Investment Tally & Perspective

First Quarter 2018 Review

MAJOR ASSET CLASS RETURNS				
	1st Qtr. 2018	1-Year	3-Year	5-Year
Equities				
S&P 500	-0.8%	14.0%	10.8%	13.3%
MSCI EAFE	-1.5%	14.8%	5.6%	6.5%
MSCI Emerging Markets	1.4%	24.9%	8.8%	5.0%
Fixed Income				
Barclays Capital US Aggregate	-1.5%	1.2%	1.2%	1.8%
Barclays Capital US Corp. Inv. Grade	-2.3%	2.7%	2.3%	3.0%
Barclays Capital Emerging Market	-1.5%	3.2%	5.1%	3.9%
Other Assets				
MSCI US Reit Index	-8.1%	-4.4%	0.9%	5.9%
S&P GSCI	2.2%	13.8%	-4.2%	-11.9%
ICE WTI Crude Oil	7.5%	28.3%	10.9%	-7.8%
Comex Gold	1.4%	6.1%	3.9%	-3.6%

Source: Capital IQ — All returns greater than one year are annualized

Financial Markets

Equities - For all of the equity volatility witnessed in the first quarter, there was very little to show for it when looking at asset returns for the period. The S&P 500 ended the first quarter close to where it started. Although recent weeks may feel uncharacteristically volatile, it was actually last year that was unique. The chart on the following page shows the annual return (black bar), and the maximum drawdown (red dot, measured as peak to trough return within a given year) between 1980 and 2018. As noted, for the 38-year period, stocks posted positive returns in 29 years despite an average decline (peak to trough) of 13.8% per year.

Fixed income - Interest rates rose and, as a result, bond prices declined during the first quarter. The Barclays Aggregate Index, a benchmark for U.S. investment grade debt, ended the quarter down 1.5% on a total return basis. Corporate bond prices also moved lower as rates rose and investors increased the interest rate premium for default risk during the period.

Other Assets - Commodities had a benign quarter, and industrial metals posted mixed results. Copper and aluminum were down in the first quarter, while steel prices were markedly higher. Publicly traded real estate had a particularly difficult quarter, as the fixed income proxy is being repriced to the higher interest rate environment

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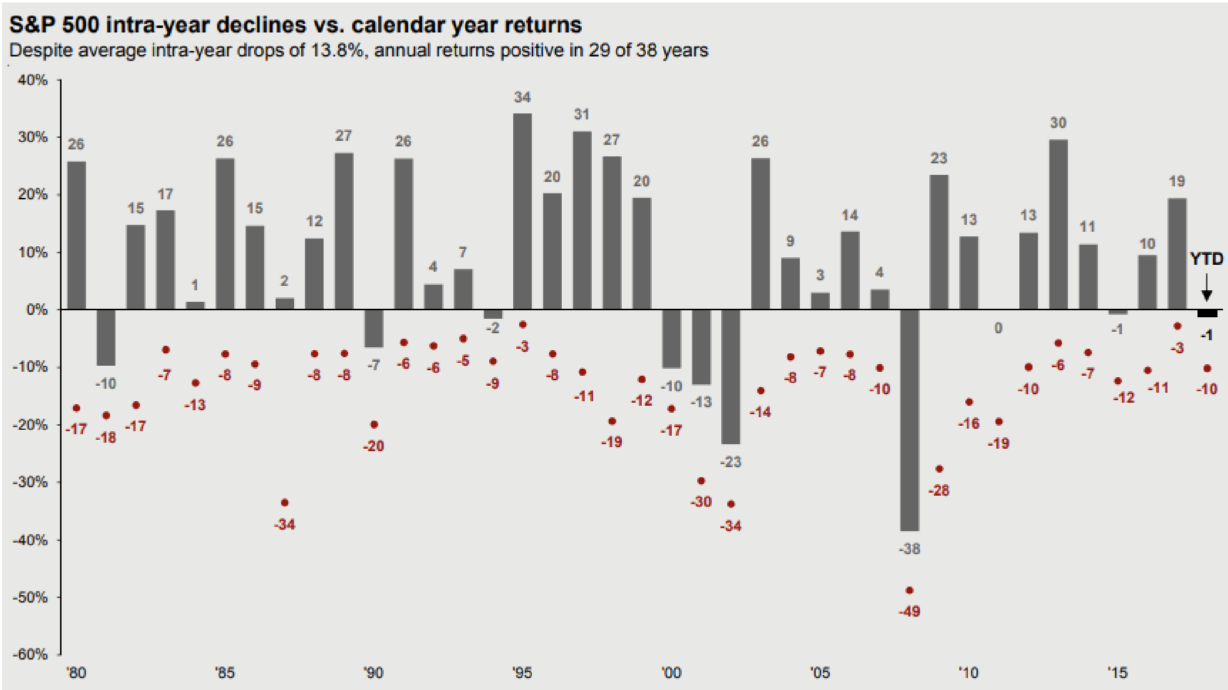


Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2017, over which time period the average annual return was 8.8%.
Guide to the Markets – U.S. Data are as of March 31, 2018.

Economic Developments

Though global GDP continued to grow in the first quarter, there appears to have been a slowdown in output for both the U.S. and Europe. The U.S. posted GDP growth above 2.5% for each of the past three quarters; however estimates for Q1 have fallen below this level. The Atlanta Fed growth forecast for Q1 2018 is currently pegged at 2.3%, down considerably from the early March estimate of 3+%. Two main reasons for this decline are less inventory building and lower personal consumption expenditures (PCE) than previously anticipated. The growth in PCE for the first quarter is presently forecast to be the lowest since Q2 2013; this is concerning, and worth watching. In the Eurozone, Citigroup's Economic Surprise Index is presently negative, meaning that economic data has generally been coming in worse than consensus expectations. The March reading of the Eurozone Purchasing Managers Index registered its lowest composite print in 14-months (though still indicating expansion). In summary, global growth appears set to continue in a similar fashion as 2017, but perhaps less than previously anticipated.

The U.S. labor market was a key focal point in the first quarter with the U.S. Bureau of Labor Statistics reporting average hourly earnings increased 2.9% in January. This report was a contributing factor for the recent stock decline as investors fear higher inflation and interest rates would crimp economic growth and pressure equity prices. Interestingly, though reported figures were revised lower, we expect wage inflation to move higher this year with interest rates following suit.

Monetary Developments

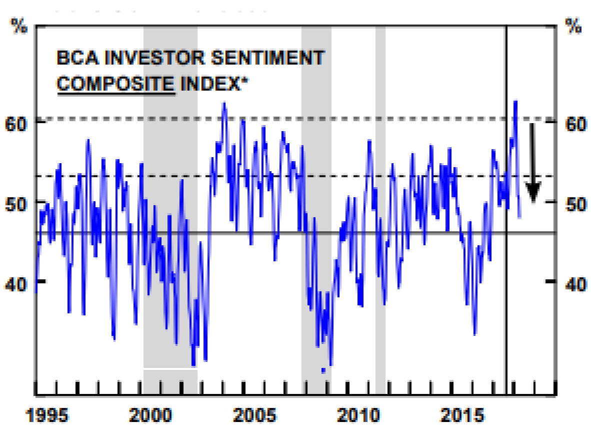
Jerome Powell was sworn in as the new Chair of the Federal Reserve Board of Governors while John Williams, the current President of the San Francisco Fed, was announced to be the new President of the New York Fed (the division responsible for implementing monetary policy and a permanent voting member of the Federal Open Market Committee). Outside of personnel changes, Fed policy remained in-tact. The balance sheet continues to be whittled down, and the bank is on course to raise short term rates 3 times in 2018 (though four times is recently getting more traction).

Global central banks also maintained their course. Investors are currently wrestling with the ECB's path to tightening policy and the pending closure of Draghi's term as the bank's head (late 2019).

Valuation & Investor Sentiment

Prior to the Tax Cuts and Jobs Act being signed (December 22nd), analysts were projecting 2018 S&P 500 earnings to grow 12.4%. By the end of the first quarter, growth forecasts for 2018 EPS rose to 19.4%. The higher estimates for earnings coupled with the decline in YTD stock prices has brought the P/E ratio (the most widely used metric for stock valuation) down to a much more reasonable level. As of today, the P/E ratio stands at 16.7x forward earnings, moderately higher than its long-term average.

Investor enthusiasm was palpable as we started the year. Today, sentiment has reversed most of the ground gained at the end of last year. BCA Research recently shared their index of sentiment, which includes individuals, traders, and advisors.



