Market Review & Outlook:
Data Dependent

TRUXTON TRUST
A PRIVATE BANK

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Executive Summary

- *The S&P 500 declined 6.8% in October despite a still strong economy and the majority of companies reporting earnings above expectations.*
- *The US economy continues to grow; however, moderation in international markets, tariff threats, rising rates, and weaker housing statistics raise concern about stability.*
- *A possible rate hike in December has created concerns that the Fed is more hawkish than data dependent.*

Uncertainty dominated market sentiment in a difficult October. Will the control of the US Congress change and what would that mean? Will the Federal Reserve raise interest rates in December? Will long-term interest rates rise at a faster pace? Will President Trump go to the mat with the Chinese tariffs? Can economic and corporate earnings growth slow down without reversing? What does all this mean for equities?

The S&P 500 declined 6.84% in October. As of November 9, the S&P was about 6% below the all-time high established in September. Technology stocks, which had led the market year-to-date, led the declines with the tech-heavy NASDAQ Composite index declining 9.2% in October. For the most part, the long bull market's greatest winners saw the worst declines. The fundamentals are not bad; they are just not getting better. With 89% of S&P 1500 companies having reported earnings, 70% have beaten consensus EPS expectations versus 66% in the third quarter 2017 (FactSet Research, November 9, 2018). The tax cut tailwind, which has played a major role in the 20% + earnings growth seen year-to-date will cease to be a benefit starting in the first quarter 2019. Revenue growth remains impressive for the most part, but there are questions about the sustainability should the global economy slow. In many ways, the correction, so far as it is related to earnings reports, is a matter of fatigue. There are also some points of concern. The declines started with pre-announcements from several automotive manufacturers and suppliers that suggested that new and anticipated tariffs are impacting the rate at which auto manufacturers plan to build new cars. The strong dollar is hurting both sales and profitability for companies with significant international business. Housing is also a point of concern as industry aggregate reports, rising rates and company earnings anecdotes suggest a sharp slowdown in activity. Housing activity has seen ups and downs since the 2008 recession that we believe reflect a healthier sensitivity to pricing and rates than those

Equity Market Index Returns

As of September 30, 2018

Asset Class	Index	3Q 2018 (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	10 years (%)
Large Cap U.S.	S&P 500 Index	7.71	10.57	17.91	17.31	13.95	11.96
	Russell 1000 Large Growth Index	9.18	17.09	26.30	20.56	16.59	14.31
	Russell 1000 Large Value Index	5.71	3.92	9.45	13.54	10.71	9.78
	DJ US Select Dividend Index	3.08	4.14	10.59	15.24	12.53	10.75
Mid Cap U.S.	S&P 400 Mid Cap Index	3.85	7.47	14.20	15.67	11.91	12.49
Small Cap U.S.	S&P 600 Small Cap Index	4.71	14.55	19.09	19.41	13.32	12.86
Developed International	MSCI EAFE Index	1.36	-1.42	2.75	9.23	4.42	5.38
Emerging Markets	MSCI Emerging Market Index	-1.09	-7.66	-0.79	12.37	3.62	5.40
Commodities	Bloomberg Commodity Total Return Index	-2.02	-2.03	2.59	-0.12	-7.18	-6.24
Real Estate	NAREIT Equity Index	0.78	1.80	3.34	7.63	9.16	7.44
Global Market Cap Weighted	MSCI World Index*	4.98	5.44	11.25	13.53	9.28	8.56

**The U.S. represents about 51% of the MSCI World Index.*
All returns greater than one year are annualized. Source: Greenhill Market Index Review as of September 30, 2018

that led to the housing crisis. Despite some volatility, we believe that demographic and employment trends are still supportive of a stable to improving housing market over time.

The US economy continues to perform well, but like earnings it is not accelerating. 3.5% third quarter GDP growth was better than anticipated with continued strength in consumption and growing defense spending. Fourth quarter and full-year estimates are stable at 2.6% and 2.9%, respectively. Inflation has reached the Fed's 2% target. The 57.7 October ISM readings continue a trend of moderation from very high levels set earlier in the year. The ISM survey measures the outlook for near-term economic activity for which any reading above 50 indicates growth. October non-farm payrolls increased 250,000, recovering from a disappointing 118,000 September addition. Monthly results have fluctuated all year, but the trend seems to be above 200,000 per month despite 3.7% unemployment (see chart on next page). Average hourly earnings increases are accelerating, which raises some concern about inflation and the margin component of corporate earnings growth. 3.1% average hourly earnings growth in October increased from 2.8% in September and the persistent range of 2.5% throughout much of the cycle. The economy is still healthy; however, it is performing above the level that most economists see as "potential" based on reasonable demographic and productivity assumptions. Investors are concerned about whether we simply moderate toward "potential" or adjust in a more significant way.

Meanwhile, international economies are raising concerns that the dynamic of synchronized global growth is breaking down. The European Union has seen some moderation in GDP growth. Annualized growth fell to 2.1% in the second quarter from 2.4% for the quarter ended in March. Italian budgets, Brexit and other expressions of nationalistic tendencies have renewed concerns that the EU is at risk. We continue to believe that the EU constituents will continue to muddle through. The IMF forecast for Eurozone GDP growth is about 2% after rising to 2.5% for a brief period. Coming from depressed levels, we see continued growth as a catalyst for international equities once exchange rates stabilize.

Monthly Change in Non-Farm Payrolls (October 2016-October 2018)

Source: Factset Research as of October 31, 2018

The Federal Reserve has raised rates three times in 2018 bringing the Fed Funds rate to 2.25%. Prior concern about a flat yield curve has been overcome by concern about rising long-term rates. The 10-year Treasury yield is 3.19% having seen a significant move higher following comments by Federal Reserve Chairman Jerome Powell. For lack of anything more substantive to say, many have highlighted "Fed Policy mistakes" as a risk to the equity markets and economy. We will not know whether a mistake has been made until after the fact, so we are focused on what has changed in the Fed's communications and decision making. This is particularly relevant because Powell is new. He took over as Fed Chairman in February 2018. Two subtle differences have raised concerns. First, his communications suggest he is more determined to raise rates than his predecessor. Second, he has made the first significant change in the forecasted cadence of Fed rate increases since the financial crisis. Credibility is an important concept in monetary policy. It is similar, but more specific than the broader definition of the word. Basically, it means that the Fed should not surprise people. Ben Bernanke and Janet Yellen took Fed credibility very seriously focusing on clear and long-range communications strategies that informed the markets not only about what the Fed planned to do, but also when they planned to do it. I don't think that Jerome Powell is significantly different, but the idea that the Fed might raise rates a fourth time in 2018 can be construed as the first "surprise" since the Fed embarked on its program of quantitative easing. Now, the December decision is an uncertain one. While the Fed still claims to be "data dependent," the new Fed seems more determined to go ahead and normalize rates whereas the prior Fed was most focused on delivering increases on the exact cadence laid out well in advance. The derivatives markets have reduced the probability of a December rate increase from nearly 80% in September to 65% today, but we don't know whether the Fed is more "data dependent" or determined. In our opinion, that is the subtle difference that has disturbed the market.

We are still data dependent. We believe that the data suggests that the economy is still healthy. Earnings will moderate, but we still believe that a diversified portfolio of equities and investment grade bonds is a proven way to grow wealth faster than inflation. Equity valuations are at the high end of a normal range with pockets of extremes we believe justify very limited exposure. The data also suggests that detailed planning and diligent implementation and review are the controllable factors that so often determine a good outcome.