MARKET COMMENTARY & OUTLOOK

Second Quarter, 2018

LAMCO ADVISORY SERVICES, INC.

Most signs continued to suggest the U.S. economy remained on solid footing during the second quarter. In fact, by one measure, domestic economic conditions were precisely where they should be. Inflation finished the first quarter in an upward trend—prices for core personal consumption expenditures jumped to a 1.9% year-over-year increase in March—but then held right around that level for the whole second quarter. Price stability, or low and steady inflation (typically projected around 2%), is one of the key factors in the Federal Reserve's (Fed) decisions, along with full employment. Our central bank is essentially working with an optimal inflation level, so its actions will now be heavily influenced by how to restrain inflation from continuing to rise.

This challenge is complicated by very low unemployment and tariff-based trade policy. Strong labor-market conditions put upward pressure on inflation by fostering wage growth, which has been healthy but not necessarily elevated thus far. U.S. payrolls added more than 600,000 workers in the second quarter, right in line with their first-quarter average of about 200,000 per month. The four-week moving average for unemployment claims fell in May to its lowest level since 1969, and finished the second quarter in the same neighborhood.

Economic Statistics	Current	One Year Ago
Real GDP Growth (Annl. % Change From Prior Qtr.)	2.85%	2.11%
Unemployment Rate	3.90%	4.30%
Labor Force Participation Rate	62.90%	62.90%
Core CPI (Year-Over-Year)	2.33%	1.71%
Real Personal Income Growth (Year-over-Year)	2.62%	2.75%
10 Year Treasury Rate	2.89%	2.32%

Data Source: Federal Reserve, LAMCO Advisory

As for tariffs, their costs are borne by consumers in the form of higher prices on targeted goods. These costs are already evident in higher prices for lumber and dishwashers, where tariffs were applied late last year and the beginning of this year, respectively. This scenario can also be expected to play out for the long list of other goods that have been subjected to tariffs in recent months. The trend in consumer spending has been more dependent on strong employment than any concerns about trade tensions, however. Consumers remained buoyant throughout the second quarter, beginning with a 0.6% jump in spending during April and then settling back into a 0.2% to 0.4% range in May and June.

Business activity took a well-earned breather at the beginning of the second quarter. Manufacturing growth slowed coming into April—albeit to levels still consistent with a healthy expansion—before reaccelerating into May and June to surpass its first quarter peak. Activity in the non-manufacturing segments of the economy (services, construction, mining, agriculture and elsewhere) followed a similar growth trajectory to end the second quarter in red-hot territory.

Looking ahead, the Fed's June economic projections strengthened from a quarter earlier: Median estimates for overall 2018 economic growth (gross domestic product) increased, the year-end unemployment rate estimate decreased, and inflation expectations rose. Projections looking out to 2019 and 2020 were mostly static from a quarter earlier, although unemployment was expected to fall by a bit more. This outlook is a reflection of the fact that "the economy is doing very well," as Fed Chair Jay Powell asserted during his June press conference in deliberately plain English to denote a shift from the central bank's traditional economist-speak.

The Fed announced a 0.25% increase in the funds rate to a range between 1.75% and 2% following its June meeting, as was widely expected, marking the second rate hike of 2018 and the seventh since December 2015. Investors are projecting with near certainty that the Fed will increase rates by 0.25% again in September, and giving strong odds—a 65% probability—to another rate hike in December. This would put the year-end 2018 funds rate in the 2.25% to 2.5% range, which squares well with the Fed's median projection in June for a year-end funds rate at 2.4%.

The employment landscape is obviously very bright, so the Fed is probably not going to be deterred by concerns that hiking rates might soften labor-market conditions. Inflation is right where it needs to be, for now, and it remains to be seen whether the Fed's rate-hike schedule keeps it near the bullseye or overshoots in either direction.

