MARBLE TRAIL ADVISORS

Financial Planning & Wealth Management

Market Update

3rd Quarter 2018

Global Stock Market Highlights

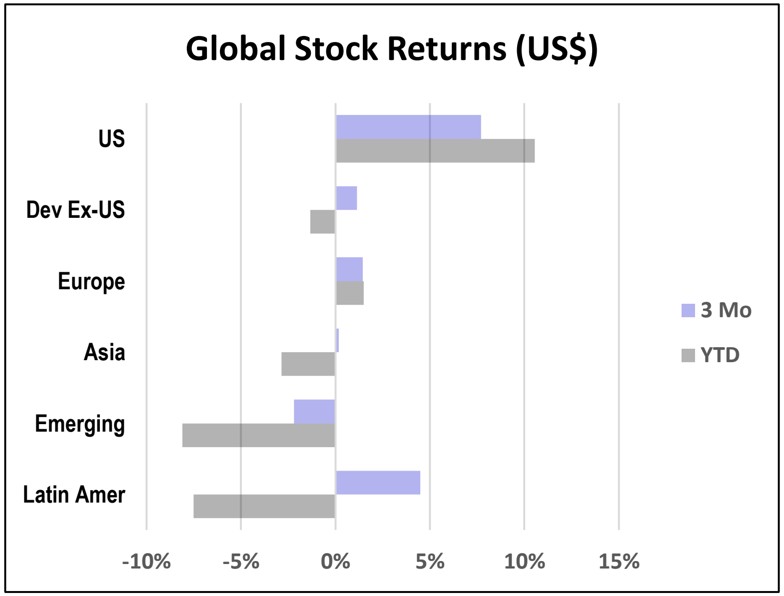
- Trade tensions that dominated the second quarter provided mixed signals in the third. An agreement by the US, Mexico and Canada to update NAFTA lifted stocks in those countries even as simmering tensions between the US and China rippled through emerging markets.
- European markets were generally flat and seemingly dominated by local issues. The market has gone back and forth between optimism and despair about both Brexit and Italy. The downside scenario for Britain of a no-deal “hard“ exit from the EU looks increasingly likely, while the potential for an Italian debt crisis a la Greece remains in doubt. The markets are inflicting moderate punishment on the region, with stocks and currencies down relative to the US, but generally flat overall.
- US volatility has been below average since April and is approaching 2017’s historic lows, suggesting some amount of complacency in the US market.

Vix Volatility Index

Source: Yahoo Finance

P/E Ratios	Current	1 Yr Ago	3 Years Ago
S&P 500	21.0	22.0	18.0
Russell 2000 (Small)	18.0	21.5	18.5
Europe	14.8	18.5	17.0
Emerging Markets	14.2	15.1	12.3

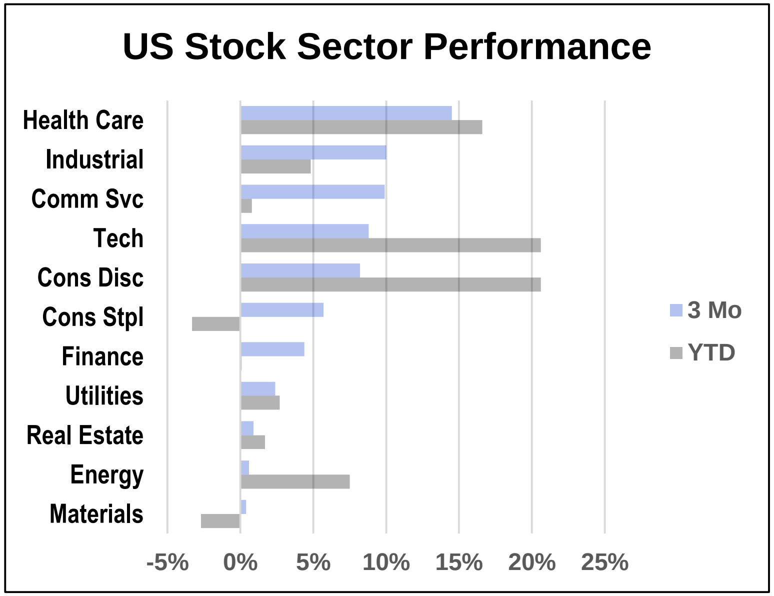
Source: Morningstar



Source: S&P Dow Jones

Stock Sector Highlights

- Unlike recent quarters where performance was dominated by tech and consumer discretionary companies, prosperity was broadly shared across the US market.
- Health care led the way as fear that the Trump administration will pressure drug prices has waned just as policies to speed the approval of new drugs have provided a lift to biotech companies. Resurgent interest in biotech startups has raised the ratio of IPO companies with negative earnings to the highest level since dotcom era.
- Industrials have benefitted as much as any sector from fiscal stimulus, because of the many defense companies included in the index. New trade protections also have the potential to help (and harm) the sector.
- While corporate earnings remain strong, most sectors seem expensive on a price-to-earnings basis, with the possible exception of financials. The market seems less inclined than a year ago to believe rising interest rates will help banks boost profit margins.



