FOURTH QUARTER | 2018

INVESTMENT COMMENTARY

At a Glance

The theme of low volatility that headlined our investment commentaries over the past three years came to a sudden halt in the fourth quarter. Reacting to multiple global concerns in the news, the S&P 500 Total Return Index suffered its largest quarterly decline since the third quarter of 2011. It also ended the Index's nine-year win streak. On a positive note, the quarter provided an opportunity to demonstrate how our Global Wealth Strategy (GWS) adapted to an increasing risk environment.

We believe that GWS's adapting to risk minimized the impact of the fourth quarter's significant decline in global equity markets. The GWS Portfolio finished the quarter down -6.96% (net of fees) compared to a negative -13.52% for the S&P 500 Total Return Index and -11.46% for the MSCI All Country World Total Return Index ex-U.S.

Highlights:

- Global Uncertainty Sends Equity Markets Reeling
- Rising Risk Means Time to Play Defense
- Utilities Hang on Amid U.S. Large Cap Rout

Global Uncertainty Sends Equity Markets Reeling

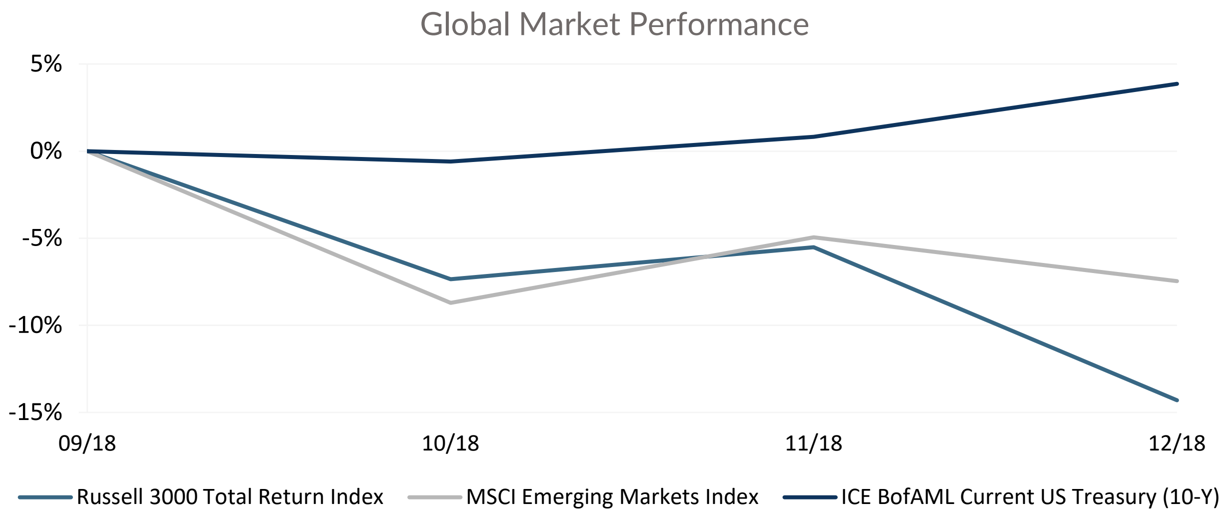
The fourth quarter got off to a rocky start in October, triggered by concerns over the pace of 2019 interest rate hikes suggested by the U.S. Federal Reserve. If that wasn't enough, markets were additionally rattled by a significant slowdown in China's economy. The negative news left global stocks in the red with the MSCI All Country World Total Return Index down -7.49% in October.

Although there was a slight reprieve in November, the move lower accelerated in December. There were plenty of issues that likely contributed to the global rout in stocks, including the fear of a global economic slowdown, a peak in earnings, and sinking oil prices. The news had the largest effect on U.S. markets. For the quarter, emerging markets held up much better than U.S. markets with the MSCI Emerging Market Index down -7.47% compared to -14.30% for the Russell 3000 Total Return Index. Our proprietary risk management model used to manage GWS adapted to the relative increase in U.S. Equity risk by reducing the allocation to U.S. Equities. International Equities exposure was also reduced, although, not as much as the U.S.

In the Fixed Income markets, all year long US Treasury yields were increasing, but the market turmoil in the fourth quarter led to a "flight to quality" as seen by the yield on the 10-year U.S. Treasury Bond dropping from 3.05% at the end of September to 2.68% at the end of December.

The decline in yield produced an attractive return of 3.86% for the 10-year U.S Treasury Bond in the fourth quarter and demonstrated the importance of evaluating correlation when constructing an investment portfolio.

The chart below compares the fourth quarter returns of the Russell 3000 Total Return Index, MSCI Emerging Markets Index and the ICE BoAML Current U.S. Treasury (10-Y).



Source: FactSet. Period shown is October 1, 2018 through December 31, 2018.

