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Market Review and Outlook

July 2018

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Investment Highlights

2Q 2018 Major Investment Themes

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Source: Bloomberg

- A Balancing Act: Strong Fundamentals vs. Macro Uncertainty – The second quarter was marked by two opposing sentiments: strong market fundamentals via solid corporate earnings and improvements in valuations vs. growing macro uncertainty in the form of rising interest rates, an escalation in trade war rhetoric, and other geopolitical threats.
- Positive Signals for Stocks – S&P 500 companies increased earnings by 26% in the first quarter and earnings are expected to increase another 20% in the second quarter. As stock prices have not kept pace with earnings increases, valuation multiple contraction has somewhat muted one of the primary concerns about the domestic equity markets.
- U.S. Fiscal Stimulus – The estimated savings from the tax cut have largely gone to returning value to shareholders, in the form of dividend increase and share buybacks, while only about 15% has gone to increasing employee compensation. Companies are reporting plans to boost CapEx, but those appear concentrated in the energy and technology sectors.
- U.S. Trade Tensions Build & Spread – The primary driver of equity market volatility in 2018 continues to be retaliatory tariffs imposed by the U.S. and its trading partners. Economists predict an initial supply shock (a decrease in the volume of imports) will likely only stunt growth, but a longer-term demand shock could trigger a recession.
- Cash is Back – After years of easy monetary policy driving investors out on the risk spectrum in search of yield, investors are again receiving >1% on cash deposits. The yield curve is at its flattest level in a decade with the 2-year vs. 10-year U.S. Treasury bond spread dropping from 0.51% to 0.33% at quarter end.

2018 Outlook

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2018 OUTLOOK (Established 1/1/18)	2018 OUTLOOK (Updated 7/1/18)
Domestic Equities: While valuations are elevated, a continuation of the strong fundamental backdrop should allow domestic equities to produce mid- to high-single digit results in 2018, with the first half of the year likely stronger than the second half.	Although there are a number of idiosyncratic risks to the 9+ year bull equity market, a strong economic backdrop and earnings growth should lead equities to rise by year-end. A good defense today is a focus on quality companies – meaning those with good free cash flow, clean balance sheets, and the ability to preserve or increase dividends. We are, however, rebalancing portfolios (i.e. trimming equity exposure) to ensure they align with our clients' long-term goals and risk appetites.
International Equities: Attractive relative valuations versus U.S. equities, improving economic growth prospects and an uptrend in corporate earnings should position foreign equities for another good year in 2018.	While foreign equities may face some near-tern headwinds associated with a rising U.S. dollar, we remain bullish on foreign equities relative to domestic equities, and overweight emerging markets over the medium to long term.
Equity Income: U.S. production of oil, natural gas and liquids is expected to grow in 2018, leading to higher revenues and earnings for MLPs. The strategy should be able to provide a 7-8% dividend yield and 2-4% earnings growth; an attractive opportunity on both an absolute and relative basis.	We continue to believe most of the drivers of underperformance are sentiment driven and not a result of permanent impairment. MLP fundamentals are improving and we see greater potential upside and limited downside risk from today's levels.
Fixed Income: We expect rates to increase gradually throughout the year with minimal change to the steepness of the yield curve at year-end. 2018 fixed income results should be close to the coupon rate of interest, as bonds are unlikely to benefit from lower rates or be dramatically negatively impacted by rising rates.	Our outlook remains unchanged in that we continue to expect the yield curve to steepen and rates on longer term bonds to move up more than shorter-term bonds through the third quarter as inflation data trends higher. In this environment, positioning portfolios in shorter duration fixed income is prudent. We also see using current tight credit spreads as an opportunity to reduce higher risk credits and improve portfolio credit quality without giving up much yield.

Keys to Success in 2018 and Beyond

Looking ahead, it is important that we position portfolios to capture the upside we expect in 2018. That said, as we are deep into one of the longer bull equity markets in history, and the U.S. economy is likely in a late stage of the economic cycle, it is equally important that we position portfolios to protect client capital. In order to accomplish this we are taking a number of steps, all of which are fundamental to our investment philosophy:

- Rebalance portfolios to each client's long-term asset allocation: As the equity market continues to rise, portfolios have organically become more aggressive. We are actively taking profits to insure that client portfolios remain aligned with their long-term asset allocation targets.

- Maintain our valuation-conscious discipline: We understand that our conservative, value-focused philosophy means that we may miss out on all of the upside in momentum-driven years like 2017. We are firm believers that this approach will help protect capital when markets turn.

- Seek pockets of value: Though most equity asset classes are trading at valuations above historical averages, there are pockets of value that remain attractive on both an absolute and relative basis.

- Utilize alternative investments: Where appropriate, we utilize both private and liquid alternative investments to provide meaningful portfolio diversification. These strategies are less reliant on equity markets to produce positive results and can be a useful tool to provide downside protection.

- Tactically shift portfolios to capture opportunities: As has always been the case, we review portfolios on an ongoing basis and shift strategies when we uncover a more favorable risk/reward opportunity. This may include raising cash levels as valuation levels rise too far, investing where transitory variables have unnecessarily impacted asset prices, and seeking new ideas that offer superior risk/return trade-offs.

Investment Strategy Review

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U.S. Equity Markets: 2Q 2018 Review

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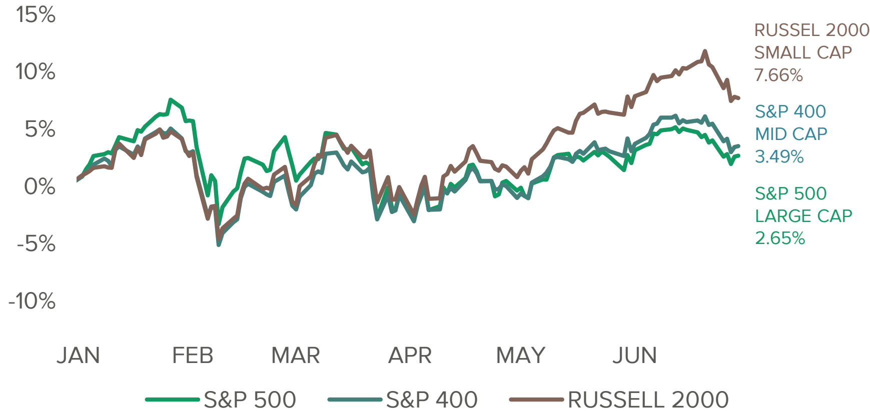
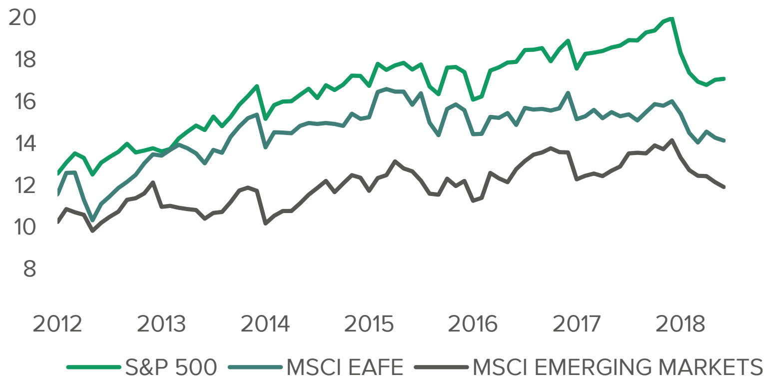
EQUITY MARKET RETURNS
FROM 1/1/2018 THROUGH 6/30/2018



