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Economic and Market Environment
First Quarter 2019

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The Economy

- In 2018 the U.S. economy produced its best performance in years. Faster growth was balanced with low inflation. Strong demand continues in the consumer sector.
- Continued expansion is expected in 2019, although signs point to a slower rate of growth. Recession fears are rising, but we do not believe they will be realized in the near future.
- The Federal Reserve (Fed) will have choices to make in 2019: continue to raise federal funds or pause to measure the degree to which the economy slows.
- Corporate profits are expected to be higher, but less so than in 2018 as the impact of the Trump tax cut diminishes.
- U.S. trade policy is changing under President Trump. This has investors unsettled, as the prospect of trade wars threatens economic growth.

Stocks & Bonds

- U.S. stock investors were buffeted with two stock market corrections in 2018: one at the beginning of the year and one at the end.
- Fear of trade wars, slower economic growth here and abroad, and rising interest rates contributed to investor uncertainty. These issues remain unresolved as we enter 2019.
- Stock gains did not keep up with corporate earnings increases in 2018, leaving stocks more attractively priced going into the new year.
- High quality bonds provided slightly positive returns in 2018. Slower economic and corporate growth means quality should continue to be an important characteristic for bond investors this year.
- The outlook for bonds and stocks is less clear as we enter 2019. Looking to the longer term, we remain constructive, but advise continued emphasis on high quality stocks and bonds.

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Major Economic Elements

GDP	• 3% plus real Gross Domestic Product in 2018 • Elevated and steady consumer demand • Fiscal stimulus – Trump tax cuts
Unemployment	• 3.7% unemployment, lowest in decades • Improvement in the participation rate • 98 consecutive months of job growth
Inflation	• Core inflation at 2.2% year-over-year • Consumer Price Index declining due to oil price decline • Inflation expectations remain low
Interest Rates	• Remain low in historical context • Fed intentions to raise rates further may be curbed by slower growth • Yield curve flattening

Source: Federal Reserve Bank of St. Louis, Bureau of Labor Statistics, Bureau of Economic Analysis

- 2018 was a very successful year for the U.S. economy. Each of its four structural elements ended the year in good condition.
- Looking ahead, there are warning signs as we enter 2019.

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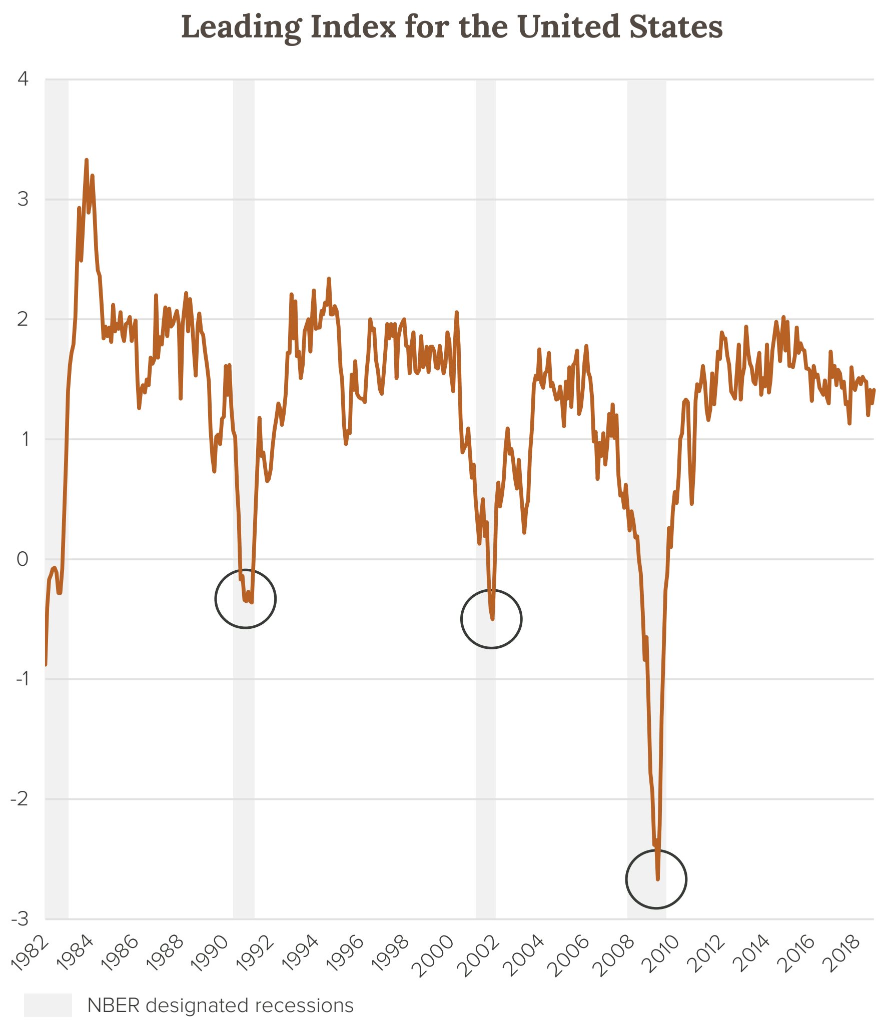