It's worth keeping in mind that the Fed has limited control over longer-term rates, even though they have a heavy bearing on borrowing conditions throughout the economy. The 10-year U.S. Treasury yield spiked upward early in the first quarter, and threatened to climb even higher in the middle of the second quarter—breaking 3% for the first time since 2013—before settling back to 2.85% to finish June.

US Equity Market

Observations

- The domestic equity market was dominated by small cap stocks and growth stocks in the second quarter. From a capitalization perspective, small cap stocks out performed large cap stocks for the quarter and the year to date periods. Small cap stocks are viewed as a safe haven from tariff associated risks.
- From a style perspective, growth stocks have outperformed value stocks by a wide margin. The Russell 3000 Growth Index has outperformed the Russell 3000 Value index by 4.16% and 8.60% for the second quarter and the year to date periods, respectively.
- In the current market environment, stock valuations do not appear to be a primary concern. During the second quarter, overvalued stocks, as measured by Morningstar, returned 9.4% while undervalued stocks returned -2.46%. The second quarter was a difficult environment for investment managers who believe valuations matter. This factor has also been significant headwind for many fundamentally oriented long/ short equity strategies.
- Not surprisingly in a market dominated by growth stocks, companies that do not pay a dividend yield outpaced those that do pay dividends. During the quarter, stocks with a dividend yield below .53% returned 7.9% while stocks with a dividend yield above 1.73% returned an average of 2.19% during the quarter.
- With an average return of 18%, Amazon, Apple, Facebook, Microsoft, and Netflix delivered half of the S&P500's return for the quarter.
- Of the ten (10) largest stocks in the S&P 500, Exxon was the only non-social/mobile/cloud stock with positive returns.
- This is a narrow market where the perceived strength of the market is being influenced by a select group of securities.

Major US Market Averages

	Q2, 2018	YTD	1 Year	3 Year	5 Year	2017	2016	2015
Russell 3000 Index	3.9%	3.2%	14.8%	11.6%	13.3%	21.1%	12.7%	0.5%
FTSE RAFI US 3000 Index	3.2%	0.9%	12.1%	10.3%	12.0%	16.2%	18.1%	-2.7%
Russell 3000 Equal Weighted	7.6%	7.0%	17.2%	11.0%	12.3%	15.6%	21.6%	-6.2%
S&P 500 Index	3.4%	2.7%	14.4%	11.9%	13.4%	21.8%	12.0%	1.4%
Russell Mid Cap Index	2.8%	2.4%	12.3%	9.6%	12.2%	18.5%	13.8%	-2.4%
Russell 2000 Index	7.8%	7.7%	17.6%	11.0%	12.5%	14.7%	21.3%	-4.4%
NASDAQ 100	7.3%	10.7%	26.0%	18.4%	20.8%	33.0%	7.3%	9.8%

