SC Capital Advisors
Strategic, Custom Wealth Solutions
A fee-only, fiduciary Registered Investment Advisor

Investor Insights

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3rd Quarter 2018

We will continue to ignore political and economic forecasts which are an expensive distraction for many investors . . ."

—Warren Buffett

U.S. asset classes win

Asset Class Returns Q3 2018 (9-30-2018)

	US Large	US Mid	US Small	REITs	Intl Large	Intl Small	Em Mkts	Bonds
Q1	-0.7%	-0.8%	-0.1%	-5.9%	-1.5%	0.2%	1.4%	-1.5%
Q2	3.6%	4.3%	7.8%	7.8%	-1.2%	-1.6%	-8.0%	-0.2%
Q3	**7.4%**	**3.9%**	**3.6%**	**0.7%**	**1.4%**	**-0.9%**	**-1.1%**	**0.0%**
YTD	10.5%	7.5%	11.5%	2.1%	-1.4%	-2.2%	-7.7%	-1.6%

Indexes: US Large, Russell 1000; US Mid, S&P MidCap 400; US Small, Russell 2000; REITS, DJ US Real Estate; Intl Large, MSCI EAFE; US Small, MSCI EAFE SMall Cap; EM, MSCI Emerging Markets; Bonds, BBgBArc US Agg Bond. Source: Morningstar.

The broader asset class returns, right, seem to be indicating that, in the minds of investors, the U.S. is winning the trade war and on the economic front. U.S. Large and Small Cap stocks posted double digits returns through September 30 while Mid Caps and REITs were positive. All International asset classes were in negative territory with Emerging Markets down the most at -7.7%. Although flat for the 3rd quarter, the Barclays Aggregate Bond Index was down -1.6% year-to-date through September 30.

Asset Class Returns October through 10/12/2018

	US Large	US Mid	US Small	REITs	Intl Large	Intl Small	Em Mkts	Bonds
Oct - 2018	-5.2%	-7.3%	-8.8%	-5.7%	-6.2%	-6.7%	-6.4%	-0.5%

Storms clouds, however, blew in for the month of October. The 10-year Treasury yield hitting a 7-year high, fears of slowing economic growth in China, and unresolved trade agreements with China led to a broad sell off in global equities in the second week of October. We also think that investors are simply rebalancing portfolios after a couple of years of very strong returns for stocks. Our broader asset class returns table for the month of October through Friday the 12th shows that U.S. Mid and Small Cap stocks erased nearly all of their previous gains for the year, and International and Emerging Markets widened their negative performance gap relative to U.S. Large Cap stocks.

Yields rise

Higher yields provide a headwind for stocks on two fronts. Yields on short term Treasuries are now higher than the dividend yield on the S&P 500 index. This creates additional competition for capital from yield-hungry investors. Also, stocks are valued based on various discounted cash flow models which have interest rate assumptions in the denominators of the equations. Thus, higher interest rates theoretically reduce stock valuations, although interest rates are still quite low historically.

Treasury Yield Curve

Date	1 mo	3 mo	6 mo	1 yr	2 yr	3 yr	5 yr	7 yr	10 yr	20 yr	30 yr
1/2/2018	1.29	1.44	1.61	1.83	1.92	2.01	2.25	2.38	2.46	2.64	2.81
10/12/2018	2.14	2.28	2.44	2.66	2.85	2.93	3.00	3.09	3.15	3.25	3.32
% Change	65.9%	58.3%	51.6%	45.4%	48.4%	45.8%	33.3%	29.8%	28.0%	23.1%	18.1%

Source: U.S. Department of the Treasury

The table above compares the U.S. Treasury yield curve on January 2 and October 12 of this year. Yields have risen significantly across all maturities and flattened, with longer maturity yields rising less than short maturities. An inverted yield curve, i.e. long maturities lower than short, has often been a precursor to a downturn in the economy. The yield curve had been steepening up until the October selloff and subsequent flight to quality pushed long rates down.

