GRANT STREET ASSET MANAGEMENT, INC.

QUARTERLY LETTER

1st QUARTER 2018

3/31/18

When compared to 2017's steady increase of equity markets around the world, the first quarter of 2018 reflected a return to more normal market fluctuations. While stocks rallied 5.7% in January, markets reversed in February and March, resulting in negative returns so far for 2018 for most market indexes around the world. For historical context, the S&P 500 on average experiences one 10% drawdown and five 5% drawdowns in a given calendar year, and yet it posts positive calendar year returns 76% of the time. Prior to January 2018, the S&P 500 had gone 1.5 years without a single 5% or higher drawdown. As long-term investors, we acknowledge that such a low volatility environment is not sustainable. We believe it is important to note that the recent market sell-off was not driven by any measurable deterioration in economic or corporate fundamental data. Instead, expectations for rapidly rising inflation and the Trump Administration's newly proposed trade tariffs dominated headlines and impacted investor psychology.

Index	First Quarter 2018
S&P 500 (Large Companies)	-0.8%
S&P 400 (Mid-sized Cos.)	-0.8%
S&P 600 (Small-sized Cos.)	+0.6%
MSCI EAFE (Europe, Australia and Far East)	-1.5%
MSCI Europe	-2.0%
MSCI EM (Emerging Markets)	+1.4%

When examining data that drives economic and market cycles, fundamentals remain strong and supportive of continued stock market expansion. Fourth quarter U.S. GDP expanded at 2.9%, better than expected and driven strongly by real consumer spending at 4.0%. Consumer confidence indices reached an 18-year peak in February, and consumers appear healthy overall due to modestly rising incomes, impressive job gains and headline unemployment at 4.1%. Even the U6 measure of unemployment, which includes employed workers considered underemployed, has fallen below the long-term average to levels not seen

PITTSBURGH: 380 SOUTHPOINTE BLVD. · PLAZA II, SUITE 315 · CANONSBURG , PA 15317 412-257-8060 · Fax 412-257-8435
CHARLOTTE: 128 SOUTH TRYON STREET · SUITE 1710 · CHARLOTTE, NC 28202 704-719-1060 · Fax 412-257-8435

since 2007 and prior to that 2001. This data reflects a U.S. economy at "full-employment". The U.S. manufacturing sector continues to strengthen, achieving its strongest readings since 2004 (based on the ISM Manufacturing PMI data), and corporate revenue growth for fourth quarter (reported in Q1 2018) was at its strongest level in over five years.

Internationally, the story for fundamental economic and market data is similar. The purchasing manager index (PMI) for developed economies globally remains in solid growth territory, with readings in the mid-50s (anything above 50 signals expansion). European companies are consistently growing earnings for the first time since 2014, with expectations of 8% earnings growth in 2018. Euro-area unemployment is down to 7.3%, and GDP growth exceeded that of the U.S. for the first time in a decade, accelerating through year end to 2.5% growth for 2017. Political uncertainty in Europe led headlines during the quarter but did nothing to derail overall economic activity. In China, manufacturing data reflects growth and GDP is estimated at 6.6% for the fourth quarter. Other Asian economies also reflect solid growth expectations, with Vietnam GDP reaching 7.4% in the fourth quarter.

Back in the U.S., new Federal Reserve Chairman Jerome Powell used his first FOMC meeting to increase the federal funds rate by 25 basis points (0.25%) to a range of 1.50% to 1.75%. His comments after the meeting that the Federal Reserve did not see the economy "on the cusp of an acceleration in inflation" allayed investors' inflation fears for the time being. The 10-year U.S. Treasury peaked at 2.94% and ended the first quarter at 2.74%, representing a 34 basis point increase over the prior quarter and the largest since late 2016. As a result, bond returns in the U.S. were also negative for the quarter.

Index	**First Quarter 2018**
Bloomberg Barclays Aggregate Bond	-1.5%
Bloomberg Barclays Municipal Bond	-1.1%
Bloomberg Barclays High Yield	-0.9%

With regard to interest rates, the Fed has signaled continued rate increases over the next several years. For consumers and investors, these short-term rate changes drive changes in longer-term rates applicable to credit cards and loans for vehicles and homes. Freddie Mac's Primary Mortgage Market Survey showed home loan rates on conventional 30-year mortgages are now at 4.44%, up from 3.99% at the end of December. 15-year fixed mortgages increased to 3.90% from 3.44%. While rates are higher, they remain near all-time lows and continue to be very supportive of further growth in housing and consumer spending.

