GPM | GRIFFIN PORTFOLIO MANAGEMENT CORP.

30500 Northwestern Hwy., Suite 313
Farmington Hills, MI 48334
(248) 865-0518
Fax (248) 865-0662
grifport.com

Fourth Quarter 2018 Review *January 3, 2019*

- **Stocks: broadly lower in the fourth quarter (Q4)**; S&P 500: -13.7%. Full year: -4.5%.
- **Treasuries: rebounded in Q4 following four negative quarters**; 10-Year Yield: 2.69% from 3.06% @ Sep-30.
- **Corporate Bonds: modest Q4 gains**; lagged Treasuries.
- **High-Yield Bonds: lost substantial ground in Q4** – turned full year red; followed stocks in risk-off selling.
- **U.S. Real GDP: +3.4%** (Sep '18 quarter); from +4.2%, +2.2%, +2.3%, +2.8% in the prior four Q's.

Markets Summary

From new all-time highs in September, stocks fell hard in the fourth quarter (Q4) and especially during December. Sentiment turned more cautious driven by growing uncertainty from continuing trade friction and the resulting drag on global growth; confusion over U.S. Fed rate policy; disgust with U.S. politics and Trump; Brexit, and dysfunctional Eurozone leadership – a lot to digest for sure. Diminished investor confidence is most evident in recent heavy selling of risk-assets, i.e.; commodities, stocks and eventually, high-yield bonds. U.S. Treasury bonds rebounded as yields quickly fell to the lowest level since spring on a flight to quality and a broadening belief by some bond investors that additional Fed rate hikes are on hold for now because the economy won't be solid enough to support steady increases.

Unable to compartmentalize the elements of this uncertainty confluence, some investors decide to sell stocks. The sharpest decline occurred in December, which we believe added a wave of year-end tax-loss selling and downward price pressure to the normal ebb and flow of financial markets which **showed early signs of capitulation**.

	% Below	% Return for the Period			Average Annual % Returns				Income
Reference Index Fund	1 yr High	Q-4 '18	2018	2017	3 Yrs	5 Yrs	10 Yrs	15 Yrs	Yield %
Short-Term Treasury Bond	0.8	1.4	1.4	0.4	0.9	0.8	1.1	2.1	2.5
Intermediate-Term Treasury Bond	1.4	2.8	1.0	1.6	1.3	1.9	2.4	3.7	2.6
Intermediate-Term Investment Grade Bond	3.7	1.1	-0.5	4.3	2.6	3.0	5.8	4.6	3.8
High-Yield Bond	8.7	-4.4	-2.9	7.1	5.0	3.7	9.2	5.9	6.8
S&P 500 Stock	14.8	-13.6	-4.5	21.7	9.1	8.3	13.0	7.6	1.9
Small-Cap Stock	20.4	-18.4	-9.4	16.1	7.5	5.1	13.4	8.5	1.4
Total International Stock	22.7	-11.7	-14.4	27.4	4.5	0.9	6.3	5.1	3.1

Data is for Vanguard funds and returns include reinvested income. Income/dividend yield shown is SEC format.

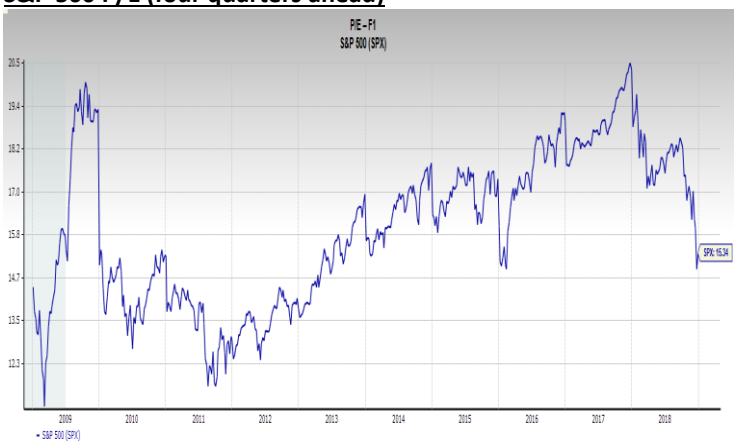
Looking ahead, we believe real and expected trade friction and the resulting global growth drag can be lessened over the next several months and quarters. Longer-term positives should come from the U.S. proactively pursuing trade and competition policies that protect U.S. companies property ownership and control rights and their industrial capabilities, technology and intellectual property while opening market access. We think Fed-Chief Powell will back away from further rate hikes for a while until global growth reaccelerates. The Fed has hiked nine times since December 2015 and the U.S. is feeling the trade driven deceleration in global growth. A wait-and-see Fed has to be influenced by difficult to ignore disgust with and diminished confidence in U.S. political leadership. Eventually, Brexit will be resolved and broader Europe will move on – continuing to grow slowly, while the U.S., China and a few other countries lead global growth at Europe's expense.

Corporate earnings (S&P 500) should be up more than 25% in 2018 and stock prices fell 15% in Q4. The market has reset to a very attractive valuation level. S&P 500 revenue and earnings (EPS) are expected to grow more than 5% in 2019, resulting in a price earnings ratio (P/E) of 14.4X – the lowest since early 2013. Some secular growth companies, including those owned by GPM, are now priced at very compelling levels that should reward long-term investors. We think the stock market pullback has created a large gap between solid underlying business fundamentals and bearish sentiment reflected in recent price action. While the recent rear view is bearish, lower prices and attractive valuations setup a bullish forward view.