Russell 3000 Style & Cap Summary

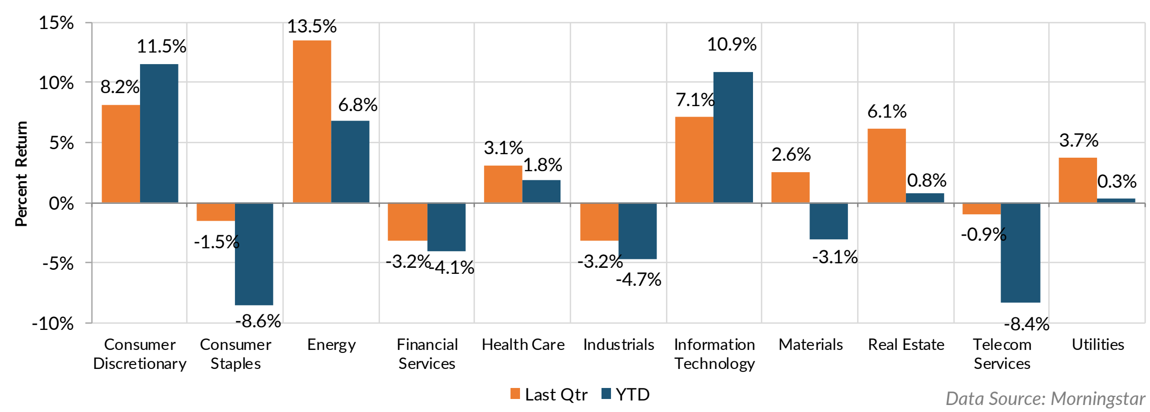
Second Quarter Results

	Mo.	Qtr	Value		Core		Growth	
Large	Apr	Q2	0.25%	0.60%	0.53%	3.86%	0.77%	6.58%
	May		0.36%		2.66%		4.59%	
	June		-0.02%		0.63%		1.13%	
Mid	Apr	Q2	0.50%	2.41%	-0.15%	2.82%	-0.94%	3.16%
	May		1.09%		2.27%		3.74%	
	June		0.81%		0.69%		0.39%	
Small	Apr	Q2	1.73%	8.30%	0.86%	7.75%	0.10%	7.23%
	May		5.82%		6.07%		6.30%	
	June		0.61%		0.72%		0.78%	

Year To Date Results

	Value	Core	Growth
Large	-2.41%	3.05%	7.83%
Mid	-0.16%	2.35%	5.40%
Small	5.44%	7.66%	9.70%

S&P 500 Sector Performance



Data Source: Morningstar

US Equity Market

Dividend Yield [a]	Avg. Weight %	Return %	Contribution to Return %
Dividend Yield [2.62 - 86.69]	25.03%	3.56%	0.90%
Dividend Yield [1.73 - 2.62)	23.64%	0.75%	0.19%
Dividend Yield [0.53 - 1.73)	24.59%	3.02%	0.75%
Dividend Yield [0.00 - 0.53)	26.45%	7.90%	2.03%
Attribution Total	**99.72%**		**3.88%**

*Avg. Weight excludes cash (0.29%)

Capitalization [a]	Avg. Weight %	Return %	Contribution to Return %
Mega Cap (>$85 Billion)	46.21%	4.59%	2.12%
Large Cap ($18 Billion -$85 Billion)	29.27%	2.55%	0.75%
Mid Cap ($3 Billion - $18 Billion)	17.66%	3.20%	0.56%
Small Cap ($700 Million - $3 Billion)	5.26%	7.23%	0.37%
Micro Cap (< $700 Million)	0.79%	3.75%	0.03%
Unclassified	0.52%	9.67%	0.05%
Total	**99.72%**		**3.88%**

Valuation [a]	Avg. Weight %	Return %	Contribution to Return %
Fairly Valued	39.72%	4.31%	1.70%
Overvalued	31.29%	9.40%	2.86%
Undervalued	28.25%	-2.46%	-0.73%
Unclassified	0.46%	9.40%	0.04%
Attribution Total	**99.72%**		**3.88%**

*Avg. Weight excludes cash (0.29%)

(a) = ishares Russell 3000 ETF
(b) = SPDR S&P 500 ETF

Data Source for all data in tables: Morningstar Direct

Top Weights [b]	Weight	Return	Contribution
Apple Inc	3.96%	10.76%	0.41%
Microsoft Corp	3.23%	8.51%	0.27%
Amazon.com Inc	2.76%	17.44%	0.45%
Facebook Inc A	1.87%	21.61%	0.37%
JPMorgan Chase & Co	1.63%	-4.77%	-0.08%
Berkshire Hathaway Inc B	1.63%	-6.43%	-0.11%
Exxon Mobil Corp	1.46%	12.00%	0.17%
Johnson & Johnson	1.45%	-4.61%	-0.07%
Alphabet Inc C	1.42%	8.13%	0.11%
Alphabet Inc A	1.40%	8.88%	0.12%