Source: BCA Research Inc.

Investment Outlook & Strategy

Stocks never suffered a monthly decline in 2017 (highly unusual) and the exuberance continued in the initial days of the New Year. Then, following the peak on January 26th, stock prices declined more than 10% (a correction). The main question - "Is the correction over, or is this the start of a bear market?".

We view the recent weakness as a correction in share prices that were quite elevated following nearly a decade of central banks suppressing interest rates and manipulating bond markets. With the Fed well into its announced plan of gradually raising interest rates and reducing trillions of bonds from its balance sheet, and with other central banks expected to take similar actions over time, increased market volatility is to be expected. Equity moves in this environment are likely to be exaggerated by structural changes in the financial systems and myriad geo-political risks (Iran, Iraq, China, Syria, impeachment efforts from President Trump's antagonists, Putin etc.).

This week starts the process of quarterly earnings reports being issued which will change some of the focus of investors and the media away from the mega-worries noted above to how well companies are doing and, importantly, their outlook for the remainder of 2018 and 2019. We expect stocks to react positively as reported earnings and outlooks provide support for stocks in the months ahead. However, these earnings reports will likely mark the peak in earnings growth rates while, at the same time, building inflation pressures negatively impact interest rates.

In sum, numerous changes in the investment landscape are steering us to a gradual change in investment strategy. While we are cautiously optimistic near term, the increasing probability of a recession in 2019-2020 warrants a change in strategy and mindset towards becoming more defensive and gradually reducing risk exposure as we approach 2019.

<u>Common Questions on Social Security</u>

In 2018, 63 million Americans will receive approximately one trillion dollars in Social Security benefits, according to the Social Security Administration (SSA). Although people of all ages receive benefits, the majority are retirees. Below are a few of the questions we at Lincoln Capital have been asked in regards to Social Security.

What are my earnings based on? The system is based on a simple premise for retired workers: throughout your career, a portion of your earnings have gone into the Social Security trust fund, with your employer paying an equal amount, earning you credits that enable you to qualify. You can earn up to 4 credits per year, and need at least 40 credits (10 years) to be eligible for retirement benefits. The amount of the benefit is based on your average earnings over your career. Higher lifetime earnings equate to higher benefits. To earn the highest benefit possible at Full Retirement Age (FRA) a worker's income needs to be at Social Security earnings ceiling for at least 35 years, which in 2017 was at least $127,200. The maximum monthly benefit at age 66 in 2017 was $2,687, though the average benefit was $1,342. You can calculate your own benefits on the Social Security website at www.ssa.gov by creating an account.

I've heard Social Security benefits are going to run out. Is this true? No, this is not true. As long as people continue to work and pay taxes, Social Security will not run out of money. What is on track to be depleted by 2034, according to the SSA's 2015 report, is the Social Security Trust, which is a surplus that was built up when taxes collected exceeded benefits paid out, and makes up the difference between current money coming in and money going out. This trust pays about 25% of current benefits, so the system is not going to 0%, more like 75%. This problem is not difficult to fix, though political administrations seem unwilling to tackle the issue as all solutions presented favor a certain class over another.

Are my Social Security benefits taxable? They can be. Up to 85% of benefits can be taxed at your income rate. This happens if you have other substantial income, such as wages, pensions, interest and dividends, in addition to your benefit. If you file a joint return and your income is between $32,000 and $44,000 ($25,000 and $34,000 for single filers), you will have to pay income tax on up to 50% of your benefits. If you're joint income is more than $44,000 ($34,000 for single filers), than up to 85% of your benefits may be taxable.

When should I begin taking Social Security benefits? There a lot of factors that influence when a person should begin taking Social Security benefits. You can claim retirement benefits as early as age 62, or delay until you reach age 70. While taking benefits prior to your FRA reduces your annual benefit (at 62, the reduction is 25%), delaying your benefit can add 8% per year up to age 70. Factors to consider include your cash needs, life expectancy and break-even age, whether you plan to work part-time, and your spouse's benefits (one could begin early while the other delays). When it comes to beginning Social Security, there is no right age that's appropriate for everyone.

Please view Lincoln Capital, and our research and financial planning tools as resources to help you decide when you should start collecting benefits.