When stock market sentiment turns bearish, *it's worthwhile to distinguish between how our companies perform as businesses and how their stocks behave*. Our 29 portfolio companies are doing well (not perfect) and continued a trend of strong results in their most recent reported quarter. On average, their revenue increased 9.8% and earnings (EPS) grew 26.7% from a year ago. Average revenue was about $12 billion in the quarter or close to $50 billion annually. We expect healthy sales and earnings growth from our companies in 2018 and 2019. Our stocks fell hard with the broader market. *We remain very confident in the companies we own and their ability to continue adapting, competing successfully and rewarding long-term shareholders like GPM – our clients and employees.*

Sharp market pullbacks never feel good to stockholders. This one has surely taken away some froth. Notably, while advancing nicely from the financial crisis lows set in March of 2009, the SP500 has pulled back more than 9% six times, including 16% in '10; 19% in '11; 12% in '15/early '16 and 10% in early '18, followed by new highs in September and the current pullback of nearly 20% measured at December's low. The broader stock market has also seen multiple pullbacks in the range of 5% along the way (see right chart below).

S&P 500 P/E (four quarters ahead)



Notable S&P 500 declines from 2009

- ✓ OECD growth forecasts for next year have been revised down for most of the world's major economies. In late November, global GDP was expected to expand 3.5% in 2019 vs 3.9% forecast in May's Outlook. U.S. tariffs and continuing trade friction are cited as the key issues. With slower expansion evident in recent data and rising bearish sentiment, global economists will continue to revise their forecasts to reflect slower growth expectations.
- ✓ December's ISM U.S. manufacturing report showed slower growth into year-end.
- ✓ Q4 U.S. corporate earnings and business conditions commentary should be OK, but will likely reflect a bit more caution than we've seen the past several quarters due in part to the negative sentiment factors cited above. Expectations have come down, with Q4 EPS now expected to rise 12.3%, revised down from +15.9% after Q3 results.

S&P 500 Stock Index

High-Yield Bonds

10 Year Treasury Yield: 3.69% -37 bps

Sector Allocation Breakdown	
Technology:	26.0%
Industrials:	24.2%
Healthcare:	15.4%
Financial Services:	15.2%
Consumer Defensive:	7.7%
Consumer Cyclical:	5.6%
Basic Materials:	4.0%
Real Estate:	2.1%
	100%

# of Cos. that Raised Dividend	
Fourth Quarter:	*6*
Year-to-date 2018:	*25*

P/E 5-year average:	20.4X
P/E trailing 12 months:	18.0X
P/E forward 12 months est:	16.0X

Market-Cap Weighting:	
Large-cap:	**~81%**
Mid and small:	**~19%**

Above is approximate @ quarter-end.

Like the broad market, ***GPM stock portfolios lost ground in the fourth quarter*** *to turn the full year negative, following a strong 2017.*

Our long-term growth (LTG) accounts are normally invested 100% in stocks. Balanced accounts take a more conservative approach and hold stocks and bonds. LTG and balanced accounts hold the same stocks.

During the quarter we deployed new money opportunistically on the way down and up in a skittish/volatile market. We liquidated one stock after the company announced a significant acquisition which we viewed unfavorably. We also sold out of an industrial sector stock ETF. Sale proceeds covered the addition of one new stock and increases in size (bought more) of multiple core positions.

We like the businesses we own and now hold 29 stocks with an average dividend yield of 2.0% (highest since May 2016). Three GPM stocks pay no dividend (they surely could). 26 of our 26 dividend paying companies raised their cash dividend during 2018 by amounts ranging from 7% to 43%. Two companies hiked twice.

GPM Balanced Accounts

Balanced accounts lost ground in Q4, due primarily to the broad decline in stocks and high yield bonds (HYB). Our floating rate bonds posted slightly negative returns in the quarter, while our short duration corporate bonds gained. **High-yield bonds** lost substantial ground in Q4. For nearly two years through October high-yield bonds led all fixed income, but that changed in Q4 as broad-based risk reduction spilled over from stocks into the high-yield bond market. GPM's allocation to HYB is focused in the top quality half of that market, which looks attractive after yields and spreads quickly reset to the highest and widest levels in two years. Default rates are still low. We believe the Fed will back off the rate hike pedal and actually become data dependent in 2019.

As always, thank you for allowing GPM to serve as your investment manager and advisor. Do not hesitate to contact us to discuss your portfolio and other financial planning matters. Have a healthy and happy 2019.

Sincerely, the *GPM Team*

Two Strategies – One Foundation

Our Long Term Growth Strategy (100% stock) is centered around two core competencies - researching high quality companies and actively managing portfolios built with the individual stocks of those companies to deliver growth and income for our clients. We invest client portfolios in approximately 30 individual stocks of U.S. based industry leaders that compete and win around the world. We focus on high-ROE businesses with track records of delivering rewarding long-term growth in sales, earnings, cash flow, dividends, and ultimately stock prices. Our "GPM Grade" companies are built to adapt and thrive while generating growth in value and income for shareholders. *We add select stock ETFs to broaden diversification and/or target certain sectors that we believe have substantial upside potential*. Our approach gives us confidence to ride out market pullbacks and is well understood by our clients, who share our long-term view. GPM's focus list is comprised of a continuously refined group of about one-hundred leading companies that we follow closely.

Our Balanced Strategy takes a more conservative approach. We combine a solid foundation of GPM stocks with a well-diversified bond component to buffer risk and add income. *Balanced portfolios are flexibly managed and tailored to individual client risk*. Bond holdings include cash, investment grade floating rate and short-duration corporate and high yield bonds.

GPM's Balanced Portfolio Modeling Targets	
Strategy Model	***Target Allocation since September '17***
Balanced - Primarily Growth (BPG)	70% stocks and 30% bonds
Balanced - Growth and Income (BGI)	60% stocks and 40% bonds
Balanced - Primarily Income (BPI) GPM's lowest overall risk balanced model.	50% stocks and 50% bonds *All models subject to change at GPM discretion.*