



## **QUARTER AND YEAR IN REVIEW**

One might suggest any hesitancy to be exposed to investment risk at the end of the third quarter proved misplaced, as returns for Q4 2019 show green most places one looks. Then again, one might in response state that *misplaced* is a poor choice of words, with *premature* perhaps a better qualifier as relevant risks remain reasonably elevated as we head into 2020. Such is the natural push/pull of acknowledging the past and gauging proper expectations for the future. Our perspective? As always, there are reasons to be both cautious and optimistic. Depending, of course, on individual preference for each.

### **Stellar Near All 'Round**

Stocks were up. Bonds were up. This was up. That was up. What wasn't up? Market volatility. Though the year started all hair-on-fire, and while late spring and summer brought some additional heat in the form of moderate market tumult, global equity markets marched a mostly upward diagonal line during the fourth quarter, confirming that though history might be rhyming the market need not also sing a familiar tune.

### **Keep in Mind That Left Behind**

Though still offering historically superior gains in 2019, our more favored equity investment factors—Size and Relative Price—turned in reasonably strong underperformance relative to the broader market. Stocks of smaller companies and those that may be seen and undervalued, versus their peers, continue to find less favor than larger and more richly priced stocks. Easy to find many folks suggesting this trend will continue. This is not surprising, considering the greater challenge of pressing folks stay a course that has proved more difficult than perhaps earlier thought. But, these are the periods when, in the past at least, such patience and fortitude eventually have found their greater rewards.

### **Cycle Starts Anew**

Front-of-face this year—whether we'll like it or not—shall be the election and its potential ramifications. Readers of our commentaries might guess that we'll reprise our reviews of the market implications of dominant political persuasions. For those who've yet not seem such reviews, here's a hint: It Just Doesn't Matter. Despite all the fuss, political persuasions seemingly leave few if any discernible marks on medium-term returns. And any near-term noise seems to be lost over time amidst the impacts of more relevant macroeconomic and fundamental shifts. We might argue about longer-term implications of the grander accomplishments of our leaders. But, honest efforts to position portfolios in advance of any such "expected" secular shifts, in our view, should tend to bring one back to the choice of an investment allocation that broadly aligns with individual appetite for investment risk. Put another way, given the uncertainty of the longevity of any current or soon-to-be-likely political course—let alone its impact—we find it far better to presume lack of specific foresight and allow the markets to proceed along the course that they will, matching tolerance for more estimable ranges of future outcomes to provide the firmer basis for investment decisions.

**Figure 1: Year Summary**

Overall Take			
↑	↑	Equity: Stellar year for sure, but one must remember much of the gain was a catch-up from the year-end decline of 2018. Even so, risk was well rewarded last year	
	↑	Fixed Income: Here, too, acceptance of risk generally was rewarded. Credit spreads narrowed as rates overall fell. Even so, those trends fostered nostalgia for more generous yields of not so long ago	
Equity			
↑	Domestic Out of the park (after a bit of a rain delay in Q4 '18). Still among the best annual returns in history	↗	International Substantial gains abroad, too, supported near year end by an ebbing dollar

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

After a relatively unremarkable third quarter, equity markets around the globe rose strongly through year end. American stocks turned in their best year since 2013 and many markets outside of the U.S. had a stellar go at it as well. It helped those stocks outside of the States that the U.S. dollar's peak for the year against a basket of developed currencies fell right at the end of the third quarter. International stock returns therefore received an extra boost for American investors (gains in other currencies were worth more when translated back into dollars). Even so, domestic equities continued to outpace stocks in much of the rest of the world, with the longer-term performance gap opening up a bit more through 2019.