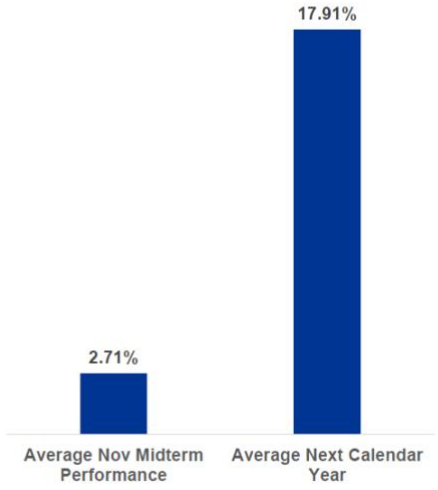
The U.S. has successfully renegotiated trade agreements with multiple trading partners including the EU, Canada, and Mexico. No new agreements have been made with China yet, and this uncertainty remains a headwind to global stock markets. The standoff between the U.S. and China will likely remained stalled until after the midterm elections. The Trump administration would like to reach an agreement prior to the elections, but China would like to see if any power shifts occur because of the elections. So this will likely remain an overhang through November.

While we still see strong U.S. and global economic and corporate earnings conditions being positive for stocks, rising macro uncertainty can lead to a wider range of outcomes. Thus, we will continue to build and maintain resiliency in our portfolios by owning high quality companies and a bias toward U.S. asset classes. Our focus on companies with barriers to competition (economic moats) and reasonable valuations have paid off significantly. The U.S. satellite or individual stock segment of our portfolios has performed better than other segments over the last two years with exception of the Momentum Factor ETFs. However, during the October downturn, our U.S. individual stocks also performed significantly better than all other segments including the Momentum Factor ETFs. Many people see the ownership of individual stocks as being "riskier" than owning mutual funds or ETFs. With our focus on quality and price, we are seeing that the opposite is true, although we can make no assurances that this will continue in the future. Our strategy of low duration, high quality for our fixed income portfolios has paid off well relative to longer durations and poorer credit quality.

Ignore politics

2. Midterm Elections and US Stock Market Performance

US stock performance and midterm elections



US stock market performance

Midterm Election Year	Nov US Stock Performance		Next Calendar Year, US Stocks	
1926	Nov-26	3.47	1927	37.49
1930	Nov-30	-0.89	1931	-43.34
1934	Nov-34	9.42	1935	47.67
1938	Nov-38	-2.73	1939	-0.41
1942	Nov-42	-0.21	1943	25.90
1946	Nov-46	-0.27	1947	5.71
1950	Nov-50	1.69	1951	24.02
1954	Nov-54	9.09	1955	31.56
1958	Nov-58	2.84	1959	11.96
1962	Nov-62	10.86	1963	22.80
1966	Nov-66	0.95	1967	23.98
1970	Nov-70	5.06	1971	14.30
1974	Nov-74	-4.89	1975	37.23
1978	Nov-78	2.15	1979	18.61
1982	Nov-82	4.04	1983	22.56
1986	Nov-86	2.43	1987	5.25
1990	Nov-90	6.46	1991	30.47
1994	Nov-94	-3.64	1995	37.58
1998	Nov-98	6.06	1999	21.04
2002	Nov-02	5.89	2003	28.68
2006	Nov-06	1.90	2007	5.49
2010	Nov-10	0.01	2011	2.11
2014	Nov-14	2.69	2015	1.38
Avg		2.71		17.91

Source: Morningstar, as of 8/31/18. Performance is historical and does not guarantee future results. Data calculated using the IA SBBI US Large Stock TR USD Index.

