Independence | Asset Advisors

GLOBAL MARKETS OUTLOOK & FIRST HALF 2018 REVIEW

JUNE 30, 2018

DISCLAIMER

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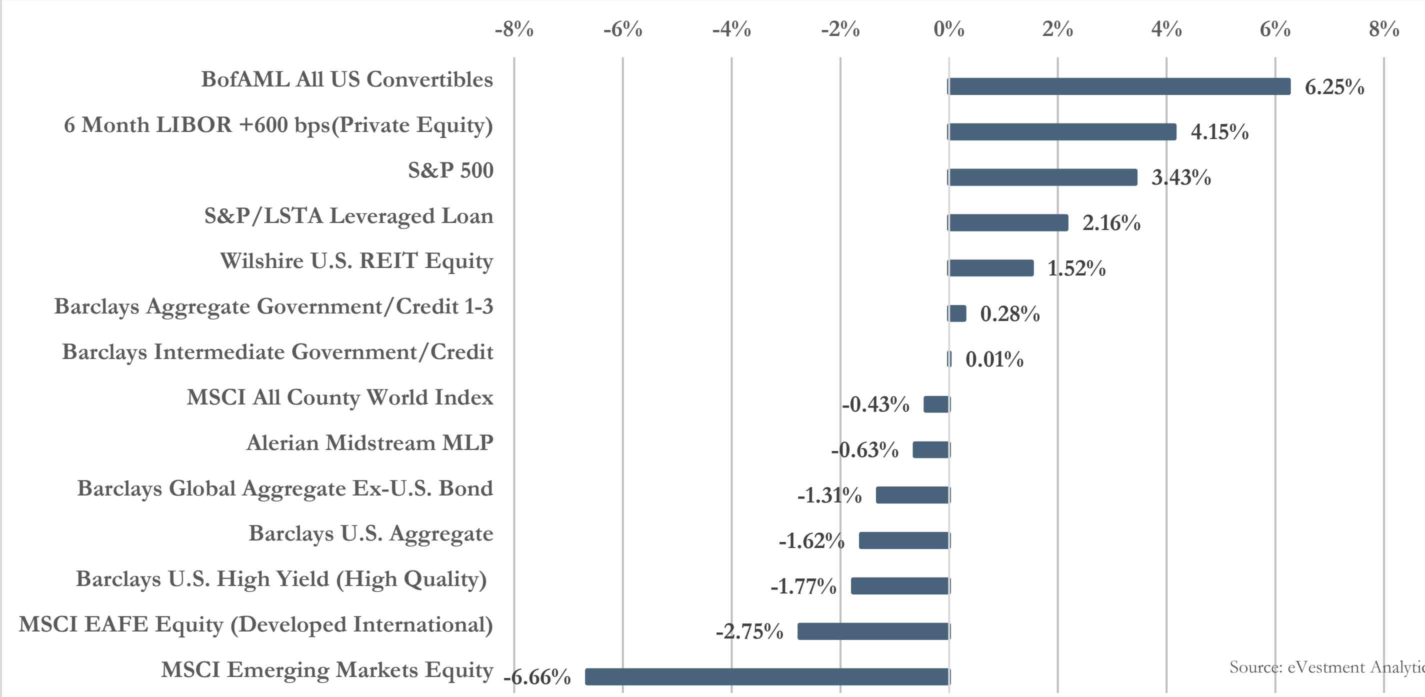
I. GLOBAL MARKETS REVIEW: YEAR-TO-DATE AS OF JUNE 30, 3018