Source: Federal Reserve Bank of St. Louis
Leading Index for the United States, Percent, Monthly, Seasonally Adjusted (Data Through: October 2018)

- The Leading Economic Index is still indicating a healthy economy, but has been trending down since its cycle peak in 2015.
- This index is important since it is forward looking and can be a predictor of future trends in economic activity.
- Stock prices are an important component of the index. Recent weakness in stocks is likely to extend the downward trend.
- The good news is that the index is still strong and well above a recession warning level. Future readings should be monitored closely.

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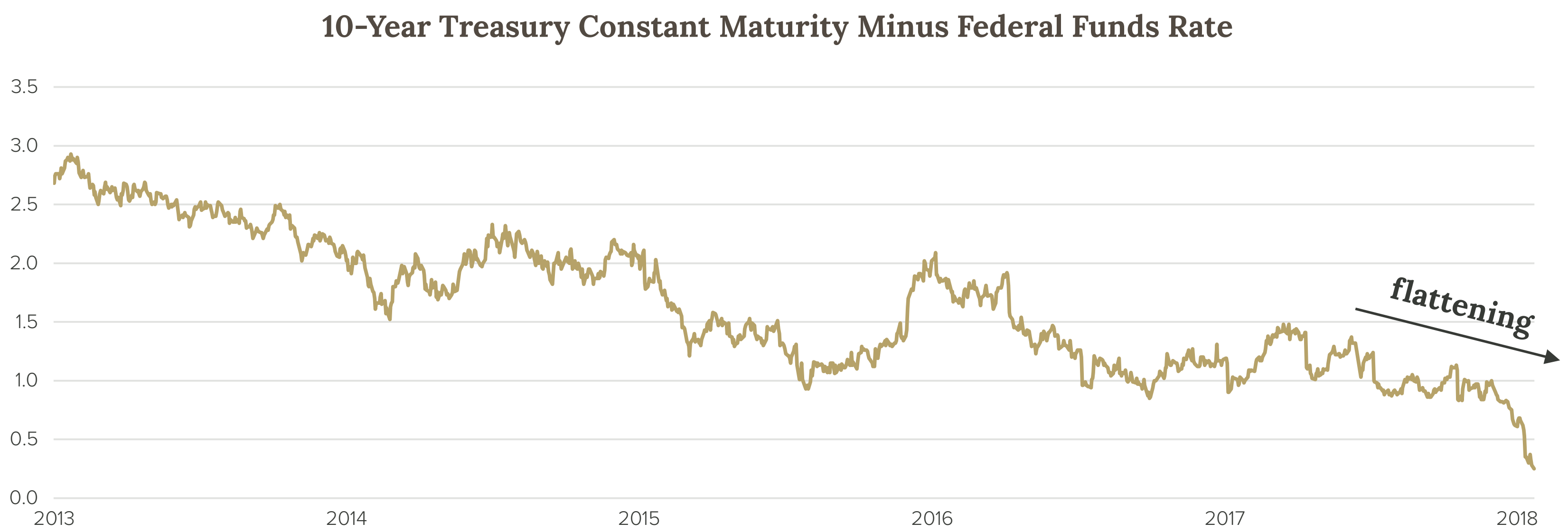