Source: Bloomberg

FORWARD P/E RATIOS
FROM 1/1/2012 THROUGH 6/30/2018



Source: Morningstar

Driven primarily by an exacerbation in trade battles, the second quarter of 2018 saw a continuation in equity market volatility, albeit without a downside volatility shock like that of early February. As a result, domestic equity markets were positive across the board during the quarter.

- Stocks repeatedly sold off and rebounded after each round of tit-for-tat tariffs were announced by the U.S. and its trading partners. The difference this quarter was that the sell-offs were generally less steep, as the markets seemed to shrug the negative news off rather quickly.
- All major market cap segments and styles of U.S. stocks posted positive returns in 2Q.
- Small caps (+8%) led the way by a wide margin, followed by large caps (+3%) and mid caps (+3%).
- Growth again outperformed value, but this dynamic was much concentrated in a handful of technology stocks (Amazon, Apple, Facebook, Microsoft, Netflix) that drove large-cap returns for the quarter.
- Seven of eleven sectors in the S&P 500 Index posted positive returns in the quarter, with Energy (+14%) leading the way as a result of rising oil prices.

Domestic equity valuations have declined from their late-2017 peaks.

- Importantly, this was not the result of price declines, but rather due to an acceleration in corporate earnings growth.
- While valuations for most asset classes remain relatively high, dispersion is also high. There is a much more meaningful difference between companies that can demonstrate structural growth and those that cannot.

Although there are a number of idiosyncratic risks to the 9+ year bull equity market, a strong economic backdrop and earnings growth should lead equities to rise by year end. A good defense today is a focus on quality companies – meaning those with good free cash flow, clean balance sheets, and the ability to preserve or increase dividends. We are, however, rebalancing portfolios (i.e. trimming equity exposure) to ensure they align with our clients' long term goals and risk appetites.

International Equity Markets: 2Q 2018 Review

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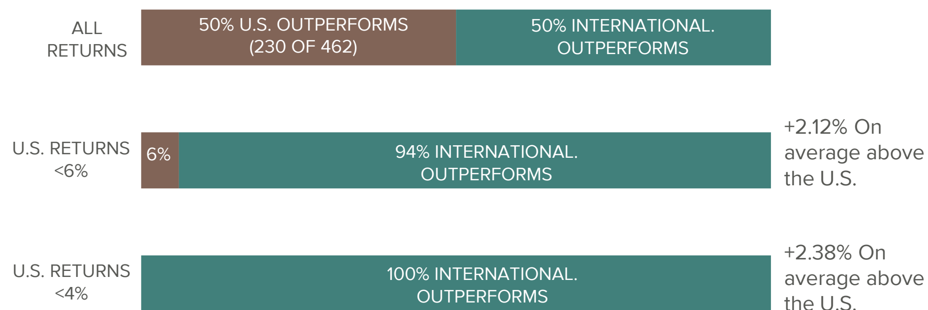
MARKET PERFORMANCE AS OF 6/30/2018

INDEX NAME	QTD	YTD
S&P 500	3.43%	2.65%
MSCI EAFE	-1.24%	-2.75%
MSCI Europe	-1.27%	-3.23%
NIKKEI 225 (Japan)	4.08%	-1.06%
MSCI Emerging Markets	-7.96%	-6.58%
MSCI BRIC	-6.71%	-4.49%
MSCI Emerging Asia	-5.85%	-4.96%
MSCI Latin American	-17.75%	-11.15%

Source: Bloomberg

OUTPERFORMANCE INTERNATIONAL VS. U.S.

ROLLING 10-YEAR PERIODS, 1/1/1970 THROUGH 5/31/2018



Source: Morningstar

Following a sharp market leadership reversal which saw foreign stocks take the reigns from their domestic equity counterparts during 2017, foreign equities underperformed U.S. markets during the second quarter and YTD

The foreign equity story is one of short-term risks vs. long-term opportunity.

- International economic growth moderated somewhat during the second quarter, though long-term -growth prospects remain intact.
- Rising U.S. rates and dollar appreciation weighed on EM stocks, as local currency weakness increased financial risk.
- Idiosyncratic risk (Italy, Argentina, Brazil) suggests that not all foreign markets present similar opportunities.

Foreign equities continue to look attractive over the longer term for many reasons.

- Strong demographic trends are afoot. More than 90% of the next one billion entrants into the global middle class from 2015 to 2022 will be from India, China, or other Asian countries.
- In a world of relatively expensive stock valuations, both developed and emerging equity valuations are at discounts to U.S. equities.
- Americans are not increasing their savings rates (today near an all-time low of 3%) to fund the large fiscal deficit created by the tax cut. When this last occurred in 2004, Americans instead bought items from all over the world, allowing the U.S. stimulus to “leak” outside of the U.S.
- As shown in the bar chart to the left, foreign stocks tend to outperform in lower return environments for U.S. equities (4-6%).

While foreign equities may face some near-term headwinds associated with a rising U.S. dollar, we remain bullish on foreign equities relative to domestic equities, and overweight emerging markets over the medium to long term.

