# Quarterly Market Review

Third Quarter 2018

THE MILESTONE GROUP
Wealth Through Discipline

# Asset Class Performance

Third Quarter 2018

U.S. Large Stocks delivered the highest return of all asset classes in the third quarter of 2018, with a gain of 7.7%. In aggregate, U.S. Stocks outperformed Foreign and Emerging Market stocks as the prospect of trade wars dominated headlines. MLPs once again posted strong returns, up 6.8% during the third quarter.

In September, for the third time in 2018, the Federal Reserve increased the Federal Funds target range by 25 basis points. Even with short-term interest rates increasing and putting pressure on bond prices, short and intermediate term bond returns were relatively flat. The worst performing asset class, U.S. Government Long-Term bonds, delivered a -2.8% return as longer-term interest rates increased.

| Asset Class | Third Quarter 2018 | YTD | Past 1 Year | Past 10 Years* |
|---|---|---|---|---|
| U.S. Large Stocks: S&P 500 | 7.7% | 10.6% | 17.9% | 12.0% |
| Master Limited Partnerships | 6.8% | 4.6% | 2.5% | N/A |
| U.S. Large Value Stocks | 5.7% | 3.9% | 9.5% | 9.8% |
| U.S. Small Stocks | 3.6% | 11.5% | 15.2% | 11.1% |
| U.S. Micro Cap Stocks | 3.5% | 11.3% | 14.3% | 12.1% |
| High Yield Bonds | 2.3% | 2.5% | 3.1% | 8.9% |
| U.S. Small Value Stocks | 1.6% | 7.1% | 9.3% | 9.5% |
| Foreign Large Stocks | 1.4% | -1.4% | 2.7% | 5.4% |
| Commodities | 1.3% | 11.8% | 22.9% | -9.2% |
| Foreign Large Value Stocks | 1.3% | -3.3% | 1.9% | 4.8% |
| U.S. Real Estate | 0.5% | 1.8% | 4.3% | 7.8% |
| U.S. T-Bills / Cash | 0.5% | 1.3% | 1.5% | 0.3% |
| Corporate Bonds | 0.4% | -1.0% | -1.1% | 3.7% |
| U.S. Govt. Short-Term Bonds | 0.2% | 0.2% | 0.0% | 1.1% |
| U.S. Govt. Intermediate Bonds | -0.1% | -0.8% | -1.2% | 2.2% |
| Municipal Bonds | -0.2% | -0.4% | 0.3% | 4.8% |
| Foreign Hedged Govt. Bonds | -0.6% | 0.0% | 0.7% | 3.7% |
| U.S. Inflation Indexed Bonds | -0.8% | -0.8% | 0.4% | 3.3% |
| Foreign Small Value Stocks | -1.0% | -6.6% | -3.0% | 8.5% |
| Emerging Market Stocks | -1.1% | -7.7% | -0.8% | 5.4% |
| Foreign Small Stocks | -1.1% | -3.5% | 1.0% | 8.9% |
| Foreign Real Estate | -1.5% | -3.3% | 3.1% | 5.7% |
| U.S. Govt. Long-Term Bonds | -2.8% | -5.6% | -3.6% | 5.4% |