Source: Federal Reserve Bank of St. Louis
10-Year Treasury Constant Maturity Minus Federal Funds Rate, Percent, Daily, Not Seasonally Adjusted (Data Through: December 2018)

- The yield curve is considered one of the more important indicators of future economic growth.
- The Federal funds rate to the 10-year U.S. Treasury note is the Fed's favorite yield curve measure.
- The yield curve has been flattening during 2017-2018, and currently only 29 basis points of yield separate the two parts of the curve.
- An inverted yield curve has been a very good predictor of recession.
- We do not believe the Fed will allow the yield curve to invert.

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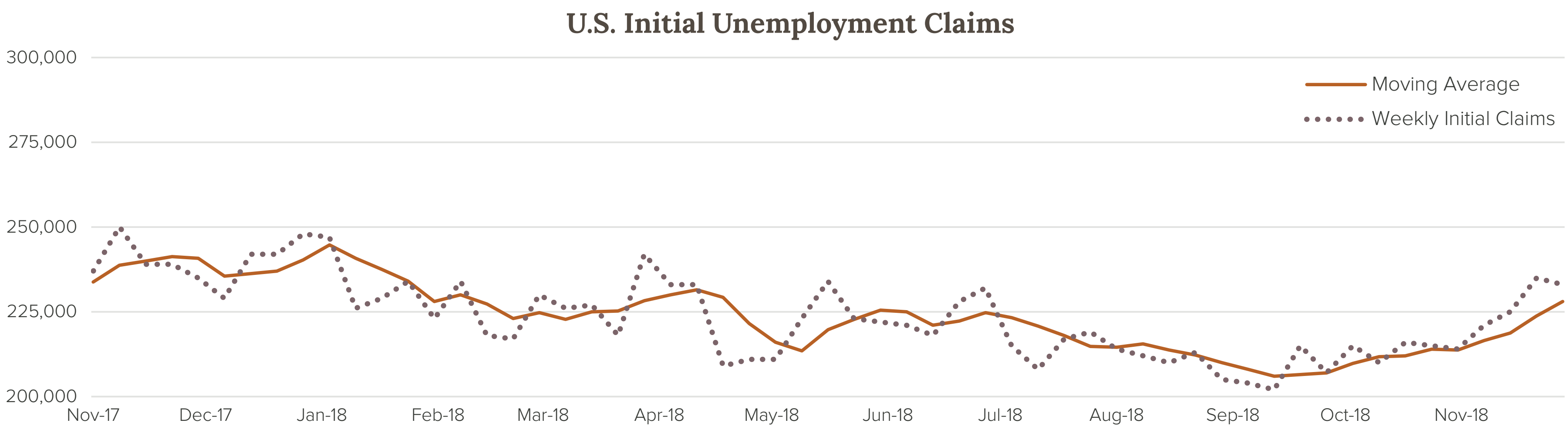

Source: Federal Reserve Bank of St. Louis, Bureau of Labor
4-Week Moving Average of Initial Claims, Number, Weekly, Seasonally Adjusted (Data Through: December 2018)
Initial Claims, Number, Weekly, Seasonally Adjusted (Data Through: December 2018)

- Initial unemployment claims can be a leading indicator of rising unemployment.
- In the past when initial claims have increased for three consecutive months, it has been a harbinger of recession.
- Claims rose in September and October, but declined in November.

Our assessment of the three warning signs is that they signal slowing economic growth, but do not indicate an imminent recession.