Equity Income: 2Q 2018 Review

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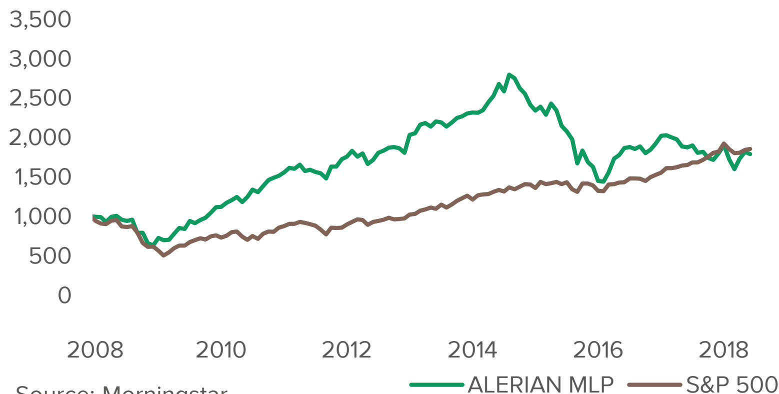
MARKET PERFORMANCE

INDEX NAME	FROM 1/1/2018 THROUGH 6/30/18
Alerian MLP Index	-0.6%
FTSE Mortgage REIT Index	1.3%
S&P 500 Index	2.6%
Bloomberg Barclays U.S. AGG Intermediate	-1.6%

Source: Bloomberg

S&P 500 AND ALERIAN MLP GROWTH OF $1,000 FROM 1/1/2008 THROUGH 6/30/2018



Source: Morningstar

The second quarter of 2018 brought strong positive performance for the Cedar Hill Equity Income strategy. The Alerian Master Limited Partnership (MLP) Index returned nearly 12% during the quarter, bringing its YTD performance to near flat. The drivers of this positive performance were:

- U.S. production of crude oil and natural gas continues to make new highs, leading to increased demand for more energy infrastructure.
- MLP dividends (around 7-8%) appear to be well covered and distribution growth is expected to be in the low/mid single-digit range.
- Across the entire investment landscape, MLPs remain among the most attractively valued opportunities relative to historical valuation levels. MLP earnings growth is accelerating, driving valuation multiples to well below long-term averages.
- While regulatory developments were a short-term negative during the first quarter, investors are now more comfortable with potential regulatory risks and the current Administration remains friendly to domestic energy production.

We continue to believe most of the drivers of recent underperformance are sentiment driven and not a result of permanent impairment. Critically, MLP fundamentals continue to improve, but risks remain.

- Given MLPs' high correlation to volatile oil prices, a dramatic sell off in energy prices will impact MLP stock prices.
- Management teams remain cautious and continue to weigh using increased profits to either improve balance sheets or increase distributions to shareholders.
- MLP valuations are attractive both on an absolute basis and relative to most other asset categories.
- Corporate structure simplifications continue to create some uncertainty as to how investors will look at the strategy going forward.

Fixed Income Markets: 2Q 2018 Review

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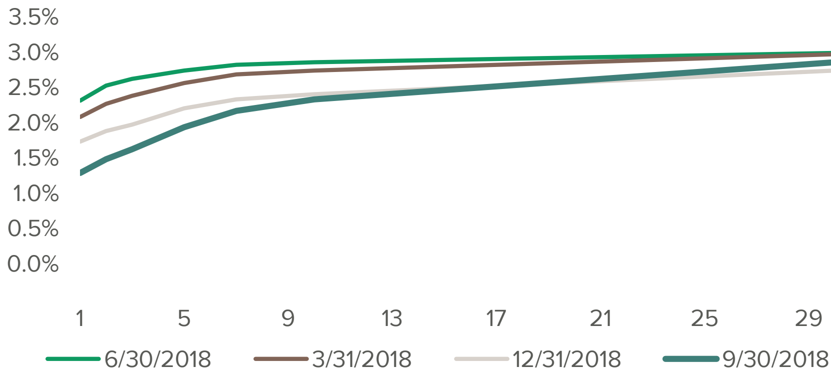
INTEREST RATES

BOND INDEX	3/31/2018	6/30/2018
1-Year Treasury	2.08%	2.31%
5-Year Treasury	2.56%	2.74%
10-Year Treasury	2.74%	2.86%
30-Year Treasury	2.97%	2.99%
Bloomberg Barclays U.S. AGG Intermediate	2.99%	3.17%
Bloomberg Barclays 5-Yr Muni Bond	2.22%	2.18%
Bloomberg Barclays U.S. Corporate Credit Index	3.76%	4.02%
Bloomberg Barclays U.S. High Yield	6.19%	6.49%

Source: Bloomberg

U.S. TREASURY YIELD CURVE
IN YEARS



Source: Morningstar

Both short- and longer-term Interest rates rose in the first half of the quarter, but rates on the long end of the yield curve fell prior to quarter-end.

- These interest rate moves resulted in the flattest yield curve in a decade with the 2-year vs. 10-year U.S. Treasury bond spread dropping from 0.51% to 0.33% at quarter end. The flattening was even more pronounced in longer maturities as the 2-year vs. 30-year spread dropped from 0.98% to 0.65%.
- The flattening of the curve indicates market participants expect the Federal Reserve to continue raising short-term interest rates, but investors remain skeptical about longer-term economic growth, especially given the risk of a trade war.
- In an unusual move, high yield spreads tightened over the quarter and remained at historically low levels while low-quality investment grade spreads (BBB-rated bonds) widened modestly.

Our outlook remains unchanged; we continue to expect the yield curve to steepen and rates on longer term bonds to move up more than shorter term bonds through the third quarter as inflation data trends higher. In this environment, positioning portfolios in shorter duration fixed income is prudent. We also see using current tight credit spreads as an opportune time to reduce higher risk credits and improve portfolio credit quality without giving up much yield.