Top Contributors [b]	Weight	Return	Contribution
Amazon.com Inc	2.76%	17.44%	0.45%
Apple Inc	3.96%	10.76%	0.41%
Facebook Inc A	1.87%	21.61%	0.37%
Microsoft Corp	3.23%	8.51%	0.27%
Netflix Inc	0.64%	32.53%	0.19%
Exxon Mobil Corp	1.46%	12.00%	0.17%
UnitedHealth Group Inc	1.00%	15.05%	0.14%
Alphabet Inc A	1.40%	8.88%	0.12%
Chevron Corp	1.02%	11.82%	0.11%
Alphabet Inc C	1.42%	8.13%	0.11%

Top Detractors [b]	Weight	Return	Contribution
Philip Morris International Inc	0.57%	-17.61%	-0.12%
Berkshire Hathaway Inc B	1.63%	-6.43%	-0.11%
AT&T Inc	0.91%	-8.65%	-0.08%
JPMorgan Chase & Co	1.63%	-4.77%	-0.08%
Bank of America Corporation	1.24%	-5.61%	-0.07%
Johnson & Johnson	1.45%	-4.61%	-0.07%
3M Co	0.53%	-9.78%	-0.06%
Bristol-Myers Squibb Company	0.38%	-11.94%	-0.05%
Starbucks Corp	0.35%	-15.17%	-0.05%
Goldman Sachs Group Inc	0.37%	-12.12%	-0.05%

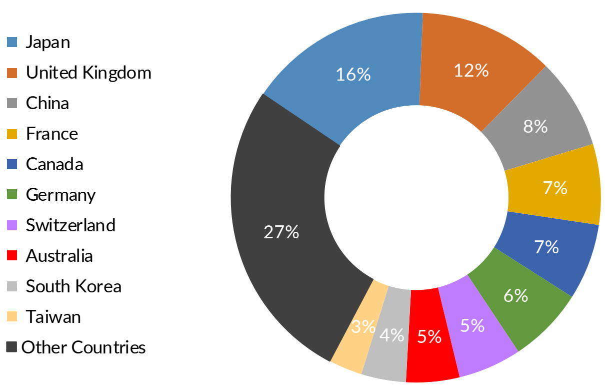
Observations

- The strengthening US dollar has been a significant headwind for foreign stocks. The strengthening dollar reduced the return of foreign stocks by 4.51% and 2.52% for the last 3 months and the last 6 months respectively. The Yen (Japan) is the only currency which has appreciated against the dollar this year.
- Rising tensions resulting from tariff discussions has negatively impacted foreign equity returns. After outpacing US stocks in 2017, Foreign stocks have trailed by a meaningful margin in 2018.
- As has been the case with US stocks, Growth stocks have outpaced value stocks, albeit by a smaller margin.

International Equity Market Performance

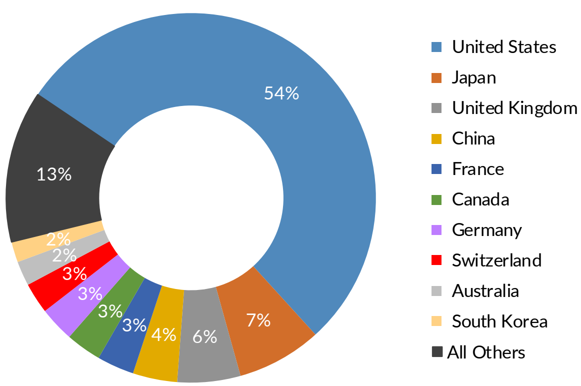
	Q2, 2018	YTD	1 Year	3 Year	5 Year
MSCI EAFE	-0.97%	-2.37%	7.37%	7.37%	7.37%
MSCI EAFE Value	-2.33%	-4.16%	4.87%	4.87%	4.87%
MSCI EAFE Growth	0.35%	-0.62%	9.84%	9.84%	9.84%
MSCI EM	-7.86%	-6.51%	8.59%	8.59%	8.59%
MSCI ACWI Ex. USA.	-2.39%	-3.44%	7.79%	7.79%	7.79%

Country Weights



MSCI All Country World Index (Ex. USA)

MSCI All Country World Index



Data Source: Morningstar and iShares ETFs as the representative index proxies. Weights are average for Q4.

