GRANT STREET ASSET MANAGEMENT, INC.

QUARTERLY LETTER

2nd QUARTER 2018

6/30/18

The first quarter left most equity markets slightly negative for the year; however, the second quarter brought positive returns on the back of solid economic data and the strongest U.S. corporate earnings season since 2011. The earnings of companies within the S&P 500 Index (large-cap stocks) actually grew 24.6% over the same quarter last year, but these results did not drive stock prices much higher in the second quarter. While the significant growth in earnings was boosted by the recently enacted corporate tax cuts, it was the strong global economy that drove revenue growth, which was over 8% for large-cap stocks. Throughout the quarter, market sentiment was periodically affected by short-term psychological concerns regarding rising interest rates, inflation and concerns that discourse about tariffs and trade may affect global growth. Despite tariff-dominated headlines and unfavorable commentary from financial pundits, markets marched steadily higher. Underlying economic data and corporate fundamentals, both of which drive long-term stock market performance, in our estimation remain solid. For the quarter and year to date, small companies outperformed their large counterparts due to their limited foreign exposure, as the following chart reveals:

Index	Second Quarter 2018	Year to Date
S&P 500 (Large Companies)	+3.4%	+2.7%
S&P 400 (Mid-sized Companies)	+4.3%	+3.5%
S&P 600 (Small-sized Companies)	+8.8%	+9.4%
MSCI EAFE (Europe, Australia and Far East)	-1.2%	-2.8%
MSCI Europe	-1.3%	-3.2%
MSCI EM (Emerging Markets)	-8.0%	-6.7%

First quarter U.S. GDP expanded at 2.0% in-line with expectations after a strong fourth quarter. Recent consumer spending data has been strong, indicating second quarter consumer spending could be upwards of 4% annualized. Confidence among both small businesses and consumers remains near historical highs. The NFIB's small business optimism index achieved its second highest reading in the 45-year history of the survey, with business owners reporting confidence regarding both expansion opportunities and earnings trends (compensation). Consumer confidence remains near its highest levels in over 18 years on sustained job growth

(May was the 92nd consecutive month of job growth in the U.S., the longest recorded streak) and wage gains at 2.7% year-over-year in May. The U.S. economy is currently operating at or near "full employment", with more job openings reported than the number of unemployed workers in the economy.

International economic data pulled back slightly during the second quarter, but remains firmly in expansionary territory with the purchasing manager indices (PMI) readings solidly in the mid-50s (a reading above 50 signals economic expansion). Similar to the U.S. consumer, Eurozone consumer confidence is at its highest levels since the early 2000s amidst improving wage growth and a continued decline in the unemployment rate. European corporations (as measured by the STOXX 600 Index) are expected to report strong earnings growth of approximately 8% for 2018. The European Central Bank (ECB) announced that it would phase out its government bond purchase program by December, marking an end to the extraordinary monetary policy enacted after the 2008 financial crisis and 2011 economic recession; however, short-term interest rate increases are not anticipated until at least mid-2019. It seems that every quarter brings a new political issue to diffuse in Europe, but markets have not reacted to the region's political dysfunction, which many consider business as usual. While the Italians were initially unable to form a functioning government, the second attempt was successful and relieved pressure on both bond and currency markets. Emerging markets continued to underperform as the U.S. dollar strengthened and expectations for rising interest rates put pressure on EM currencies.

The Federal Reserve once again increased the federal funds rate by 25 basis points (0.25%) to a range of 1.75% to 2.00%. As investors have anticipated, Fed board members increased their overall expected number of rate increases this year to four instead of just three. Chairman Powell also announced that the Fed would now hold a press conference at every meeting going forward. This may provide more freedom to the Fed to raise rates more frequently because the prior pattern had been to only raise rates at meetings with press conferences, which occurred every other meeting. The 10-year U.S. Treasury breached the 3% level for the first time since early 2014, peaking at 3.12% in mid-May and ended the second quarter at 2.85%. This move represents an 11-basis point increase over the prior quarter. As a result, bond results were mixed for the quarter, with taxable high-quality bonds posting negative returns.

Index	**Second Quarter 2018**	**Year to Date**
Bloomberg Barclays Aggregate Bond	-0.2%	-1.6%
Bloomberg Barclays Municipal Bond	+0.9%	-0.3%
Bloomberg Barclays High Yield	+1.0%	+0.2%

As we see sustained strength in the economic and corporate data that we track and review on a weekly basis, we continue to lean on equities to drive growth in portfolios. We believe the positive fundamentals will overcome any short-term psychological concerns regarding trade issues. Analysts' calculations suggest that global tariffs announced thus far are too small of a dollar amount to alone derail what is otherwise a global economy driven by organic growth and improvement. There is no doubt that sustained and sizable tariffs can impact business decisions and capital investment eventually, which can in turn lead to weaker growth than otherwise may have been achieved. While we continue to survey the outcome of the trade talks and their possible impact on global growth in the future, we are hopeful that much of the political rhetoric may be nothing more than a negotiation starting point for a modestly better global trade position for the U.S.

Investors have also expressed concern surrounding the shift towards a higher interest rate environment, after slowly tiptoeing into the rising rate waters since the first Fed Funds increase way back in December 2015. We began positioning the fixed income section of portfolios to combat the tide of rising interest rates early in 2013. We have continued to add specialized strategies to achieve positive returns in the fixed income section, while still positioning this segment as "defensive" and a true hedge against the volatile nature of equities. Most recently, we took action to further reduce the interest rate sensitivity of our fixed income segment without reducing quality or yield. We are optimistic about the current strength and pace of U.S. and global growth for the remainder of 2018, and we remain vigilant in our tracking of economic and corporate data to assess the potential for continued strength in equity markets and sustainable growth in this notably long economic recovery.

Sincerely,

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