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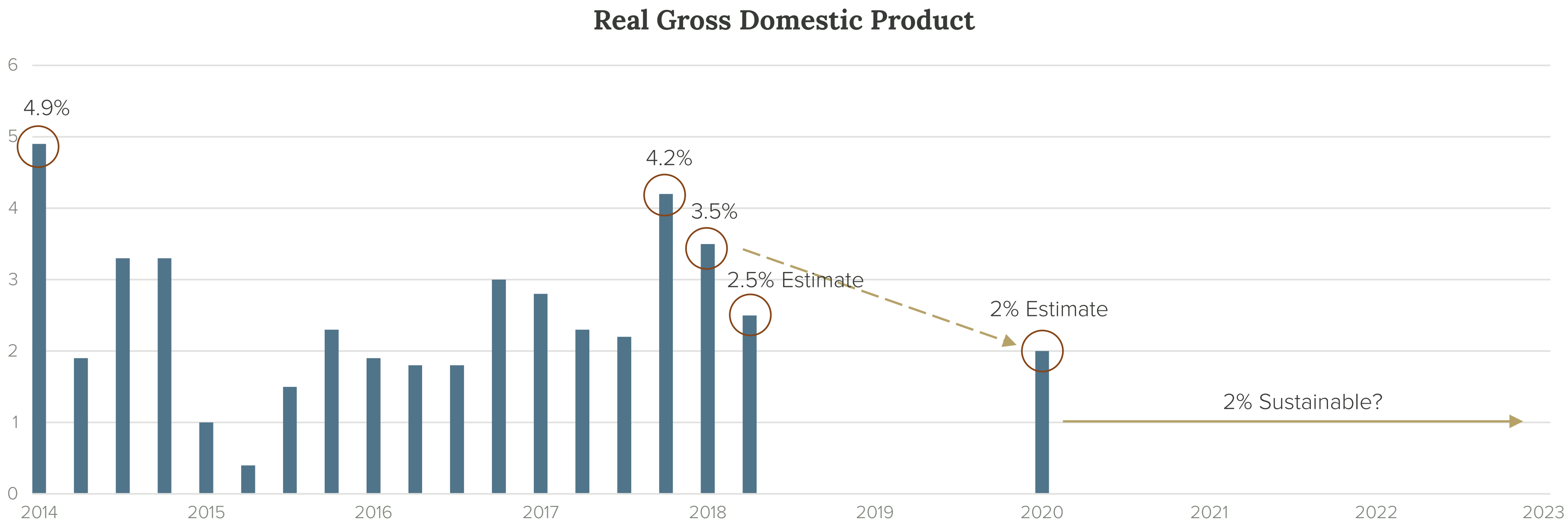

Source: Federal Reserve Bank of St. Louis
Real Gross Domestic Product, Percent Change from Preceding Period, Quarterly, Seasonally Adjusted Annual Rate (Data Through: July 2018)

- Both the Federal Reserve and International Monetary Fund forecast a long-term, sustainable growth rate of 1.8% for the U.S. economy.
- Through monetary policy, the Federal Reserve appears to be attempting to manage the U.S. economy towards the sustainable growth rate over the next several years. The goal is to extend the expansion without causing disruption. This is an ambitious undertaking.
- We believe there is a reasonable chance of this scenario playing out favorably. If inflation remains well contained, the chances of success improve substantially.