	Last Quarter			Year To Date		
	Local	USD	Impact Of US Dollar [a]	Local	USD	Impact Of US Dollar [a]
MSCI ACWI Ex USA	2.12%	-2.39%	-4.51%	-0.92%	-3.44%	-2.52%
MSCI Europe	4.51%	-0.87%	-5.38%	0.09%	-2.71%	-2.80%
MSCI Europe Ex UK	2.65%	-2.31%	-4.96%	-0.47%	-3.37%	-2.90%
MSCI United Kingdom	9.40%	2.96%	-6.44%	1.42%	-1.01%	-2.43%
MSCI Pacific Ex Japan	4.54%	1.81%	-2.73%	1.65%	-1.97%	-3.62%
MSCI Japan	1.23%	-2.80%	-4.03%	-3.49%	-1.85%	1.64%
MSCI France	5.67%	0.32%	-5.35%	3.58%	0.71%	-2.87%
MSCI Switzerland	1.39%	-2.22%	-3.61%	-4.27%	-6.05%	-1.78%
MSCI Germany	1.79%	-3.36%	-5.15%	-4.11%	-6.76%	-2.65%
MSCI Canada	7.02%	4.89%	-2.13%	2.20%	-2.66%	-4.86%
MSCI China	-3.43%	-3.44%	-0.01%	-1.38%	-1.69%	-0.31%
MSCI India	4.42%	-0.60%	-5.02%	-0.72%	-7.51%	-6.79%
MSCI Brazil	-14.76%	-26.37%	-11.61%	-3.95%	-17.19%	-13.24%
MSCI Russia	1.52%	-5.79%	-7.31%	10.97%	3.04%	-7.93%

Assumes Gross Reinvestment Of Dividends *Data Source: Morningstar*

(a) Impact of Dollar: For a US investor, a strengthening dollar has a negative impact on non-US asset returns when converted to US dollars since the conversion requires more of a foreign currency to purchase the more expensive US dollar. A weakening dollar has the opposite effect; the foreign currency can buy more US dollars.

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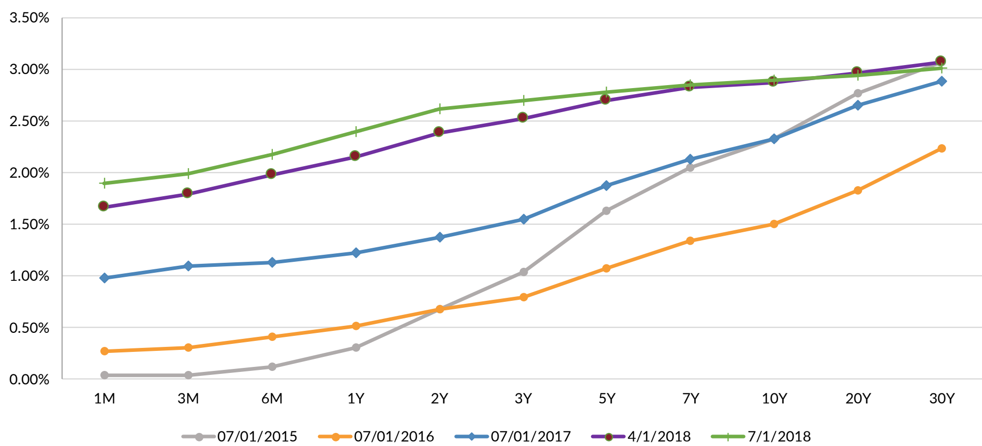
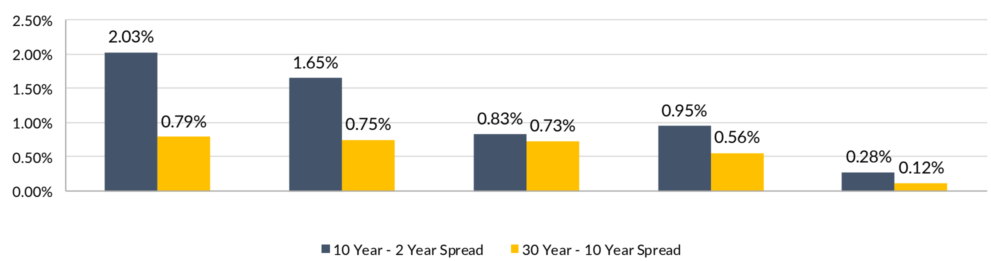
Observations

