SIGNATURE RESOURCES
CAPITAL MANAGEMENT

Third Quarter 2018

QUARTER IN REVIEW

Thinking about the past three months, the word divergence comes to mind. Within equities, U.S. stocks continued to pull away from global peers as the U.S. economy furthered similar feats of distinction. Beginning later in the quarter and hastening in the current one, the domestic bond market sank anew, representing for many a departure from the conventional view of bonds as a source of relative safety. Despite the scale of these near- and medium-term shifts, we continue to believe that most portfolios may benefit from the additional diversification global equity exposures provide. And while the rising-rate environment may continue to weight bond returns in the nearer term, we remain confident in the belief that fixed income may provide appropriate portfolio ballast for those wishing to dampen equity-driven volatility.

Macro Mattered More

At the end of last quarter, we remarked that macroeconomic trends were likely to continue to be a primary driver of market returns. This quarter certainly met that expectation, as further strength in corporate fundamentals and a more broadly strengthening economy could be seen as having provided strong support for very good domestic equity gains. Not so much could have been said for equity markets outside of the U.S., however. Investors seemed spooked by relatively tame macroeconomic trends and political instability in Europe and heightened duress among emerging markets.

Fed Gained Credibility

With the U.S. economy humming along, the Federal Reserve furthered progress toward a less-accommodative monetary policy stance. The central bank raised its target for inter-bank overnight lending (the federal funds target rate, a benchmark influencing a range of interest rates across the economy) to between 2.00% and 2.25% near the end of September, the eighth advance since the Financial Crisis. The Fed's steady approach has boosted investor confidence in its mission, approach and reliability.

Late-Quarter Rumbles

And that confidence seems to have proved a bit of a problem for equity and fixed income investors, alike, later in the third quarter and so far in Q4. Time was not too long ago when both groups discounted potential Fed rate hikes as too soon and/or too much…or too little and/or too late. That perceived lack of Fed authority left the actual impacts on those asset classes seeming to lag what might have been expected given the Fed's intentions. We find the renewed investor confidence in the Fed a good thing. Much of the effectiveness of monetary policy is the anticipated impact of existing policy and outlooks for future policy. To the extent that outside views of the methods and consequences of future Fed policy have solidified, investors (and other interested parties) may find more manageable the remaining breadth of variables they must incorporate into their decisions.

Figure 1: Quarter Summary

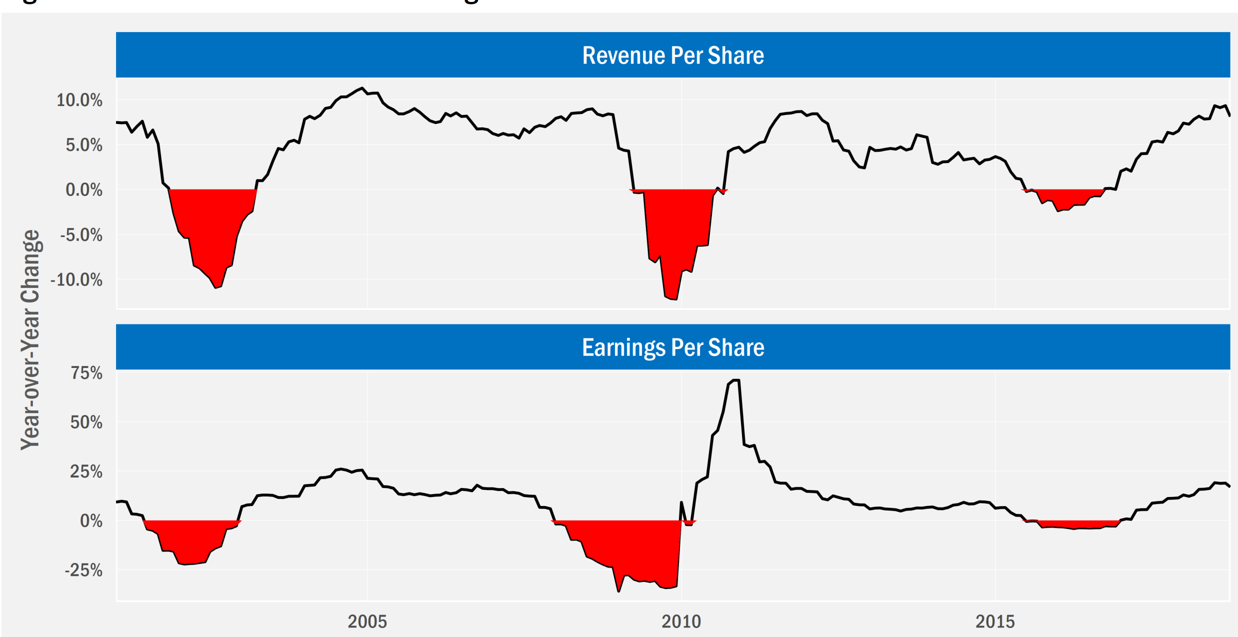
Overall Take				
		Equity: An above-average quarter at home and a welcome turn positive for the bulk of international stocks		
		Fixed Income: With a further upward shift in interest rates, returns were negative across Treasuries with maturities outside of the near term. But, narrowing spreads allowed U.S. corporate bonds to turn in gains		
Equity				
	Domestic A steady march higher was led by large-cap stocks—growthy ones in particular—though small-cap and Value stocks still turned in a positive quarter			International Against a strengthening dollar, returns rolled between up and down more than 2%, but ended at the top of the quarter's band