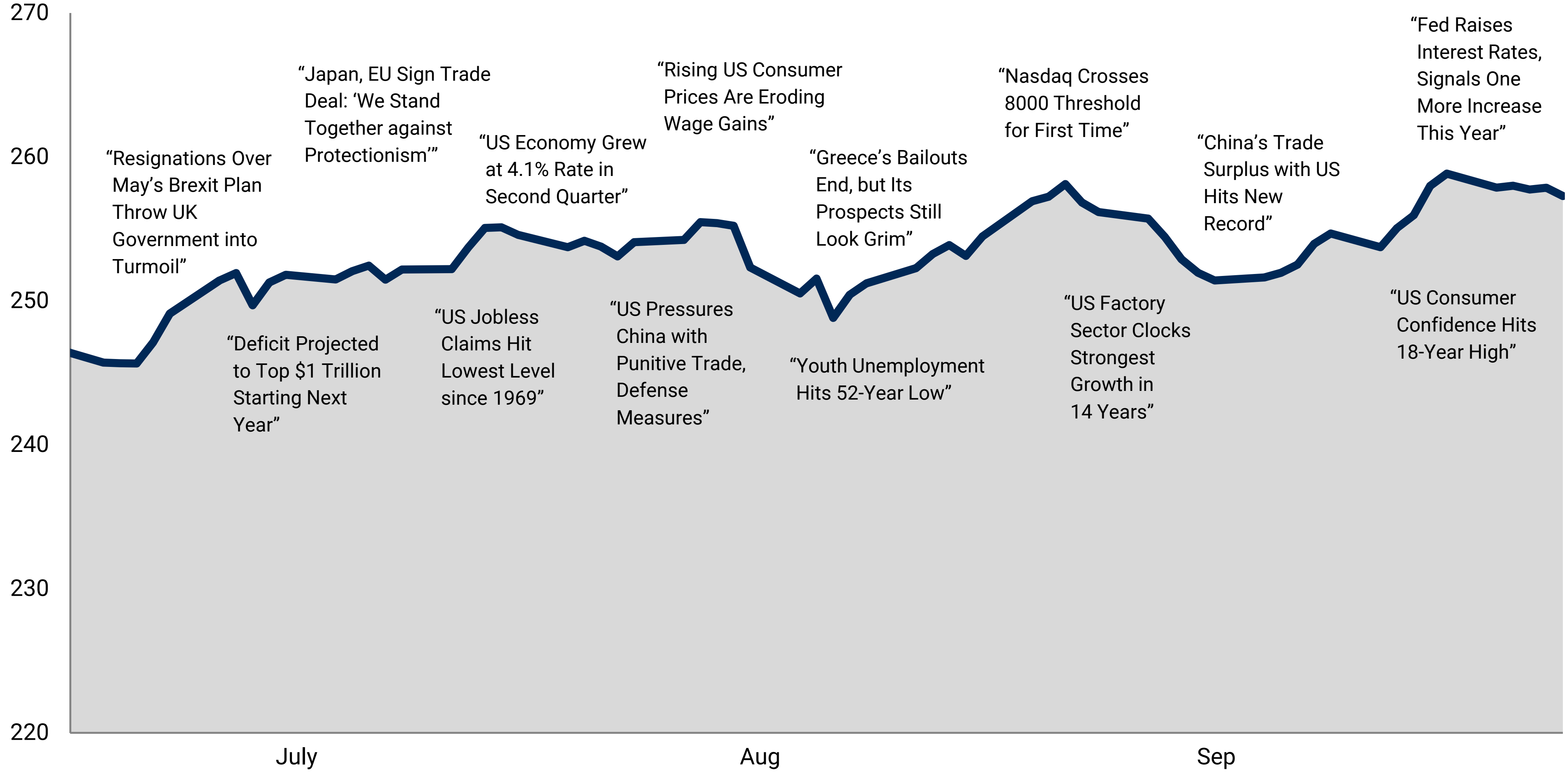
*Annualized

Source: Morningstar Direct. Data as of September 30, 2018

# World Stock Market Performance [1]

Third Quarter 2018

With selected headlines from Q3 2018



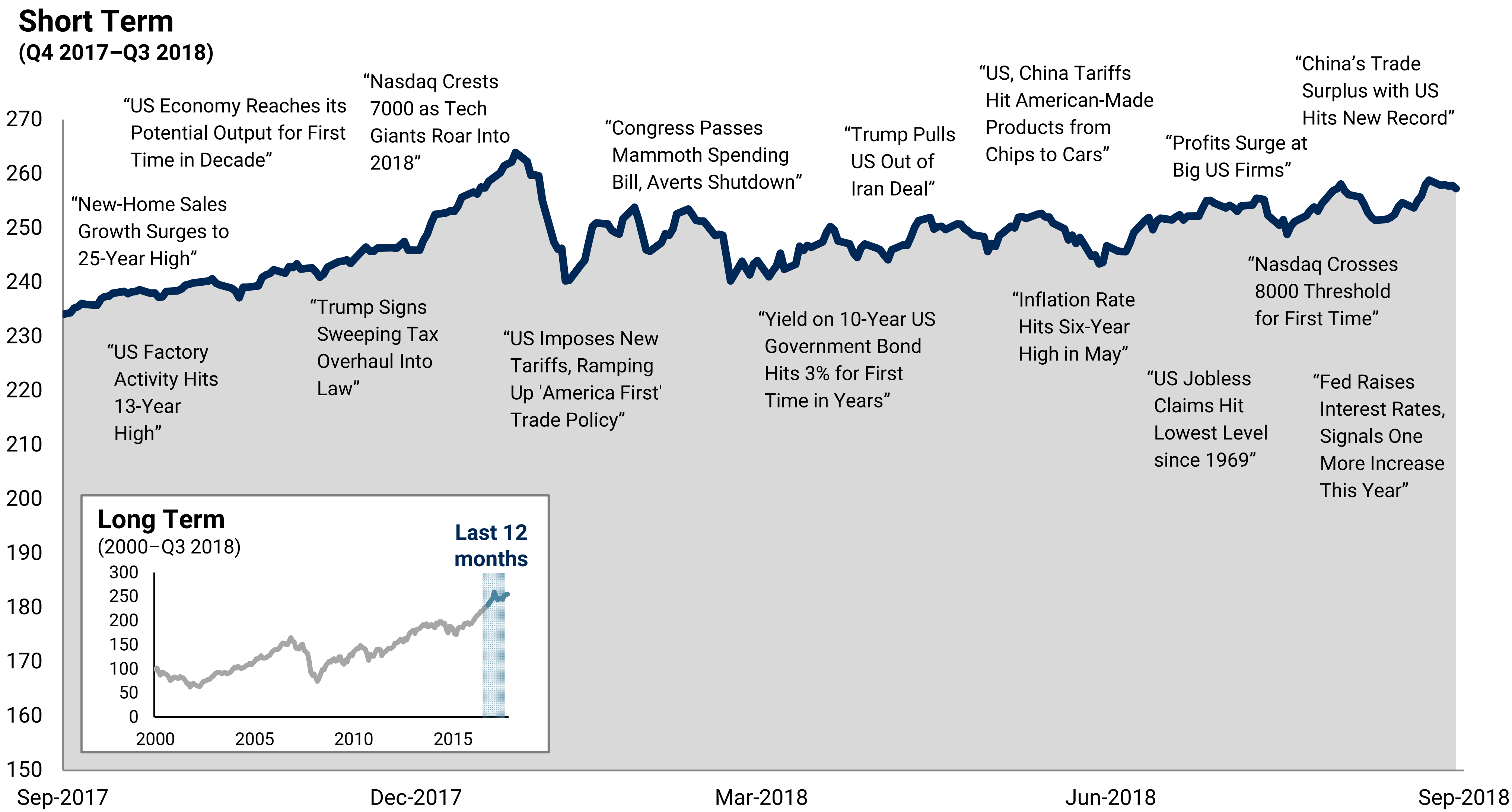

[1] MSCI ACWI Index [net div.]. MSCI data © MSCI 2018, all rights reserved. These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news. It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

Source: DFA Quarterly Market Review. Data as of September 30, 2018

# World Stock Market Performance [1]

Third Quarter 2018

With selected headlines for the past 12 months




[1] MSCI ACWI Index [net div.]. MSCI data © MSCI 2018, all rights reserved. These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news. It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