**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	9.05	26.35	12.09	8.34	8.91
World ex. U.S.	9.20	21.63	9.84	5.71	5.21
World ex. U.S. Large-Cap	8.74	21.32	9.85	5.33	4.74
World ex. U.S. Mid-Cap	9.68	22.31	9.88	6.24	5.99
World ex. U.S. Small-Cap	11.01	22.42	9.65	7.04	6.92
U.S.	9.06	31.10	14.61	11.31	13.32
U.S. Large-Cap	9.52	31.85	15.73	11.93	13.41
U.S. Mid-Cap	6.81	30.61	13.00	10.08	13.51
U.S. Small-Cap	8.83	25.87	8.88	8.60	12.48
Developed Markets	8.64	22.44	9.75	6.09	5.90
Emerging Markets	11.59	17.64	11.00	5.30	3.60

From 12.31.09 to 12.31.19. 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 3: Annual Performance of Regional Equity Indexes, Ranked**

*Performance leadership has varied widely through the years*

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%	-5.0%	30.9%
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%	-17.2%	27.5%
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%	-14.9%	23.8%
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%	-12.9%	19.6%
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%	-15.5%	19.2%
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%	-10.3%	18.4%
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%	-16.4%	18.0%
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%	-6.6%	17.5%
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%	-16.0%	15.5%
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019

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

From 12.31.02 to 12.31.19. 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

Lest we get too excited about 2019’s results, we must recall that the final quarter of 2018 proved rather gruesome for stock returns. The U.S. market fell more than 14% in Q4 2018, while stocks outside of the U.S. fell just shy of 12% on average. Nonetheless the two-year average gain for U.S. stocks remains a very respectable 11.4%. Can’t say the same, though, for international stocks, which strongly lagged their American peers, up just 1.8% per year since the end of 2017.

Though the trade turned for a bit in the fourth quarter, 2019 was yet another year of Growth’s dominance over Value. Figure 4 shows the rather dramatic positive gap in gains for stocks that rank more expensive relative to the performance that may be considered inexpensive. As we wrote in our November 2019 commentary, such periods of Value “factor” underperformance are not uncommon. Indeed, the risk of that underperformance may be considered part of the driver of the historic outperformance of Value stocks over Growth stocks. May be tough to persevere through the headwind of investor disinterest, but we continue to believe that patience may be rewarded over time.

Same may be said for the relative performance of smaller-cap stocks (the Size factor). Smaller stocks tended to underperform larger stocks in the fourth quarter and through 2019. In the U.S., that is, as smaller stocks outperformed larger stocks over the quarter and year.

