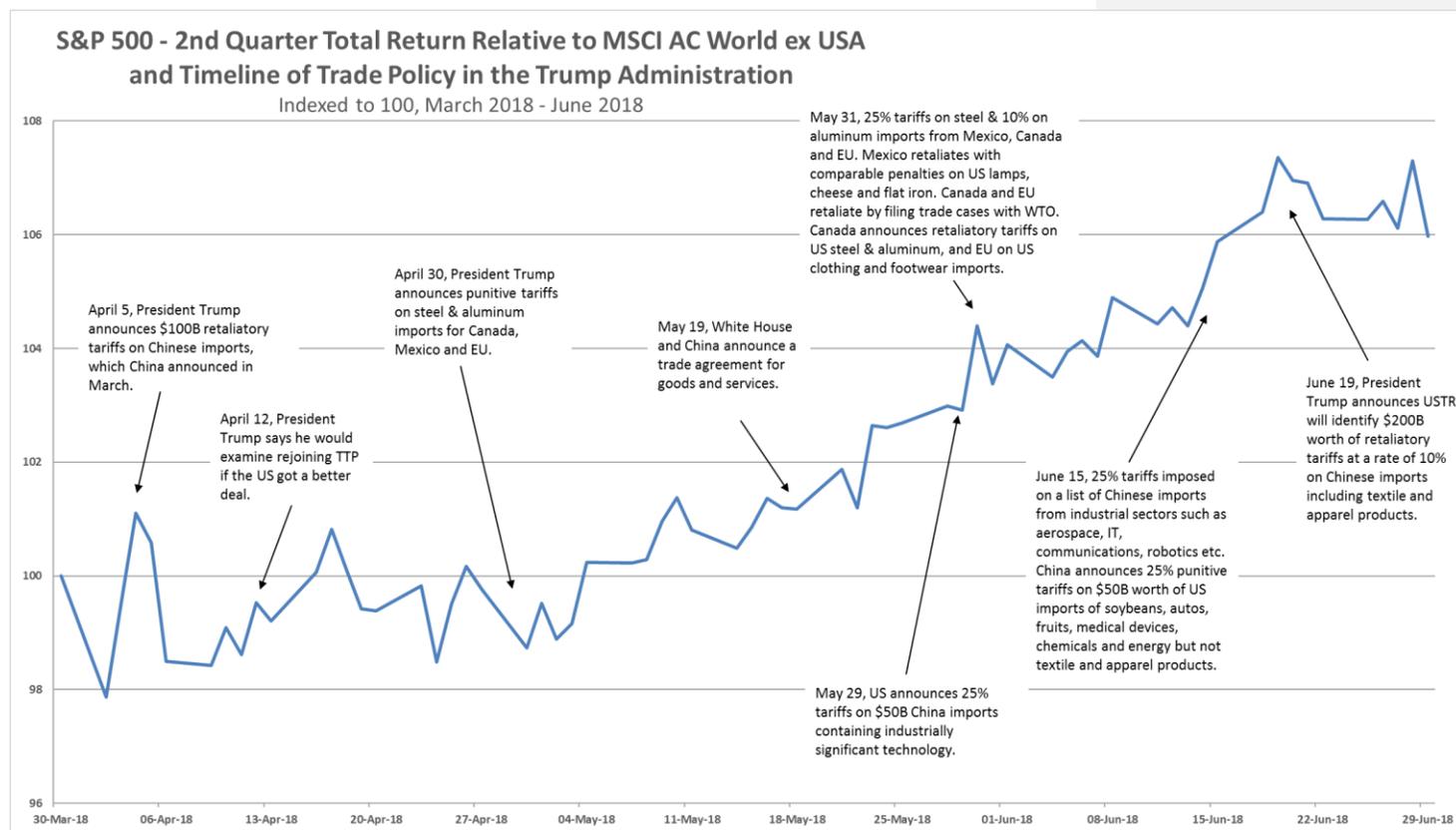




Global Politics, and Markets, Diverge Further in Q2

U.S. stocks, particularly small caps with less exposure to foreign trade, outperformed almost all other regions in the second quarter as the inflation fears that dominated Q1 gave way to new concerns about the damaging effects of higher tariffs between the U.S. and its major trading partners. Investors voted with their feet and by July 4th, European and Emerging Market equity funds had experienced their longest stretch of outflows since 2016¹. The chart below highlights the relative performance between the S&P 500 (blue line) and the MSCI All Country World (ACWI) ex USA Index throughout the quarter as the call and response between the U.S. and China, Europe, Mexico and Canada grew ever louder. For the quarter, the S&P 500 rose 3.4% and the small cap Russell 2000 jumped 7.8%, while the ACWI ex USA dropped 2.6%. Year-to-date those indexes are up 2.7%, up 7.7% and down 3.8%, respectively. The Shanghai Composite was down 14.7% for the second quarter and is down 15.4% year-to-date, and Mexico and Canada are now down 2.7% and 3.0% year-to-date, respectively.