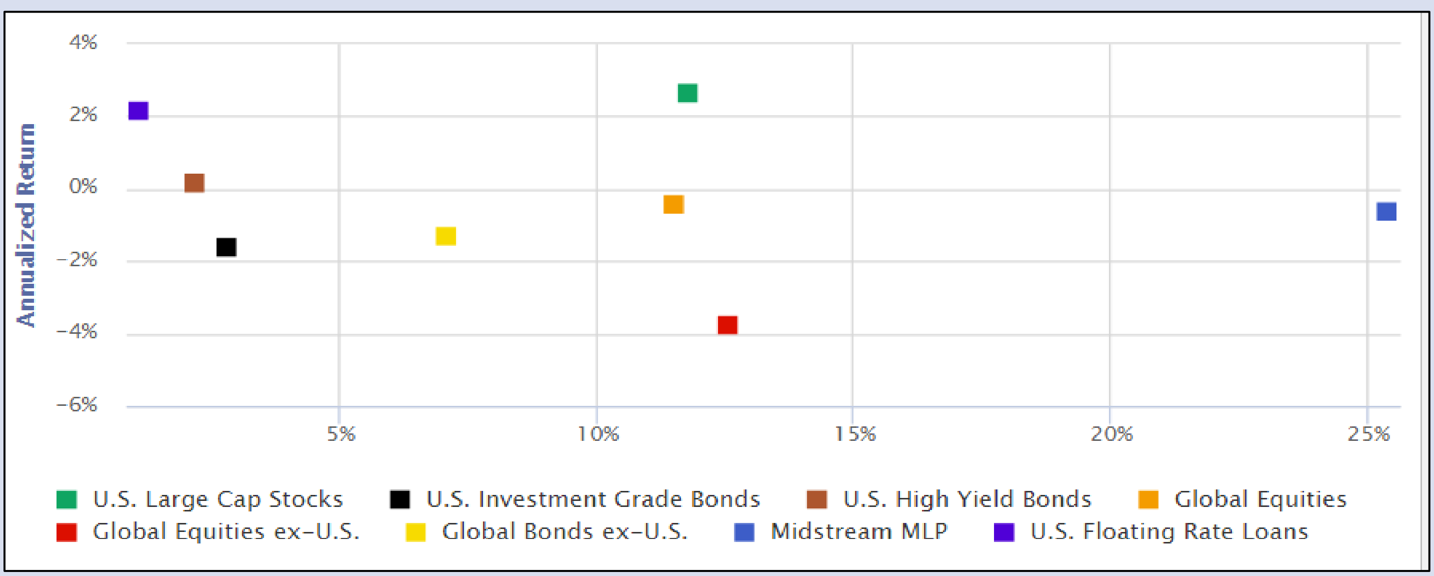
GLOBAL BENCHMARKS – YEAR TO DATE AT JUNE 30, 2018



Source: eVestment Analytics

2018 First Half Market Review – The first half of 2018 saw broadly lower total returns amid periods of higher volatility. The table below provides a visual guide to the results of primary global equity and fixed income asset classes during the first half of the year. The takeaway is that the U.S outperformed international as the U.S. dollar appreciated 7% and high yield credit outperformed investment grade bonds. Bank loans, high yield and Credit L.P. added value, while allocations to international assets detracted.

GLOBAL MARKET INDICES – YEAR TO DATE AT JUNE 30, 2018 (RISK VS RETURN)



Source: eVestment Analytics

II. GLOBAL MARKETS: FIRST HALF REVIEW & 2018 FULL-YEAR OUTLOOK

First Half Review

Heading into the current year, expectations were high that equity markets would maintain a robust pace of growth and positive returns. However, there was caution related to fixed income investment in the face of rising interest rates. This outlook was supported by positive economic growth guidance, strong forecasted earnings, stimulative fiscal policy and an outlook to gradually reduce accommodative monetary policy. In fact, 2018 had a strong start, as evidenced by the MSCI All Country World Index, which gained 5.6% in January. However, over the next five months, this same benchmark declined 5.8%. What happened?

Inflation concerns derailed global markets at the end of January, reintroducing volatility to the stock market and resulting in a brief market correction. Investors generally accepted that a correction was likely to occur after such a long period of positive returns, but investors were also wary of mounting geopolitical tensions between the U.S. and North Korea, currency and commodity price volatility, and fears over a global trade war with both our allies and China, all against the backdrop of tightening monetary policy by the Federal Reserve.

Global markets remained shaky through the remainder of the first half, with investors frequently entering and exiting asset classes and sectors based on sentiment-driven risk appetites. However, as the first half came to a close, it was clear that global financial markets had diverged and U.S. markets had outperformed. An impressive and unexpected rally in the U.S. dollar during the second quarter reversed the nearly 2% loss the greenback registered during the first quarter, creating a headwind for U.S.-based international investors. Stock prices in most international developed markets advanced in local terms, but those gains were canceled by the dollar's rebound.

