October 17, 2018

Dear Valued Client:

"Fall is in the air" is a simple way to start this letter. Weather is one of the easiest topics for us to discuss when making small talk. We love it, we hate it, seldom is it just right. Similarly, economic forecasters never seem to be satisfied with something. As an example, good news on employment or the economy portends bad news on interest rates. Rates have been kept low for the last 10 years helping to spark a flood of liquidity into the market and drive a bull market now over 10 years old.

The Fed has raised short-term interest rates eight times since December 2015 and has suggested at least four more hikes are on the way. The cooling effect of these rates is just now being seen in some housing and auto numbers and is likely to begin showing up in earnings. The significant fiscal stimulus injected into the economy is creating nice headline GDP but at the same time is making the case for the rate hike. It is a delicate balancing act that the Fed must navigate as the growth of the economy is at stake.

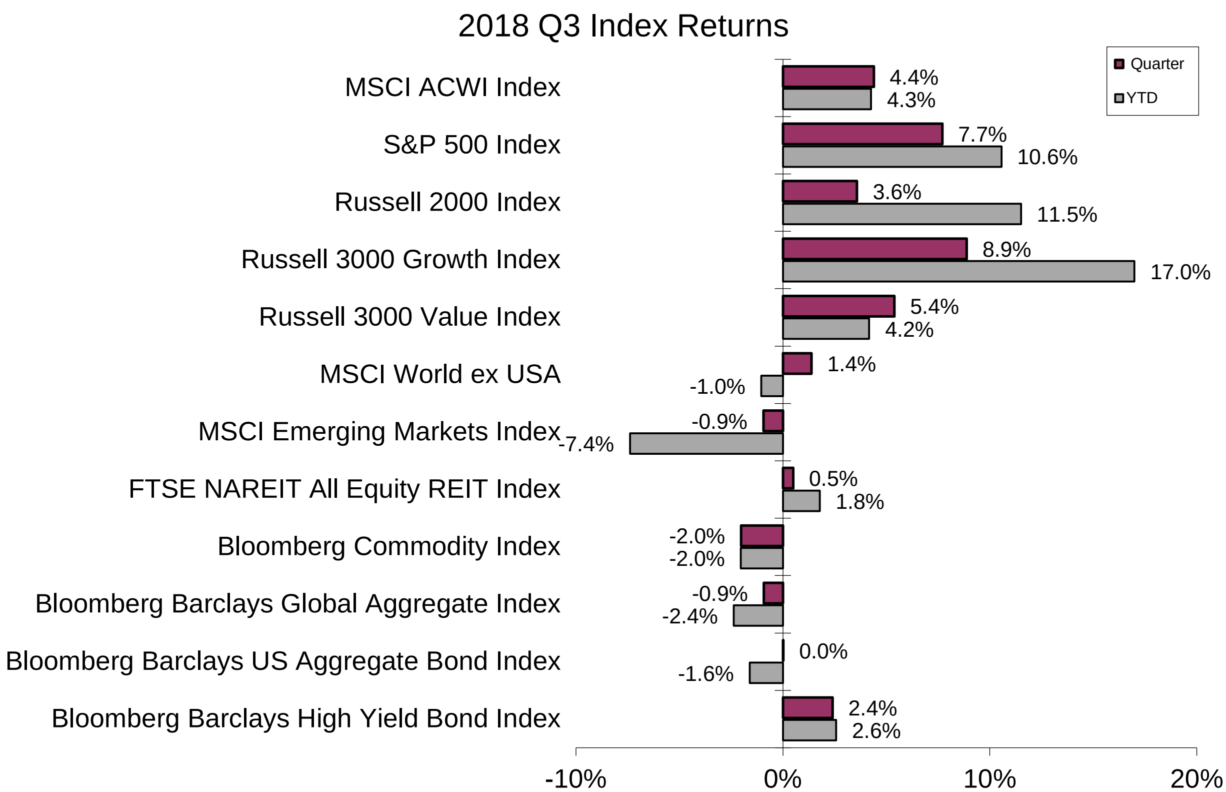
Third Quarter Market Review

Global stocks advanced 4.4% during the third quarter of 2018, as measured by the MSCI ACWI Index, while the Bloomberg Barclays Global Aggregate Bond index declined 0.9%.[i] Stocks rose even as economic growth prospects diverged across the globe with rising trade tensions, political uncertainty, and tightening financial conditions in emerging markets.[ii] The underlying strength in the US economy helped drive strong gains for US stocks, lifting broader global equity markets for the quarter and year. For the first nine months of 2018, global stocks returned 4.3%.