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

Further top-line growth and additional margin gains derived from last year's tax reform fostered year-over-year percentage earnings growth in the high teens for large-cap U.S. companies. Revenue gains were healthy, too, further supporting margin expansion. That fundamental growth otherwise might have alleviated some of the valuation pressures often cited as reason for caution toward equity exposures. But, investors took those data and continued strength in the domestic economy to pull U.S. stocks higher for the quarter. This, despite ongoing trade tensions that boosted investor and executive uncertainty.

Figure 2: Per-Share Revenue and Earnings Growth of the S&P 500 Index



From 12.29.00 to 09.28.18. 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

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 09.30.18			1-Year Period ended 09.30.18		
		Value	Growth		Value	Growth
All Stocks	7.4%	5.6%	8.9%	17.7%	10.3%	24.6%
Large	7.7%	5.9%	9.3%	17.9%	10.1%	25.2%
Mid	3.9%	3.8%	4.0%	14.2%	11.7%	16.6%
Small	4.7%	1.6%	5.5%	19.1%	9.3%	21.1%

International Stocks

	3-Month Period ended 09.30.18			1-Year Period ended 09.30.18		
		Value	Growth		Value	Growth
All Stocks	0.4%	1.3%	-0.5%	1.8%	0.3%	3.2%
Large	0.9%	1.9%	-0.2%	1.5%	0.2%	2.9%
Mid	0.0%	0.6%	-0.4%	2.6%	1.0%	3.6%
Small	-1.5%	-0.9%	-2.1%	1.9%	-0.3%	4.0%

From 09.30.17 to 09.30.18. 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

Outside of the U.S., trends in corporate fundamentals have remained positive, on balance, though market returns have not kept the same pace as those in the U.S. While we can appreciate the additional diversification that divergent trends in regional markets have provided, we'd have rathered that the trend were accompanied by similarly positive returns. Alas, that has not been the case, but that lack of positive momentum in international markets and the now even more attractive relative valuations that have arisen strengthen our commitment to oversees exposures for the longer term.

Domestic small-cap and Value stocks underperformed larger and more expensive stocks, respectively, during the quarter. Value outperformed abroad, however, driven by a very strong performance within emerging markets, while small-cap stocks outside the U.S. still had a tough go of things. Here, too, despite medium-term relative losses, we find little reason to think long-term prospects for relative outperformance for either the Value or the Size factors have diminished and remain confident in our portfolio tilts.

Figure 4: Trailing Broad Equity-Market Performance

Broad Equity-Market Indexes

	3 Month	1 Year	3 Year	5 Year	10 Year
Global	4.28	9.77	13.40	8.67	8.19
World ex. U.S.	0.39	1.79	10.14	4.39	5.60
World ex. U.S. Small-Cap	-1.51	1.86	11.24	6.14	8.73
U.S.	7.12	17.58	17.07	13.46	12.01
U.S. Large-Cap	7.71	17.91	17.31	13.95	11.97
U.S. Mid-Cap	3.86	14.21	15.68	11.91	12.49
U.S. Small-Cap	3.58	15.24	17.12	11.07	11.11
Developed Markets	1.35	2.74	9.23	4.42	5.38
Emerging Markets	-1.09	-0.81	12.36	3.61	5.40