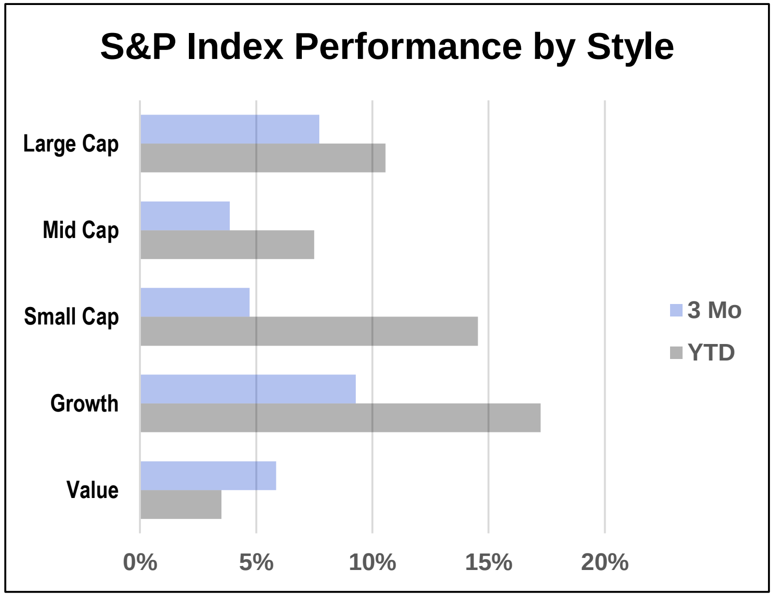
Source: S&P Dow Jones

	P/E Ratios			Yields	
Sector	Current	1 Yr Ago	3 Years Ago	Current	3 Years Ago
Consumer Discretionary	24.1	21.6	19.2	1.1%	1.5%
Consumer Staples	21.0	21.2	22.3	2.8%	2.7%
Energy	17.9	32.6	14.9	3.0%	3.2%
Financials	13.9	16.5	14.5	1.7%	1.9%
Health Care	29.7	23.7	21.3	1.5%	1.5%
Industrials	20.4	22.8	17.3	1.9%	2.3%
Technology	26.8	23.1	18.6	1.3%	1.9%
Utilities	16.4	21.9	16.7	3.4%	3.6%
S&P 500	*21.0*	*22.0*	*18.0*	*1.9%*	*2.3%*

Source: Morningstar

Stock Market Performance by Style

- Despite significant declines in Facebook and Netflix, growth stocks again outperformed in the 3rd quarter. Apple and Amazon continued their great run (achieving record-breaking market caps exceeding $1 trillion each), and other growth industries, like health care and semiconductors, experienced solid returns. Still, performance in week 1 of the fourth quarter suggests sentiment may be turning away from these high fliers.
- Reversing recent trend, small companies were outperformed by large ones in Q3. Medium-sized companies again trailed both, for no apparent reason other than something akin to "middle child syndrome."
- Valuations continue to be stretched for most sectors and investment styles, but value and smaller companies have less far to fall should sentiment suddenly turn from bullish to bearish.



