GRANT STREET ASSET MANAGEMENT, INC.

QUARTERLY LETTER

2ND QUARTER 2019

6/30/19

As of this month, the U.S. has now experienced the longest economic expansion in history. The recovery coming out of the 2007-08 Global Financial Crisis officially began in June 2009 and is now over 10 years old. To put this into perspective, prior to the current period, the longest expansion lasted exactly 120 months in the 1990s (ending in 2001), whereas the average post-World War II economic expansion in the U.S. is about five years. This impressive economic feat can be attributed to multiple factors, including consistent, albeit slow economic growth, accommodative monetary policy and low levels of inflation. Economic data continues to be mostly positive in the U.S., although it has slowed overall since the third quarter of 2018.

While the second quarter was marked by global trade-related swings in stock prices, returns were positive for the quarter overall and have contributed to impressive gains so far in 2019. Stock returns around the world were as follows:

Index	**2Q 2019**	**Year-to Date 2019**
S&P 500 (Large Companies)	+4.3%	+18.5%
S&P 400 (Mid-sized Companies)	+3.0%	+18.0%
Russell 2000 (Small-sized Companies)	+2.1%	+17.0%
MSCI EAFE (Europe, Australia & Far East)	+4.0%	+14.5%
MSCI Emerging Markets	+0.8%	+10.8%
MSCI ACWI (All Country World Index)	+3.6%	+16.2%

First quarter GDP, which was released during the second quarter, had a solid start to the year, up 3.1%. The consumer continues to be upbeat. Consumer confidence hit a 6-month high in May and dipped slightly in June on trade concerns. U.S. retail sales increased in May at a 3.2% year-over-year rate, and sales for April were revised higher to positive 0.3% from a previously estimated negative 0.2%. Consumer spending has slowed from peak levels, but it remains a solid contributor to economic growth. Employment also continues to be a bright spot. The unemployment rate remains near 50-year lows at 3.7% with wage growth most recently at 3.1%, a slight dip from recent readings. A modest wage growth figure also bodes well for controlled inflation. Both headline and core inflation (excluding food and energy) are currently reading below the Federal Reserve's 2.0% target, providing evidence that the economy is not overheated. Finally, the leading economic indicators index consisting of 10 broad-based economic factors that shift ahead of economic cycles continues to improve. This measure historically peaks and begins contracting twelve to eighteen months prior to a recession. While the latest reading was flat from

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

the prior month, we have not yet witnessed a peak in this data point, which we believe is a yet another signal that this economic recovery has further to run.

While there are many positive economic data points to reference, there are pockets of weakness that warrant attention at this phase of the cycle. The U.S. consumer remains strong and upbeat; however, business confidence metrics are less robust and have dropped noticeably on the uncertainty related to the near-term direction of global trade. Also related to trade uncertainties is weakening global manufacturing. Manufacturing PMI data for the U.S. has fallen steadily but remains in expansion territory, whereas global PMIs fell to 49.8 in May, indicating contraction for the first time since 2012. U.S. inventories have also climbed. This may be due to some stockpiling of goods and raw materials ahead of planned tariffs, but high inventories may lead to anemic second quarter GDP growth, in the range of 1.0-1.5%. We believe the majority of weakness we are tracking in economic data is due to lack of clarity on global trade.

The U.S./China trade deal, which appeared to be heading towards a resolution early in the quarter, took markets by surprise when talks unexpectedly broke down. In May, the U.S. administration committed to increasing tariffs to 25% (from 10%) on $200 billion of Chinese goods, and China retaliated by threatening to increase tariffs on $60 billion of U.S. goods. In June at the G20 conference, President Trump called for a temporary truce and postponement of the tariffs and committed to restarting negotiations. Investors reacted to this "good news", and stock markets posted one of the best June returns in history. Investors and businesses continue to wait for clarity on the outcome of these trade negotiations.

During the increased equity market volatility in the month of May, investors sought out the safety of fixed income, and more specifically U.S. Treasury Bonds. Throughout the quarter, the 10-year U.S. Treasury yield dropped to 2.00% from 2.41% as investors increased their expectations that the Federal Reserve would cut interest rates as soon as July due to economic weakness. Markets are currently pricing in two potential rate cuts before year end 2019, which comes after a total of nine interest rate increases since December 2015. Fed Chair Jerome Powell indicated that the Fed would "act as appropriate" to sustain the expansion, comments that indicated to markets that an interest rate cut would be considered if needed. The dramatic shift in Fed policy since the end of 2018 has reversed investors' concerns of interest rate spikes and led to positive fixed income returns across most bond sectors.

Index	**2Q 2019**	**Year-to-date 2019**
Bloomberg Barclays U.S. Aggregate Bond	+3.1%	+6.1%
Bloomberg Barclays Municipal Bond	+2.1%	+5.1%
Bloomberg Barclays U.S. Corporate High Yield	+2.5%	+9.9%

Globally, geopolitics and central bank activity continued to drive headlines. In the U.K., British Prime Minister Theresa May resigned following yet another failed attempt at uniting Parliament on a plan for England's exit from the European Union. Her successor will likely take office this month. The favorite, Boris Johnson, is outspokenly pro-Brexit and has indicated that he is prepared for the October 31 deadline to exit the E.U. with or without a deal.

Concerns about global economic slowdown prompted central banks in Australia, Chile, India and Russia to all cut interest rates in June in an effort to stimulate their economies. The European Central Bank joined the chorus and reversed previous guidance for rate hikes. In its June meeting it held rates steady at 0% and forecasted no rate hikes through mid-2020. The Bank of Japan followed suit, indicating a steady rate for now and increased willingness to cut rates this year. Accommodative monetary policy around the world may continue to be supportive of stock prices despite uncertainties related to trade.

As we believe economic growth will continue at a slower pace, we have made few changes to portfolios in the second quarter. Within the fixed income portion of client portfolios, we continue to increase the quality of the holdings and have added to the U.S. Treasury position that was initiated in the first quarter. When investors sell stocks and push down bond yields in anticipation of central bank rate cuts, U.S. Treasury returns rally and are considered a safe haven. At this phase of the cycle, we are no longer concerned about a spike in interest rates. As a result, some of the unique bond strategies that have performed well in rising rate environments that have been part of the fixed income section of client portfolios since 2013 have been transitioned to high-quality government bonds as a small step towards building in more resilience to portfolios as we enter later phases of the current cycle. On the stock side, we continue to be positioned for economic growth. We are diligently monitoring the U.S. and global environment for signs of shifting tides while identifying investment opportunities for appreciation in a slow-growing global economy.