Rembert | Pendleton | Jackson

Financial Advisors

JANUARY 15, 2019

QUARTERLY PERFORMANCE REVIEW FOURTH QUARTER 2018

Dear Client:

We have enclosed your fourth quarter 2018 Portfolio Performance Report. Please review the materials and insert them behind the green "Performance" tab in your "Planbook."

This table presents the 2018 fourth quarter and 2018 full year returns of the benchmarks for selected asset classes.

Asset Class Returns

Asset Class	4th Qtr 2018	Calendar 2018	Benchmark Index
Domestic Fixed Income	1.65%	0.88%	Barclays Intermediate Gov't / Corp Bond
Domestic Inflation Protected	-0.42%	-1.26%	Barclays TIPS Index
International Fixed Income	2.42%	3.58%	JP Morgan – Global Gov't - Non US (hedged)
Domestic Equity (Large)	-13.52%	-4.38%	S&P 500 with Dividends
Domestic Equity (Large Value)	-11.72%	-8.27%	Russell 1000 Value Index
Domestic Equity (Small)	-20.20%	-11.01%	Russell 2000
Domestic Equity (Small Value)	-18.67%	-12.86%	Russell 2000 Value
International Equity	-12.54%	-13.79%	MSCI EAFE Equity Index with Dividends
Real Estate	-6.06%	-4.04%	FTSE NAREIT Equity
Precious Metals	7.73%	-0.93%	Gold
Natural Resources	-8.60%	-8.91%	Dow Jones UBS Commodity Index

The table above provides a perspective on how individual asset classes performed. Many were down significantly in the fourth quarter which erased gains from earlier in the year and resulted in negative performance for the full year.

Of course, many portfolios are not concentrated in a single asset class. Diversification means there is an allocation across many different asset classes.

Donald Mosby Rembert
CFP®, AIF®

Newton G. Pendleton III
CFP®, AIF®

Charles E. Rembert
CFP®, AIF®

Dwayne A. Jackson
CFP®

Brett W. Roper
CFP®, AIF®

Leslie D. Irby
CFP®, AIF®

Elizabeth D. Verdi
CFP®, AIF®

Elizabeth S. Clough
CFP®, AIF®

John K. Wolff
CFP®

U.S. Debt

The U.S. debt is approaching $22 trillion. The distribution of that debt and many other interesting statistics can be seen in real time at: http://www.usdebtclock.org/

We believe it is important to consider how composite portfolio performance is impacted by asset class performance, asset class weighting, and time. Here are two simple examples using the table above.

Example 1: A composite portfolio has a 40 percent allocation (weight) to Domestic Large Cap Equities for all of calendar 2018. Using the S&P 500 with Dividends return of -4.38 percent for the year, then that asset class would have contributed -1.75 percent return to the portfolio for the year.

Example 2: A composite portfolio has a 20 percent allocation (weight) to International Equities for all of calendar year 2018. Using the MSCI EAFE Equity index return of -13.79 percent for the year, then that asset class would have contributed -2.75 percent return to the portfolio for the year.

Other factors that impact composite portfolio performance include, but are not limited to: the amount of time an investment is part of the portfolio, investment expense ratios, advisor fees, and dividends paid in cash or reinvested.

We believe focusing only on the news about the three major US stock indices (Dow, S&P 500, and Nasdaq) presents an incomplete view of a diversified portfolio's performance, whether positive or negative. Those three indices often represent less than 50 percent of a composite portfolio.

Here is a brief summary of the broad asset classes for the full calendar year 2018.

Domestic Fixed Income (0.88%): The rising interest rates had a gradual positive impact on bond yields as the year progressed. However, it was more beneficial to short term bonds than longer maturity bonds. The rates for one month T-bills rose from 1.27 percent to 2.36 percent during the year. [Source: www.treasury.gov] Longer duration bonds also saw a rise in yield, but also had a drop in prices which offset those payments. The net result for domestic fixed income in general was very small returns (plus or minus) for most bond asset classes.

International Fixed Income (3.58%): Interest rates on government and corporate bonds and the yield curve are different than the US in other parts of the globe. Exposure to high-quality bonds in multiple world economies increases diversification and may help to complement overall bond performance that may be dominated by domestic only offerings.