Source: DFA Quarterly Market Review. Data as of September 30, 2018

# Fixed Income Performance & Yield Analysis

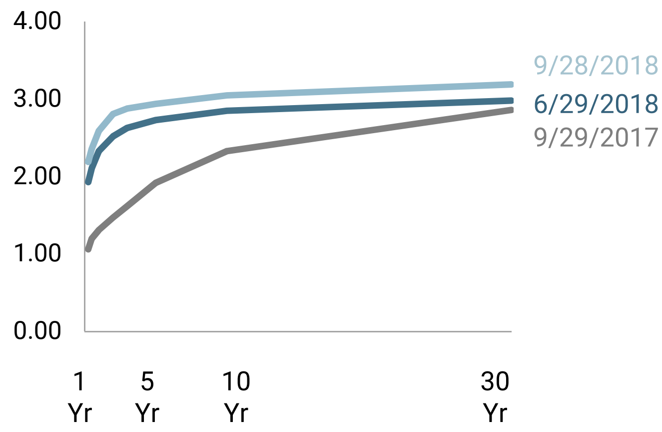
Third Quarter 2018

Interest rates increased in the US during the third quarter. The yield on the 5-year Treasury note rose 21 basis points (bps), ending at 2.94%. The yield on the 10-year Treasury note increased 20 bps to 3.05%. The 30-year Treasury bond yield rose 21 bps to 3.19%.

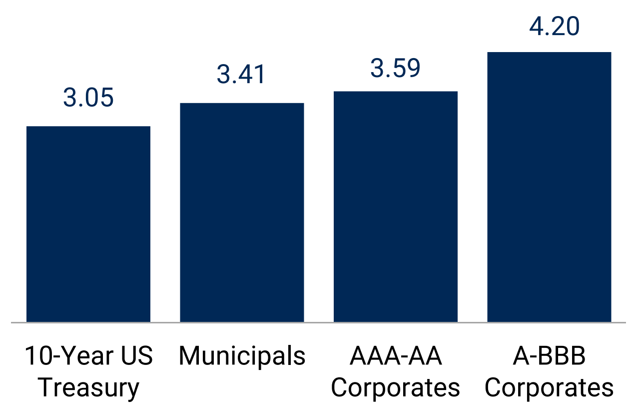
On the short end of the yield curve, the 1-month Treasury bill yield increased 35 bps to 2.12%, while the 1-year Treasury bill yield rose 26 bps to 2.59%. The 2-year Treasury note yield finished at 2.81% after an increase of 29 bps.

In terms of total return, short-term corporate bonds gained 0.71%, while intermediate-term corporates returned 0.80%. Short-term municipal bonds declined 0.11%, while intermediate-term munis dipped 0.06%. Revenue bonds (–0.16%) performed in line with general obligation bonds (–0.14%).

## US Treasury Yield Curve (%)[2]




## Bond Yields across Issuers (%)[3]




## Period Returns (%)[4]

*Annualized

| Asset Class | QTR | YTD | 1 Year | 3 Years* | 5 Years* | 10 Years* |
|---|---|---|---|---|---|---|
| Bloomberg Barclays US High Yield Corporate Bond Index | 2.40 | 2.57 | 3.05 | 8.15 | 5.54 | 9.46 |
| ICE BofAML US 3-Month Treasury Bill Index | 0.49 | 1.30 | 1.59 | 0.84 | 0.52 | 0.34 |
| ICE BofAML 1-Year US Treasury Note Index | 0.41 | 1.07 | 1.08 | 0.74 | 0.55 | 0.71 |
| FTSE World Government Bond Index 1-5 Years (hedged to USD) | 0.17 | 0.58 | 0.64 | 1.04 | 1.26 | 1.90 |
| Bloomberg Barclays US Aggregate Bond Index | 0.02 | -1.60 | -1.22 | 1.31 | 2.16 | 3.77 |
| Bloomberg Barclays Municipal Bond Index | -0.15 | -0.40 | 0.35 | 2.24 | 3.54 | 4.75 |
| FTSE World Government Bond Index 1-5 Years | -0.63 | -1.68 | -1.39 | 0.84 | -1.16 | 0.88 |
| Bloomberg Barclays US TIPS Index | -0.82 | -0.84 | 0.41 | 2.04 | 1.37 | 3.32 |
| Bloomberg Barclays US Government Bond Index Long | -2.82 | -5.71 | -3.50 | 0.78 | 4.41 | 5.45 |

One basis point equals 0.01%. Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Yield curve data from Federal Reserve. State and local bonds are from the S&P National AMT-Free Municipal Bond Index. AAA-AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA-AAA rated. A-BBB Corporates represent the Bank of America Merrill Lynch US Corporates, BBB-A rated. Bloomberg Barclays data provided by Bloomberg. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield). FTSE fixed income indices © 2018 FTSE Fixed Income LLC, all rights reserved. ICE BofAML index data © 2018 ICE Data Indices, LLC.

