Quarterly Letter

April 2018

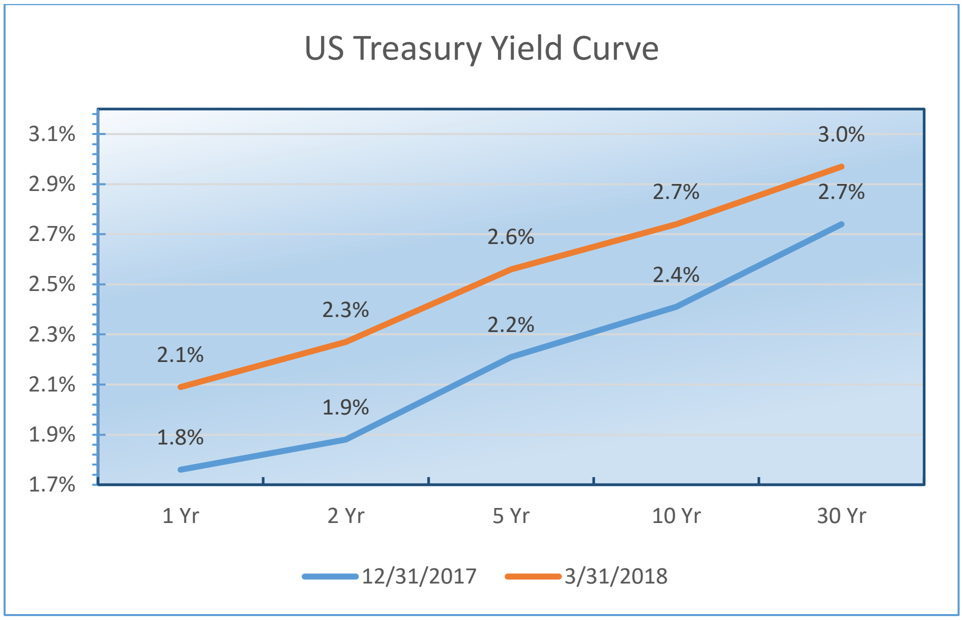
Financial markets kicked off the first quarter of 2018 with support from ongoing strength in economic data and a freshly-signed major tax reform package. However, in late January the potential for elevated US inflation and the subsequent risk of proactive increases in the target Fed Funds rate brought stocks lower. Calm returned by mid-February, but escalating tariff rhetoric followed by US-China trade sanctions precipitated a renewed bout of turbulence in March. In a whipsaw pattern, global equities shed just under 9% from peak to trough during the quarter. The US, Eurozone, UK, and Japan delivered negative returns in the first quarter. Asia and Emerging markets finished in positive territory. After a strong, sudden selloff in early February, the market-leading technology, and discretionary sectors recovered to print positive returns. With interest rates trending higher, bond proxy equities such as REITs, utilities and telecom fell out of favor.

Investors 'Picked' Emerging Markets and 'Panned' Non-US Stocks in 1Q 2018:

Benchmark	1Q18	1 Year	3 Years	5 Years
Emerging Markets Stocks	1.4	24.9	8.8	5.0
Commodities	0.4	3.7	-3.2	-8.3
US Stocks	-0.8	14.0	10.8	13.3
High Yield Bonds	-0.9	3.8	5.2	5.0
US Treasuries	-1.2	0.4	0.5	1.1
Global Stocks	-1.3	13.6	8.0	9.7
US Bond Market	-1.5	1.2	1.2	1.8
Non-US Stocks	-2.0	13.9	5.3	6.0

Source: Morningstar. Returns expressed in USD and %. 1Q18 and 1 Year are actual returns for the period. 3 Years and 5 Years are annualized returns as of 03/31/2018. See Disclosure section for reference to specific benchmark used in the table.

US Treasury yields rose across the maturity curve over the quarter as expectations for growth and inflation shifted higher. The increased sentiment toward higher rates and repricing of risk-free rates ultimately affected markets that had benefited from the low cost of funding and leverage. For the first time in many years, money market returns paid 2% interest. Investment grade bonds and high yield bonds underperformed government bonds, reflecting nervousness toward the LIBOR rates increase.



Source: Federal Reserve Bank of St. Louis

Commodities posted positive returns and were led higher by energy, agriculture, and gold. Industrial metals trended lower as demand concerns were called into questions from global trade tensions.

Outlook and Portfolio Positioning

As of quarter end, the global expansion remains steady and relatively well synchronized. Broadly speaking, most developed economies have low recession risk and as a group are situated in the mid to late stages of the business cycle. Core and peripheral countries of the Euro-zone have potential to capture above-average growth, providing an excellent opportunity for equity market diversification. US profit and credit trends continue to hold steady and the follow through from tax reform and legislation favoring infrastructure spending have the potential to support growth well into 2019.