This is a good example of why we don't rely on forecasts or factor them into the GWS strategy to make investment decisions. If we had, our allocation to US Treasuries would not have increased and would have missed out on the best performing asset in the GWS Portfolio during the 4th quarter.

Rising Risk - Time to Play Defense

The success in the fourth quarter wasn't due to a prediction that the global markets would decline. It was because the Portfolio adapted to the increasing risk environment and kept the Portfolio's risk balanced. As an example, from September 30th to November 30th, our quantitative risk model required the allocation to the Fixed Income class be increased from 29.95% to 46.76% and the allocation to the US Equities class be reduced from 25.31% to 11.81%.

We saw that the elevated risk environment led investors down the path to lower risk assets. Our quantitative approach correctly identified the need for a risk outlet which resulted in a substantial increase in the allocation to defensive assets. U.S. Treasuries had the largest allocation increase of 6.69%, moving from 10.71% up to 17.40%

The chart below illustrates the adaptive nature of GWS and displays the month-over-month allocation changes for the fourth quarter.

Asset Class	9/30/18	10/31/18	11/30/18	Change from 9/30/18 to 11/30/18
US Equities	25.31%	12.08%	11.81%	-13.50%
International Equities	19.82%	15.15%	15.40%	-4.42%
Fixed Income	29.95%	47.98%	46.76%	16.81%
Inflation Hedges	24.92%	24.79%	26.03%	1.11%

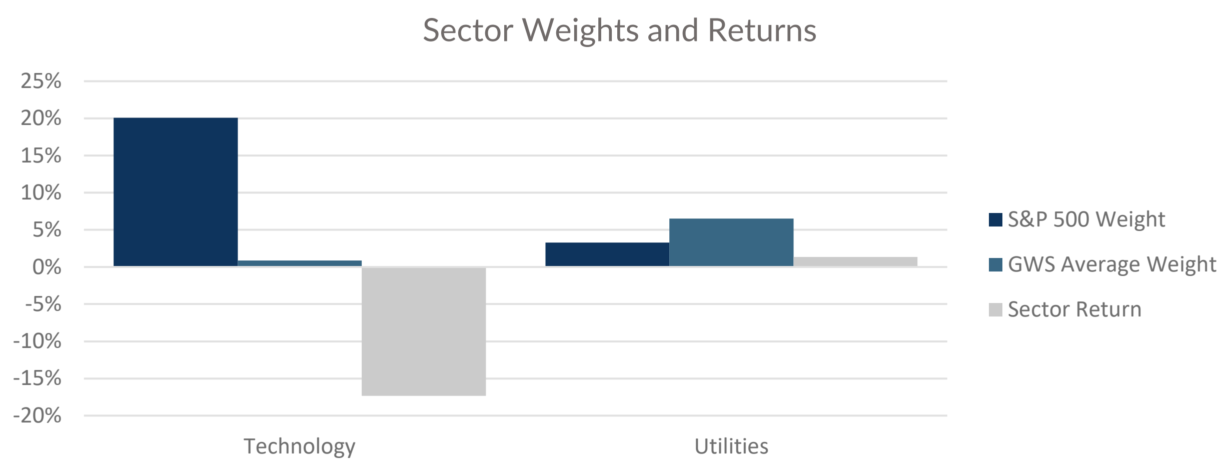
The Portfolio was re-allocated on the last trading day of the month.

An important take away here is the value of our quantitative, rules-based investment process. We didn't attempt to forecast the market decline, we followed our investment process and continually adapted to the increase in risk - without emotion or subjectivity.

Utilities Hang on Amid U.S. Large Cap Rout

The fourth quarter showed that there's more than one way to play defense. Every risk environment is different, and the assets in the Portfolio that respond well in a particular risk environment may not fare so well in another type of environment. For example, in the fourth quarter a flight to safety was also seen at the equity sector level. With 4 out the 11 S&P 500 sectors down over 15%, the Utilities sector broke away from the "herd" and was able to finish the quarter up 1.36%. Utilities also outperformed three other major fixed income segments: U.S. Corporates (-0.54%), U.S. High Yield (-4.24%), and Emerging Market Bonds (-0.18%).

The chart below compares the S&P 500 Total Return Index and GWS Portfolio weights to the US Large Cap Technology and U.S. Large Cap Utilities sector as well as the returns for the two sectors.



Source: S&P Dow Jones Indices as of December 31, 2018. Period shown is October 1, 2018 through December 31, 2018.

The global uncertainty had a much larger impact on the risk of technology stocks than utility stocks. We believe having multiple sources of return and no constraints on allocations were key contributors to our success in the fourth quarter.

Final Thoughts

Although negative returns are never pleasant, the Portfolio, in our opinion, weathered the storm. With risk remaining high heading into 2019, we continue to maintain an overweight to defensive assets.

The key to the GWS Portfolio performance was adapting and not forecasting. Having a quantitative and rules-based investment process helps eliminate emotions and questions like "is this the bottom?"

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