Source: DFA Quarterly Market Review. Data as of September 30, 2018

# Midterm Elections & Interest Rates

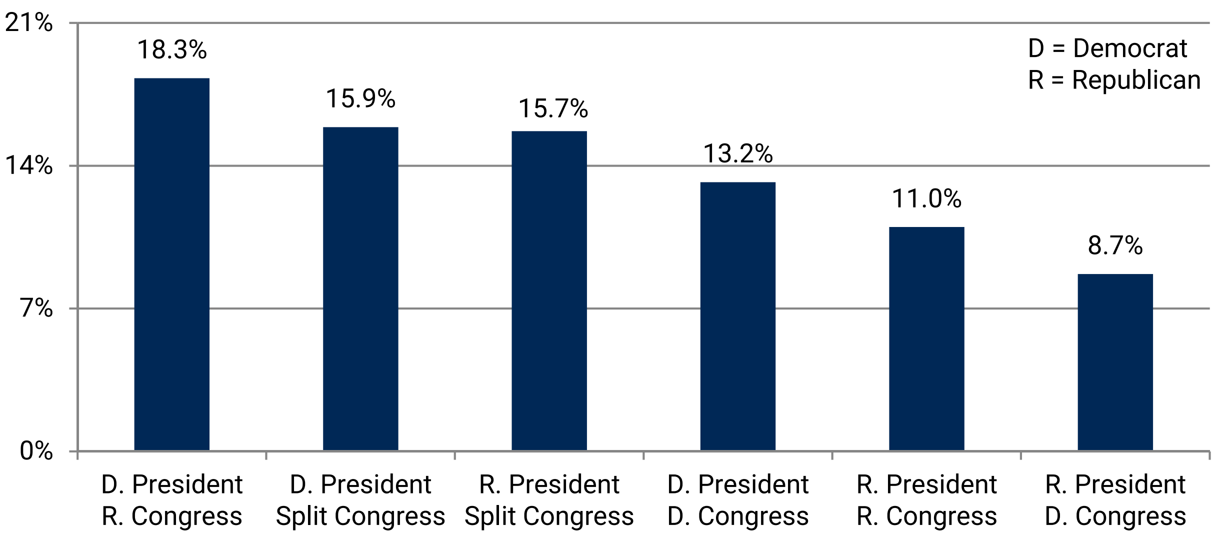


### Is Gridlock Good?

Despite a steady economy and reasonable global stock returns, many investors have mixed emotions about the upcoming midterm elections. Regardless of party affiliation, investors may seek to predict the election outcome and have the urge to make portfolio adjustments accordingly. One useful exercise is to review past investment results to gain some perspective. The results can be counterintuitive.

First, current predictions using prior election patterns and recent polling suggest that Republicans may lose seats in both the House and the Senate. However, this result should not be overly surprising since midterm elections are rarely kind to the political party of the sitting president. When reviewing midterm election statistics going back to 1934, on average, the president's party loses 27 seats in the House of Representatives and 4 seats in the Senate.[5] The number of lost seats often correlates with the president's approval rating. Typically, the party of the less popular president experiences the largest losses.

### Average S&P 500 Performance: Republican vs. Democrat Control[6]




In addition, the change in majority control of the House of Representatives occurs far less frequently, but this could be a significant 2018 election outcome[7].

