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Investment Briefing

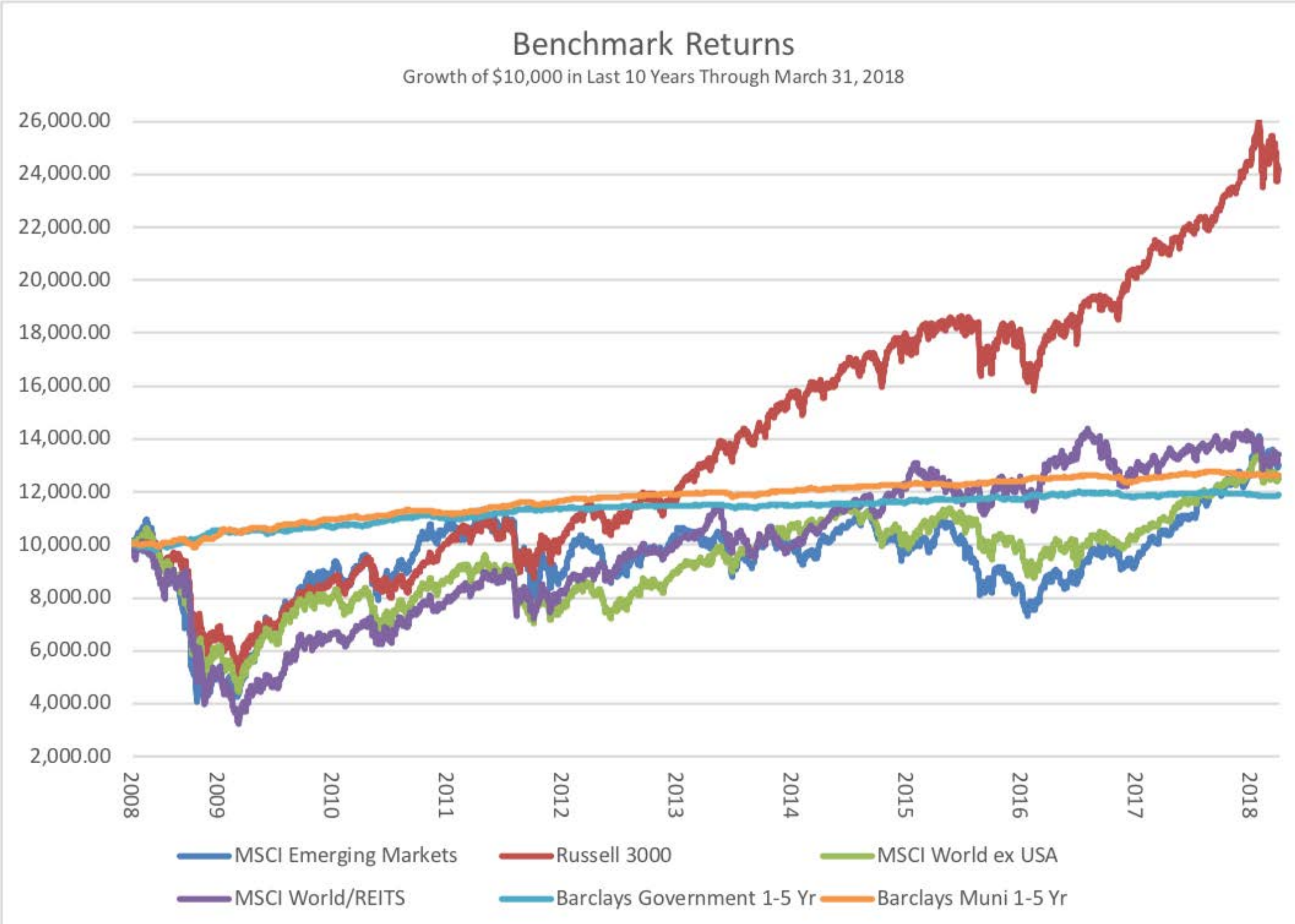
First Quarter 2018

Introduction

After the best January since 1987, most asset classes ended the first quarter slightly lower.

Emerging markets did the best for the quarter while real estate investment trusts finally lost to increasing interest rates and bonds finished slightly lower. Over the last 12 months through March, emerging markets were the best performers by far. Looking at longer time periods, U.S. stocks are still the leaders with bonds being the laggards.