Other Charts

Leading Economic Indicators

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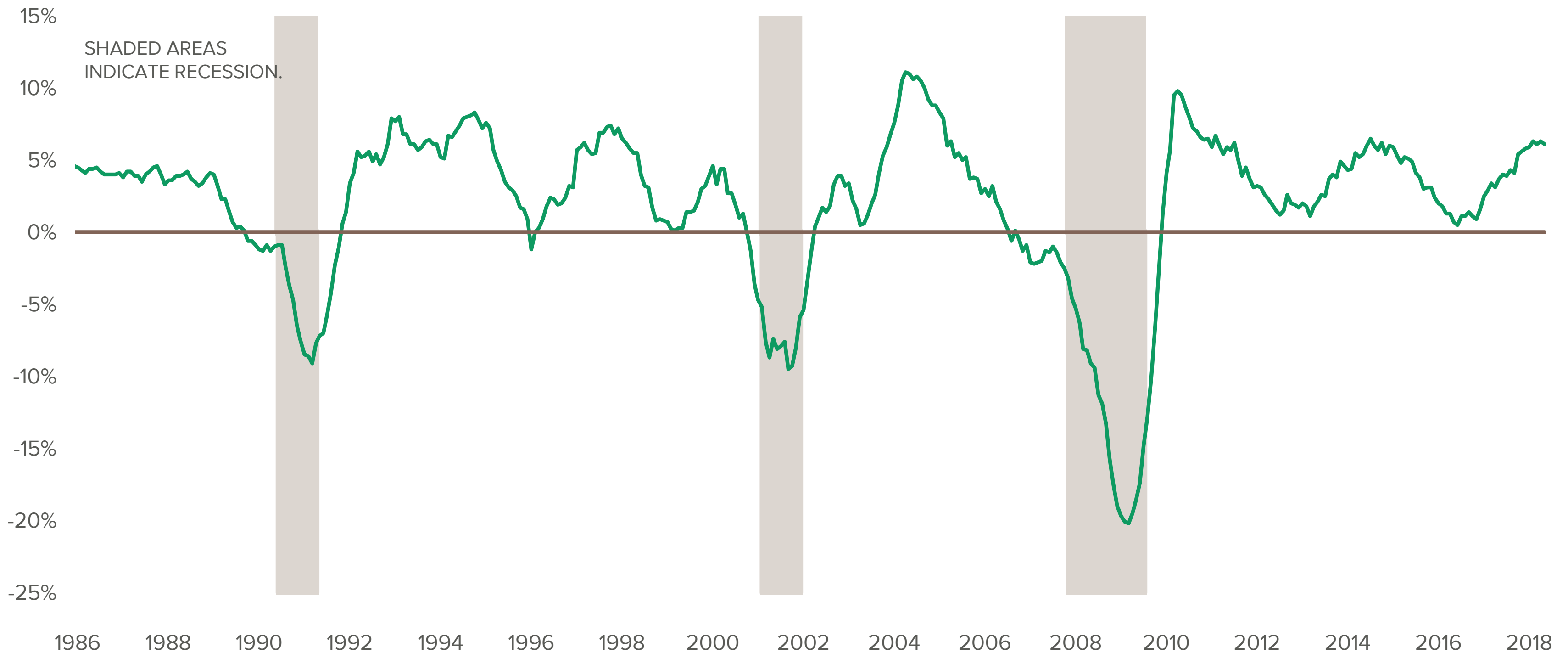
Leading indicators include economic variables that tend to move before changes in the overall economy. A negative reading in these indicators preceded each of the last three recessions. The latest reading suggests current economic conditions still remain favorable.



Source: Bloomberg

U.S. GDP & Inflation

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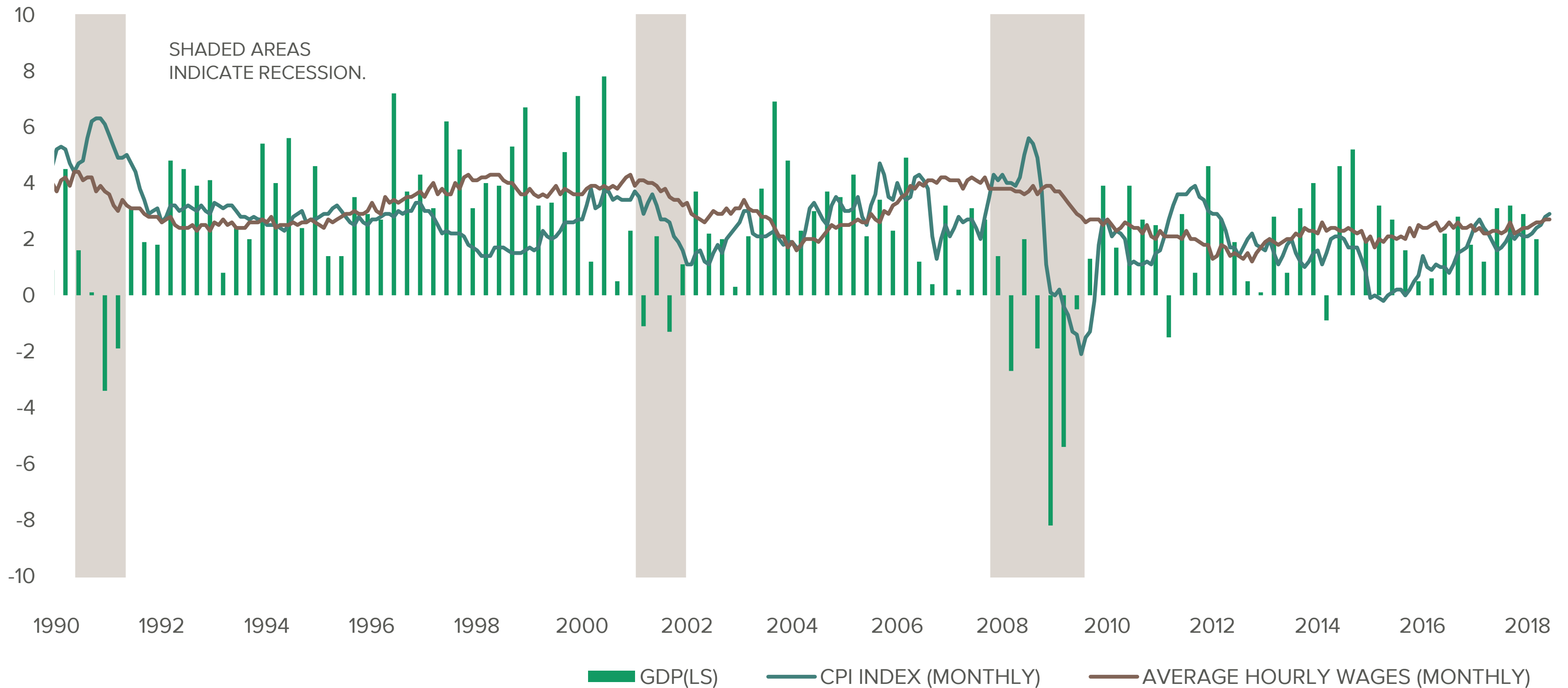
While the current recovery has been longer than most past economic expansions, the pace has been somewhat anemic. The silver lining may be that the period of economic expansion is not yet over, as GDP growth is forecast to accelerate.