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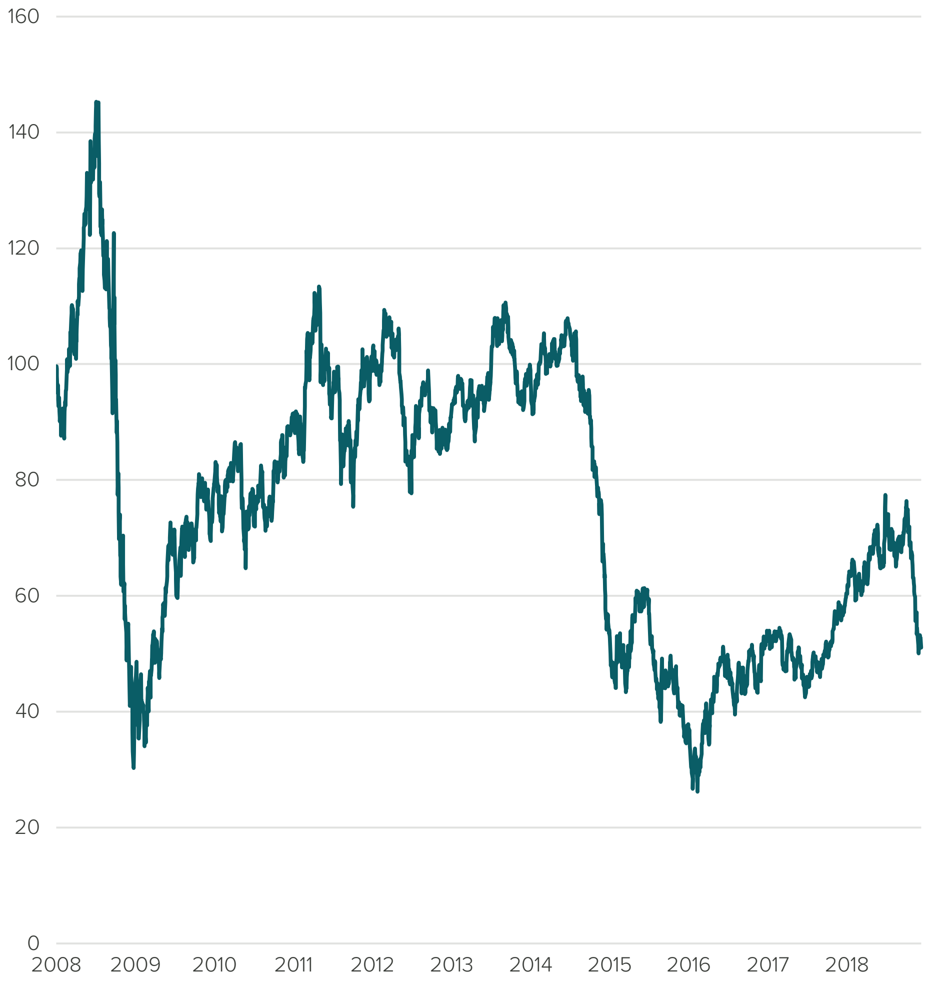
Crude Oil Prices: West Texas Intermediate (WTI)



Source: Federal Reserve Bank of St. Louis
Crude Oil Prices: West Texas Intermediate (WTI) - Cushing, Oklahoma, Dollars per Barrel, Daily, Not Seasonally Adjusted
(Data Through: December 2018)

- The price of oil was in freefall in the latter part of 2018, ending the year near its lowest point in a year.
- Why is the price of oil declining? The answer is twofold: excess supply and weakening global demand.
- The U.S. has become the global leader in oil production. This changes the longer-term dynamic for oil pricing and may suggest long-term-price weakness.
- We see declining oil prices as a deflationary sign and a bonus for consumers and businesses.