### Figure 4: Trailing Equity-Market Performance

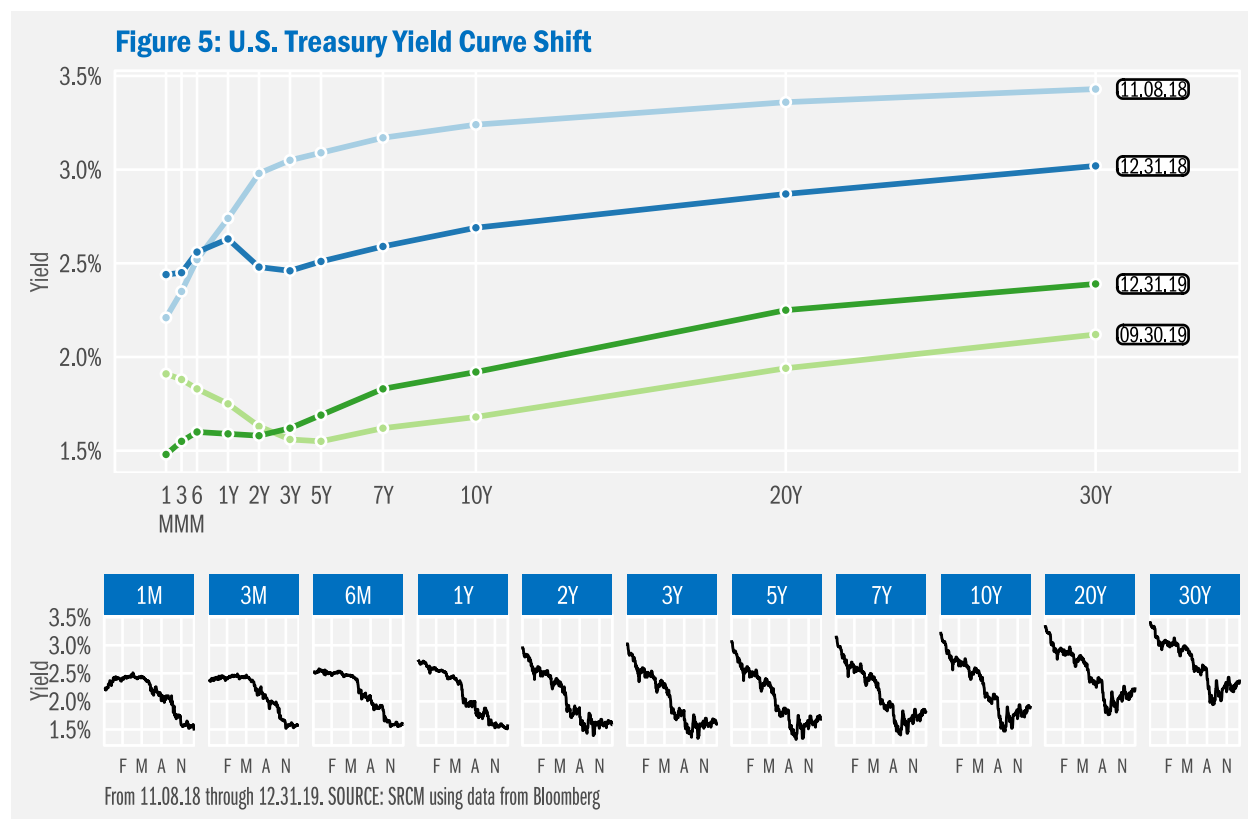
The tables below display the relative performance of different indexes representing U.S. and international stock markets. Broad market performance is shown in the upper left of each group (3-month and 1-year periods). The remainder of the table displays the performance of various indexes, including large-, 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.

	3-Month Period ended 12.31.19				1-Year Period ended 12.31.19							
			Value		Growth				Value		Growth	
U.S. Stocks	All Stocks	9.1%	7.5%	10.6%	31.1%	25.7%	36.6%					
	Large	9.5%	7.7%	11.3%	31.8%	25.7%	38.1%					
	Mid	6.8%	6.1%	7.6%	30.6%	27.6%	33.5%					
	Small	8.8%	7.3%	10.3%	25.9%	22.3%	29.5%					
International Stocks	All Stocks	9.2%	8.6%	9.8%	21.6%	16.3%	27.0%					
	Large	8.7%	8.0%	9.5%	21.3%	15.4%	28.0%					
	Mid	9.7%	9.2%	9.9%	22.3%	17.4%	25.3%					
	Small	11.0%	10.8%	11.2%	22.4%	20.3%	24.6%					