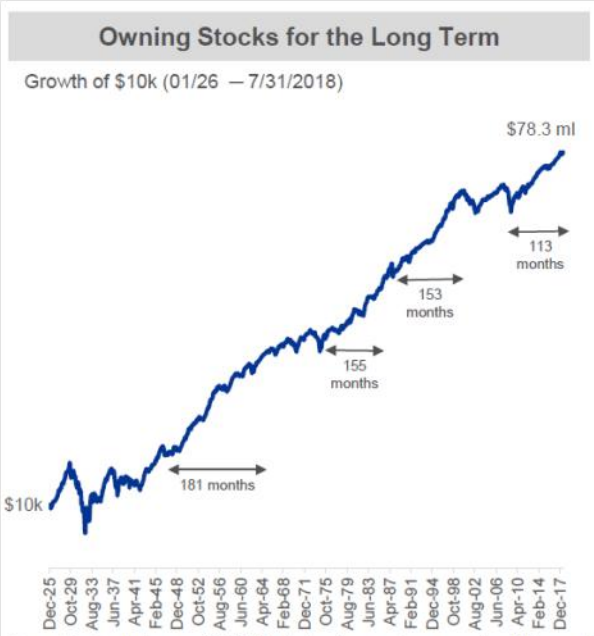
We thought it was a good time to recycle a quote at the beginning of this piece by legendary investor Warren Buffett who has deployed capital over the decades no matter who is in the White House or which party controls Congress. It seems the polarization and divisiveness between political parties has never been so extreme. The Congressional confirmation process culminating in Q3 of President Trump's nominee Judge Brett Kavanaugh turned out to be an ugly partisan spectacle. President Trump is certainly a controversial, polarizing figure that has contributed to the nasty political climate. However, if you are an investor who thought the world would come to an end under President Trump and left the market, you would have paid a painful price as the market has soared since the November 2016 election. Since November 1, 2016, though end of Q3

2018, the Dow Jones Industrial Average, S&P 500, and NASDAQ composite indexes are up 53%, 42.5%, and 58%, respectively. During this period, there has never been a better lesson that politics should rarely, if ever, be a consideration in an investment strategy.

If you are worried about the mid-term elections coming up and what might happen to the stock market, data suggest you shouldn't be. According to the Blackrock, the average November midterm performance for stocks has been 2.71%, and the following calendar year after a midterm election has been almost always positive (see above chart). Only two years since 1926 have been down years for the broader U.S. stock market following a midterm election.

Longest bull run?

In late August, cable news made a big deal about the longest bull market in history for stocks without a 20% correction, based on daily closing prices. But if you use month-end returns, Blackrock points out that this has not been the longest bull market in history. Month-end returns are often the industry standard for calculating returns and risk, particularly in client communications. Through the end of July, the current bull market for stocks without a 20% correction was only the 4th longest in history based on month end data. Three other periods were longer with a greater total return percentage. All 4 periods had a maximum drawdown of -15% or greater during the bull market, but not 20%.



Source: Morningstar Inc., as of 7/31/2018. Past performance is no guarantee of future results. It is not possible to invest directly in an index

Longest Bull Markets (Month-end Returns)

Date	Months	Return	Max Drawdown
11/46-12/61	181	946%	-15%
09/74-08/87	155	845%	-16.5%
11/87-8/00	153	816%	-15.4%
2/09-7/18	113	367%	-16.3%

Outlook

The market's focus going forward will be on the midterm elections and the 4th quarter earnings season, which we think will be quite positive for our portfolio holdings. The January downturn in stocks occurred when the Morningstar price-to-fair value (PFV) ratio hit 1.11, meaning stocks in the Morningstar coverage universe were moderately overvalued. The ratio subsequently dipped to 0.97 in early April.

The same ratio closed September at 1.03, lower than the January peak. It now stands at 0.96. The current PFV ratio for our top 40 wide and narrow moat stock and ADR holdings stands at 0.81. This includes Apple Inc. (AAPL) which has a PFV

ratio of 1.11, but we discount this valuation as Berkshire Hathaway is building a large position in the stock and the company has an extremely liquid balance sheet and high operating cash flows.