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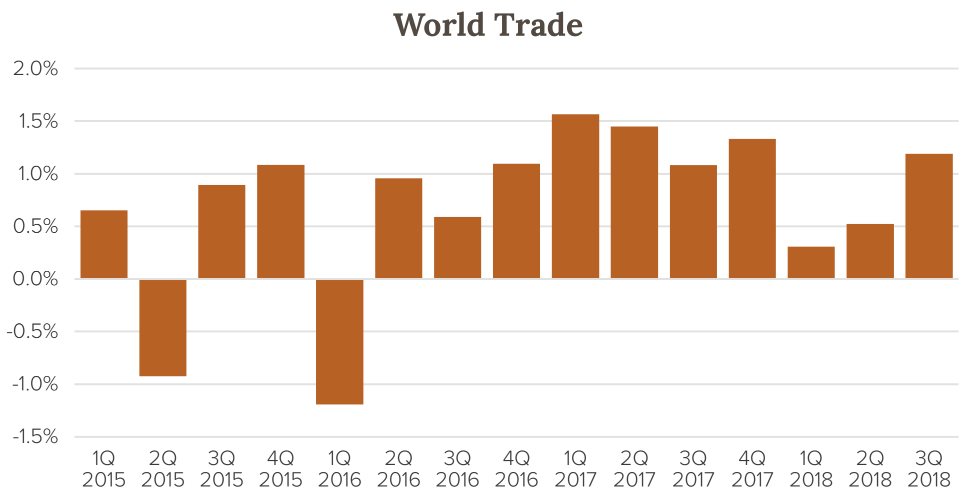

Source: World Trade Organization
World trade, quarterly % change, seasonally adjusted, average exports/imports (Data Through: September 2018)

Source: Bloomberg
Citi Economic Surprise Index, Developed Markets, Daily (Data Through: December 2018)

- One of the worrying aspects of the economic environment is slowing growth in the rest of the world.
- World trade, after expanding in 2017, weakened in the first two quarters of 2018, but recovered in the third quarter.
- It is difficult to know if the U.S./China trade dispute has contributed to the trade slowdown.
- The Citi Economic Surprise Index measures economic data in the developed economies as released, relative to expectations. It is confirming the trade data.

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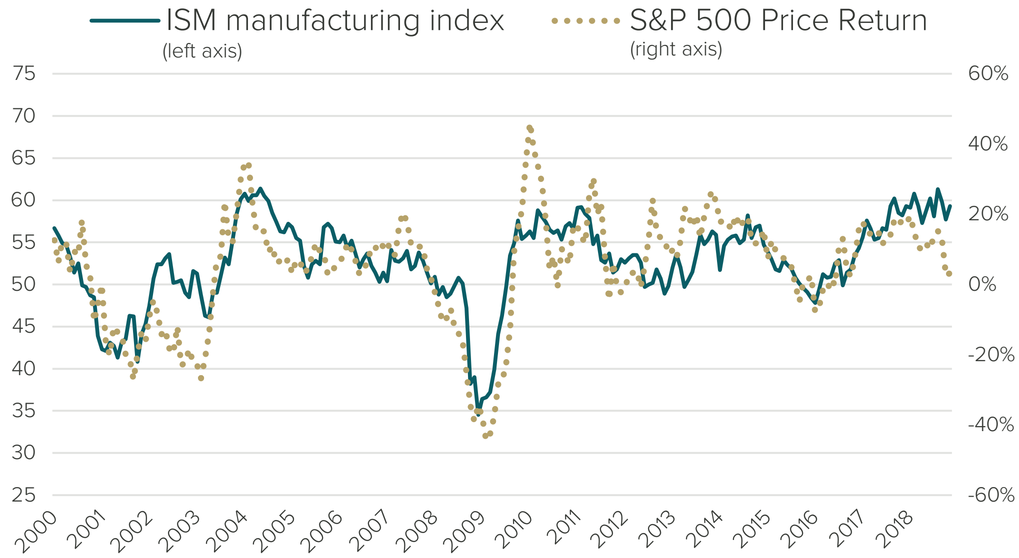
S&P 500 Index

Source: Bloomberg
Forward Price to Earnings Ratio of S&P 500 Index (Data Trough: December 2018)



Source: Bloomberg, Institute for Supply Management
ISM Manufacturing Index (Data Trough November 2018)
Trailing 12 month S&P 500 Price Return (Data Trough November 2018)

- In 2018 stock prices declined while corporate earnings advanced sharply, thereby reducing valuations.
- At less than 15 times, the price-to-earnings ratio on the S&P500 is now down from its peak in 2018 of 20 times.
- One way of looking at valuations is to measure the price of stocks relative to manufacturing activity. Stocks have declined much more than manufacturing activity, indicating that stocks are cheaper, relative to the economy.