The strong U.S. dollar also affected global bond markets, with U.S. bonds generally performing better than foreign bonds. U.S. municipal bonds outperformed U.S. investment grade taxable bonds. Based on valuations, municipal bonds are even more expensive, trading at a $7.30 premium to par, while taxable bonds are trading at about par. U.S. high yield bonds participated in the second quarter market rally, gaining 1%, while bank loans gained 0.70% and are now trading back below par. Global bond markets were negatively impacted by the stronger U.S. dollar and international fixed income returns were generally negative in the first half.

2018 Full-Year Outlook

We see no respite ahead for investors concerned over the headwinds from the first half. Rising inflation and continued solid GDP growth should keep the Fed on track for continued quarterly rate increases through mid-2019. Europe continued to recover slowly, with Brexit, U.S. tariffs and trade tensions all adding to uncertainty.

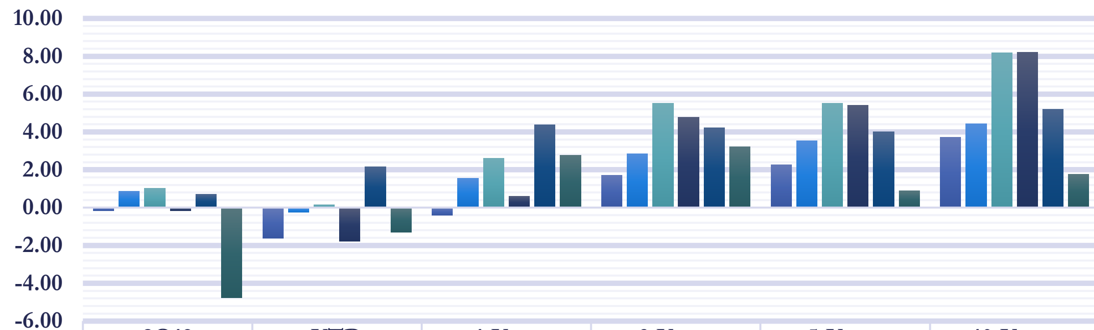
International developed and emerging market equity indexes do offer better value relative to U.S. equities, along with relatively higher yields, but in our estimation the headwinds pressuring these markets are likely to result in additional volatility and low, neutral or negative returns for the year.

U.S. equity markets, which gained 3.4% in the second quarter, remain fully supported by strong corporate earnings and full employment. With 4% second quarter GDP growth and analysts forecasting 2.8% growth for the year, we expect smaller companies to outperform due to tax policy, eased borrowing conditions, higher consumer spending and less negative impact from trading partners imposing reciprocal tariffs. Looking ahead, the U.S. appears well positioned for moderate sustained growth; however, rising interest rates, tariff uncertainty and general political tension are likely to result in more market turbulence.

With the U.S. dollar over-valued against many trading partners, international bonds may perform better should the Greenback weaken. U.S. high yield bonds and floating rate loans offer the best protection against further rate hikes, while shorter term investment grade bonds offer lower credit risk.

IV. 2018 FIXED INCOME MARKETS

SELECT BENCHMARKS – GLOBAL FIXED INCOME MARKETS – **JUNE 30, 2018**



	2Q18	YTD	1-Year	3-Years	5-Years	10-Years
US Aggregate Bond	-0.16	-1.62	-0.40	1.72	2.27	3.72
US Municipal Bond	0.87	-0.25	1.56	2.85	3.53	4.43
US Corporate High Yield	1.03	0.16	2.62	5.53	5.51	8.19
US High Quality High Yield	-0.17	-1.77	0.60	4.78	5.42	8.22
S&P/LSTA Leveraged Loans	0.70	2.16	4.37	4.21	4.00	5.19
Global Agg. Ex-U.S.	-4.76	-1.31	2.78	3.23	0.88	1.76

Source: eVestment Analytics

U.S. INVESTMENT GRADE TAXABLE BONDS [FIRST HALF (1.62%)]

REVIEW: U.S. investment grade bonds lagged lower quality fixed income in the first half. The Barclays U.S. Aggregate Bond Index declined 1.6%, which compared unfavorably against both high yield bonds and floating rate loans by 1.8% and 3.8%, respectively. Higher quality bonds have longer average maturities and lower yields, making them more sensitive to rising rates as compared to lower quality issues with shorter durations and higher yields.

