COMPASS INVESTMENTS LLC

Market & Investment Update

Martin A. Wildy, CFA & Geoffrey P. Caber, AIF®

August 6, 2019

July was a busy month in financial markets as investors spent the first few weeks digesting second quarter company earnings, US Gross Domestic Product (GDP) and Federal Reserve interest rate policy. In aggregate, conditions appear mixed, with the US consumer providing support for the overall economy as businesses have pulled back modestly, while global growth and trade have slowed.

The S&P 500 marked an all-time high on July 26th at 3,026 while assets that are typically viewed as safe havens such as bonds and gold have rallied as well. Investors focused on bonds and gold appear to be pricing in significant future distress, while equity markets are relatively optimistic. Our view is that neither is fully accurate and recently equity markets have experienced a 5% pullback as trade tensions and strained relations between President Trump and President Xi have re-surfaced.

At this stage, we do not anticipate a meaningful US recession on the horizon over the next year, but the likelihood seems to have increased over the last several weeks. This is mostly driven by the lack of an anticipated near-term resolution to the US/China trade dispute. We believe equity markets had not been appropriately discounting the risks of slowing earnings/economic growth nor the impact of geopolitical risks. The risks include the United Kingdom abruptly leaving the European Union in October (“hard Brexit”), or the ongoing/ increasing trade wars. In short, signals are mixed today, and a neutral position feels appropriate.

Year-to-Date Returns (as of August 5, 2019)

Category	Representative Index	YTD 2019	July 2019	2018
US Large Cap Equity	S&P 500	14.80%	1.44%	-4.4%
US Small Cap Equity	Russell 2000	11.16%	0.58%	-11.0%
Foreign Developed Equity	MSCI EAFE	8.77%	-1.27%	-13.8%
Emerging Market Equity	MSCI Emerging Markets	2.51%	-1.22%	-14.6%
US High Yield Fixed Income	ICE BofAML High Yield	9.52%	0.51%	-2.3%
US Fixed Income	Barclays Aggregate Bond	7.67%	0.22%	0.0%
Cash Equivalents	ICE BofAML 3 Mo Deposit	1.44%	0.18%	2.1%

COMPASS
INVESTMENTS LLC

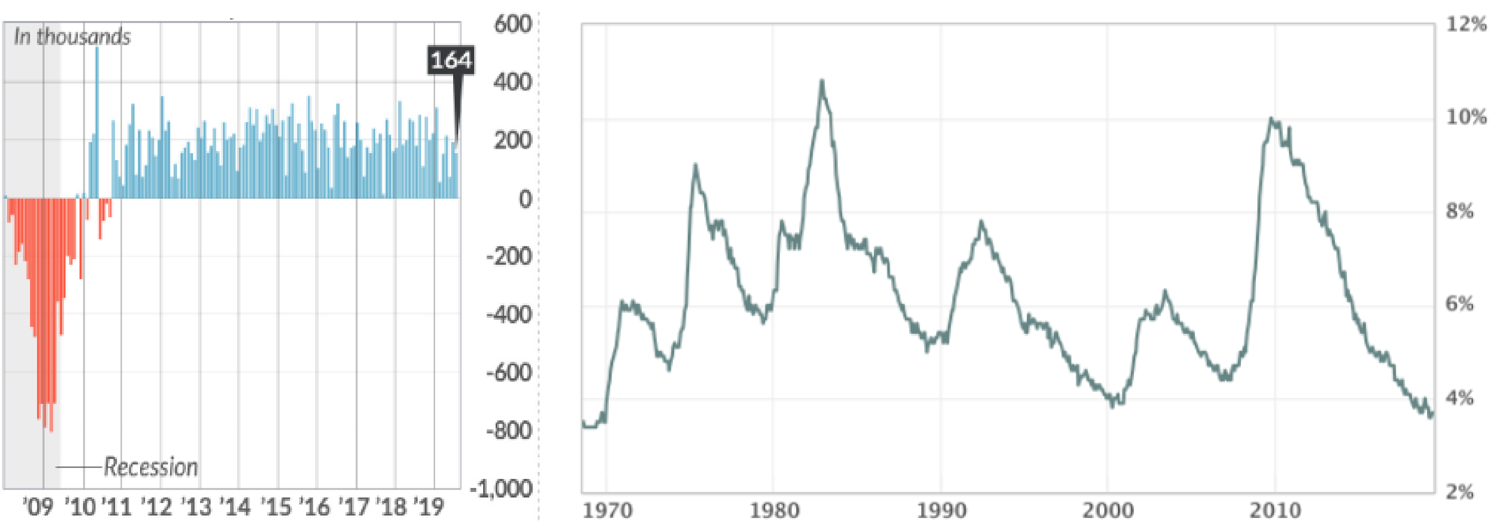
Economy

On July 26th, we received the second quarter US gross domestic product report ("GDP"). The number, which will likely be revised over the next several weeks, implied 2.1% year-over-year US growth, which was better than consensus expectations of 1.8%, but the pace of growth slowed from 3.1% in the first quarter. Encouragingly, consumer spending, which represents approximately two-thirds of economic activity rose by 4.3%, up sharply from the 1.1% pace in the previous quarter. GDP was held back by falling business investment, potentially the result of ongoing uncertainties regarding trade policies, particularly between the US & China. Surprisingly robust non-defense government spending also supported economic growth.