The S&P 500® Index of large-cap US stocks surged 7.7% during the third quarter, as the index posted its best quarter since 2013. Growth-oriented sectors such as technology (+8.8%) and consumer discretionary (+8.2%) continued to record impressive gains, while leadership shifted from small caps to larger caps. Health care stocks (+14.5%) were lifted by positive earnings reports, but the outlook for energy (+0.6%) and materials (+0.4%) companies was more mixed. Defensive and higher-dividend sectors such as utilities (+2.4%) and real estate (+0.9%) lagged with the rise in interest rates.

The MSCI ACWI ex-US Index of international stocks posted more muted results, returning 0.8% for the quarter, as the depreciation in foreign currencies versus the US dollar detracted from returns. Asian markets were lifted by Japan (+3.8%) with companies reporting higher earnings and the weaker yen benefiting exporters. Broader Europe (+0.8%) was weighed down by uncertainties related to trade tariffs, issues in Italy, and Brexit negotiations. Emerging markets (-0.9%) were mixed as concerns over debt levels and US trade negotiations hurt China (-7.4%), while progress on a new US trade deal benefited Mexico (+7.0%).

In fixed income, the Bloomberg Barclays US Aggregate Bond Index was little changed for the quarter, as the narrowing in credit spreads countered the rise in rates. Long-term Treasury bonds (-2.9%) felt the larger impact as the 10-year Treasury yield rose from 2.85% to 3.05%. Corporate bonds were mostly in positive territory, including the investment grade (+1.0%) and high yield sectors (+2.4%). International bonds (-1.7%) were hurt by the weakness in foreign currencies, while emerging market bonds (+1.6%) recovered some of the declines from the first half of the year.



An index is a portfolio of specific securities, the performance of which is often used as a benchmark in judging the relative performance of certain asset classes. Indices are unmanaged, with no associated expenses, and investors cannot invest directly in an index. All index returns shown in the table represent total return figures in US dollars, with dividends reinvested, which means the returns include not only the change in prices for the securities in the index, but any income generated by those securities.
Sources: Bloomberg, Barclays, Dow Jones, Morningstar, MSCI Barra, Russell, Zephyr Associates.

Economic Highlights

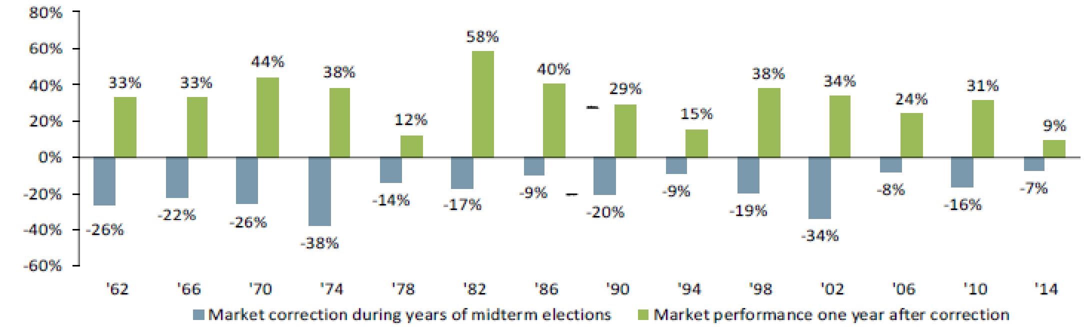
The US economy expanded 4.2% during the second quarter of 2018, up from the 2.2% reading for the first quarter. The acceleration in growth was driven by increases in consumer spending, exports, and business investment. Early estimates from the Federal Reserve Bank of Atlanta indicate that gross domestic product (GDP) rose 4.1% in the third quarter, with the improved employment picture and high confidence levels supporting consumer spending.[iii] Corporate earnings rose 25.0% in the second quarter (versus the prior year), the biggest increase since 2010. Analysts estimate S&P 500 earnings growth of 19.3% for the third quarter.[iv]

