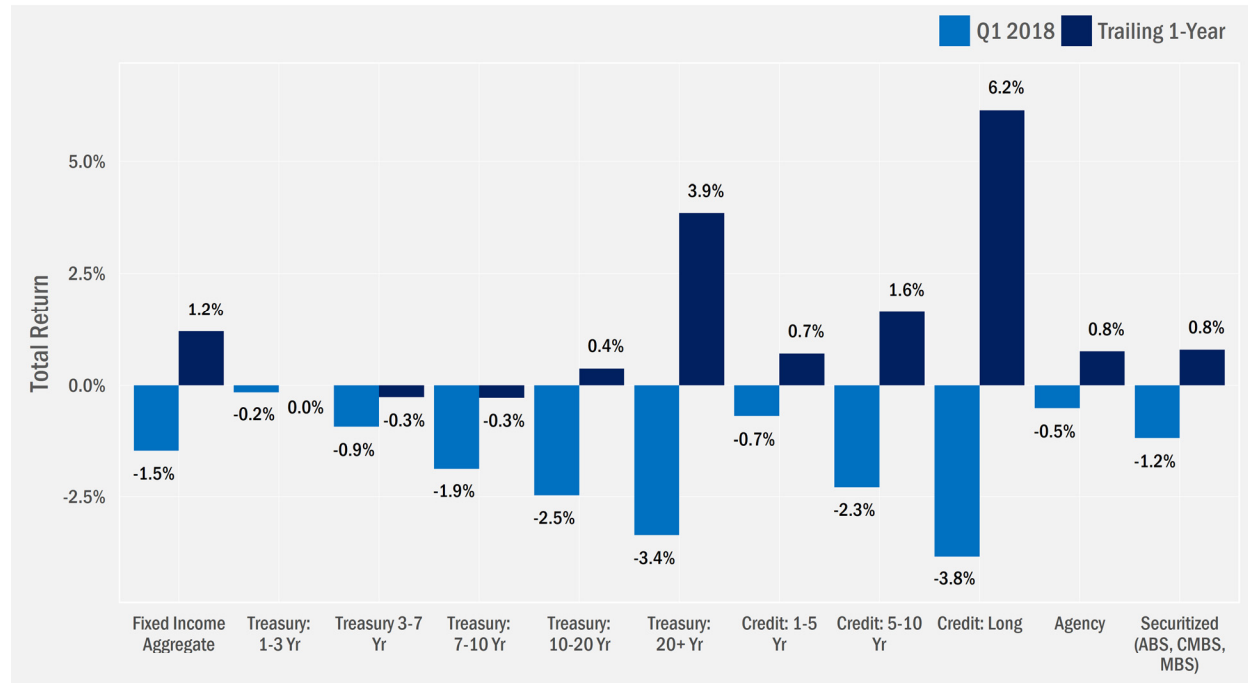
Broad Equity-Market Indexes					
	3 Month	1 Year	3 Year	5 Year	10 Year
Global	-0.96	14.85	8.12	9.20	5.57
World ex. U.S.	-1.06	17.10	6.75	6.24	3.06
World ex. U.S. Small-Cap	-0.35	20.60	10.40	8.57	5.51
U.S.	-0.64	13.81	10.22	13.03	9.62
U.S. Large-Cap	-0.76	13.99	10.78	13.31	9.49
U.S. Mid-Cap	-0.77	10.97	8.96	11.97	10.90
U.S. Small-Cap	-0.08	11.79	8.39	11.47	9.84
Developed Markets	-1.53	14.80	5.55	6.50	2.74
Emerging Markets	1.42	24.93	8.81	4.99	3.02
Value Component of Equity Indexes					
	3 Month	1 Year	3 Year	5 Year	10 Year
Global	-2.62	9.83	6.65	7.54	4.37
World ex. U.S.	-1.51	13.88	5.67	5.31	2.56
World ex. U.S. Small-Cap	-1.55	17.65	9.71	8.07	5.69
U.S.	-2.82	6.81	7.87	10.71	7.84
U.S. Large-Cap	-3.57	7.69	8.40	10.87	7.42
U.S. Mid-Cap	-3.01	6.12	7.76	11.02	10.12
U.S. Small-Cap	-2.64	5.13	7.87	9.96	8.61
Developed Markets	-2.03	12.19	4.29	5.78	1.97
Emerging Markets	1.62	18.14	6.65	2.57	2.07
Value Component Vs. Aggregate Equity Indexes					
	3 Month	1 Year	3 Year	5 Year	10 Year
Global	-1.66	-5.02	-1.47	-1.67	-1.20
World ex. U.S.	-0.44	-3.23	-1.08	-0.93	-0.50
World ex. U.S. Small-Cap	-1.20	-2.95	-0.69	-0.50	0.18
U.S.	-2.17	-7.01	-2.36	-2.32	-1.78
U.S. Large-Cap	-2.81	-6.30	-2.38	-2.43	-2.08
U.S. Mid-Cap	-2.23	-4.85	-1.20	-0.95	-0.79
U.S. Small-Cap	-2.56	-6.67	-0.52	-1.51	-1.23
Developed Markets	-0.50	-2.61	-1.26	-0.71	-0.77
Emerging Markets	0.20	-6.79	-2.16	-2.42	-0.94