Employment growth in July totaled 164,000 net new jobs, which remains a robust number, particularly ten years into an economic expansion with an unemployment rate at 3.7%. The Conference Board's composite of leading economic indicators ("LEI") has shown some signs that economic growth may be approaching a slowdown. The LEI composite is comprised of ten components that include measures of manufacturing, employment, housing, credit conditions, consumer sentiment, and stock market activity.

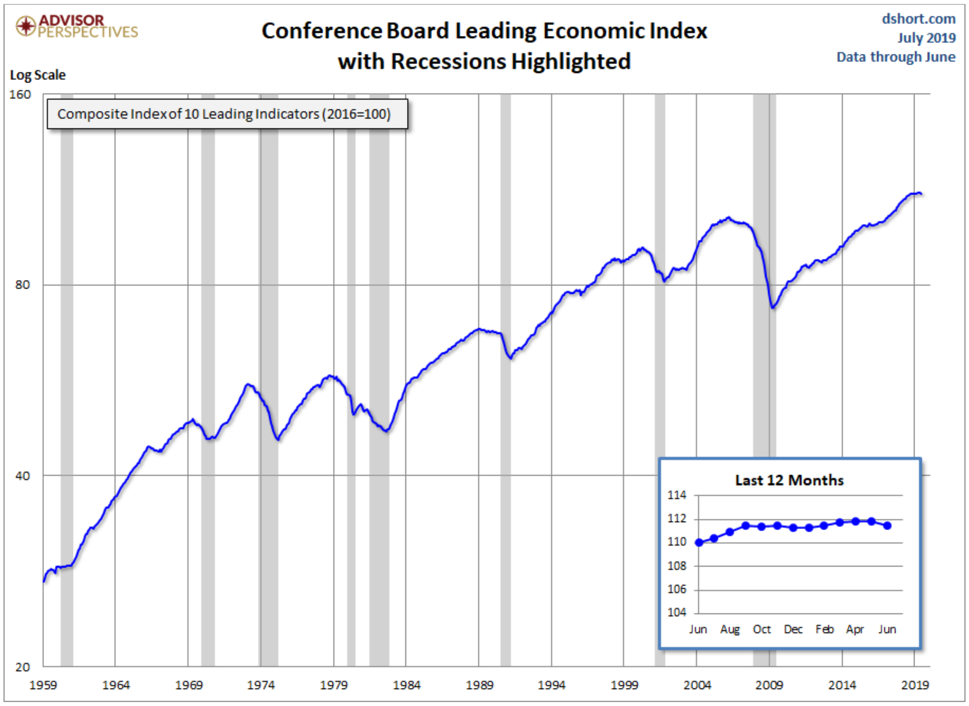
Looking ahead, lower interest rates will help many rate sensitive sectors of the economy such as housing, construction, and automotive but this could be offset by any negative impacts from increased trade tensions and tariffs between the U.S. and China.

Monthly Jobs Growth (Left) & Unemployment Rate (Right)