Equity, fixed income and commodity market volatility of the 1st quarter has introduced a heightened concern for factors that could derail the fundamental economic story. Trade tariffs and sanctions risk could slow global economic growth and increase inflation. Inflation risk also typically builds in mid to late cycle economies that have pricing pressure on wages and goods.

US Federal Reserve Chairman Powell has reinforced the goal of keeping inflation at approximately 2%. We are a long way from a Whip Inflation Now or WIN campaign backed by President Ford in 1974 because President Trump's Tax Reform and Infrastructure goals are pro–spend and pro-consume. The Fed goal and Trump's plans are contradictory. We caution that inflation fighting by hiking interest rates and boosting economic growth with stimulative fiscal policies provide potential to keep markets active and tricky.

We continue to favor global equity and fixed income strategies in the current environment of stable economic growth and low inflation. However, we can't ignore the mid to late economic cycle position in developed countries, the unwind of accommodative monetary policy, inflation risk and increasing geopolitical risk. For both equity and fixed income, we favor active management to optimize economic value. We invest in best-in-class funds with a history of organizational and cost aware success.

- In equities, we continue to favor overweights in small-mid cap stocks which have the potential to avoid tariff pressure and have higher risk premiums (and higher return potential) to combat purchasing power erosion from inflation. Global diversification is used to broaden the sources of potential returns.
- In fixed income, we are investing clients assets with lower duration risk (i.e. shorter maturities) than the overall market. To make up for the yield deficit, the portfolio is overweight short-term spread markets such as 1-3 Credit and floating rate notes. The target fixed income portfolio also holds allocations to Core-plus mutual funds.

Summary of our three main Market Themes and the corresponding Investment Views:

Market Theme	Investment View
Treasury bond price (duration) risk is high.	Underweight duration. Capture yield advantage of with short-term corporate bonds.
We are living in a low-return world.	Use active management for enhancing economic value and achieving excess returns.
A new consumer class in developing economies is on the rise.	Moderate exposure to emerging markets and Europe. Ensure active funds have a bias to consumer and cyclical sectors.

Risk Tolerance and Risk Composure

In reaction to the latest bout of market volatility, Jack Bogle, of Vanguard commented: “I’ve never seen anything like this.” Could the founder of passive investing and the firm that dominates the $4.6 trillion ETF market, which makes frequent trading cheap and easy, be part of the problem?

Advisors initially set their clients’ Risk Tolerance using questionnaires that ask about time horizon, age, income needs, desire for extra gains and willingness to have an unrealized loss of principal. What advisors don’t always communicate well is the perceived risk in the portfolio. They often fail to understand how clients will react in times of extremes; that is, many advisors don’t comprehend their clients’ Risk Composure.

Investors should have an understanding of their own behavioral biases when Fear and Greed drive the market. If you have high-Risk Composure you can handle the risk when markets get volatile. It doesn’t guarantee you will make good decisions, but at least you will have a degree of comfort with the risk you are taking. A problem to address is when clients have a poor understanding of their own perception of risk. A low-Risk Composure investor is more likely to change their risk tolerance in reaction to events. This group is most likely to suffer from bad decisions.

Tools and probing questions can help clients develop a better gauge of their true risk profile as investors. Portfolio returns can suffer, and long-term goals may have to be adjusted when individuals choose to ‘go it alone’ and invest without the help of a professional advisor. Many investors hold accounts in custody relationships where a phone center support group or a rep with hundreds of accounts is their partner. Or people have 401k/403b accounts that are long-term assets but are underinvested because they misunderstand market risk. The cost differential between good advice and no advice that results in underinvestment or poorly-timed decisions favors working with a professional partner. We know that both cost and returns matter.

This information is not personalized investment advice or an investment recommendation from Laurentide Advisory. There is no guarantee that any investment strategy illustrated will be successful or achieve any particular level of results. The performance quoted represents past performance and does not guarantee future results. Investing involves risk, including possible loss of principal. Asset allocation and diversification may not protect against market risk, loss of principal or volatility of returns.

Global Stocks is the MSCI World Index. A market capitalization weighted index that is designed to measure the equity market performance of developed markets. US Stocks is the S&P 500 index. A market capitalization weighted index consisting of a basket of 500 stocks that are widely held. Non-US Stocks is the MSCI EAFE Index. Representing the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. Emerging Market Stocks is the MSCI Emerging Markets Index. Representing 23 countries and 10% of world market capitalization. US Bond Market is the Bloomberg Barclays US Aggregate Bond Index. A rules-based index measuring the total return of the investment grade, US dollar, fixed-rate taxable bond market. U.S. Treasuries is the Bloomberg Barclays US Treasury Intermediate Index. Measures the total return of USD denominated, fixed rate 1-10-year nominal debt. High Yield Bonds is the Banc of America/Merrill US Master HY Index total return of high yield US corporate bonds. Commodities are the Bloomberg Commodity Index. Representing a diversified commodities benchmark of energy, metals, and agriculture.

Please visit our website www:LaurentideAdvisory.com for important disclosures.