Asset Class[1]	1st Quarter	12 Months	5 Years (annualized)	10 Years (annualized)
U.S. Stocks (Russell 3000)	-0.64%	13.81%	13.03%	9.62%
International Developed (MSCI World ex U.S.)	-2.04%	13.92%	6.04%	2.59%
Emerging Markets (MSCI EM)	1.42%	24.93%	4.99%	3.02%
Real Estate Investment Trusts (MSCI World REITs)	-5.43%	1.50%	4.82%	3.52%
Taxable Bonds (Barclays 1-5 Yr Gov)	-0.39%	-0.09%	0.63%	1.66%
Municipal Bonds (Barclays Muni 1-5 Yr)	-0.05%	0.53%	1.10%	2.3%

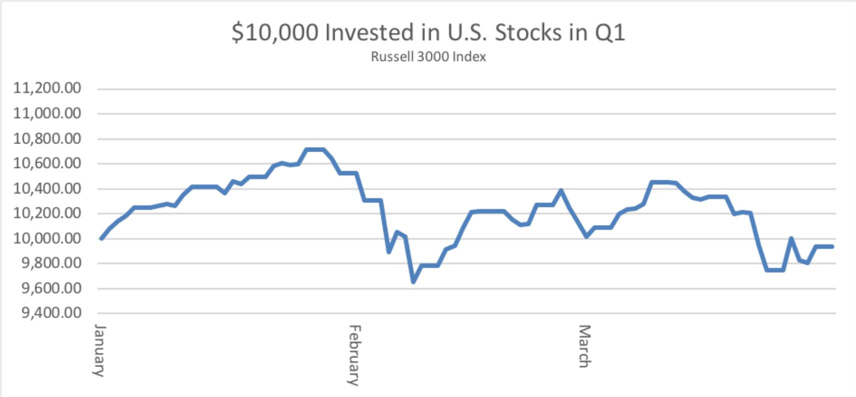


References

1. Return data and charts are from Morningstar Direct.

U.S. Stocks: Mountainous Terrain

As the chart shows, Q1 will be remembered for being a time when volatility returned to the stock markets.



After a smooth 2017 (the least volatile year in stock market history) and the strongest January since 1987, a host of issues finally topped investor concerns. Those included tough trade talk from President Trump and a tech sector whose investors had mostly kept buying Facebook, Amazon, Apple, Netflix and Google shares until February. When Facebook admitted to selling user data to Cambridge Analytica for what may have been political purposes, Washington began to focus more heavily on the tech industry. In addition, new tariffs levied on Chinese metal imports and a new Fed Chairman added to investors' discomfort.

The market was indeed more than overdue for a correction and higher volatility. It comes with a

background of an economy growing at an increasing pace and company earnings that are generally regarded as being strong and rising. So there are good reasons for investors to be optimistic. Of course, at some point, the market will anticipate a recession and when that happens we'll see more volatility and negative performance. These periods of discomfort are necessary for long-term growth. In other words, we can't have strong positive years without incurring some losses from time to time. Staying invested through the bad times so that we participate in the good times is what gets us to our financial goals.

Studies show that volatility tends to have its own momentum: periods of low volatility usually lead to more low volatility and periods of high volatility lead to more high volatility, so we should expect volatility to be present for a while. An interesting statistic is helpful to keep in mind. Of the last 90 years of U.S. stock market history, how many of them have ended with annual returns higher than positive 20% or lower than negative 20%? The answer is 40. That brings us some historical perspective on stock market volatility.

International Developed Stocks: 4-wheel Drive Recommended

This chart shows that international stocks weren't quite as mountainous as U.S. stocks and ended slightly lower, in percentage terms.

While the chart of performance for US stocks looked like it would be an impassable mountain range on four wheels, international markets look like we could work through them with the right four wheel drive setup. Diversification, whether in portfolios or vehicles is the key to getting to our destinations. Diversification worked across companies as well as across countries and their currencies, with both the Japanese yen and euro up significantly against the dollar, improving our portfolio returns.

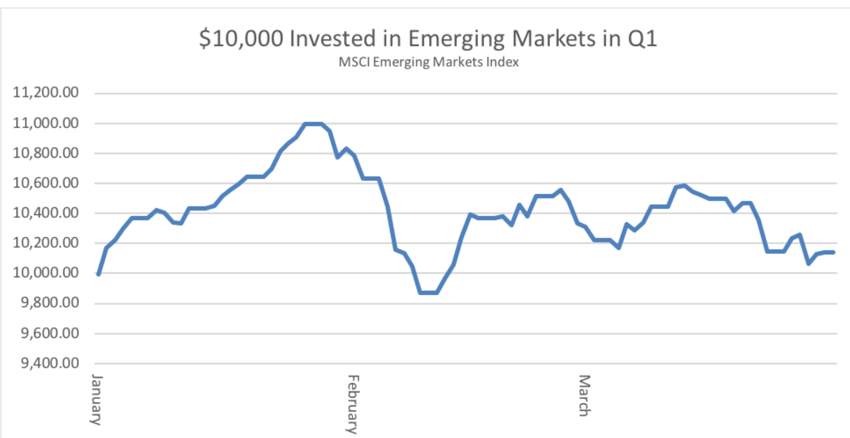
Some signs of slowing did show up internationally, and of course there is never an absence of news:

- Germany’s Merkel struggled to form a new Grand Coalition government, but finally succeeded.
- Italy’s president dissolved parliament and an election was set in March that showed no clear winning party, but tended to lean toward populism.
- Japan’s finance ministry admitted to altering documents relating to a sale of state land at a huge discount to Akie Abe, the wife of Prime Minister Shinzo Abe. You may recall that Mr. Abe easily won re-election last year and his popularity has now fallen significantly.