A frequent question investors ask is which political leadership combination in Washington D.C. is best for the stock market. The data in the chart below might offer something for everyone and allows neither party a claim on better investment results given the historical record. In fact, better returns occurred in environments where no side enjoys complete control over the legislative and executive branches of government.

Some observers believe political landscapes that feature a balance of power have been stronger for investors because they lead to greater policy certainty. Passing new "game changing" legislation is more difficult when opposing views have to come together and find compromises.

If the makeup of congress shifts, future policy implications are increasingly uncertain. However, economic fundamentals remain strong supported by robust corporate earnings, solid business and consumer confidence and an unemployment rate at its lowest level in almost two decades.

### Rising Interest Rates and Stock Returns

The Federal Reserve started raising interest rates in December 2015 to normalize monetary policy during a period of solid economic expansion, declining unemployment and benign inflation. Amid this current tightening cycle, short-term interest rates experienced meaningful increases, which has led investors to worry about how this impacts the stock market. The conventional wisdom among investors seems to be that

Source: LPL Financial as of September 18, 2018 rising rates are a bad omen for stocks. Higher rates can dampen the pace of economic growth, but make bond yields more attractive than stocks. Yet the historical data doesn't show a pattern of falling stock prices when interest rates rise. As the graphic below illustrates, during the 11 rising rate cycles spanning over 50 years, stock market returns were positive in all but one instance. In fact, the returns across the 11 periods is in line with the 10% average return for stocks since 1926. The long-term evidence also supports a similar return relationship for foreign stocks as well.[8]

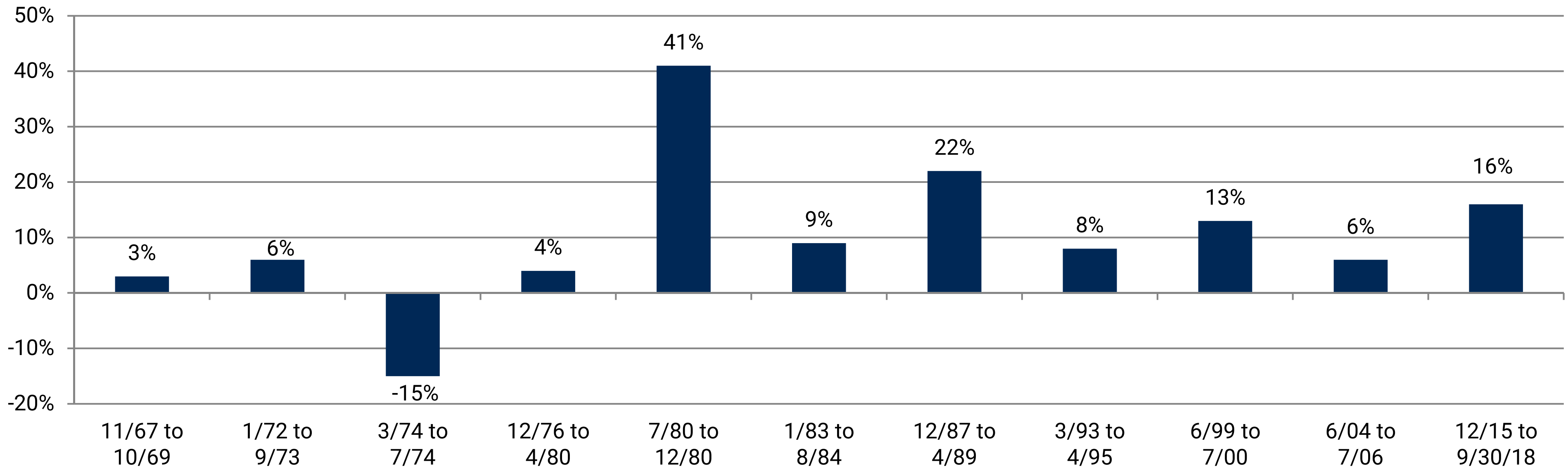
The results should not be too surprising since there are reasons stock returns appreciate in the face of higher yields. Rising rates usually reflect a healthy and growing economy with expanding corporate profits, which serve as a catalyst for equity market returns.

