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Financial Advisors

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QUARTERLY PERFORMANCE REVIEW   FIRST QUARTER 2019

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Dear Client:

We have enclosed your first quarter 2019 Portfolio Performance Report. Please review the materials and insert them behind the green “Performance” tab in your “Planbook.”

This table presents the 2019 first quarter returns of the benchmarks for selected asset classes.

Asset Class Returns

Asset Class	1st Qtr 2019	Benchmark Index
Domestic Fixed Income	2.32%	Barclays Intermediate Gov’t / Corp Bond
Domestic Inflation Protected	3.19%	Barclays TIPS Index
International Fixed Income	3.06%	JP Morgan – Global Gov’t - Non US (hedged)
Domestic Equity (Large)	13.65%	S&P 500 with Dividends
Domestic Equity (Large Value)	11.93%	Russell 1000 Value Index
Domestic Equity (Small)	14.58%	Russell 2000
Domestic Equity (Small Value)	11.93%	Russell 2000 Value
International Equity	9.98%	MSCI EAFE Equity Index with Dividends
Real Estate	17.17%	FTSE NAREIT Equity
Precious Metals	1.28%	Gold
Natural Resources	7.52%	Dow Jones UBS Commodity Index

The table above shows how some individual asset classes performed for the first quarter of the calendar year. Equity asset classes benefitted from a solid rebound driven in part by the Fed’s decision to stop raising interest rates and optimism in trade talks. GDP growth remains positive, unemployment is below four percent, the annual inflation rate still hovers around two percent, and corporate earnings are in line with expectations. This is a good reminder that long term investors can benefit from staying the course even when there are periods of turmoil mixed in the along the way.

We believe that having an allocation to the fixed income asset classes is an important part of portfolio diversification. This newsletter provides some discussion on that belief and some perspective on the breadth of the fixed income asset class.

Fixed-income is the broad term used to describe an investment that provides a return in the form of fixed periodic interest payments to investors. The most common type of fixed-income security is a bond.

A bond is an investment product that is issued by corporate and government entities to raise capital to finance and expand their operations and projects. The issuer (borrower) promises to pay interest (also called the coupon), on a fixed schedule (i.e., quarterly, semi-annual, annual) until a set date. On that date (maturity date), the issuer returns the principal (face value) to the investor.

Government bonds can be issued by the US government in the form of Treasury bills (maturity of one year or less), Treasury Notes (maturity of ten years or less) and Treasury Bonds (maturity of 20 years or more). Government bonds can also be issued by states, cities and counties and are called municipal bonds. Interest on municipal bonds may get favorable tax treatment.

Corporate bonds are issued by companies (public or private) and can be either investment grade or non-investment grade. Investment grade bonds are issued by stable companies with a low risk of default and therefore have lower interest rates than non-investment grade bonds. Non-investment grade bonds (also known as junk bonds or high yield bonds) have very low credit ratings due to a higher probability of the corporate issuer defaulting on interest payments and therefore have a higher rate of interest than investment grade bonds.

The interest rate paid by bond issuers varies, generally paying a higher interest rate for longer borrowing periods (or lower credit worthiness). The range of interest rates is often described as the "yield curve," showing lower interest rates for short-term borrowing and higher interest rates for longer term borrowing. However, the rates do not rise on a consistent or predictable linear scale from shortest to longest maturity.

Today, the yield curve is described as flat, meaning the difference between very short-term interest rates and longer term interest rates is very small. A simple example using US treasuries as of March 31, 2019 is: 6-month T-bill (2.43%), 2-year note (2.27%), 5-year note (2.24%), 10-year note (2.41%).

Interest rates can change daily, just as the price of stock investments change daily. If interest rates rise over time, then a borrower that owns a bond may be getting a lower rate than the "current" market rate. Similarly, if interest rates fall over time, then a borrower that owns a bond may be getting a higher rate than the "current" market rate.

Respectfully

John Bogle, the founder of Vanguard and a long time champion of diversification and low cost investment options passed away on January 16, 2019 at the age of 89. We have admired his practical approach to investing and used his quotes in our newsletters in the past. We plan to continue to do so.

World Stock Market

The following are estimates of the percent of world stock market capitalization by Country as of 12/31/2018.

-Source: Bloomberg Market Cap Indices

United States – 40%

Japan – 7.6%

China – 7.5%

Hong Kong – 6.5%

United Kingdom – 4.5%

France – 3.2%

Germany – 2.9%

India – 2.8%

Canada – 2.8%

Switzerland – 2.0%

As a result, bond prices can rise or fall. The borrower is subject to a potential loss of principal (when interest rates rise and a new borrower can get a higher rate) or potential gain of principal (when interest rates fall and a new borrower can only get a lower rate) if they choose to sell their bond before maturity.

We believe it is also important to note that the size of the US bond market (estimate of $40 trillion) is larger than the size of the US stock market (estimate of $30 trillion). [Source: Zacks: Steven Melendez, updated March 6, 2019] This is true globally as well, with total global bond market exceeding the size of the total global equity market.

The general role of bonds in a diversified portfolio is to lower risk of loss compared to a portfolio that is only in equities. Bonds have historically had lower average annual rates of returns compared to equities AND bonds have historically had less volatility (rise and/or fall of prices) compared to equities. [Source: Dimensional Fund Advisors, Matrix Book 2018, Annualized Rates of Return table, 80 Year period 1938 thru 2017, Bonds (Long Term Government Bonds) – 6.0%, Equities (S&P 500 Index) – 11.2%]

Additionally, bonds generally perform differently than equities. This is known as correlation. If one asset class in a portfolio has a “low” correlation to a different asset class, the expectation is that gains or losses in one asset class are not generally mirrored in the asset class with low correlation. Thus when equity markets have large losses, bonds may experience a much smaller loss or a small gain.

As you can surmise from the short discussion above, there are many different types of bonds available. We believe that making a determination of how much to allocate to bonds in general, then selecting a mix of bond types to best suit a portfolio’s overall objective, is just as important as determining the equity allocation and selection decisions.

We also believe that market forces and slow, but noticeable, changes in interest rates are factors that need to be considered as part of monitoring the chosen bond strategy in any portfolio.

Our investment philosophy continues to advocate participation in the markets with a globally diversified portfolio as a prudent strategy for the long journey. We welcome your comments and value the relationship we have with each of you. Stay safe and enjoy the spring!

Regards,

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Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that the future performance of any specific investment, asset class, or investment strategy (including the investments and/or investment strategies recommended by the adviser), will be profitable or equal to past performance levels. In particular, debt and fixed income securities are subject to credit risk, which is the risk that a borrower will be unable to make principal and interest payments on its outstanding debt obligations when due. There can be no assurance that a borrower will service debt obligations, and, in any such case, you may suffer a partial or total loss of invested capital.

Each index used as proxy for a given asset class/investment category referenced in this newsletter is a commonly used benchmark for that asset class. Historical performance results for investment indices and/or categories have been provided for general comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your account holdings correspond directly to any comparative indices. An investor may not directly invest in an index.

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