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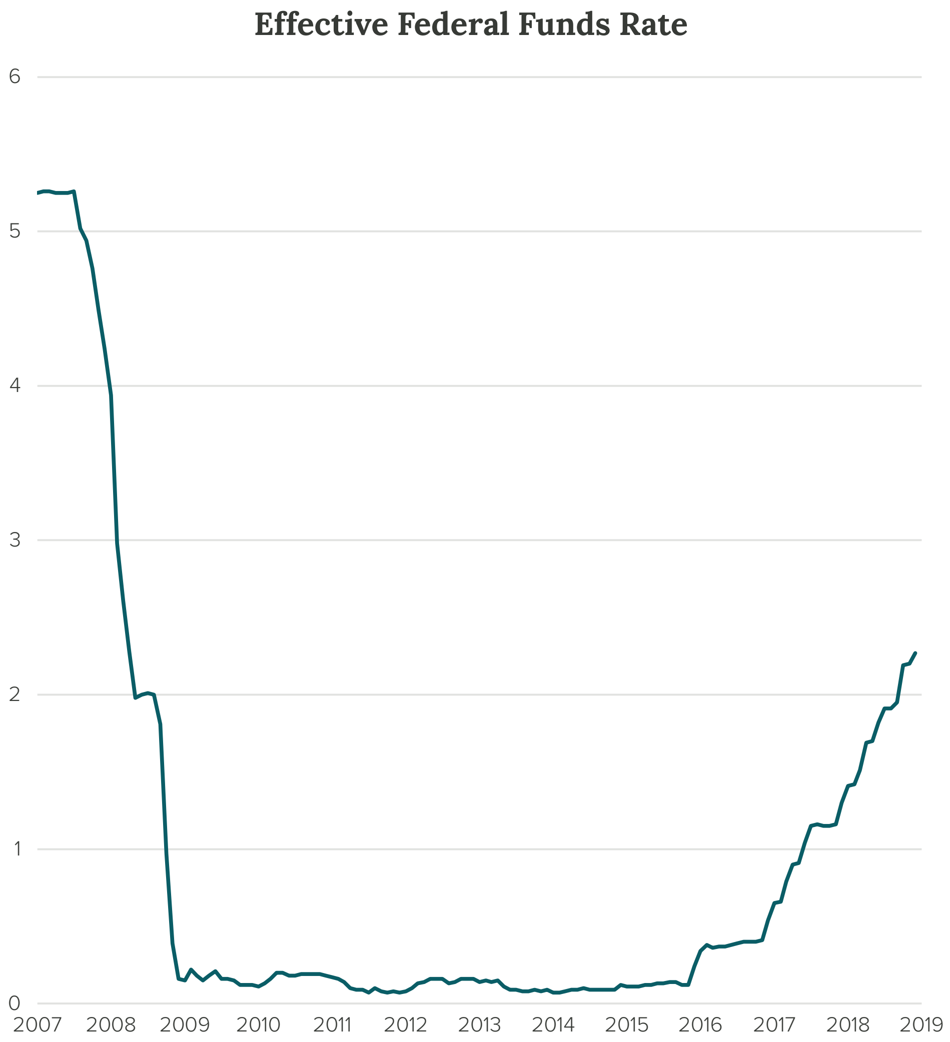
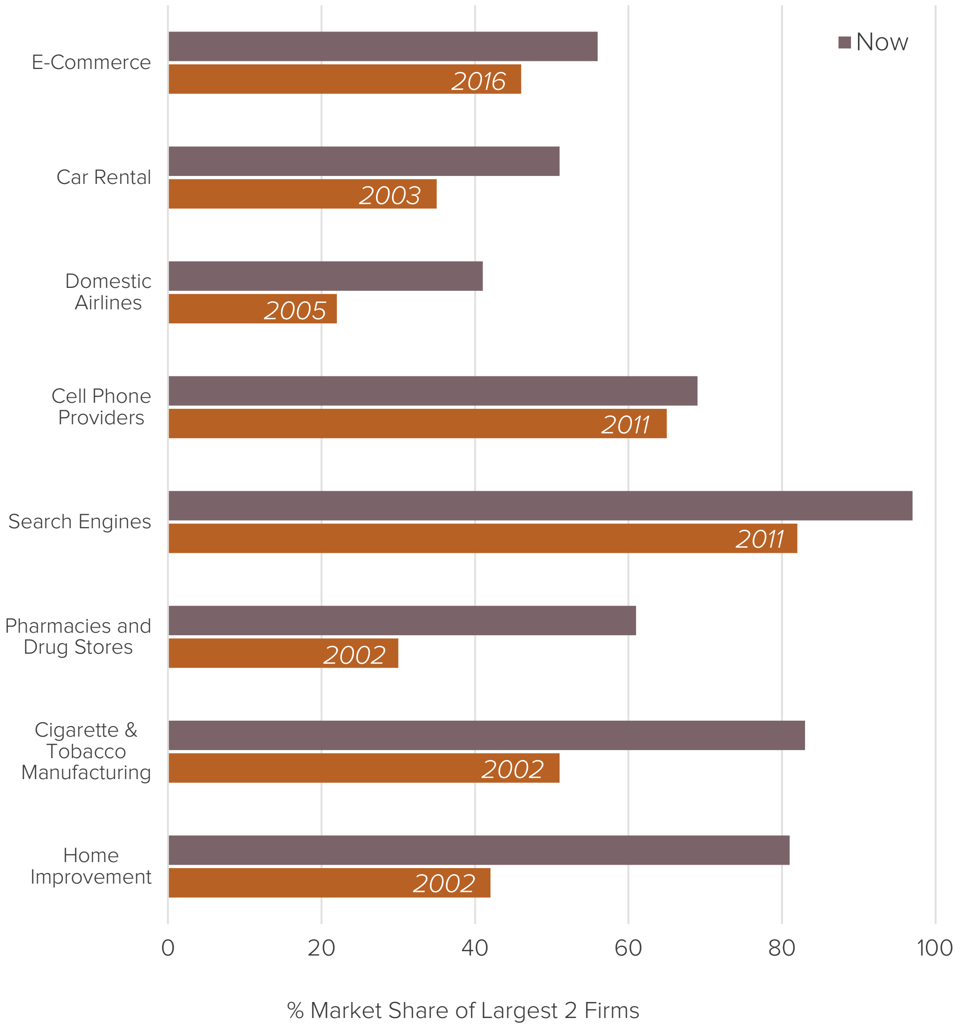