The Federal Reserve (Fed) increased short-term interest rates to 2.00-2.25% at the September FOMC meeting and removed the "accommodative" description from their policy comments. The Fed highlighted the strengthening labor market, with the unemployment rate at 3.9% in August. The Consumer Price Index inflation rate rose 2.7% for the 12-month period through August, lifted by higher energy prices. Core inflation (excluding food and energy) rose 2.2%, closer in-line with the Fed's 2% preferred target. In view of the economic data, the Fed projected another rate increase for December and three more in 2019.

Mid-Term Elections

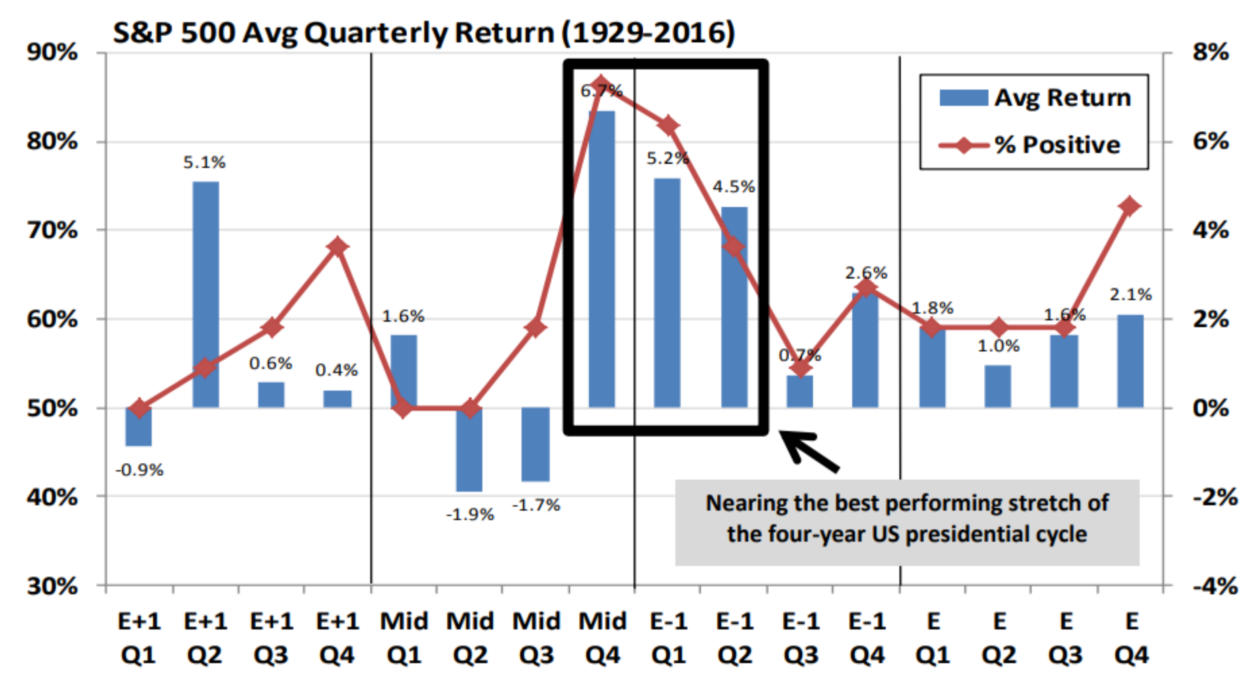
As the days wind down towards Election Day 2018, headlines and pundits are proselytizing their views on how the votes will fall. Media outlets are blaring predictions of a blue wave, a red wave, and are attempting to rally their base. As we know, the market hates uncertainty and without missing a beat the markets are correcting like we have seen during the past 14 midterm cycles. Going back to 1962, the S&P 500 has an average correction of 19% in midterm years. Once the veil of political uncertainty lifts and the market can once again focus on fundamentals, historically, the year following midterm elections has seen a 31% climb on average.[v]

Chart 4. S&P 500 Index historically has corrected before midterm elections, yet outperformed after them



Sources: Strategas Securities, Wells Fargo Investment Institute, August 28, 2018. Data is for S&P 500 Index performance year to date preceding midterm elections, compared to one year performance following the election. Data is through the last midterm election in 2014. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment.