Source: Bloomberg

Employment Data

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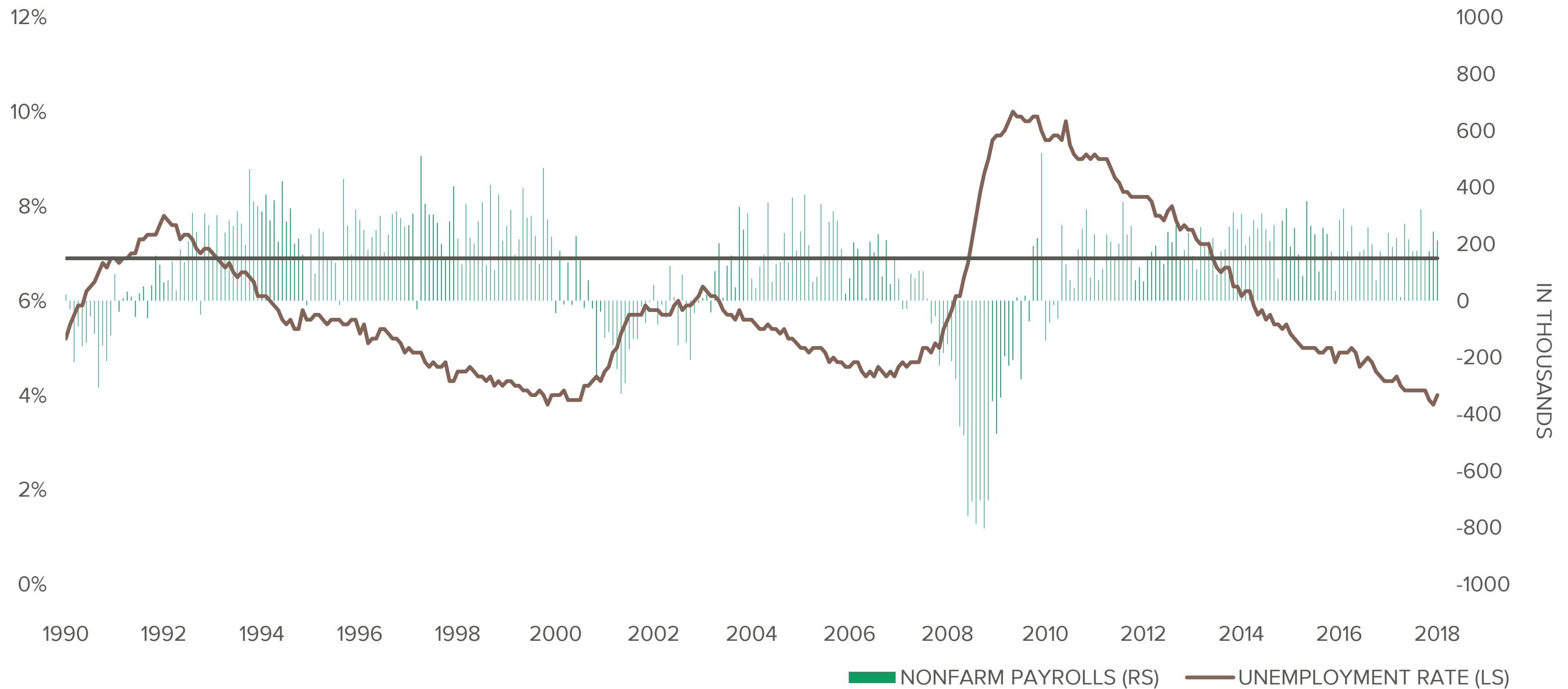
A trend of relatively consistent job additions since early 2011 has brought the unemployment rate down to nearly 4% and eliminated much of the slack remaining in the labor market.

UNEMPLOYMENT RATE & NONFARM PAYROLLS
FROM 6/1/1990 THROUGH 6/30/2018



Source: Bloomberg

U.S. Dollar Strength

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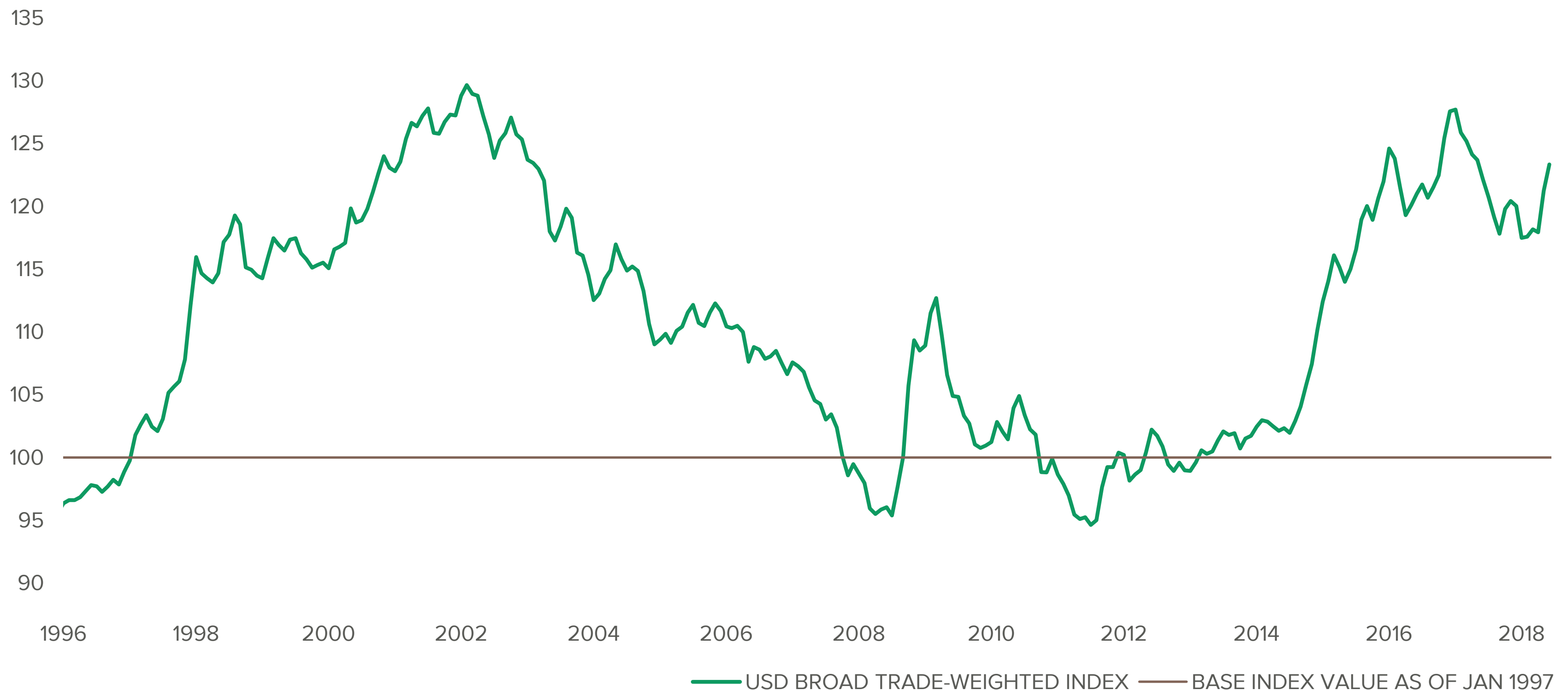
While it has stabilized somewhat over the past two years, the value of the U.S. dollar remains very strong relative to a basket of global currencies. An expectation of a protracted rise in domestic interest rates should prove to be a continued tailwind for the dollar.