Domestic Equity [Large Cap]: (-4.38%): The news was dominated by the large growth stocks like Facebook (-25%), Amazon (28%), Apple (-7%), Netflix (40%), and Google (-1%). These five stocks alone had mixed performance results at year end. The S&P 500 ended with 174 companies positive for the year with average gain of about 15 percent, while the remaining 331 were negative with average loss of about 21 percent. At year end, Price to Earnings ratios are within their normal historical range. [Source: S&P Dow Jones, Market Attributes, US Equities Highlights 2018]

[Small Cap] (-11.01%): The small cap stock decline is partially due to being caught in the large cap downdraft. They are also more sensitive to the potential impacts of higher interest rates, trade wars, and a constant stream of "uncertainty" which can slow decisions on hiring and expanding. Small companies tend to slow more than large companies as general economic activity either slows or shows signs of slowing.

Last years' performance in domestic equity was dominated by technology growth companies. Without their performance, value companies, which are not typically in technology sectors, lagged the results of both growth and blend categories.

International Equity [Developed] (-13.79%): Equity markets outside the US have their own mix of concerns about trade, consistent government policies, monetary policy, and the rate of growth of their economies. In general, they have a larger dependence on economic interactions with other nations than the US does. Global and internal country political and economic uncertainty was at a heightened level in 2018 and impacted the performance of Developed Markets (down 13.79%). The smaller, more vulnerable emerging international markets are more impacted by increases in costs of materials or decreases in orders for their goods and services. They were down a bit more than developed markets.

Domestic Real Estate (-4.04%): This asset class covers many different sectors of the real estate market, but all are impacted by changing interest rates. Higher mortgage rates and the need to do short-term loans to support operations impacts their bottom line until they can increase rents or lower operating costs. Over time, the asset class has done well, but often declines in periods of rising costs.

Precious Metals (-0.93%): Gold and silver, the two leading components of precious metals, saw a bit weaker demand for commercial use and consumption, but can remain a favored investment holding as a diversifier, inflation-hedge, and an asset that has maintained its value over the long term.

Natural Resources (-8.91%): Natural resources in addition to precious metals had mixed performance. An increase in supply of oil has led to lower prices even as natural gas prices have risen. Slower growing economies need fewer raw materials (i.e., copper, iron ore, lumber), which also leads to price softening for those basic materials. Agricultural commodities were mixed with wheat and orange juice rising but corn and coffee falling.

As the year ends, we also would like to add a note about market volatility.

> "About 85 percent of all stock market trading today is controlled by machines, models, or passive investing formulas, creating a trading herd that moves swiftly in unison. Quantitative hedge funds account for about 28.7 percent of trading in the stock market, according to data from Tabb Group, a share that's more than doubled since 2013.

Quotable Quotes

"The Chinese can't really afford to have any weakness in their exports, given the weakness in their domestic economy and demand. People are living longer and not having enough kids to support them with domestic growth. China is rapidly emerging as the world's largest nursing home."

- Ed Yardeni, President Yardeni Research

Quote in Washington Post: January 3, 2019

> They now trade more than retail investors and everyone else. Add to that passive funds, index investors, high-frequency traders, market makers, and others who aren't buying because they have a fundamental new view of a company's prospects, and you get to around 85 percent of trading volume."
> [Source: Wall Street Journal: 12/26/2018; Behind the Market Swoon: The Herdlike Behavior of Computerized Trading; Gregory Zuckerman, Rachael Levy, Nick Timiraos]

Computers can receive, interpret, and act on lots of small bits of information much faster than humans and without any emotional bias. The assumption is that this approach creates an advantage that (if the computer algorithm interprets and acts on the data correctly) may result in positive investment returns. This is making investment decisions in less than a second instead of making strategic decisions based upon fundamental economic analysis. As described in the Wall Street Journal article, we believe this phenomenon is a significant contributor to daily market volatility and adds very little, if any, value for the long-term investor.

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 winter!

Regards,

Rembert Pendleton Jackson

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Rembert | Pendleton | Jackson
7647 Leesburg Pike
Falls Church, VA 22043
(703) 821-6655
www.rpjadvisors.com (website)