2nd Quarter 2019

Quarterly Recap Performance Review and Near-term Outlook

Quarterly Recap

As of July 1, the current U.S. economic expansion reached 121 months long. Since 1854, the average U.S. economic expansion lasted just over three years. Since World War II, the average economic expansion has lasted not quite five years. The current expansion, now more than 10 years old, stands as the longest expansion in recorded U.S. history. The U.S. stock market also marked its longest bull market run in history just last August, and now stands at 125 months long.

Holding these records, and sitting near all-time market highs, can soften our memories of what has been a period of great uncertainty. You no doubt recall that in the fall of 2018, from late September through Christmas Eve, the S&P 500® Index fell more than 19%. The market snapped back sharply in Q1, with the Index retaking nearly 14% of lost ground. Despite mid-quarter volatility due to intensifying multi-front trade conflicts, domestic and international markets during Q2 again delivered positive results. No doubt, year-to-date performance for most markets and sectors has been impressive. But we also had an impressive hole from which to climb. Many markets, sectors, styles, and regions have merely returned to levels last marked 15-18 months ago.

> Economic Expansions Do Not Die of Old Age.
>
> They Are Murdered.

U.S. stocks, as measured by the Russell 3000 Index — a measure of the largest 3,000 U.S. companies, and a proxy for the complete U.S. stock universe — climbed 4.1% during Q2, for a year-to-date return of 20.92%. Nearly all investment styles, industry sectors, and company sizes within the U.S. market increased. Growth-oriented strategies continued to beat value-oriented strategies. Large-company stocks outperformed small-company stocks. Cyclical sectors tended to outperform defensive sectors. Energy, the only sector that posted a negative return, fell 2.8% in lockstep with WTI Crude Oil prices.

International stocks encountered a different investment climate during Q2 than in Q1. After a calm Q1, macroeconomic and geopolitical risks increased once again, raising tensions and volatility in foreign markets. International stocks again trailed U.S. stocks, though the performance differential was less than 1.0%. Far less dramatic than during 2018 when international markets underperformed the U.S. by approximately 10.0%. Emerging markets, more sensitive to disruptions in global funds and goods flows, eked out a small positive return.

Among the most important stories during Q2 was the rapid decline in interest rates. As bond prices are inversely related to interest rates, both stock and bond prices benefited from lower rates and the dovish shift in tone from global monetary policymakers. Investors are betting that the shift back towards lower interest rate policy will reignite a slowing global economy, and help to sustain the U.S. expansion.

Last year, with GDP growth averaging 3.8% over Q2 and Q3, the U.S. economy charged solidly ahead. 2017's tax cuts, federal spending stimulus, and broad global economic acceleration provided the fuel. But the foot, as we predicted, has slipped off the gas. All three of those drivers have turned neutral, if not negative. The short-lived corporate earnings boost from the Tax Cut and Jobs Act is over. The ballooning, soon-to-be $1Trillion+, federal deficit has us in uncharted waters. Most importantly, the secondary effects of Trump's multi-front trade wars are compounding other downward pressures on business confidence and investment. Business investment during Q2 turned negative for the first time since early 2016.

Downward revisions to 2018's GDP growth rate once again put U.S. annual growth sub-3.0%, in line with all other post-crisis results. 2019's GDP growth rate is now barely clocking 2.0%, aided by a significant amount of federal stimulus. According to the Atlanta Fed's most recent GDPNow Forecast, U.S. GDP growth could fall to about 1.5%. As we stated last quarter, growth is still growth. So although our Outlook has moderated further, we are maintaining course.

Performance Review

During Q2, under the myriad of markets pressures, particularly the threat of significant tariffs to be levied against our now largest trading partner, Mexico, we significantly reduced risk exposures in all client portfolios. Volatility had been increasing since early May, as Trump ratcheted up his threats against China in that ongoing trade dispute. In the midst of those new threats, during a three day span markets dropped by nearly 5%. Barely two weeks later, Trump opened a new front in the trade wars, threatening to levy a 25% tariff on ALL imports from Mexico as part of migration control efforts. Volatility spiked, and markets sold off further.

Having recovered 2018's losses, rather than risk yet another large pullback in an uncertain environment, we made the decision to protect year-to-date gains in client portfolios. Moving to a significant cash allocation in all portfolios, until an agreement with Mexico was reached, we believed a worthwhile cost to protect clients from another potential protracted downturn. Once an agreement was reached in the second week of June, we began the process of reinvesting client cash, and managed to capture most of the resulting upside through quarter-end. Nonetheless, when reviewing your specific performance information on the following page, you will see that this protection cost us about 1.0% in return during the quarter. Therefore, Q2 performance aligns with conservative benchmarks rather than our typical, more aggressive, posture.

Lake Jericho client portfolios are, most typically, balanced, globally diversified strategies that incorporate varying combinations of multiple asset types. Each asset type has a meaningful impact upon returns. Reviewing asset types below, you see where, and how, Lake Jericho managed portfolios were impacted. Atop the following page, we present the Morningstar, Inc. *Target Risk Portfolio* Series of benchmarks, for a comprehensive, and relative performance comparison against independent, objective, balanced, globally diversified strategies.