Expanding our sample size over the past 80 years, which gives us a small sample of 21 elections, the median return from August to mid-October is -1.4%. As of this writing, the S&P 500 is down just over 3%. Measuring from a month before the elections to two months following the markets has produced a median gain of 8%, which includes only one decline that happened in 1978 when the market declined 4%. On a longer horizon from August to March, there has historically been a rally of 14.5%.[vi]



Source: Oppenheimer & Co. and Bloomberg. Note: These results cannot and should not be viewed as an indicator of future performance.

Some believe that if the Democrats take control of the House of Representatives, the Senate, or both chambers of Congress, the markets could become unnerved. If we look at the most important items on the Republican Party's legislative agenda, they have mostly been accomplished. The Trump administration's tax bill of 2017, the budget agreement passed in February, and a number of regulatory reforms passed over the past two years. The markets have reacted positively to these pro-growth measures as they have been beneficial to corporate earnings and GDP growth. In order for the Democrats to roll back any of these measures they would need to win a super-majority (a two thirds majority in the House and the Senate) which is impossible to do in the Senate.[vii] Based on current polling[viii] it is likely the Democrats will gain enough seats to take control of the House while the Republicans keep control of the Senate.

Does it matter which party picks up more seats? Many would pose the argument that Republicans favor lower taxes and the Democrats want stricter business regulations; therefore, the Democrats gaining seats would be bad for the economy. If we look back at history, that hasn't necessarily been the case. Using the same sample as before, over all post-election timeframes (one day, three months, one year), the average S&P 500 return was greater when Democrats gained seats than when Republicans did.[ix]

Midterm Election Outcomes and Stock Performance		
1930-2014		
Party Gaining Seats:	**Republicans**	**Democrats**
Number of Years	10	10
S&P500 PRICE CHANGE (%)		
First Day		
Average	0.27	0.83
Standard Deviation	1.89	2.45
Percent Up	70	80
Percent Down	30	20
First 3 Months		
Average	4.01	7.02
Standard Deviation	7.30	6.60
Percent Up	80	80
Percent Down	20	20
First 12 Months		
Average	10.95	14.45
Standard Deviation	10.61	21.64
Percent Up	90	90
Percent Down	10	10
None of the GOP-Dems differences are statistically significant.		
Sources: Bloomberg, Wikipedia		

While the timeframe following the elections has historically been positive, policies or events that unfold over the next year could have a meaningful impact on the markets.

Outlook

US stocks continued their strong run in the third quarter, with the S&P 500 on pace for its 10th straight year of gains dating back to 2009. International stocks also recorded positive returns over this stretch but have not seen the same level of upside participation, particularly with the disappointing results seen so far in 2018. One key driver has been the contribution from growth-style stocks and technology companies, which are less represented in international developed markets. With the divergence across global regions, the US market rose to represent over 55% of the MSCI ACWI global index in the third quarter, the highest level for US stocks since the early 1980's.[x]

Given market results since the financial crisis, it is reasonable for investors to question the value of international equity diversification. Taking a historical perspective, leadership has tended to shift between US and international markets over time, supporting global allocations. For example, during the early 1980's, the US market rose to comprise roughly 60% of the global equity index. However, by the latter half of the 1980's the Japanese market surged ahead, and US stocks declined to represent only 29% of the global index. More recently, the US stock market comprised 55% of the global market in late 2002-early 2003, which corresponded to a strong run for international markets over the 2002-2007 period.

In the fixed income markets, there are also uncertainties with the Federal Reserve shifting away from its accommodative stance and raising interest rates. While the US economy appears to be on solid footing, the impact of a shift in monetary policy, global trade frictions, and the outcome of Brexit are among the risks on the horizon. Below we have highlighted some additional market tailwinds and headwinds.