For example, during the first half, U.S. investment grade corporate bond yields increased from 3.3% to 4.0%, but the asset class declined 3.3% overall. This result makes sense as a 1% rise in interest rates and 6.8 year duration risk equates to as much as a 6.8% price decline. High yield bonds may experience price declines under the same 1% rate rise scenario of up to 4%; however, their higher yield would result in an average positive total return of 2.5%. Floating rate loans, meanwhile, experience almost no price decline and a positive total return of 3%.

OUTLOOK: We expect additional 0.25% rate hike in September and December. The impact from tightening should be less of a total return detraction since yields are higher now as compared to the start of the year and offer more cushion to offset negative price return. Our expectation for the second half of the year is a flat to slightly positive total return for the Barclays U.S. Aggregate Index. We will also pay close attention to the yield curve, which ended the first half essentially flat. As the Federal Reserve raised rates, the 10-year treasury term premium narrowed from 1% in 2013 to just 0.1% as of June 30th.

U.S. MUNICIPAL BONDS [FIRST HALF (0.25%)]

REVIEW: U.S. investment grade municipal bonds were resilient during the first half and generally outperformed most major global indices despite returning negative 0.3%. Issuance remained depressed as a result of tax reform (which eliminated the exemption for advanced refunding bonds), but overall we saw a net negative supply environment that benefitted the asset class.

OUTLOOK: Looking ahead, we expect a continuation of the strong demand that has seen eight straight weeks of inflows. We expect municipals will outperform taxable-equivalent bonds in 2018, but we do anticipate some event-risk associated with the forecasted third quarter rate hike, plus mid-term elections and the curtailment of the tax benefit. As of mid-year, the tax-equivalent yield continues to favor municipals for the highest earners.

U.S. HIGH YIELD [FIRST HALF +0.16%]

REVIEW: U.S. high yield bond returns were generally flat in the first half, with the broad U.S. high yield index gaining 0.2%. Lower-rated bonds generated the strongest returns, with the highest quality (BB/Ba) high yield bonds declining 1.8%. Higher quality high yield bond spreads widened modestly, though they remain tight by historical norms at 368 basis points, compared to a long-term average of 551 basis points. These bonds should be purchased for income yield and the expectation of price gains.

OUTLOOK: We believe high yield bonds, and more specifically higher quality high yield bonds, continue to offer an appealing combination of shelter against rising rates, higher relative yields and below average default risk.

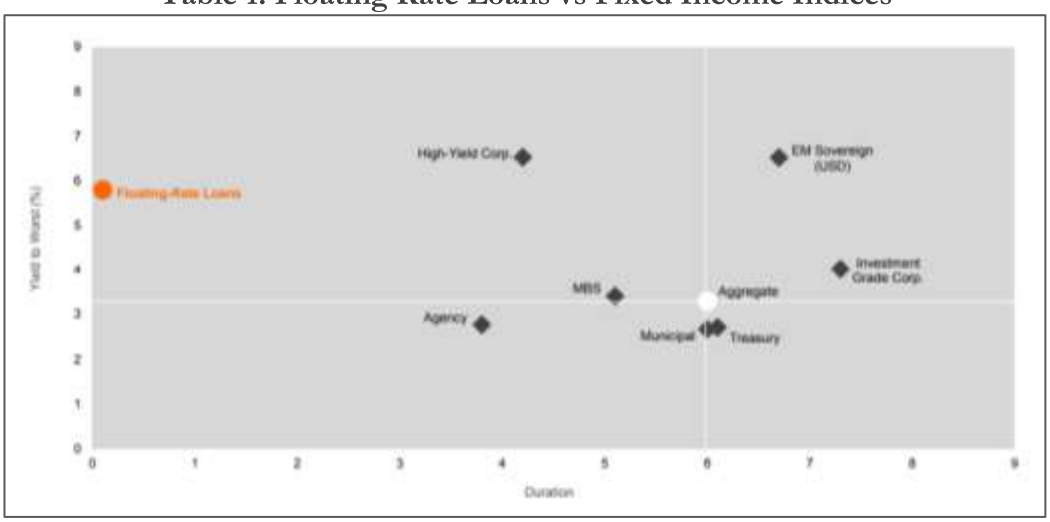
We are mindful, however, of a few key detractors that could persist in the second half, including reduced interest deductibility rules for highly leveraged companies. We are also cognizant that while leverage for high yield companies has ticked up recently, interest coverage has climbed with strong earnings. Forecasted default rates remain extremely low at about 2% compared to a longer-term average of about 4%.

