3rd Quarter 2019

Quarterly Recap
Performance Review
and Near-term Outlook

Quarterly Recap

Substitute a few market sectors, replace a couple of Tweets, adjust numbers a bit, and I could have copied and pasted nearly any *Quarterly Recap* from the last two years to create a workable Q3 2019 version. Once again, the tariff-lead multi-front trade war, negative impacts upon global economic growth, and interest rate anxiety sank U.S. equity benchmarks mid-quarter by about 6% from mid-summer highs.

Charged once more with re-climbing the same wall of worry, resilient markets did retake the same lost ground, getting back to positive returns before the end of Q3. International markets, and some sub-sectors here at home, regained positive ground once well into Q4.

For multiple quarters, I have talked about threats to our continued global growth investment thesis, and also about why Lake Jericho remains committed to this thesis for client portfolios. At times, such as Q4 2018, and to some extent the just-finished Q3, client returns suffered when other market participants abandoned growth themes. As market participants again embraced the growth thesis during Q4, markets normalized, and client returns are benefitting. Where we lagged during Q3, we now lead during Q4.

Lather.

Rinse.

Repeat.

As for Q3-ending numbers, 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 1.16%, for a year-to-date return of 20.09%. While on balance the U.S. market finished higher for the quarter, investment styles and sector performance within the U.S. market were mixed. Year-to-date, however, all strategies, sectors, and company sizes remain comfortably higher.

Information Technology, the year-to-date leader, and a meaningful overweight in our client portfolios, lagged during Q3. Industry sectors such as energy, materials, and healthcare finished in negative territory, as did small- and mid-sized company shares. Meaningful exposure to small- and mid-sized company stocks have remained a drag on client performance for all observation periods of one-year or less.

On the back of trade worries, Brexit fears, and manufacturing contractions in major world economies, international stocks again trailed U.S. stocks. Developed market countries finished lower by 0.84%. Emerging markets, more sensitive to slowing global growth, finished Q3 lower by 4.28%. Year-to-date, our international allocations have performed well, certainly better than index returns imply. Nonetheless, despite our steady reduction in international allocations throughout 2019, those allocations have been a drag on client performance for all observation periods of one-year or less.

Performance Review

On the following page, together with your own portfolio returns, we present the iShares (by Blackrock) Core Allocation ETF Portfolio Series benchmarks. We provide this information for a relative performance comparison against independent, balanced, globally diversified strategies that are managed to similar risk profiles. In past quarters we presented the Morningstar, Inc. Target Series benchmarks for comparison. We are making the change from Morningstar data to iShares data for two reasons. First, the Morningstar information is neither easily nor freely available to clients for independent review. Second, the Morningstar information is not available within the Interactive Brokers Portfolio Analyst benchmark database for clients to incorporate into their own analysis. As the iShares information is freely available, and is available within the Portfolio Analyst benchmark universe, this change enhances transparency and comparability for all clients.

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 returns that follow, you see where, and how, Lake Jericho managed portfolios were impacted.

- The Dow Jones Industrial Average, 30 "blue-chip" U.S. companies with an industrial company bias, finished Q3 with a total gain of 1.83%, for a year-to-date return of 17.51%, and a one-year return of 4.21%.
- The S&P 500® Index, a broad index of the 500 largest U.S. companies, finished Q3 with a total gain of 1.70%, for a year-to-date return of 20.55%, and a one-year return of 4.25%.
- Reflecting this quarter's underperformance of cyclical/growth sectors, the technology and consumer-cyclical heavy NASDAQ Composite Index finished Q3 with a total gain of 0.18%, for a year-to-date return of 21.54%, and a one-year return of 0.52%.
- Small- and mid-sized companies, as measured by the Russell 2500™ Index, finished Q3 with a total loss of 1.28%, for a year-to-date return of 17.72%, and a one-year loss of 4.04%.
- International developed markets, as measured by the MSCI World (ex-U.S.) Investable Market Index, finished Q3 with a total loss of 0.84%, for a year-to-date return of 13.43%, and a one-year loss of 1.64%.
- International emerging markets, as measured by the MSCI Emerging Markets Investable Market Index, finished Q3 with a loss of 4.28%, for a year-to-date return of 5.42%, and a one-year loss of 2.41%.
- Bonds, with the tailwind of falling interest rates, provided meaningful gains for investors during Q3, as they have for the past year. The Bloomberg Barclays U.S. Aggregate Bond Index, a broad measure of the performance of the U.S. investment grade bond market, finished Q3 with a total return of 2.27%, for a year-to-date return of 8.52%, and a one-year return of 10.30%.