Source: Federal Reserve Bank of St. Louis
Effective Federal Funds Rate, Percent, Monthly, Not Seasonally Adjusted (Data Through: December 2018)

- Since 2015 the Fed has consistently raised its federal funds rate, from 0.25% to 2.25 - 2.50%.
- The goal is to restore normalcy to interest rates and to be sure they are high enough to provide downward flexibility in the next recession.
- The Fed recently adjusted downward its expected pace of federal funds increases in 2019 from three to two. This suggests a softening of its intent, and could be revised lower during the year.
- Longer-term interest rates will be impacted by Fed policy and inflation. We believe the 10-year Treasury yield will have difficulty going higher than 4% in this cycle.

CHART OF INTEREST: AMERICAN INDUSTRY CONCENTRATION



Source: IBISWorld and Open Markets Institute
https://concentrationcrisis.openmarketsinstitute.org/
Now ranges from 2017 to 2018, depending on data availability

- Data indicates growing monopoly power in the U.S. economy. A small set of companies increasingly controls America's commerce.
- The display provides some startling information. Economists are giving increased attention to this trend.
- Concentration is not unique to one or two economic sectors. Rather, it persists across a diverse range of industries.
- Is this trend good or bad? It is good for the dominant companies and their investors, but it may be bad for employees and consumers.

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