From 03.31.08 to 03.31.18. 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. 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

This past quarter we spent a few months discussing recent trends in fixed income (see our March and April 2018 commentaries). The gist was that interest rates are rising. Given bond prices move against changes in interest rates, fixed income markets have struggled in 2018. For the time being, though, fears of global geopolitical instability have led to a flight to safety, helping to cap upward yield movement. Meantime, credit spreads (the extra yield one receives for assuming default risk) generally rose in Q2, suppressing some of the incremental income those bonds provide and leaving total return for the quarter among credit exposures comparable to their same-maturity Treasury counterparts.

Figure 5: Bloomberg Barclays U.S. Aggregate and Sub-Index Performance



From 12.31.17 to 03.31.18. SOURCE: SRCM using data from Bloomberg

SRCM Portfolio Context

Given the broadly negative returns across the equity and fixed income markets, the total returns for our portfolios were negative for the quarter, increasingly so as we move up the risk spectrum. As our portfolios generally are underweight international equity, versus the benchmark's approximately 45% exposure, relative performance of our portfolios was better as returns were weaker outside the U.S. However, our Value tilts led to a relative underperformance that offset both the benefit of our U.S. bias and the relatively better performance of small-cap stocks. In fixed income, performance was lighter than that of the benchmarks to various degrees, generally due to our stronger credit tilts. These same features may explain relative performance for the prior year.

Altogether, the gaps in performance, versus the benchmark, generally were relatively modest for the quarter, while the aggregation of our relative tilts can explain a relatively wider, though still on the whole modest, underperformance over the past twelve months.

Additional composite performance details are available upon request.

Cornucopia of Distractions

The upshot of this quarter's volatility is that, despite all the hoopla, not many courses radically altered on the macroeconomic and corporate fronts. Domestic and global growth continue at reasonably strong paces, while corporate fundamentals remains robust. We have recognized signs of some weakness in trends—e.g. new jobs not being created at as high a rate and profits perhaps not growing as quickly—but we remain far from a recognizable “turn” in fortune. The potential for a multi-front trade war seems to be scaring investors in the first part of the second quarter, but we yet believe cooler heads will prevail, or at least that the details will prove mostly less impactful than the rhetoric presently suggests. Here, too, we find we are not yet at a point where actions have the potential to force major departures from present trends.

Notably, even if we were to recognize such a turn, we will reiterate the fact that our investment process breathes in long cycles. We do not react to short- or medium-term shifts in trend. Over such time frames we continue to believe that an investor's overall tolerance for and approach to accepting market risk will weigh heaviest in determining investment outcomes. That in mind, we offer our regular reminders to reach out to their advisors to ensure as best as one can those individual characteristics are matched to an appropriate level of portfolio risk.

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.

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Important Information *(cont.)*

Overall market risk, including volatility, may affect the value of the individual instruments in which the strategy invests. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be either suitable or profitable for a client's investment portfolio. Diversification does not protect against loss in declining markets.

Investing in foreign currency-denominated and/or foreign domiciled securities may involve increased overall risk due to currency, economic and political risks. Such risks may be particularly pronounced among emerging markets.

Changes in interest rates affect the values of fixed income securities, with the prices of bonds and funds that own bonds generally falling as interest rates rise. This tendency to decline as interest rates rise increases with the maturity of the bond, often reflected in a metric known as duration. Longer-duration bonds generally are more sensitive to changes in interest rates, leading to their tendency also to be more volatile.

The strategies mentioned invests primarily in mutual funds and exchange traded funds (ETFs) that are offered by prospectus only. Investors should consider the investment objectives, risks, charges and expenses carefully before investing. The prospectus, which contains these and other important details, should be read carefully before investing. The strategy is subject to management risk and investor's return and principal value of investment fluctuate, such that an investment, when liquidated, may be worth more or less than its original value. ETFs trade like stocks and may trade for less than their net asset values. Detail regarding the performance calculation and portfolio valuation methodologies, in addition to detail regarding individual and aggregate fees charged by the funds represented within this composite are available upon request. Actual fees incurred for individual portfolios may vary.

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