Source: S&P Dow Jones

Style Box Valuation

17.0	20.6	26.1	Large
15.6	20.3	28.9	Mid
15.9	18.6	23.8	Small
Value	Blend	Growth	

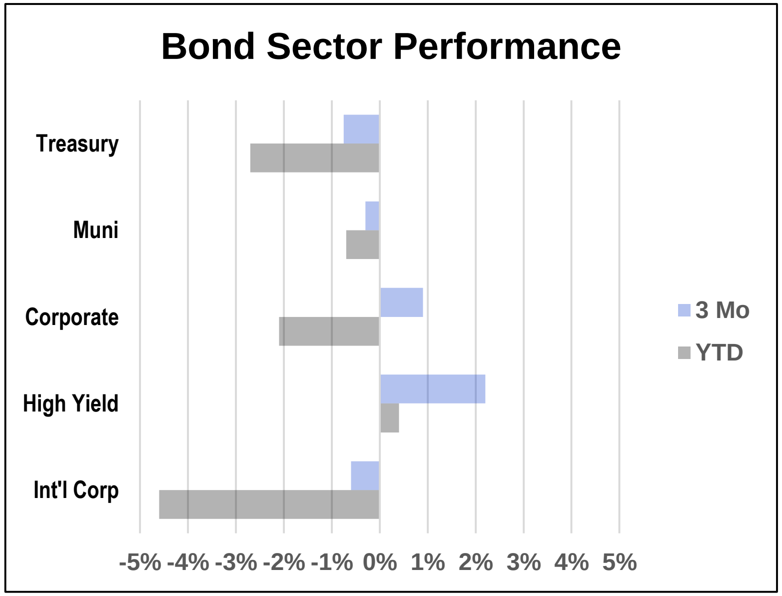
Source: Morningstar, Vanguard

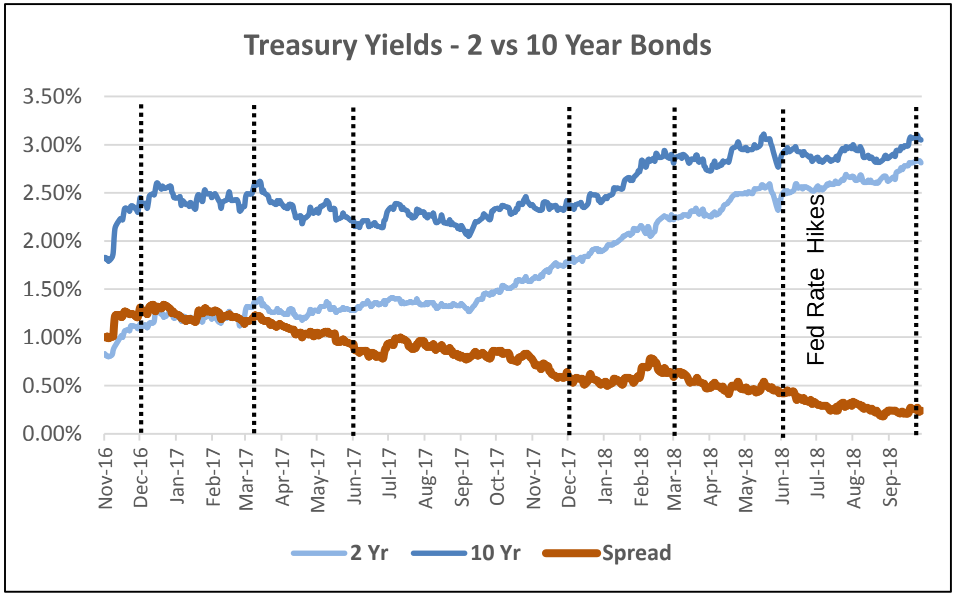
P/E Ratios	Current	1 Yr Ago	3 Years Ago
S&P 500	21.0	22.0	18.0
Russell 2000 (Small)	18.0	21.5	18.5
Large Growth	26.1	26.3	21.4
Large Value	16.3	19.7	16.2
Small Growth	23.8	26.5	26.3
Small Value	15.9	16.0	15.3