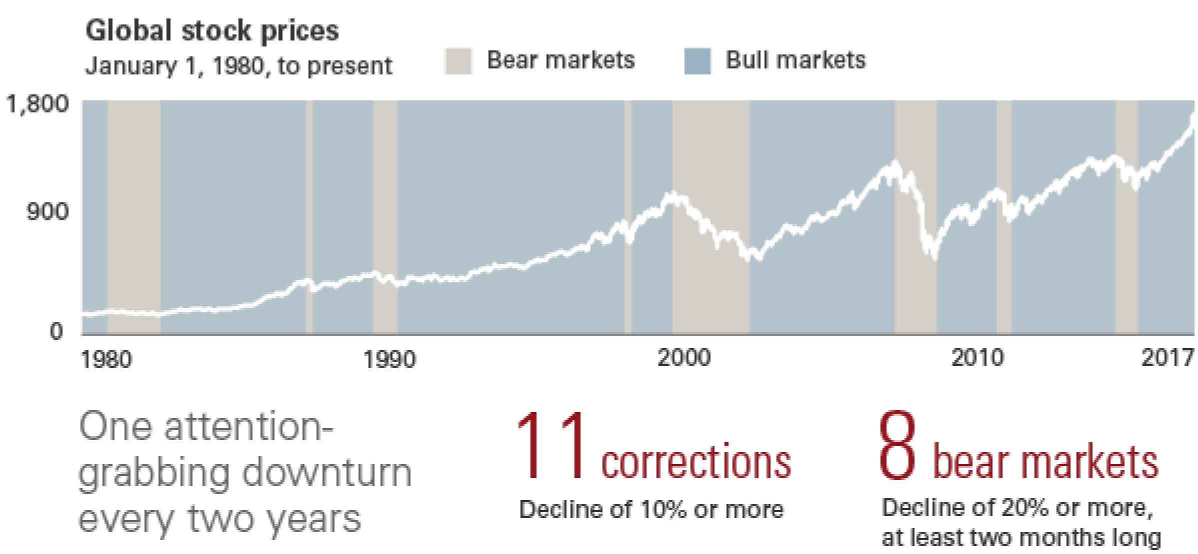
Tailwinds

U.S. Economic Growth
Strong Labor Market
Fiscal Stimulus
Strong Capex
Rising markets and leading indicators
High consumer/business confidence
Healthy Corporate Balance Sheets
Monetary policy still relatively accommodative
Moderate inflation growth

Headwinds/Concerns

Peaking Earnings Growth/Valuations
Wage inflation impacts earnings
Rising deficits/debt and overheating economy
Trade/Tariffs/protectionism
Immigration and impact on jobs/wages
Desynchronized global growth/populism
Strong U.S. dollar
Flattening yield curve
Political fissure/mid-term elections
Long in the tooth bull market?

October has gotten off to a difficult start. Concerns about the trajectory of interest rates coupled with reduced global growth expectations and trade uncertainty have impacted all markets. Growth stocks, the leaders not just in 2018 but over the past 10 years, have been particularly impacted as they have experienced the most gains. We can never know if a setback in the markets is temporary or the start of something more lasting. Historically, October has been a challenging month for stocks making the timing of the downturn understandable from a seasonal standpoint. As shown below, corrections are normal and the lack of a correction in 2017 was an anomaly.



Source: Vanguard analysis based on the MSCI World Index from January 1, 1980, through December 31, 1987, and the MSCI All Country World Index thereafter. Both indexes are denominated in U.S. dollars. Our count of corrections excludes those that turned into a bear market. We counted corrections that occurred after a bear market had recovered from its trough even if stock prices hadn't yet reached their previous peak.

We remain positive on the economy and the equity markets despite recent market activity, as fundamentals and business confidence remain high, valuations are not excessive (even more so post the pullback), and stimulus remains as a tailwind. We are most mindful of the move towards less liquidity in the system and the impact that will have in the future. The Fed is raising rates as the economy is doing well, a tough balancing act as noted above. Portfolio diversification should take on greater importance as we move forward. We do expect returns to moderate over the coming years with equity returns more likely to be in the mid-single digits.

We have benefited by tilting portfolios to growth stocks over the last few years and this has paid dividends. We continue to like the innovative companies that our managers are finding but these companies are often the hardest hit in a risk-off environment. Longer-term, we believe it is worth enduring the bumpier ride. We still favor the US over international investments but are becoming a bit more positive about international and emerging market stocks given their recent underperformance and relative valuations.