From 12.31.18 to 12.31.19. 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

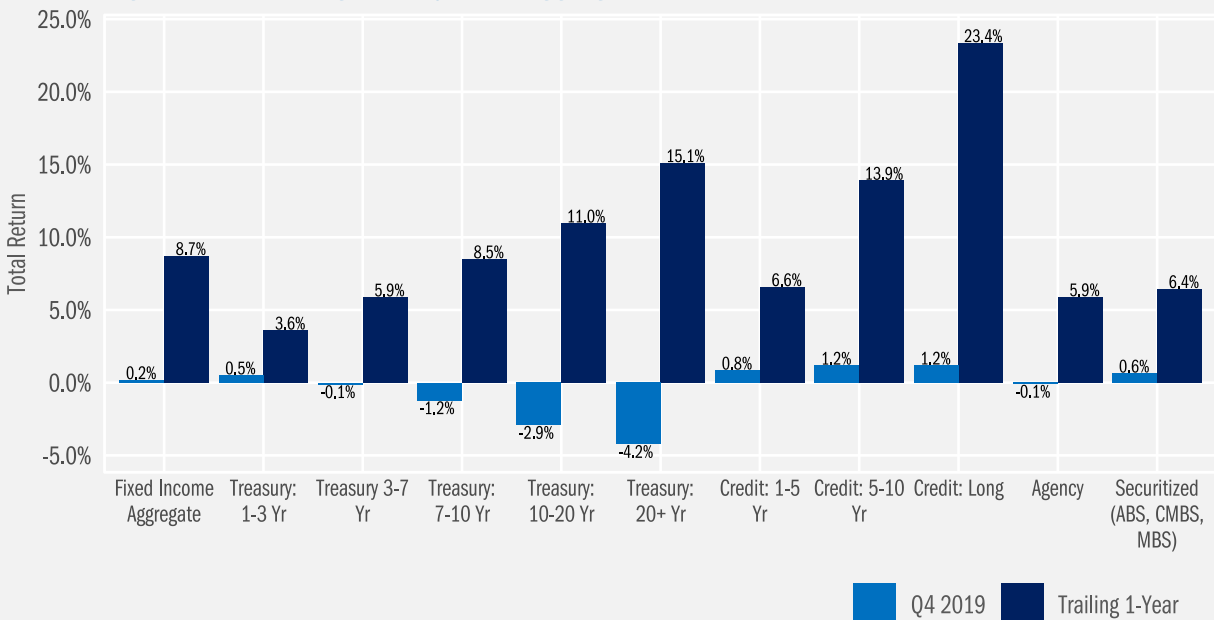
## Fixed Income Market Review

While stocks turned in a historically grand 2019, the same might be said of bond returns as well. Rates across the yield curve fell sharply on the year (in Figure 5, moving from the dark blue line to the dark green line). Since bond prices generally move in opposite to changes in interest rates, that shift lower boosted fixed income returns. In the fourth quarter (light green to dark green), rates continued to fall at the short end of the curve, though rates were higher from 3 years on out.



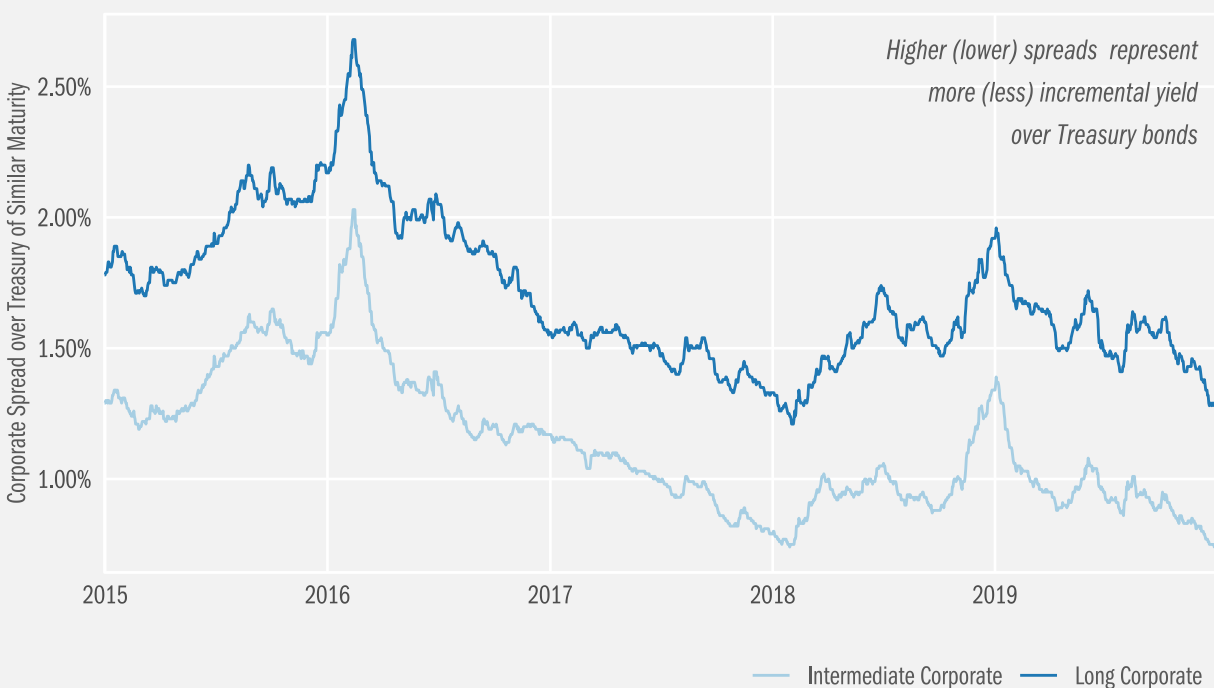
In the aggregate, the U.S. investment grade fixed income market provided modest returns in the fourth quarter, while turning in super-normal gains for the trailing twelve months. While yields remain historically low, the shift lower in short-term interest rates provided additional gains above the income those bonds offered in Q4. Losses were relatively large among longer-term Treasuries in the fourth quarter, even as the general shift lower in yields over the year led to substantial capital gains. Corporate bonds experienced the effects of the general shift lower in rates through the year, as well as the shift higher in rates among longer-maturity bonds. However, given that the upward shift in longer-term yields may be seen as indicative of potentially more robust macroeconomic growth, investors remained drawn to corporate bonds throughout 2019. Total returns for the year were stellar for corporate debt. Gains across the maturity spectrum among corporate bonds remained positive last quarter, too, as the yield “spreads” investors demand for holding bonds with the potential for default continued to fall. That trend we can see in Figure 7.