FLOATING RATE [FIRST HALF +2.16%]

REVIEW: The first half demonstrated the effectiveness of floating rate loans as a diversifier. Loans returned 1.5% in the first quarter, 0.70% in the second quarter and 2.2% year-to-date. These returns compare favorably against the Barclays U.S. Aggregate Bond Index that lost 1.5%, 0.2% and 1.6%, respectively.

At mid-year, floating rate loans were offering a yield-to-worst of 5.8% (LIBOR+3.28% at quarter-end). LIBOR has gained steadily over the past 18-months with Fed rate increases and loan distributions have increased as a result. Loan payouts are expected to continue to increase amid further Fed tightening, and as senior secured floating rate loans carry little default risk, the asset class remains an excellent source of current income and shelter against rising interest rates (see Table 1).

Table 1: Floating Rate Loans vs Fixed Income Indices



Source: eVestment Analytics

OUTLOOK: Floating rate loans remain an important component of a fully diversified "fixed" income portfolio. This "anti-bond" asset class offers an atypical return history relative to the broader bond market, and its market fundamentals remain strong (technicals are also supportive).

The prevailing default risk outlook is benign, with the current 2% rate forecasted to increase by a mere 0.4% over the next 12-months. Furthermore, the weighted average interest coverage of all outstanding loans is currently 4.4x, the highest level in a decade. The interest coverage ratio serves as the primary measure of a company's ability to pay its interest expense on outstanding debt.

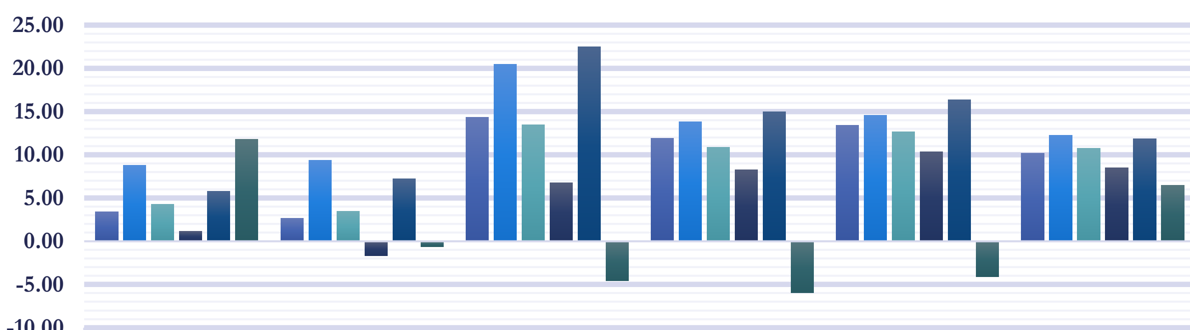
FOREIGN BOND MARKETS [FIRST HALF (1.31%)]

REVIEW: Foreign bond markets performed very well in the first quarter and very poorly in the second quarter. The Barclays Aggregate ex-U.S. Bond Index returned 3.6% in the first quarter, but fell 4.8% in the second to end the first half at a net negative 1.3%. Foreign bond markets were hit particularly hard by a rapidly strengthening U.S. dollar that resulted in negative return for U.S. investors.

OUTLOOK: The outlook for foreign bond markets is less clear relative to the U.S. bond market outlook, largely because of the impact of the U.S. dollar. Shifting monetary policy, an important election, or a trade dispute impacts not only each country's bond market, but also currency markets, which impact U.S. dollar returns. It is for this reason we work with managers that specialize in managing the complexities of both foreign fixed income and currencies.