Europe’s economy, coming off of a very strong 2017 that saw it grow more than the U.S. is showing some signs of slower capital spending, although there is still significant upward momentum. The risks of a recession in a major international economy this year remain low.

Emerging Markets: More Hills than Gullies

Emerging markets once again won the prize for best returns for the quarter, as well as over the last 12 months.



Emerging markets once again won the prize for best returns for the quarter, as well as over the last 12 months. Although the quarter's return was a bit measly at 1.42%, it is notable that EM pulled through with profits while its bigger brethren suffered losses.

The negative news items in EM, especially China, are that the trade actions have been on and off the headlines for months. Although the press mentions a lot of big numbers, they are small in relation to trade levels. For example, the steel and aluminum tariffs were projected to be on $60 billion of goods. That is a big number, but is only about 10% of our annual trade with China and less than 1% of China's gross domestic product. The press loves throwing around big numbers

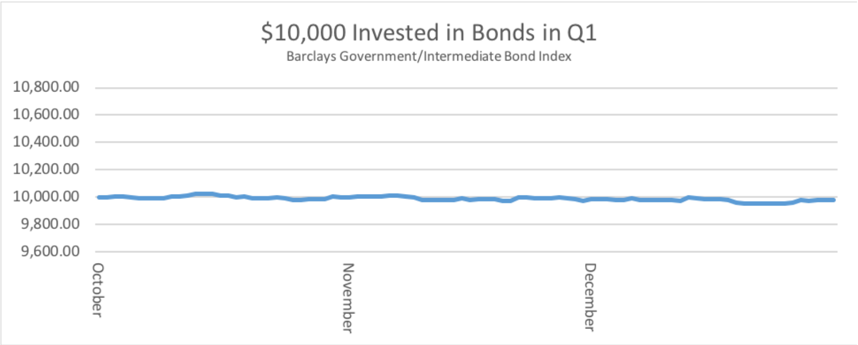
to get our attention, like billions, without putting them in context.

Could this trigger a “trade war”? Perhaps, but we need to keep in mind that we like our iPhones from China and China likes assembling them for us, along with many other things. We also have a President who likes to negotiate and he usually opens negotiations with the threat of big numbers. However, keep in mind that Congress does have the power to intercede in trade negotiations, has some important elections coming up in November, and has shaken its saber a few times in response to the President. Our system of checks and balances lives on.

While our political system lives on, China’s was dealt a blow as its parliament abolished term limits for President Xi Jinping, leading some to wonder whether the country is turning into a dictatorship. And, while we’re on the topic of rulers, Vladimir Putin won another term as leader of Russia, amid widespread word of ballot stuffing.

Some of the more quiet positives for the quarter were from India who passed the largest infrastructure improvement bill in its history and who announced that its annualized growth was 7.2% at the end of 2017. Emerging markets continue their amazing growth story despite their intriguing political environments.

Bonds: Smooth Rides



Bonds were slightly down in Q1, finally succumbing to increasing interest rates.While their market values declined, their yields increased, which means that we should eventually see better returns. Consumer lending was healthy in Q1, mimicking a growing economy.

The other big news in the bond market was our new Chairman of the Federal Reserve Board, Jerome Powell. Powell is the first Fed Chair since 1979 who has no formal training in economics. He is a lawyer-turned-banker who earlier sided with the other members who wanted to raise rates more rapidly (the “hawks”) but more recently sided with Ms. Yellen who generally kept a softer tone about interest rate rises (a “dove”). Powell first served in the government as a Treasury official in the administration of George Bush senior. He then spent time in the private sector and with a bipartisan think tank before being appointed to the Board by President Obama.

Mr. Powell’s first appearance before Congress was generally balanced and well received. It is apparent that we will have three increases in the benchmark Fed

Funds Rate target this year (the rate that banks charge each other to borrow money overnight). The first increase came at the end of March, bringing the current target rate to 1.75%.

Increasing rates indicate a growing economy while at the same time causing some concern for bond investors. As we've said in the past, it's important to keep the concept of total return in mind, especially when thinking about bonds. Total return includes both interest payments while holding bonds and the eventual maturity value. When a bond is purchased the yield to maturity is locked in. Price fluctuations in the bonds after they're purchased are meaningless as long as they are held to maturity and as long as they are paid off at maturity by the issuer. This is why Vista prefers intermediate maturity bonds that have a high probability of being paid off at maturity. We can wait out relatively short periods to maturity if we need to.

Summary: Diversification Once Again Comes Through

The first quarter saw increases in volatility in the stock markets and increases in interest rates in the bond markets. We knew that both of these would eventually occur. Despite all this activity, portfolio values were mostly flat for the quarter. This proves two things: markets change and diversification works.

We hope this briefing brings a little more light to the numbers in your reports. As always, we look forward to any questions you may have. Thank you for your trust in Vista.

Your Vista Wealth Management Team

Source of all charts and data: Morningstar Direct
Economic data is from BCA Research, Dow Jones, and The Economist Newspaper Limited.

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