Source: Morningstar

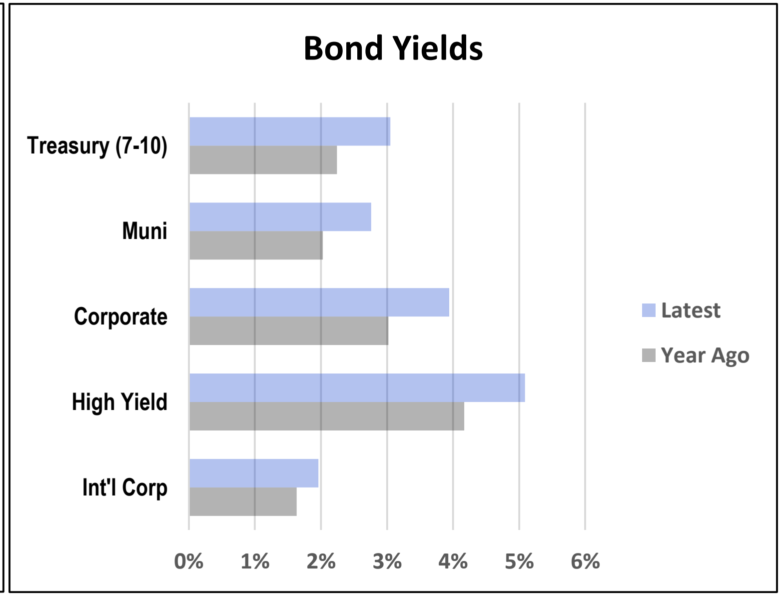
Bond Market Highlights

- Global interest rates advanced steadily, but not dramatically, in the quarter, sending bond prices down.
- Unlike Treasuries and municipals, corporate bonds generated slightly positive returns as their higher coupons were large enough to absorb the decline in bond prices.
- US investors in foreign bonds lost money again, due both to a strengthening of the dollar and rising rates.
- The spread between high yield and investment grade corporate bonds remains narrow, suggesting that the market considers the near-term risk of recession to be quite low.
- The spread between two and ten-year Treasuries continued to narrow, suggesting the market thinks the long-term economic outlook is not terribly robust.





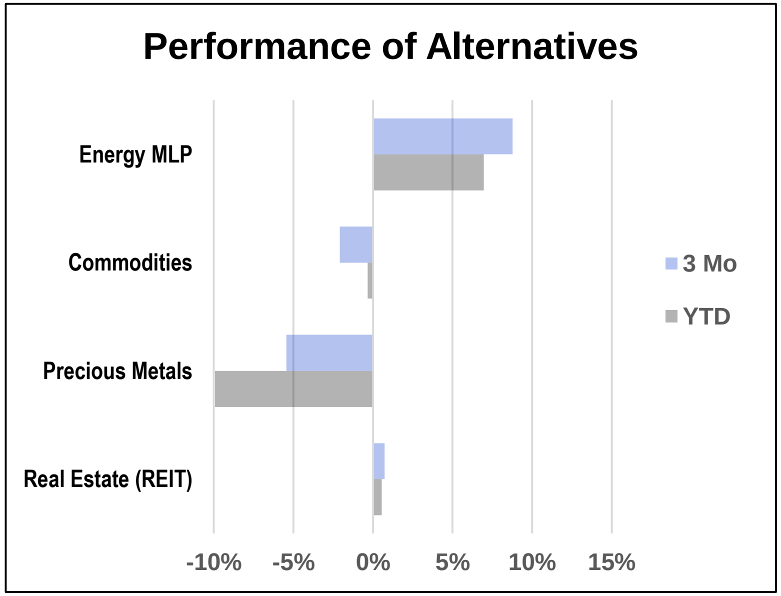
Source: St. Louis Fed



Source: S&P Dow Jones

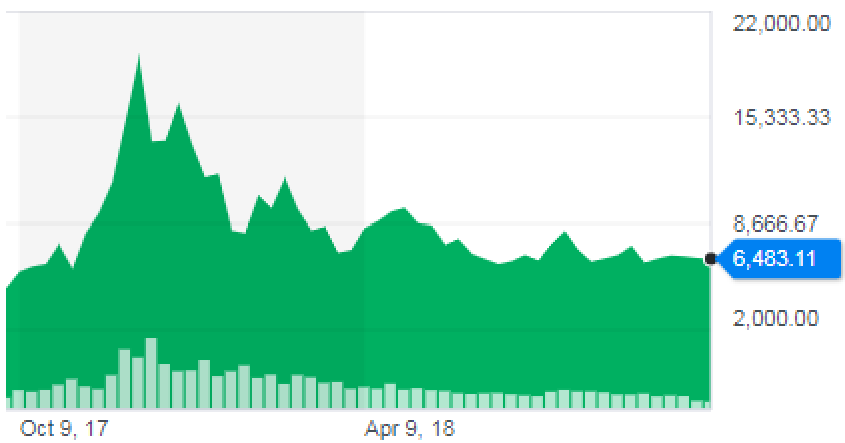
Alternative Investments

- Oil prices in the US were remarkably steady with WTI crude finishing at $74/barrel. The international standard, Brent Crude, opened up a $10 gap on WTI, rising $6 to $84 as concerns grew over the willingness and ability of other suppliers to absorb production declines in Iran and Venezuela.
- Global supply constraints are good news for the US shale industry, helping energy MLPs to solid gains in the quarter.
- Despite a robust economy REITs lagged, as higher interest rates increased the relative attractiveness of fixed income.
- Higher interest also tend to make gold less attractive, and prices fell another 5% in Q3.
- Bitcoin seems to have settled into a price range between $6-7 thousand with trading volume continuing to fall. For speculators waiting for a return to previous peaks, we would point out that it took the NASDAQ index more than 15 years to recover its losses after the bursting of the dotcom bubble.
- Investors motivated by FOMO (Fear Of Missing Out) have moved on to Canadian cannabis stocks like Canopy Growth (ticker WEED.TO) and Tilray, each of which already has a market value significantly greater than former tech darlings Snapchat, Dropbox and Roku.