Value Component of Equity Indexes

	3 Month	1 Year	3 Year	5 Year	10 Year
Global	3.98	4.79	11.46	6.58	6.76
World ex. U.S.	1.35	0.33	9.54	3.23	5.00
World ex. U.S. Small-Cap	-0.86	-0.29	11.05	5.50	8.73
U.S.	5.39	9.46	13.75	10.65	9.76
U.S. Large-Cap	5.86	10.06	14.13	10.88	9.62
U.S. Mid-Cap	3.77	11.72	15.49	11.28	11.65
U.S. Small-Cap	1.60	9.33	16.12	9.91	9.52
Developed Markets	1.18	-0.36	8.12	3.14	4.49
Emerging Markets	3.44	2.27	11.55	2.04	4.53

Value Component Vs. Aggregate Equity Indexes

	3 Month	1 Year	3 Year	5 Year	10 Year
Global	-0.29	-4.99	-1.94	-2.09	-1.43
World ex. U.S.	0.96	-1.46	-0.60	-1.17	-0.60
World ex. U.S. Small-Cap	0.65	-2.15	-0.19	-0.64	0.00
U.S.	-1.73	-8.12	-3.33	-2.81	-2.25
U.S. Large-Cap	-1.85	-7.85	-3.18	-3.07	-2.34
U.S. Mid-Cap	-0.09	-2.49	-0.19	-0.63	-0.84
U.S. Small-Cap	-1.97	-5.91	-1.00	-1.16	-1.59
Developed Markets	-0.18	-3.10	-1.11	-1.28	-0.89
Emerging Markets	4.53	3.08	-0.81	-1.57	-0.87

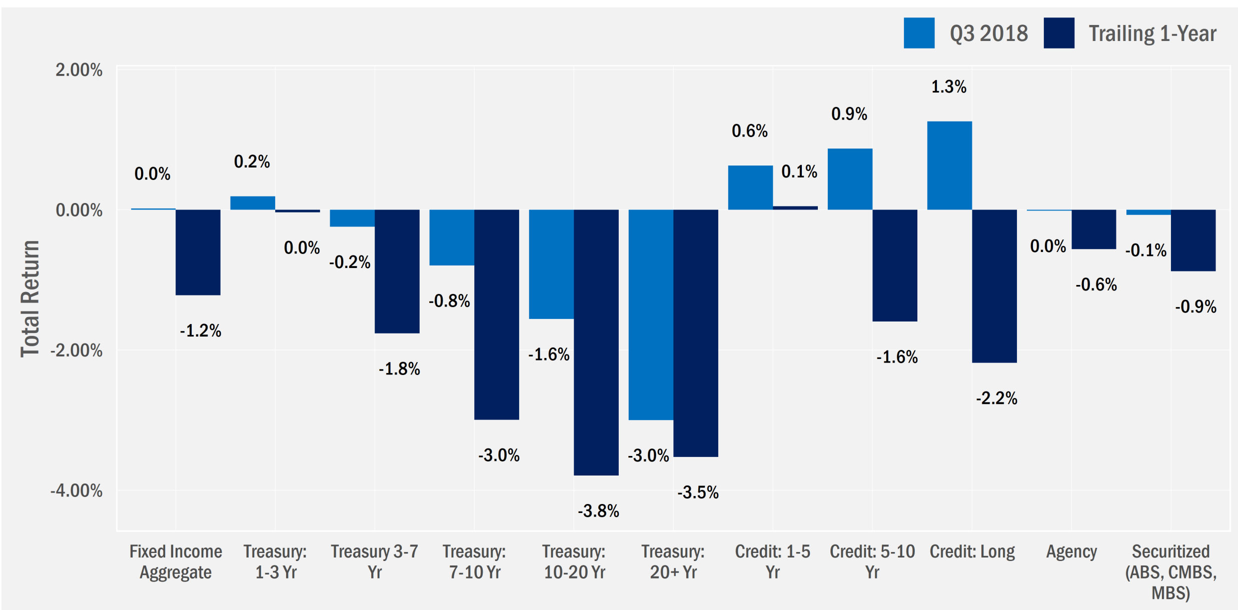
From 09.30.08 to 09.30.18. Total return data for are annualized for periods greater than 1 year. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment 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

Discussed in a bit more detail in our October commentary, domestic fixed income has faced a challenging year. A bit perversely, contributing factors otherwise can be seen as having been positive. The primary influence has been the rising-rate environment, which has depressed returns across the Treasury spectrum. The upward shift in rates has been triggered by less-accommodative monetary policy from the Federal Reserve, which lifted its benchmark target for interest rates three time this year and is likely to yet again this quarter. The more positive tone is derivative of a still-strengthening economy, which has seen unemployment and inflation trends nearer to the Fed's longer-term objectives.