When reviewing the more conservative allocations in the table below, you see that those with progressively higher bond allocations provided superior returns during both the Q3 and one-year observation periods. Although it is a pattern to which we are unaccustomed, intuitively it makes sense. Portfolios with higher allocations to more stable, and well-performing bonds in the past year were more insulated against the dramatic equity market correction during Q4 2018, and against Q3's mid-summer downturn.

The iShares Core Allocation ETF Portfolio Benchmark Series*

Performance Comparisons For All Periods Ending September 30, 2019

Core Allocation Portfolio Strategy	Q3 2019	YTD 2019	1 Year	3 Year Total Return	5 Year Total Return
Conservative (AOK)	1.90%	11.03%	7.50%	16.51%	24.93%
Moderate (AOM)	1.67%	11.77%	6.60%	18.79%	27.93%
Growth (AOR)	1.21%	13.26%	4.80%	23.33%	34.30%
Aggressive (AOA)	0.73%	14.76%	3.00%	27.81%	39.49%

* The iShares Core Allocation ETF Portfolio series is designed to meet the needs of investors who would like to maintain fixed target levels of exposure through a portfolio diversified across domestic, international, and emerging market equities, bonds, and other instruments. The Core Conservative Allocation Strategy seeks approximately 30% exposure to global equity markets. The Core Moderate Allocation Strategy seeks approximately 40% exposure to global equity markets.. The Core Growth Allocation Strategy seeks approximately 60% exposure to global equity markets. The Core Aggressive Allocation Strategy seeks approximately 80% exposure to global equity markets. Presented here is the iShares Core Allocation ETF Portfolio Benchmark performance, 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

In recent quarter's, I posited that trade-related headlines, recession fears, and Federal Reserve action were the important near-term drivers for equity prices. Headlines (more so Tweets) have moved markets regardless of underlying reality. At some point, regardless of media or macro environment — trade, growth, interest rates — stock prices must ultimately reflect market consensus of management ability to drive "top-line" revenue within the environment, and to translate that revenue into "bottom-line" earnings per share.

Watching Q3 market action, it become clear that the Q3 earnings and economic data reporting cycle was to be such a referendum on how well U.S. companies were managing this unprecedented environment. Could U.S. and international companies find ways to expand top-line revenue, to manage processes and expenses under their control to improve bottom line earnings? Another market rebound, and particularly a sustained recovery consolidating around new market highs, would depend upon the results.

> ***Earnings:*** As of the end of October, we had results from 341 S&P 500® Index members, representing 76.5% of the Index's total market capitalization. Total earnings for these 341 index members were down 0.6% from the same period last year on +4.9% higher revenues, with 60.1% beating top-line revenue estimates, and 73.9% beating bottom-line earnings per share estimates. For the small-company S&P 600® Index, we had Q3 results from 288 companies, nearly half of the Index's membership. Total revenues were up 1.7%, but earnings were lower by 2.5%, with 58.3% of companies besting top-line revenue expectations, and 68.4% beating bottom-line earnings per share estimates.
>
> We knew all along that earnings growth would be challenged in Q3, as it had been in the first half of the year. The results show that companies are challenged, but thus far making it work. Revenue growth is about the same as the preceding period, and only modestly below the pace of Q1. Foreshadowed by mid-quarter commentary, consumers were still showing up, and continued to spend. But earnings growth, the ability to translate revenue to bottom line growth, is weaker than what we saw from results in other recent periods.

The market has generally been appreciative of the Q3 earnings results. The favorable stock market reception is partly relief that the feared flood of negative results did not come to fruition. Trends in the underlying business environment, however, remain of some concern. Manufacturing is of particular concern, while the services (non-manufacturing) sector continues to expand.