If we are later in the cycle, we believe that portfolios will benefit with some risk reduction through the addition of some alternative sources of return. We are updating our portfolios to adjust for this possibility. We are making some changes to our fixed income positioning in light of both the forecasted rate hikes and improved returns now available in shorter-term, high quality bonds vs. higher yielding bonds.

PRW Wealth Management News

We are pleased to announce the newest member of our team, Stephanie Manchon. Stephanie joins as Senior Support Advisor and brings over 13 years of client service, investment management, insurance and financial planning experience to the firm. She lives in Braintree with her husband and two active young children.

Ted Dziuba just completed his 10 year anniversary with PRW and we are thrilled to have seen his expertise in the insurance area expand and grow. Teddy has become a resource to both those in the firm and to other professionals nationwide.

Janice Forgays, Estate and Wealth Management Counsel, accepted the request to re-join the Vermont Law School Board of Directors, having had 11 years of prior service on the Board.

As always, please contact us if there have been any changes to your financial situation, your investment objectives, or your instructions concerning your account(s).

We look forward to seeing and working with you in the months ahead. Thank you.

Sincerely,

William A. Payne　　Richard A. Renwick　　Elliot B. Herman

Index Definitions

MSCI ACWI (All Country World Index): A free float-adjusted capitalization weighted index that is designed to measure the equity performance of countries considered to represent both developed and emerging markets.

S&P 500®: An unmanaged index that is generally considered representative of the US equity market, consisting of 500 leading companies in leading industries of the US economy (typically large cap companies) representing approximately 75% of the investable US equity market.

Russell 2000: An unmanaged index that measures the performance of the small cap segment of the US equity universe. It is a subset of the Russell 3000 Index based on market capitalization.

Russell 3000 Growth: An index that measures the performance of the growth segment of the US equity universe. It includes those Russell 3000 companies with higher price-to-book ratios and higher forecasted growth rates.

Russell 3000 Value: An index that measures the performance of the value segment of the US equity universe. It includes those Russell 3000 companies with lower price-to-book ratios and lower expected growth rates.

MSCI World ex USA: An index that captures large and mid-cap representation across 22 of 23 Developed Markets (DM) countries – excluding the United States. With 1,020 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI Emerging Markets: A free float-adjusted, market capitalization index that is designed to measure the equity market performance of countries considered to represent emerging markets.

FTSE NAREIT All Equity REIT: A broad measure of the performance of publicly traded real estate securities, such as real estate investment trusts (REITs) and real estate operating companies.

Bloomberg Barclays Global Aggregate: An index of global investment grade debt from twenty-four local currency markets including treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers. The index also includes Eurodollar, Euro-Yen, and 144A Index-eligible securities, and debt from five local currency markets.

Bloomberg Barclays High Yield Bond: An index measuring the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. The index excludes emerging market debt.

Bloomberg Barclays US Aggregate Bond: An index covering the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The index includes bonds from the Treasury, Government-Related, Corporate, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS sectors. US Agency Hybrid Adjustable Rate Mortgage (ARM) securities were added to this index on April 1, 2007.

Bloomberg Commodity: A broadly diversified index that allows investors to track futures contracts of physical commodities traded on US exchanges. The component weightings are determined by several rules designed to ensure diversified commodity exposure.

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i Unless otherwise indicated, all index returns are from FactSet
ii Source: OECD. "Interim Economic Outlook – High Uncertainty Weighing on Global Growth (Sept. 2018)"
iii Source: Bureau of Economic Analysis (Federal Reserve Bank of Atlanta GDP forecast as of 10/1/18)
iv Source: FactSet
v Source: Marketwatch "Here's how stocks perform around midterms, in one chart (Sept 2018)"
vi Source: Marketwatch "Will midterm elections sink the stock market? Here's what history says (Sept 2018)
vii Source: Russell Investments "Do Markets Care About U.S. Midterms (Oct 2018)"
viii Source: Fivethirtyeight.com as of Oct 12 2018
ix Source: Forbes "Why Investors Shouldn't Speculate on Midterm Elections (Aug 2018)"
x Source: Vanguard. "Global Equities: Balancing Home Bias and Diversification (Feb. 2014)"