As trade war rhetoric escalated this quarter, the U.S. Dollar and oil rallied and U.S. stocks outperformed most other regions.



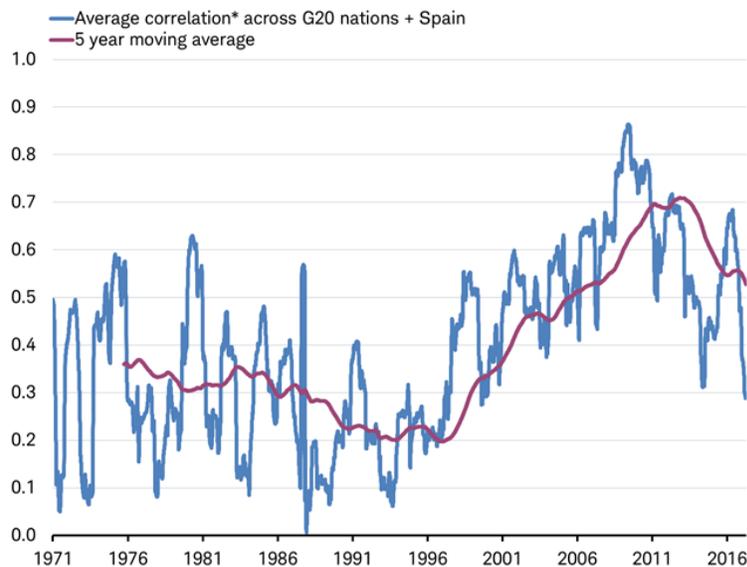
Portfolio Actions We Took During the Quarter

In our Growth Strategies, we exited a railroad stock after a good run and bought a cellular tower real estate investment trust (REIT). We like the secular tailwinds driving mobile data as more consumers use their devices to stream content on the go. In our Income Strategies, we trimmed two of our dividend

ETF holdings and bought two REITs. One is another cell tower operator and the other a healthcare facilities operator that focuses on senior housing and assisted living. We anticipate an inflection point by 2020 after which age 80+ population growth starts to accelerate. Finally, in many cases REITs are able to offer a measure of pricing power and inflation hedging to client portfolios – a desirable trait as the business cycle ages and unemployment stays low.

Chart of the Quarter:²

Global stock market correlation slides to 20 year lows



*Daily one-year rolling correlation of one month percent change in MSCI indexes for countries in G20 and Spain. Source: Charles Schwab, Factset data as of 7/11/2017.

Behind the Rhetoric: Earnings Growth and Fiscal Reform

When analyzing recent geographic performance differentials, the temptation is to cite rising political risk and a flight to U.S. safety as politicians do battle over import tariffs and intellectual property rights. While the risk of an all-out trade war is not trivial, it is difficult to price, and investors often underestimate the power of mutual self-interest among trading partners. As a result, equity multiples have compressed this year almost everywhere in the world *including* the U.S., where earnings are expanding at twice the global rate. In our opinion, it is more significant that the U.S. has addressed tax and regulatory reform at a level and pace thus far unmatched by most other countries. Can Europe and Japan, where interest rates remain close to zero, still look to central banks for answers amid fading growth expectations? Recent proposals to eliminate all tariffs on autos traded between the U.S. and Germany are being taken seriously by Angela Merkel. We will see if progress is made on this and other fiscal matters in the second half of 2018 - we doubt much improvement is priced in today.

U.S. equities have, in fact, outperformed dramatically since late 2011, while correlations among global stock markets have dropped to twenty-year lows (see graph above). This is one reason we raised our weightings to international stocks at the beginning of the year, and why we are more optimistic (not less) about future contributions to portfolio returns from geographic diversification.

Robert G. Scott
Chairman & CEO

Fraser J. McLean
Chief Investment Officer

We have recently added exposure to REITs in many of our client portfolios.

Despite (or because of) recent foreign underperformance, the benefits of geographic diversification in portfolios seem to be increasing.

Synchronized global growth will truly materialize when the baton is passed from central bankers to politicians – as it has been in the U.S.

Endnotes

¹ Alexandra Scaggs. *Investors shun Europe and emerging market funds.* FINANCIAL TIMES. July 5, 2018.

² Jeffrey Kleintop. *An Important Benefit to Global Investors Is Back After 20 Years.* CHARLES SCHWAB & Co. July 24, 2017.

Source of data not specifically cited: BlackRock, FactSet.

All return data through June 29, 2018, in U.S. Dollars, unless otherwise stated. All equity returns include dividends.

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