> ***Business Environment:*** The Manufacturing Purchasing Managers Index (PMI) from the Institute for Supply Management (ISM) is a widely followed gauge of U.S. manufacturing. October's report showed the third straight month of slowdown, coming in at 48.3 versus 49.1 expected (a number below 50 represents a contraction in the sector). Though in contraction, the October manufacturing result improved from September's 47.8, the lowest reading since 2009. August, with a reading of 49.1, ended a 35-month long expansion period where the PMI had averaged 56.5. The mid-west "rust belt" was particularly hard hit.
>
> The U.S. services sector, represented by the Non-Manufacturing Index, rebounded in October after hitting a three-year low in September. The ISM Non-Manufacturing Index increased to 54.7 versus 53.3 expected, from 52.6 in September. The report reflects an acceleration of expansion-based activity in October. Although respondents remained "concerned about tariffs, labor resources, and the geopolitical climate," according to the ISM, the results are supportive of overall economic activity since the non-manufacturing sector accounts for a significantly larger slice of U.S. economic activity than the manufacturing sector.
>
> ***GDP:*** U.S. gross domestic product (GDP) — the broadest measure of the U.S. economy — also performed better than the dour expectations. Total economic activity during Q3grew at an annualized rate of 1.9%, slightly better than the 1.6% expected. Down from Q2's 2.0% pace, but better than feared, the report was another mixed bag. The better-than-expected result was aided by strong consumer spending and government expenditures. Personal consumption expenditures, a gauge of spending by American households, rose at a 2.9% annualized rate. Government spending grew at a 2.0% rate.
>
> Growth in private investment, however, continued to decline, with a slip of 1.5%. Down once again, but far better than the 6.3% drop in the second quarter. Domestic business spending particularly weighed on the

investment number. Capital expenditures by companies continues to decline, a worrying trend as further slowing in business investment could lead to all manner of additional challenges.

Employment: The October employment report was strong, although adversely impacted by the GM strike. October non-farm payrolls increased by 128,000 versus expectations of 80,000. There were sizable upward revisions to non-farm payrolls for August and September, fewer discouraged workers, an uptick in the labor force participation rate, and rising wages for workers. A solid employment report to be sure, but a solid report within a decelerating trend as total job growth during 2019 is well behind 2018's pace.

A measure of hiring by U.S. companies has fallen to a seven-year low, and fewer employers are raising pay, a business survey found. Just one-fifth of the economists surveyed by the National Association for Business Economics said their companies have added to their workforces in the past three months. That is down from one-third in July.

The key takeaway from earnings reports and economic data is that little is emblematic of an economy that is on the brink of recession. On the contrary. It is emblematic of an economy that continues to expand and looks poised to sustain the longest economic expansion on record thanks to a still solid labor market, rising wages, lack of inflation, and accommodative interest rate policy. Constructive resolution to the greatest macro issue — trade — sooner rather than later, would help extend the expansion.

Business activity is decelerating, particularly manufacturing, and that is beginning to show in labor reports. The question is how long can that last? Both the downward trends, and the ability to stay in good shape? How far can equity markets rise with shrinking capital expenditures? When does before slower hiring becomes headcount reduction? Can we rely on rising government expenditures given ballooning budget deficits? Will consumer sentiment turn, and with it consumer's willingness to support continued economic growth? Without question, near-term risk is asymmetric and skewed to the downside.

Despite the risks, the economy remains on stronger footing than I thought possible at nearly two years into this protracted, multi-front trade war. A bit surprising to me, yes, but the U.S. is still in good shape. International markets, having struggled far more with trade destabilization, are normalizing. Q3 results, both corporate and economic, increase my comfort with continued commitment to our global growth investment theme, despite the occasional pain of short-lived downturns. Certainly, we will continue with our year-long tactical positioning; remain more concentrated in our allocations, with fewer positions, and higher cash allocations, allowing us to remain nimble should quick changes be necessary.

As always, I am available at any time, any day of the week, to discuss specific portfolio performance questions. Until then, be well. Enjoy the rest of your week, and thank you!

A.J. Walker, CFA CFP® CIMA®
Founder, President, and CEO
Lake Jericho, LLC