With the still-expanding economy, trends in U.S. corporate fundamentals have remained positive, which has led to a strengthened belief in company debt-worthiness. That confidence has led to a reduction in the additional yield that investors have required to own corporate debt, leading to outperformance among corporate bonds, versus Treasuries of similar maturities.

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



From 06.30.18 to 09.30.18. 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. 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

In the aggregate, SRCM portfolios benefitted from tilts among fixed income exposures toward credit-sensitive (corporate) bonds, offset in part by a longer portfolio-level duration than the fixed income-component benchmark (the Bloomberg Barclays 1-5 Year Government/Credit Total Return Index). Among equity exposures, tilts in more aggressive portfolios toward Value and Size factors generally detracted from performance, mostly offsetting positive contribution from the domestic-stock bias. On the contrary, the stronger domestic bias within less-aggressive portfolios overcame their generally lighter factor tilts.

The portfolios in the aggregate tended toward modest outperformance among the less-aggressive portfolios, trending toward moderate underperformance where equity exposures were more dominant.

Individual client portfolios may maintain exposures different from, sometimes materially so, the model portfolios for which performance is discussed above. Actual portfolio performance thus may differ from that discussion. Additional composite performance details are available upon request.

Breathy Breather? Or Worse?

Now having fulfilled a multitude of promises, the Fed's credibility is weighing on stocks and bonds. How so? Bond investors seem intent on getting ahead of additional rate hikes—perhaps one more this year and as many as three in 2019—pressuring bond prices. However, barring a bout of extended and unexpected inflation, we do foresee rate-related pressures on fixed income abating at some point next year. On the other hand, equity investors now have much higher (read: more attractive) bond yields to factor into equity market valuations and overall portfolio allocations. Meantime, fears have shifted toward the current quarter's upcoming earnings season and, further out, the next economic downturn, adding weight to stock returns in October. Of particular concern in the near term for many are the margins of those companies for whom now dearer material inputs and increased trade frictions are boosting costs. Third-quarter earnings season should add detail, but we expect a bit more volatility heading into the end of the year either way.

Speaking higher level, we do expect another recession at some point. We also expect another sizeable stock market decline to come about in the future. Such is the nature of cycles for both. Seems to us a recession may remain perhaps a bit off in the future, though, considering the continued progress on the macroeconomic front. Still, history is full of surprises. And though a recession is almost assured to press stocks in that direction, equity markets may turn down all on their own even without one. Lest we find ourselves out-of-step with what's to come, we suggest all readers revisit overall portfolio allocations to ensure, again as best one can in advance, that expectations regarding the range of potential portfolio outcomes fit within a band of acceptability.

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. 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 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 (stocks): 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 (stocks): 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.

Developed markets equity (stocks): 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 (stocks): 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 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.

Domestic (U.S.) equity: The S&P Composite 1500 combines three leading indices, the S&P 500, the S&P MidCap 400, and the S&P SmallCap 600 to cover approximately 90% of the U.S. market capitalization. The S&P Composite 1500 Value Index is composed of those stocks exhibiting relatively stronger Value characteristics among the constituents of the S&P Composite 1500 Index. The S&P 500 Composite 1500 Index is composed of those stocks exhibiting relatively stronger Growth characteristics among the constituents of the S&P Composite 1500 Index.

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 S&P SmallCap 600 Index measures the performance of the mid-cap segment of the U.S. equity market. The S&P SmallCap 600 Value Index is composed of those stocks exhibiting relatively stronger Value characteristics among the constituents of the S&P SmallCap 600 Index. The S&P SmallCap 600 Growth Index is composed of those stocks exhibiting relatively stronger Growth characteristics among the constituents of the S&P SmallCap 600 Index.

Important Information *(cont.)*

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Publication: 10.12.18 2018-SRCM-65