- The yield curve continued to flatten in the second quarter as the US Federal Reserve raised the Federal Funds rate to 2% in the June meeting. As shown in the exhibit below, the increase in interest rates has been much more pronounced for shorter maturities, resulting in a gradual flattening of the yield curve.
- Despite the increase in short term rates during the quarter, long term rates actually declined. The interest rate spread between the 10 year and the 2 year maturities has declined from 2% to .28% in the last 4 years, while the current spread between the 10 year and the 30 year bonds is almost imperceptible.
- From a credit perspective, the lowest credit qualities have outperformed as CCC and lower credits have outperformed high quality (AAA rated) bond by over 7%.

Yield Curve



Spread Analysis



Data Source: Federal Reserve; LAMCO Advisory

Major Market Averages

	Q2, 2018	YTD	1 Year	3 Year
ICE BofAML US 3M Treasury Bill	0.45%	0.81%	1.36%	0.68%
Bloomberg Barclays US Govt/Credit 1-3 Yr	0.28%	0.08%	0.21%	0.71%
Bloomberg Barclays US Govt Interm	0.06%	-0.67%	-0.73%	0.63%
Bloomberg Barclays US Govt/Credit Interm	0.01%	-0.97%	-0.58%	1.16%
Bloomberg Barclays US Govt/Credit	-0.33%	-1.90%	-0.63%	1.83%
Bloomberg Barclays US Agg Interm	0.09%	-0.97%	-0.32%	1.27%
Bloomberg Barclays US Agg Bond	-0.16%	-1.62%	-0.40%	1.72%
Bloomberg Barclays Global Agg Bond	-2.78%	-1.46%	1.36%	2.58%
Bloomberg Barclays US Treasury	0.10%	-1.08%	-0.65%	1.02%
Bloomberg Barclays US Treasury US TIPS	0.77%	-0.02%	2.11%	1.93%
Bloomberg Barclays US Corporate IG	-0.98%	-3.27%	-0.83%	3.07%
Bloomberg Barclays High Yield Corporate	1.03%	0.16%	2.62%	5.53%
Bloomberg Barclays Municipal	0.87%	-0.25%	1.56%	2.85%
Bloomberg Barclays Municipal 7 Yr 6-8	0.97%	-0.25%	0.30%	2.20%

Credit Quality

B of A/Merril Lynch US Corporate AAA	-0.38%	-3.21%	-0.17%	3.22%
B of A/Merril Lynch US Corporate AA	-0.41%	-2.28%	-0.44%	2.50%
B of A/Merril Lynch US Corporate A	-0.77%	-3.13%	-0.89%	2.64%
B of A/Merril Lynch US Corporate BBB	-1.20%	-3.26%	-0.58%	3.34%
B of A/Merril Lynch US Corporate BB	-0.12%	-1.77%	0.59%	4.86%
B of A/Merril Lynch US Corporate B	1.52%	1.05%	3.25%	5.12%
B of A/Merril Lynch US Corp. CCC & Lower	3.58%	3.96%	7.49%	9.58%

Data Source: Morningstar

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