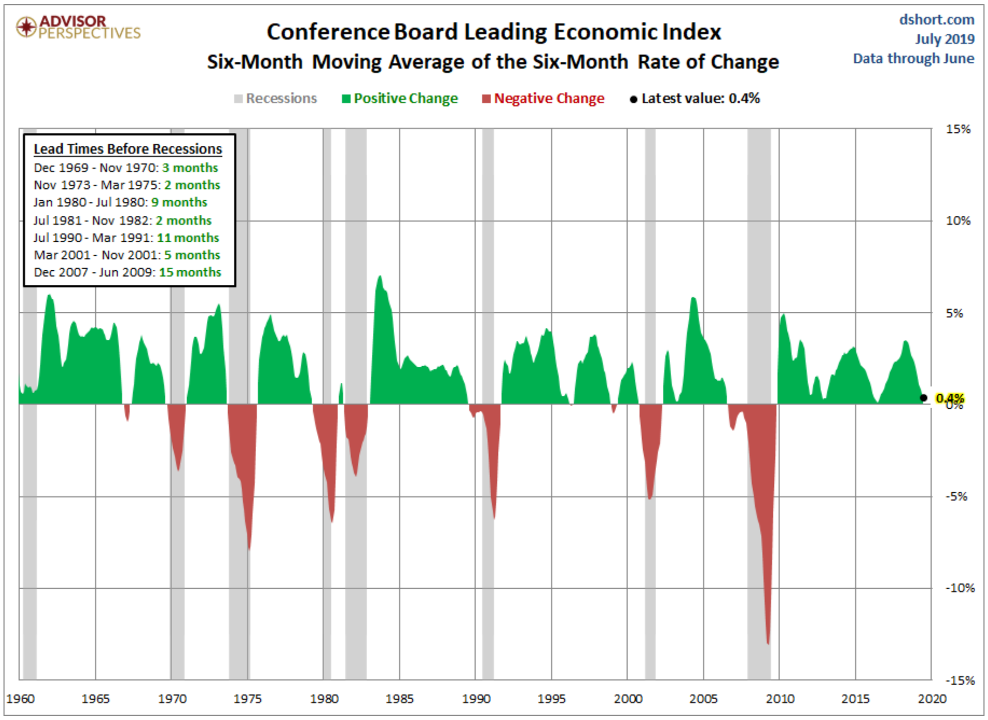


Source: Bureau of Labor Statistics, MarketWatch

Leading Economic Indicator Composite Level



Leading Economic Indicator Composite Six Month Rate of Change



Source: Conference Board, Advisor Perspectives

COMPASS INVESTMENTS LLC

Federal Reserve Policy

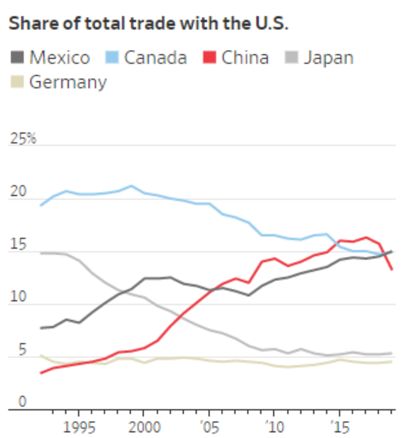
On July 31st, the Federal Reserve ("Fed") announced that it is lowering its benchmark interest rate by 0.25% to 2.00-2.25%. This was the first policy rate reduction since 2008. The Fed operates under a dual mandate of seeking to achieve maximum employment and stable prices, and obviously these forces interact with each other (higher employment leads to more consumer spending which should increase prices, and vice versa). The July Fed statement noted that "the labor market remains strong and that economic activity has been rising at a moderate rate", but inflation has been running below target. The key task for investors will be to determine if this interest rate cut is the start of a larger easing cycle to blunt the impact of a future recession, or is it simply a more-dynamic Fed taking a measured step to be accommodative and responsive to income data.

Earnings

According to FactSet, 77% of S&P 500 companies have reported second quarter results as of August 2, and 76% of those reported better-than-expected earnings; 59% of those companies reported better-than-expected revenue. However, the year-over-year earnings growth is expected to be negative for the second straight quarter (-1.0%), which last occurred during the first half of 2016. And, 49 S&P 500 companies have issued negative year-over-year earnings growth guidance for the third quarter (19 have issued positive guidance). As of August 2, the price-to-expected earnings (next 12 months) of the S&P 500 is 16.8x, which is approximately equal to the five-year average (16.5x) and above the ten-year average (14.8x), which includes the early recovery years following the Global Financial Crisis.

Trade

As mentioned above, second quarter net exports and business activity held back U.S. GDP, likely the result of ongoing trade war uncertainty, primarily with China. Following the end of the month and the Federal Reserve interest rate cut announcement, President Trump tweeted his intention to impose new 10% tariffs on all remaining Chinese goods imported to the US. The tariffs would take effect in September, and they would be levied against approximately $300 billion of goods. As shown in the charts below, trade with China has been in decline, with countries like Mexico, Canada, and Vietnam being beneficiaries.



Source: Census Bureau, Wall Street Journal

What does all this mean for markets and portfolios going forward?

As noted above, we feel that the US economy remains stable, but there is also risk that US equity investors may not be sufficiently compensated for the uncertainties of potentially slowing global growth and escalating trade wars. Conversely, bond market investors seem to have priced in significant declines in growth, inflation, and future Federal Reserve interest rate policy. We recommend a more neutral risk position today, remaining focused on long-term portfolio objectives, and taking a purposeful, yet measured, approach to portfolio rebalancing through periods of market volatility (which we expect during the second half of 2019).

Prices (as of August 6, 2019)

Representative Index	Current	Year-End 2018
S&P 500	2,881	2,507
Dow Jones Industrial Avg.	26,029	23,327
NASDAQ	7,833	6,635
Crude Oil	$53.46	$46.49
Gold	$1,487	$1,291
2 Year Treasury	1.60%	2.48%
10 Year Treasury	1.72%	2.69%
30 Year Treasury	2.25%	3.02%

Source: Morningstar, Bloomberg, US Treasury (total returns shown gross of fees)