We would tend to increase cash and bond positions for client accounts and potentially include some equity index put options as a hedge should the PFV ratio approach the 1.10 mark once again. We will also remain vigilant for signs of slowing economic conditions, which we do not see presently. We think the weakness in Emerging Markets stocks has created an opportunity. Most of our portfolios include EM ETFs, and we plan to maintain or potentially increase these positions. EM stocks are trading at a large discount to Developed Market stocks, and, according to Blackrock, strong economic conditions in most EM countries is just beginning to translate into earnings per share growth of individual companies.

Please let us know if you have any questions.

—Dana L. Crosby, CFA, CFP®, Rick Stein, & Scott Wilson

ETF Returns

For the period ending 09-30-2018

Name	Ticker	YTD	1 Month	3	12 Months	3 Year	5 Year	10 Year
U.S. Large Cap								
iShares Russell 1000	IWB	10.28	0.38	7.37	17.66	16.92	13.51	11.93
iShares Edge MSCI USA Momentum Factor	MTUM	**16.30**	0.92	8.72	25.73	21.85	18.57	-
iShares Edge MSCI USA Quality Factor	QUAL	10.15	1.07	8.74	19.24	16.52	14.17	-
PowerShares S&P 500 Low Volatility ETF	SPLV	5.37	-0.36	5.00	10.42	13.64	12.17	-
Vanguard High Dividend Yield ETF	VYM	4.02	0.40	5.67	10.70	15.08	12.02	10.97
U.S. Mid Cap								
SPDR® S&P MidCap 400 ETF	MDY	7.25	-1.07	3.80	13.95	15.35	11.57	12.18
PowerShares S&P MidCap Low Volatil ETF	XMLV	8.43	-0.57	3.74	13.27	16.59	14.76	-
PowerShares DWA Momentum ETF	PDP	**15.50**	-0.37	7.69	22.68	14.51	12.37	12.39
PowerShares High Yld Eq Div Achiev™ ETF	PEY	3.68	-0.08	2.88	8.70	16.36	14.14	9.28
U.S Small Cap								
iShares Russell 2000	IWM	**11.51**	-2.32	3.57	15.17	17.19	11.11	11.12
PowerShares S&P SmallCap Low Volatil ETF	XSLV	8.33	-2.72	2.90	9.95	17.64	14.03	-
REITs								
iShares US Real Estate	IYR	1.56	-2.84	0.29	4.12	8.40	8.84	6.99
International Large Cap								
iShares MSCI EAFE	EFA	-1.36	0.97	1.52	2.35	8.93	4.26	5.00
iShares Edge MSCI Intl Momentum Factor	IMTM	1.11	1.60	2.70	3.17	9.93	-	-
PowerShares DWA Developed Mkts Mom ETF	PIZ	**0.07**	-2.59	-0.15	2.63	8.55	3.67	7.24
iShares Edge MSCI Intl Quality Factor	IQLT	1.39	0.44	2.78	4.40	9.77	-	-
PowerShares S&P Intl Dev Quality ETF	IDHQ	**-1.49**	-0.35	-3.92	1.63	9.16	5.98	6.05
iShares Edge MSCI Min Vol EAFE	EFAV	1.80	0.80	2.35	5.12	8.63	6.88	-
iShares International Select Dividend	IDV	0.28	1.01	2.81	1.50	10.31	2.68	6.06
International Small Cap								
iShares MSCI EAFE Small-Cap	SCZ	**-2.28**	-0.72	-0.73	2.87	11.97	7.75	9.17
WisdomTree International SmallCp Div ETF	DLS	-5.11	0.21	-0.54	-0.73	12.27	6.66	8.66
Emerging Markets								
iShares MSCI Emerging Markets	EEM	-8.31	-0.58	-0.95	-2.12	11.64	3.06	4.32
PowerShares S&P Em Mkts Low Volatil ETF	EELV	1.13	2.10	5.30	5.91	9.00	0.81	-
PowerShares DWA Emerging Markets Mom	PIE	**-12.01**	-5.65	-10.17	-3.92	6.92	1.00	3.69

Data source: Morningstar