IV. 2018 U.S. EQUITY MARKET

SELECT BENCHMARKS – U.S. EQUITY MARKETS – **JUNE 30, 2018**



	2Q18	YTD	1-Year	3-Years	5-Years	10-Years
S&P 500	3.43	2.65	14.37	11.93	13.42	10.17
S&P Mid Cap 400	8.77	9.39	20.50	13.84	14.60	12.25
S&P Small Cap 600	4.29	3.49	13.50	10.89	12.69	10.78
Russell 1000 Value	1.18	-1.69	6.77	8.26	10.34	8.49
Russell 1000 Growth	5.76	7.25	22.51	14.98	16.36	11.83
Alerian MLP	11.80	-0.63	-4.58	-5.93	-4.09	6.46

U.S. LARGE CAP EQUITY [FIRST HALF +2.65%]

REVIEW: After a turbulent start to the year, U.S. equity indexes advanced in every month of the second quarter and ended the first half up 2.7%. Smaller capitalization stocks outperformed large-cap, buoyed by accommodative tax reform and higher consumer spending. Growth continued its dominance over value with another strong showing from the FAANG stocks (Facebook, Apple, Amazon, Netflix and Google). Table 2 confirms the growth-to-value outperformance, but also suggests that deep value may offer better upside opportunity for long-term investors.

Table 2: U.S. Equity Growth vs Value

2Q 2018	Value	Blend	Growth
Large	1.2%	3.4%	5.8%
Mid	2.4%	2.8%	3.2%
Small	8.3%	7.8%	7.2%

YTD	Value	Blend	Growth
Large	-1.7%	2.6%	7.3%
Mid	-0.2%	2.3%	5.4%
Small	5.4%	7.7%	9.7%

Current P/E vs. 20-year avg. P/E	Value	Blend	Growth
Large	13.8 / 13.8	16.1 / 16.0	20.3 / 19.8
Mid	14.3 / 14.2	16.5 / 16.2	21.4 / 21.1
Small	15.6 / 16.0	21.9 / 20.1	36.7 / 29.0

Source: JP Morgan

OUTLOOK: Due to trade tensions and currency risk, we favor U.S. equities over international developed and emerging markets equities. We believe tax reform effect is now fully priced in and will play less of a role in the second half; however, we believe there is enough forward earnings growth momentum to support what is now the second longest economic expansion in the post-World War II era. Furthermore, we believe the favorable combination of full employment and strong housing and consumer spending figures should encourage at least one more push towards monetary policy normalization now that inflation is slightly above the Fed's 2% target rate.

"Regression-to-the-Mean" leads us to believe the best opportunity for long-term investors is in high quality value companies. We believe that while higher valuation stocks (high price to earning) have done great over the past few years, the better opportunity for long-term growth may be found in high quality value stocks (with low price to book and price to earnings). Growth stocks, especially large cap growth, have outperformed value stocks by the largest amount and for the longest period since the dot com era of the late 90s. These trends historically regress to the mean so we expect value to perform better over the next 5-years, especially in a recessionary environment.

ENERGY INFRASTRUCTURE AND MASTER LIMITED PARTNERSHIPS [FIRST HALF (0.63%)]

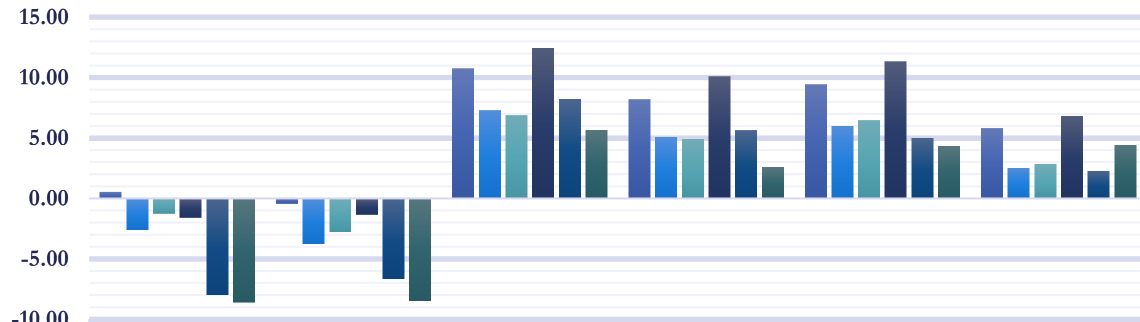
REVIEW: Midstream master limited partnerships recovered much of their losses, leading all global equity indices with an 11.8% return in the second quarter. The favorable return was attributable to a combination of factors, from the recovery of oil prices to the resolution of fears surrounding regulatory and tax changes. In addition, we have seen a sharp decline in equity issuance among midstream MLP companies, which is viewed favorably by investors concerned about potential earnings dilution. The retention of cash by these companies to cover capital expenditures and invest in growth has had a positive effect on investor sentiment.