Where do we stand today on headlines of inflation fears and tariff-talk, both of which weighed on investor optimism in the first quarter? Inflationary concerns have dissipated as recent economic data reflects a modest and "under control" inflation environment. A CPI (inflation index) spike of 0.5% in January calmed in February, with year-over-year headline inflation running at 2.2%, and core CPI (ex-food and energy) running at 1.8%. Recall the Fed's own inflation target is 2.0% core inflation, and we remain below that today.

Although tariffs have not made headlines to this extent with recent Administrations, tariffs are not new throughout history, and this will not be the last time they are used as a geopolitical tool. At this time, we envision announced tariffs as a negotiation starting point and suggest they may end up at lower levels overall once actually enacted. Equally important, any negative economic impact potentially felt by the tariffs may be more than offset by other positive economic stimulus. Robert Doll, Chief Equity Strategist at Nuveen Asset Management, details that the announced tariffs between the U.S. and China amount to less than $150 billion. This compares to positive stimulus of $200 billion from the tax cuts, $100 billion in new Congressional spending and a half a trillion dollars of corporate cash profit repatriation. It is apparent that markets have been sensitive to the tariff rhetoric recently, but we do not anticipate the impact from tariffs will have a magnitude great enough to disrupt otherwise positive economic momentum in the U.S.

We have approved two notable changes to our strategies in the first quarter. In response to what we see as continuing rising interest rates, for clients holding taxable core bond strategies, we are currently shifting a portion of the intermediate-term taxable bonds to a short-term taxable bond strategy offering the same yield with half of the interest rate risk and maintaining high quality. For clients holding tax-free municipal bond strategies, this change will not take place, as a short-term municipal strategy offers significantly less yield, and muni bonds overall are less interest rate sensitive than taxable bonds. Within stocks, we continue to focus on positive fundamentals and view the recent market weakness as an opportunity to add to stocks at better valuations. We sold the last pieces of our "defensive" stock positions (equity call writing strategy) and increased large cap international and domestic stock strategies. As reaching new highs in economic metrics typically signals the later stages of any market cycle, what lies beyond 2018 in terms of fundamental data and market valuations is less predictable today. With that outlook on the horizon, we have positioned portfolios in today's environment to benefit from positive and accelerating data from the U.S. and markets around the world and remained focused on the fundamentals to assess the progression of this market cycle.

We wish to take this opportunity to share some good news from within the Grant Street team. On March 17, we celebrated Grant Street Asset Management's 25th anniversary. We are grateful to be working for all of our clients and especially wish to express our humble gratitude to those clients that have been with us since day one. To continue providing the best service possible, we have also recently grown the Grant Street staff with two new team members. Shari Bruce has joined us as our new receptionist and administrative professional. When you call the office, you will notice her friendly voice on the phone. Shari comes to us with many years of public relations and administrative experience within the legal and special education industries. Diana Graves, the voice you know well from calling the office over recent years, has been promoted to Client Service Associate. Her excellent rapport with our clients and intimate knowledge of how we serve clients will lend well to her becoming more involved in client communications and service. Finally, we welcomed Nick O'Neill as a new Operations Associate. Nick joins us with a strong operations background through his career at Federated Investors and two other investment advisory firms. Nick will work with Kim Parenti, our Director of Operations, to support reporting, account set up and management and client requests and questions. As Grant Street grows through thoughtful referrals from our clients, we are committed to continued investment in our people and the client experience to further elevate the service we provide to you.

Sincerely,

Terry L. Pfeffer
Sr. Vice President/Finance

Michael M. Evans
President

Michael C. Loch
Vice President/Director of Research

John S. Ferraro
Sr. Vice President

Kristen E. Jackson, CFA
Vice President/Portfolio Manager

Brian W. Conway
Vice President/Sr. Research Analyst

Patrick T. Evans
Sr. Financial Advisor