Source: Bloomberg

US. Federal Funds Target Rate

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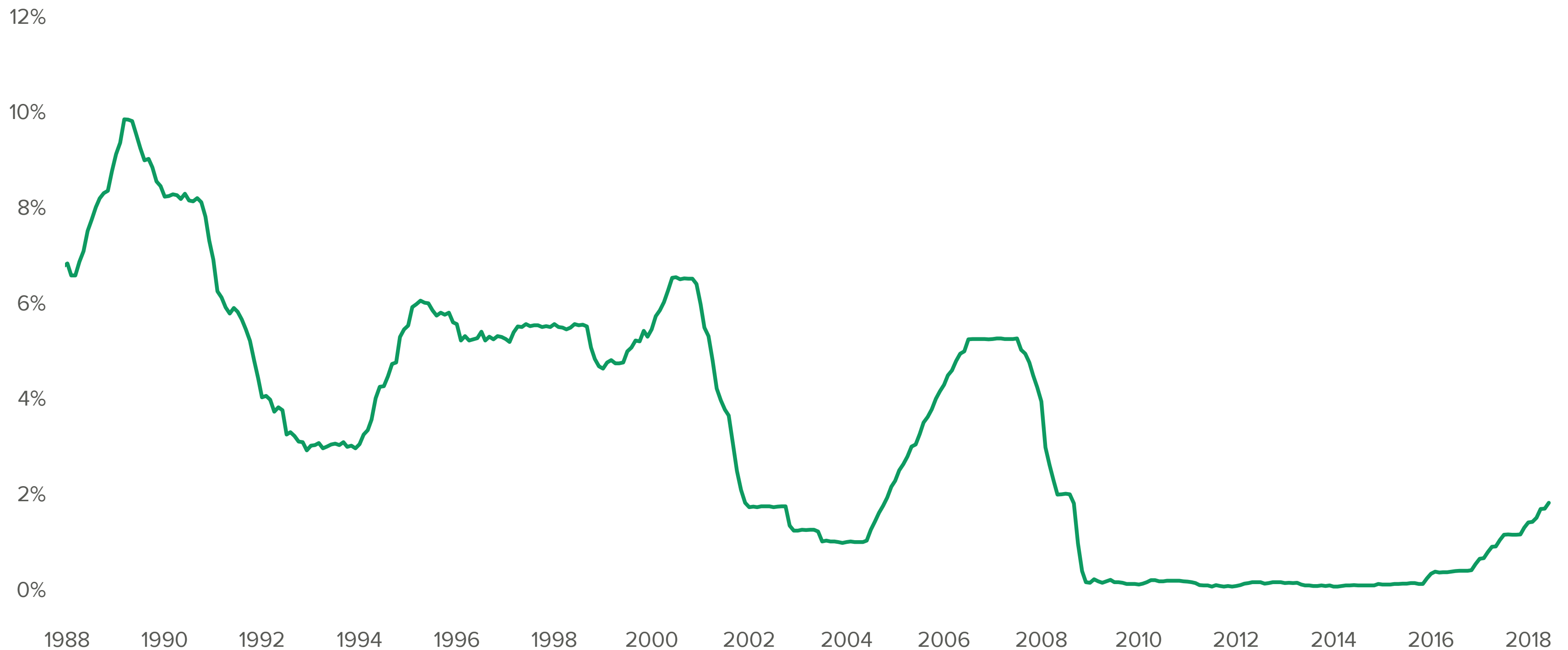
After several years of historically easy monetary policy, the Federal Reserve has begun to lift the U.S. Federal Funds Effective Rate towards its long-term target level. The Fed raised interest rates six times, for a cumulative 1.50% increase since the end of 2015, and a total of two more hikes are expected in 2018.