In addition, higher rates on cash and fixed income investments do provide additional investor benefits. Cash and bond holdings generate more interest income and higher yields improve the return and diversification benefits versus stocks. Nonetheless, after a decade of easy money policies, as rates climb to more "normal" levels, investors could experience heightened volatility and a wider range of outcomes in both stocks and fixed income investments.

### Concluding Thoughts

Most every time period presents investors with a set of worries and challenges. The impact from the midterm elections and higher interest rates appear to be two big concerns at the moment. Resisting the impulse to make portfolio changes influenced by current events and media headlines can be a challenge, but a long-term focus is critical to maintain investment discipline. One key element to investment success is to own a thoughtfully diversified collection of assets designed to meet each investor's unique goals and to avoid being unduly swayed by the inevitable swings in asset prices and investment sentiment.

**S&P 500 Annualized Returns When Interest Rates Rise[9]**




Source: Vanguard as of September 30, 2018

# Disclosures/Endnotes



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# Disclosures/Endnotes



Asset class returns illustrated on Page 1 are represented by the following indices or funds: U.S. Large Stocks: S&P 500 Index; U.S. Large Value Stocks: Russell 1000 Value Index; U.S. Small Stocks: Russell 2000 Index; U.S. Small Value Stocks: Russell 2000 Value Index; U.S Micro Cap Stocks: DFA U.S. Micro Cap Fund; Foreign Large Stocks: MSCI EAFE Free Equity Index Net Return; Foreign Large Value Stocks: DFA International Value Fund; Foreign Small Stocks: DFA International Small Company Fund; Foreign Small Value Stocks: DFA International Small Cap Value Fund; Emerging Market Stocks: MSCI Emerging Markets Index Net Return, U.S. Real Estate Stocks: FTSE NAREIT All Equity REITs Index; Foreign Real Estate : DJ Global Ex-U.S. Select RESI Index Net Return; Master Limited Partnerships: Alerian MLP ETF; U.S. T-Bills/Cash: Bloomberg U.S. Treasury Bill 1-3 Month Index; U.S. Government Short-Term Bonds: Bloomberg U.S. Treasury 1-3 Year Index, U.S. Government Intermediate Bonds: Bloomberg Intermediate U.S. Treasury Index; U.S. Government Long-Term Bonds: Bloomberg U.S. Treasury 10+ Year Index; U.S. Inflation Indexed Bonds: Bloomberg U.S. Treasury TIPS Index; Corporate Bonds: Bloomberg US Corporate AAA Intermediate Index; High Yield Bonds: Credit Suisse High Yield Index; Foreign Government Bonds: JP Morgan GBI Global Hedged US Dollar Index; Commodities: S&P Goldman Sachs Commodity Index; Municipal Bonds: Bloomberg Municipal Index; CPI: Consumer Price Index.

ENDNOTES:

1 MSCI ACWI Index (USD) [net div.]. MSCI data © MSCI 2018, all rights reserved.
2 Federal Reserve
3 State and local are from the S&P National AMT-Free Municipal Bond Index. AAA-AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA-AAA rated. A-BBB Corporates represent the Bank of America Merrill Lynch US Corporates, BBB-A rated.
4 Bloomberg; US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBI) Yearbook ™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield). Citi fixed income indices copyright 2017 by Citigroup. The BofA Merrill Lynch Indices are used with permission; © 2017 Merrill Lynch, Pierce, Fenner & Smith Incorporated; all rights reserved. Merrill Lynch, Pierce, Fenner & Smith Incorporated is a wholly owned subsidiary of Bank of America Corporation. The S&P data are provided by Standard & Poor's Index Services Group.
5 OppenheimerFunds; The American Presidency Project at UCSB.
6 LPL Financial; Average S&P 500 Annual Performance 1950 – 2017.
7 OppenheimerFunds.
8 Andrew L. Berkin, "What Happens to Stocks when Interest Rates Rise?." *The Journal of Investing* (Summer 2018): 126-135.
9 Vanguard; DFA.