- The Dow Jones Industrial Average, 30 "blue-chip" U.S. companies with an industrial company bias, finished Q2 with a total gain of 3.21%, for a year-to-date return of 15.40%, and a one-year return of 12.20%.
- The S&P 500® Index, a broad index of the 500 largest U.S. companies, finished Q2 with a total gain of 4.30%, for a year-to-date return of 18.54%, and a one-year return of 10.42%.
- The technology and consumer-cyclical heavy NASDAQ Composite Index finished Q2 with a total gain of 3.87%, for a year-to-date return of 21.33%, and a one-year return of 7.78%.
- Small- and mid-sized companies, as measured by the Russell 2500™ Index, finished Q2 with a total gain of 2.96%, for a year-to-date return of 15.74%, and a one-year return of only 1.77%.
- International developed markets, as measured by the MSCI World (ex-U.S.) Investable Market Index, finished Q2 with a total gain of 3.50%, for a year-to-date return of 14.39%, and a one-year return of 0.16%.
- International emerging markets, as measured by the MSCI Emerging Markets Investable Market Index, finished Q2 with a gain of 0.43%, for a year-to-date return of 10.14%, and a one-year return of 0.47%.
- Bonds, with the tailwind of falling interest rates, provided meaningful gains for investors during Q2. The Bloomberg Barclays U.S. Aggregate Bond Index, a broad measure of the performance of the U.S. investment grade bond market, finished Q2 with a total return of 3.08%, for a year-to-date return of 6.11%, and a one-year return of 7.87%.

Morningstar, Inc. Target Risk* Portfolio Series

Benchmark Comparisons For All Periods Ending June 30, 2019

Target Risk Portfolio	Q2 2019	YTD 2019	1 Year	3 Year Total Return	5 Year Total Return
Conservative	2.76%	7.55%	7.17%	13.20%	17.06%
Moderately Conservative	2.94%	9.85%	7.27%	20.32%	24.14%
Moderate	3.13%	12.08%	7.08%	27.02%	29.40%
Moderately Aggressive	3.29%	14.36%	6.68%	34.26%	34.65%
Aggressive	3.40%	16.05%	6.08%	39.74%	38.69%

* The Morningstar Target Risk Index family is designed to meet the needs of investors who would like to maintain a target level of equity exposure through a portfolio diversified across domestic, international, and emerging market equities, bonds and inflation-hedged instruments. The Morningstar Conservative Target Risk Index seeks approximately 20% exposure to global equity markets. The Moderately Conservative Index seeks approximately 40% exposure to global equity markets.. The Moderate Index seeks approximately 60% exposure to global equity markets. The Moderately Aggressive Index seeks approximately 80% exposure to global equity markets. The Aggressive Index seeks approximately 95% exposure to global equity markets. Benchmarks are constructed with no management fees, and with no transaction costs, while Lake Jericho portfolio performance is actual performance, net of all fees, including investment management, administration, and transaction expenses.

Near-term Outlook

For multiple quarters, I have talked about threats to the continued global growth thesis. Threats continue to mount. In prepared text for his most recent Congressional testimony, Federal Reserve Chair Jerome Powell noted that business investment has slowed because of trade fears, that economic growth has slowed as a result, and that continued uncertainties have made the economic outlook more difficult. "Apparent progress on trade turned to greater uncertainty, and our contacts in business and agriculture report heightened concerns over trade developments," the text says. "Growth indicators from around the world have disappointed on net, raising concerns that weakness in the global economy will continue to affect the U.S. economy." To outside observers, this looks like preparation for at least one rate cut in July, and perhaps more to follow later during 2019.

While the current economic expansion has been the longest, it has not been the strongest. When looking from cycle peak to cycle peak, the current expansion has, relatively speaking, seen slow GDP growth (no year greater than 3.0%), slow corporate pre-tax profit growth, and slow, but steady, equity price appreciation. Boring, maybe. But no level-headed thinker argues that a slow-and-steady, sustainable pace is inferior to more robust, yet short-lived, boom-then-bust cycles. Economies, like markets, suffer needlessly under increased volatility.

Despite the longevity of the current economic expansion and bull market, neither expansions nor bulls die of old age. They are murdered by greed and excess, by those seeking fast profits from unsustainable policy. At best, maybe they die of fright. Now, both the expansion and the bull are afraid of recession. Every Republican President since Teddy Roosevelt experienced a recession during their first term in office. Will history repeat, as once again unsustainable boom-or-bust policies break up the party? Or will this administration relent to policies that sustain growth, and then rely on the strength of the economy and bull market benefits to charge ahead in the upcoming presidential election year?

I am asked, almost daily, if we are headed for a recession. The answer, of course, is yes. Eventually. The answer to the question of "how soon" depends entirely upon two things; the path the Federal Reserve takes on interest rates, and what the Administration does to resolve trade disputes in the coming months. Rest assured, we are prepared for whatever the answers will be.

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