OUTLOOK: The outlook for midstream energy infrastructure companies is favorable and valuations are compelling. The Alerian MLP Index provides better than an 8% distribution rate to investors, supported by stable and improving distribution coverages and cash flow forecasts. The estimated average distributable cash flow growth rate for the Index is 5.6% in 2018 and forecasted to grow to 8.8% in 2019. More than 90% of midstream MLP cash flow is fee-based (low risk) and not dependent on commodity prices.

While we clearly favor this asset class, we do expect midstream energy infrastructure investments to be heavily influenced by fund flows and headline risk. Long-term investors, meanwhile, should benefit from consistently high income growth leading to rising dividends and long-term continued demand growth.

V. 2018 FOREIGN EQUITY MARKETS

SELECT BENCHMARKS – NON-U.S. EQUITY MARKETS – **JUNE 30, 2018**



	2Q18	YTD	1-Year	3-Years	5-Years	10-Years
MSCI ACWI	0.53	-0.43	10.73	8.19	9.41	5.80
MSCI ACWI ex-U.S.	-2.61	-3.77	7.28	5.07	5.99	2.54
MSCI EAFE	-1.24	-2.75	6.84	4.90	6.44	2.84
MSCI EAFE Small Cap	-1.57	-1.33	12.45	10.09	11.32	6.81
MSCI Emerging Markets	-7.96	-6.66	8.20	5.60	5.01	2.26
MSCI EM Small Cap	-8.60	-8.45	5.64	2.55	4.32	4.44

INTERNATIONAL DEVELOPED EQUITY [FIRST HALF (2.75%)]

REVIEW: International developed equities held up reasonably well in the first half, relative to emerging markets equities, but underperformed U.S. equities by 5.4%. The asset class experienced volatility throughout the first half, as generally supportive economic and earnings data was persistently depressed by an unstable political backdrop. In the Eurozone, equities actually delivered gains in the second quarter, with the European Central Bank announcing no additional monetary tightening through the summer of 2019. In the UK, the absence of a rate hike (and a decline in the value of the sterling) also supported a positive second quarter result. We now see improving earnings and an attractive yield. Asian markets advanced in the second quarter despite weak sentiment stemming from trade tensions.

OUTLOOK: We have a less favorable outlook for international developed equities relative to U.S., despite their relatively high 3.2% dividend yield. We see international developed equities, especially within the Eurozone, fading slightly as the 2017 surge in European growth subsides and political risks persist. In contrast, we see U.S. equities poised for another year of additional, albeit slower, earnings growth.

EMERGING MARKETS EQUITY [FIRST HALF (6.66%)]

REVIEW: Emerging markets equities gained 8.8% in January, followed by a five-month period where the asset class lost 13.8%. Instead of a continuation of the coordinated global acceleration, investors moved away from emerging markets in response to global trade uncertainty. The U.S. dollar's unexpected strengthening was the single greatest challenge to emerging markets equities during the first half. Year-to-date the MSCI Emerging Market Index declined 8.0% in U.S. dollar terms, and only 2.8% in local currency terms. The market narrative for emerging markets did not play out as expected through the first half.

OUTLOOK: We remain cautiously optimistic about the outlook for emerging markets. Fundamentals are positive for the asset class. Earnings growth expectation remains strong at 11% for 2019 after rising 18% in 2018. Lower valuations, 2.6% dividend yields and strong free cash flows remain attractive relative to developed equities.