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



From 12.31.18 to 12.31.19. 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

**Figure 7: U.S. Corporate Bond Spreads**



From 12.31.14 to 12.31.19. Spread is measured as difference between yields on corporate and Treasury bonds of similar maturity. SOURCE: SRCM using data from Bloomberg

## **SRCM Portfolio Context**

Domestically speaking, the substantial gap between the performance of small-cap and Value stocks, versus large-cap and Growth stocks, respectively, offers a fine reminder why we have chosen to position our portfolio exposures with tilts to Size and Relative Price, rather than wholly exclude portions of the equity universe. So while those tilts generally speaking were not additive to benchmark-relative performance in 2019, returns were not too far behind the broader market. Offsetting relative factor underperformance, our models generally benefitted on the equity side from our bias toward U.S. stocks. Even more, the factor tilts among our international exposures broadly supported benchmark-relative performance. Altogether, then, the equity portions of the portfolios performed reasonably well last year, with benchmark-relative performance improving along with the domestic equity bias (which grows as we reduce the overall equity allocation across the models).

Turning to fixed income, both credit and duration risk exposures proved additive to benchmark-relative performance. Our generally more positive stance on credit exposures offset our generally more conservative stance with respect to duration. Fixed income contribution across the models thus was broadly in-line to positive, relative to the benchmark, as we move up the risk spectrum.

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. Historical performance details relevant to each model may be found on our Composite Fact Sheets.

## **Golden Diversion**

While we might find it hard to bear the political sagas sure to present in 2020, many of us here will embrace the two other events with four-year cycles that just so happen to coincide with presidential elections. The Olympics are cherished by many, and continue in our view to represent many among the finer attributes we humans may maintain. Happy to trade the tension of two heads talking politics, with all the drama the Games always offer.

And as we look so often to find a little more time to do a few more things, we also welcome the leap year and the extra day in February it'll bring. An additional 0.27% of a year to be a bit more productive, enjoy another moment with family and friends, spend some additional time on our hobbies or just get a little more rest in 2020, and we're happy to have it.

Imagining folks to be mostly happy with the market goings on of 2019, too, we further will welcome all discussions clients may have with regard to past performance and portfolio positioning as we head into the new year.

## 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.

The S&P 500 Index measures the performance of the large-cap segment of the U.S. equity market.

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