Source: Bloomberg

Long Term U.S. 10-Year Treasury Yield

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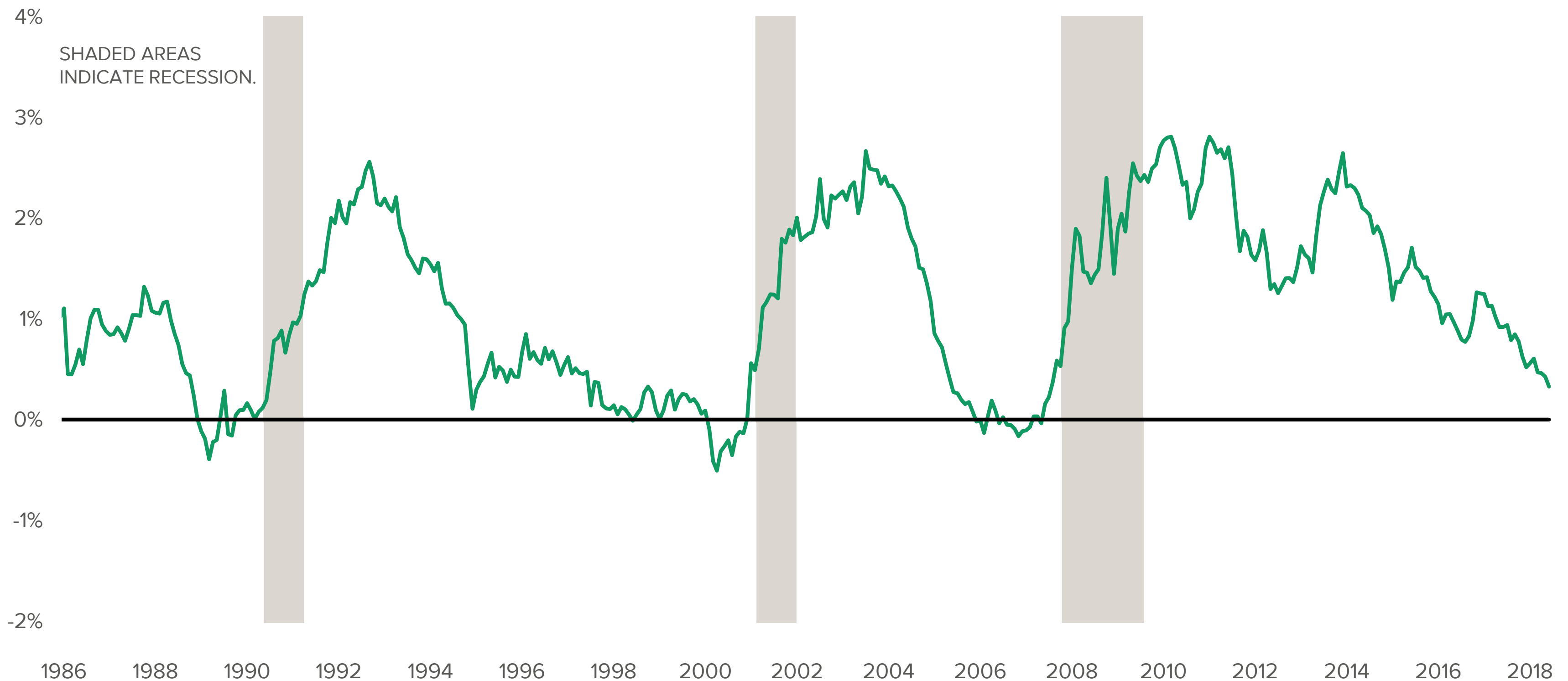
The 37-year bull market for bonds had driven the 10-Year Treasury yield to near historically low levels over the past several quarters. That said, the benchmark domestic bond yield closed the quarter at 2.86%, representing a nearly 20% increase from year-end.

Source: Bloomberg

2-Year vs. 10-Year Treasury Yield Curve Spread

A comparison of long-term versus short-term Treasury rates illustrates that past recessions were preceded by an inverted yield curve (i.e. the 10-Year Treasury yield fell below the 2-Year yield). As of 6/30/18, the 10-Year yield fell to just 0.33% above the 2-Year yield, giving us the flattest yield curve in a decade.

10-YEAR U.S. TREASURY YIELD MINUS 2-YEAR U.S. TREASURY YIELD
FROM 1/1/1986 THROUGH 6/30/2018



Source: Bloomberg

Relative Yield

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10-Year U.S. Treasury bonds have historically provided a higher yield than equities. From 2008 until as recently as last year, however, the yield on the S&P 500 has on multiple occasions eclipsed that of the 10-Year. Since late 2017, the breakout of the 10-Year has meant that investors can now enjoy a meaningfully higher yield than that provided by large cap U.S. stocks.

S&P 500 INDEX DIVIDEND YIELD VERSUS 10-YEAR TREASURY YIELD
FROM 1/1/1994 THROUGH 6/30/2018

Source: Bloomberg

Corporate Earnings & Revenue Growth

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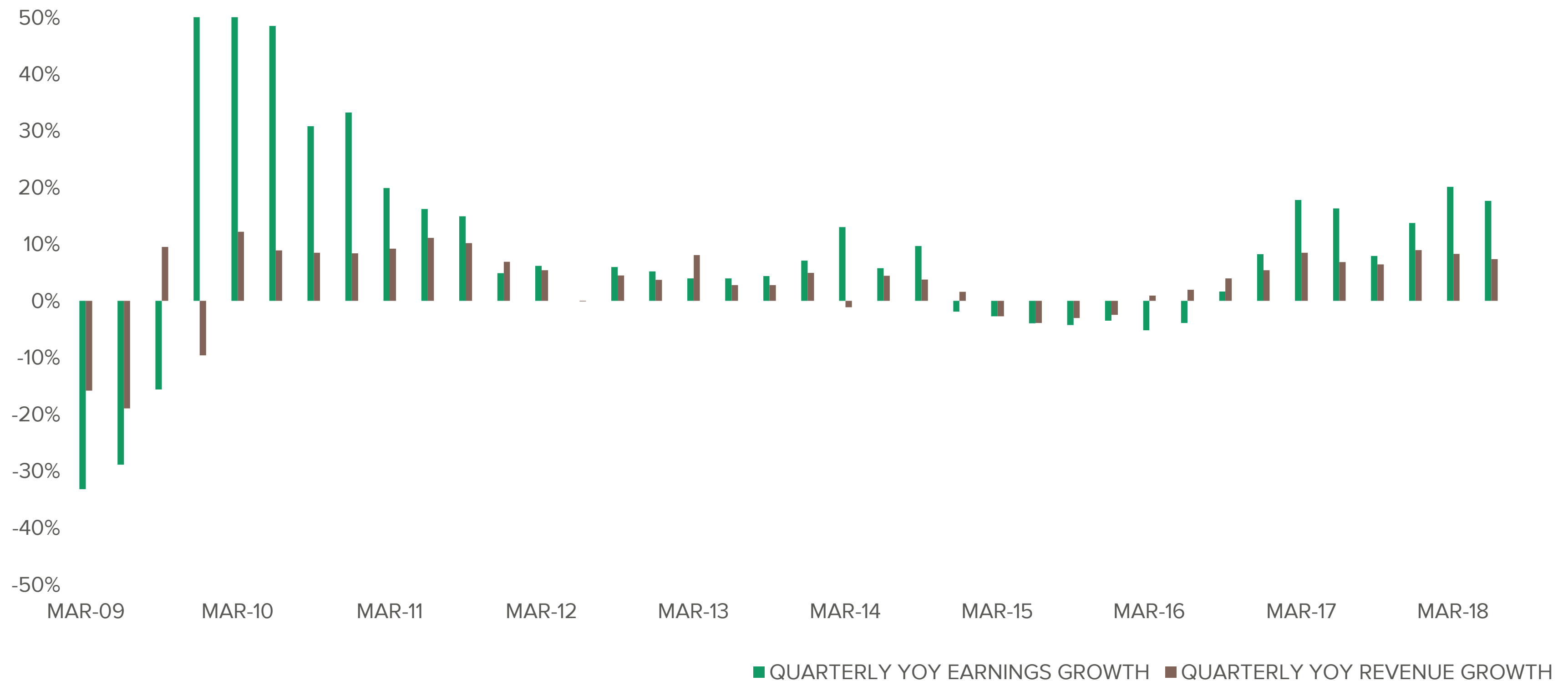
Quarterly earnings and revenue growth figures have been strong in the U.S., and have accelerated through the first half of 2018. Continued solid corporate performance in 2018 and beyond will be necessary to continue supporting elevated valuations.