Source: S&P Dow Jones, Morningstar

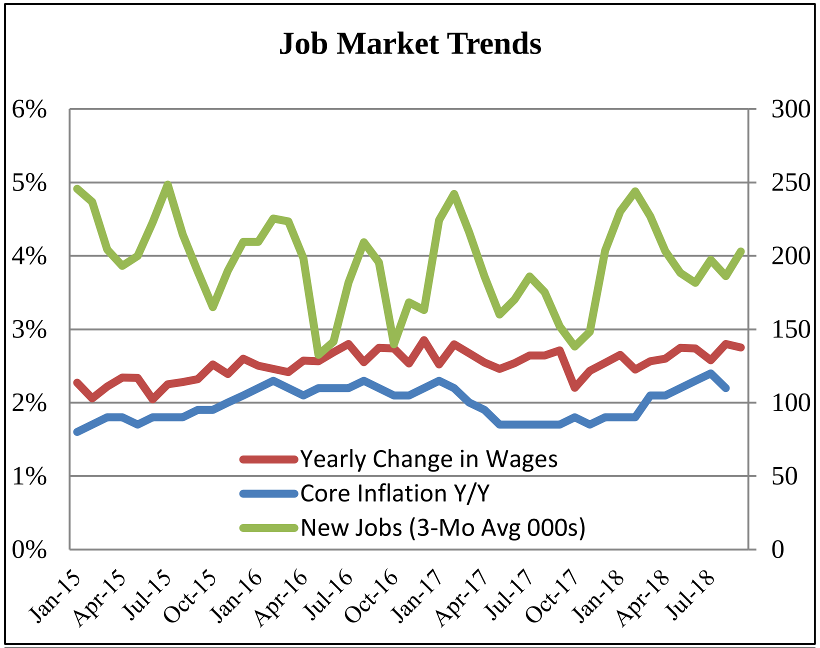
Bitcoin

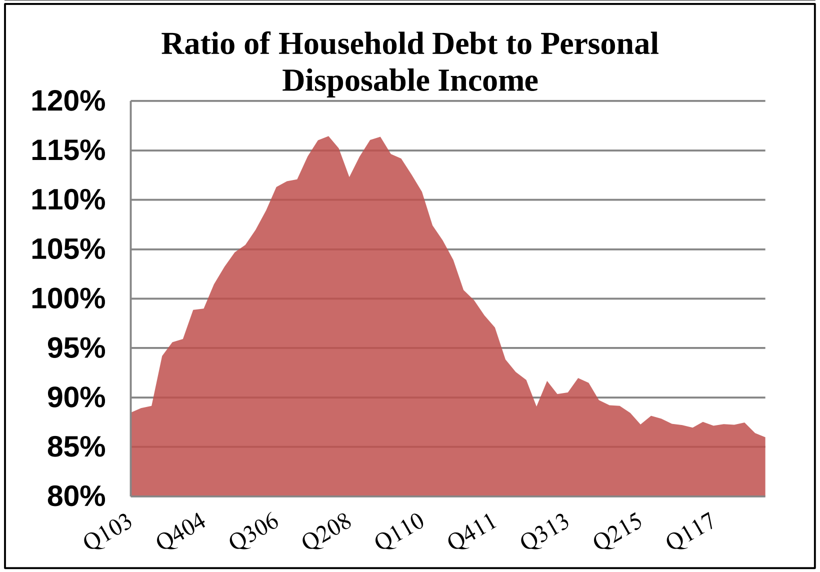


Source: Yahoo Finance

Economy

- As expected, economic growth picked up to 4.2% in the second quarter as the fiscal stimulus double-whammy of tax cuts and higher spending kicked in. Most economists are projecting a growth rate of 3% for the second half, higher than what the Fed considers sustainable.
- Robust job growth continued. The unemployment rate dropped to 3.7%, the lowest since 1969. Despite that, annual wage growth is fairly steady at 2.8% and core inflation has edged up to just 2.2%, slightly above the Fed's target and roughly where it was two years ago.
- The Fed continues to respond by gradually hiking the bank borrowing rate, which has filtered into higher rates for the rest of the economy, most notably in bond yields and consumer borrowing rates. Early signs of cooling are apparent in both the markets for new cars and homes.
- Consumer debt continues to rise gradually, but tax cuts have increased disposable income and made this slightly less burdensome, helping to offset the effects of higher interest rates. Encouragingly, we continue to see a decline in the growth rate of student loan debt, which came in at 4.5% in the most recent quarter. While this is still faster than inflation, it pales in comparison to the explosive growth experienced in the ten years from 2003-2013, which averaged 15%.
- We still consider an external shock to the system a more imminent threat to the nine-year expansion than a gradual build-up of excess. The market appears to be downplaying the threat of a trade war with China, considering the President's new NAFTA deal to be evidence that his policies are more bark than bite.





Sources: ADP, US Depts. of Labor and Commerce, & the New York Fed

Our Macro View

Region	Current Conditions	Long-term Outlook	Investment Implications
USA	Accelerating growth; labor market near full employment; early signs of excesses that typically precede recession, all clouded by trade policy.	Base: Trump backs down on trade war as effects become unpopular. Stimulus increases spending & business investment in short run; rising debt and interest rates lead to next recession (2-4 years). Downside: Trade war triggers stagflation – higher inflation & lower growth; corporate profits suffer. Upside: Trade war averted; increased investment leads to permanent rise in growth & productivity.	Tax cuts are more fully priced into market than a trade war, which leaves the market fully priced with more downside risk than upside opportunity. A more defensive posture is prudent.
Europe	Very slow growth; populist Italian government a challenge to Euro zone; little progress toward Brexit deal.	Base: Irreconcilable differences lead to slow dissolution of the EU in its current form. Downside: Nationalist sentiment (e.g., Italy) hastens the process beyond the point of prudence. Upside: Germany takes more enlightened view toward providing fiscal stimulus in South.	Market consensus not entirely in line with our base case. Brexit and Euro zone now equally in focus. Slightly lower than normal weightings with moderate currency hedges.