Source: Bloomberg

Asset Class Returns

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Asset class performance is cyclical, highlighting the importance of constructing a broadly diversified portfolio.

PERIODIC TABLE OF ASSET CLASS TOTAL RETURNS
FROM 1/1/2007 THROUGH 6/30/2018

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	YTD
EMERGING MARKETS 39.8%	LT BOND 24.0%	EMERGING MARKETS 79.0%	REAL ESTATE 27.6%	LT BOND 29.9%	REAL ESTATE 19.7%	SMALL CAP 41.3%	REAL ESTATE 28.1%	REAL ESTATE 2.8%	SMALL CAP 26.6%	EMERGING MARKETS 37.8%	SMALL CAP 9.4%
COMMODITIES 16.2%	GLOBAL BOND 9.2%	HY BOND 57.5%	SMALL CAP 26.9%	ST/IT BOND 7.8%	EMERGING MARKETS 18.6%	MID CAP 33.5%	LT BOND 25.1%	LARGE CAP 1.4%	MID CAP 20.8%	LARGE FOREIGN 25.6%	MID CAP 3.5%
LARGE FOREIGN 11.6%	ST/IT BOND 5.1%	MID CAP 37.4%	MID CAP 26.6%	REAL ESTATE 7.3%	LARGE FOREIGN 17.9%	LARGE CAP 32.4%	LARGE CAP 13.7%	ST/IT BOND 0.6%	HY BOND 17.5%	LARGE CAP 21.8%	LARGE CAP 2.7%
LT BOND 9.8%	HEDGE FUNDS -23.3%	LARGE FOREIGN 32.5%	EMERGING MARKETS 19.2%	GLOBAL BOND 6.4%	MID CAP 17.9%	LARGE FOREIGN 23.3%	MID CAP 9.8%	LARGE FOREIGN -0.4%	LARGE CAP 12.0%	MID CAP 16.2%	REAL ESTATE 1.3%
ST/IT BOND 7.4%	HY BOND -26.2%	REAL ESTATE 27.5%	COMMODITIES 16.8%	HY BOND 4.4%	SMALL CAP 16.3%	HY BOND 7.4%	ST/IT BOND 6.0%	LT BOND -1.2%	COMMODITIES 11.8%	SMALL CAP 13.2%	HY BOND 0.1%
GLOBAL BOND 5.7%	SMALL CAP -33.8%	SMALL CAP 27.2%	HY BOND 15.2%	LARGE CAP 2.1%	LARGE CAP 16.0%	HEDGE FUNDS 6.7%	SMALL CAP 4.9%	SMALL CAP -2.0%	EMERGING MARKETS 11.6%	REAL ESTATE 8.7%	COMMODITIES 0.0%
MID CAP 5.6%	COMMODITIES -35.7%	LARGE CAP 26.5%	LARGE CAP 15.1%	MID CAP -1.7%	HY BOND 15.6%	REAL ESTATE 2.9%	HY BOND 2.5%	MID CAP -2.2%	REAL ESTATE 8.6%	LT BOND 8.5%	HEDGE FUNDS -0.9%
LARGE CAP 5.5%	LARGE CAP -37.0%	COMMODITIES 18.9%	LT BOND 9.4%	SMALL CAP -4.2%	ST/IT BOND 4.2%	ST/IT BOND -2.0%	GLOBAL BOND -0.5%	GLOBAL BOND -3.6%	ST/IT BOND 2.7%	GLOBAL BOND 7.5%	GLOBAL BOND -0.9%
HEDGE FUNDS 4.2%	REAL ESTATE -37.3%	HEDGE FUNDS 13.4%	LARGE FOREIGN 8.2%	HEDGE FUNDS -8.9%	HEDGE FUNDS 3.5%	EMERGING MARKETS -2.3%	HEDGE FUNDS -0.6%	HEDGE FUNDS -3.6%	HEDGE FUNDS 2.5%	HY BOND 7.5%	ST/IT BOND -1.6%
HY BOND 1.9%	MID CAP -41.5%	ST/IT BOND 5.9%	ST/IT BOND 6.6%	LARGE FOREIGN -11.7%	LT BOND 3.4%	GLOBAL BOND -4.0%	EMERGING MARKETS -1.8%	HY BOND -4.6%	GLOBAL BOND 1.6%	HEDGE FUNDS 6.0%	LARGE FOREIGN -2.8%
SMALL CAP -1.6%	LARGE FOREIGN -43.1%	GLOBAL BOND 2.6%	GLOBAL BOND 5.2%	COMMODITIES -13.3%	GLOBAL BOND 1.7%	COMMODITIES -9.5%	LARGE FOREIGN -4.5%	EMERGING MARKETS -14.6%	LARGE FOREIGN 1.5%	ST/IT BOND 3.5%	LT BOND -3.0%
REAL ESTATE -17.8%	EMERGING MARKETS -53.2%	LT BOND -12.9%	HEDGE FUNDS 5.2%	EMERGING MARKETS -18.2%	COMMODITIES -1.1%	LT BOND -13.9%	COMMODITIES -17.0%	COMMODITIES -24.7%	LT BOND 1.3%	COMMODITIES 1.7%	EMERGING MARKETS -6.7%

Source: Bloomberg. Diversification does not guarantee a profit and does not eliminate the risk of loss. Emerging Markets: MSCI EM; Large Foreign: MSCI EAFE; Large Cap: S&P 500; Mid Cape: S&P MidCap 400 TR; Small Cap: S&P SmallCap 600; Real Estate: FTSE NAREIT All Equity REITs; LT Bond: BBgBarc US Treasury Long; Global Bond: Citi WGBI USD; HY Bond: ICE BofAML US High Yield; Hedge Funds: HFRX Global Hedge Fund Index; ST/IT Bond: BBGBarc US Agg Bond; Commodites: Bloomberg Commodity

Disclosures

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