Japan	Marginal gains in growth and inflation are fading; trade weighing on outlook; massive public debt.	Base/Downside: More of same until debt burden breaks view of Yen as safe haven asset, at which point inflation returns by way of devaluation. Upside: Nation implements structural reforms and immigration policy to inject dynamism.	Slightly below normal weightings with hedging of currency exposure.
China	Tariffs appear to be hurting industry; in response the State is allowing its currency to devalue and is relaxing credit, adding to already high public & private debt levels.	Base: Slowing of economy creates domestic issues absorbing central government resources, pressuring stocks and the currency. Conflict with US simmers without boiling over. Downside: Either government missteps or a trade war lead to rising unemployment & unrest and investment moving to other emerging markets. Upside: Consumer economy grows fast enough to outweigh other problems.	Chinese stocks in bear market due to trade worries. Potentially more near-term upside than downside, but range of possible outcomes extremely wide. Selectivity remains key; avoid state-owned enterprises, heavy industry; favor consumer and smaller companies.

Our Fundamental View

Fundamental	Medium- to Long-term Outlook	Investment Implications
Stock Market Valuation	Virtually all assets are expensive relative to historical averages, which suggests that investment returns for everything from stocks to bonds and real estate will be below long-term averages. Tax cuts justify some of the appreciation since Nov 2016, but companies will have to deliver in 2018, which they started to do prior to the trade battles. Higher valuations mean more vulnerability to shocks, with North Korea and Trump's trade agenda still being the most proximate risks.	Achieving 5-7% annual returns over the next 5-10 years will require embracing stock market volatility to the extent afforded by your risk tolerance and portfolio withdrawal rate. Diversification will remain key to generating decent returns while managing risk.
Interest Rates	The era of policy divergence has moved to the middle stages with the US tightening and most of the world still accommodative. Powell unlikely to push major policy changes at Fed. Europe, Japan and China, awash in money, have helped contain long-term interest rates in U.S., but debt will rise substantially in coming years. Europe is around two years behind the U.S. in policy, which suggests tightening starts in 2019; disparate North-South conditions – and the potential for trade to cause a global slowdown – add uncertainty to that outlook. Draghi's successor in 2019 may be German and less supportive of easy money policies.	Continue to employ reasonable hedges against rising rates, including laddered bond portfolios, floating rate notes and cash. With short-term rates high relative to long-term, focus on the near-end of the yield curve for now.