



GRANT STREET ASSET MANAGEMENT, INC.
QUARTERLY LETTER
3RD QUARTER 2018
9/30/18

Equity markets benefited from a second consecutive robust quarterly earnings season, with the S&P 500 Index (large-cap stocks) gaining more than 3% in both July and August, before achieving more modest gains in September. The earnings of companies within the S&P 500 Index grew at 25% over the same quarter last year. Corporations continue to reap the benefits from the corporate tax cuts enacted in late 2017, while strong economic data has propelled revenue growth, which was over 9% for large-cap stocks. Throughout the quarter, U.S. markets digested concerns as they have in previous periods: rising interest rates, global trade concerns amidst tariff escalations, and international political discord. At the end of the quarter, with a looming deadline, the U.S., Mexico and Canada negotiated an updated trade deal (USMCA) to replace the 25-year old tri-lateral NAFTA. Due in part to the strength of the underlying economy, U.S. equity markets brushed off each potential area of concern and continued to push higher.

European earnings continue to be solid in 2018, albeit not as strong as their U.S. counterparts, with earnings growth of 9.7% and revenue growth at 3.2%. Economic data, which has pulled back from highs achieved in late 2017/early 2018, remains in expansionary territory with the German IFO Business Climate Index turning higher into quarter-end and major country purchasing manager indices (PMI) readings above 50 (with the exception of Italy). International markets did not fare as well as domestic markets amidst ongoing political issues in Turkey and Italy, Brexit uncertainty, and a stronger U.S. dollar (which weakens returns for U.S.-based investors).

Index	Third Quarter 2018	Year to Date
S&P 500 (Large Companies)	+7.7%	+10.6%
S&P 400 (Mid-sized Companies)	+3.9%	+7.5%
S&P 600 (Small-sized Companies)	+4.7%	+14.5%
MSCI EAFE (Europe, Australia and Far East)	+1.4%	-1.4%
MSCI Europe	+0.8%	-2.5%
MSCI EM (Emerging Markets)	-1.1%	-7.7%

Second quarter U.S. GDP expanded at an impressive 4.2%, a significant improvement from the first quarter and represents the strongest quarterly growth since 2014. Higher consumer spending and business investment propelled economic growth for the quarter. Based on the strong first half of 2018 and expectations for continued economic gains in the second half, GDP for the entire year could be upwards of 3% annualized. To put that growth estimate into perspective, annual GDP has averaged 2.2% since the 2008 financial crisis, and has not achieved 3% since 2005. Confidence among both small businesses and consumers remains near highs. Consumer confidence achieved an 18-year high in September, while the University of Michigan Consumer Sentiment survey topped 100 for just the third time since 2004. The NIFB's small business optimism index achieved the highest level in the 45-year history of the survey in August. The employment situation continues to be a leading driver of consumer confidence, with the September unemployment rate falling to 3.7%, the lowest level since December 1969. While the economy added less jobs than anticipated in September (+134k), the previous two months were revised higher, which pushed the monthly average jobs gain to over 210,000 for the year. One area within the employment data that has yet to achieve pre-2008 levels is wage growth, which came in at 2.8% year-over-year in September. However, modest wage growth also keeps a lid on a rapid rise in inflation, which today is at 2.2% year-over-year as measured by CPI.

The Federal Reserve increased the federal funds rate by 25 basis points (0.25%) to a range of 2.00% to 2.25%. Expectations are for a fourth increase this year at the upcoming December meeting, while Fed board members have indicated three increases next year. The 10-year U.S. Treasury grinded slightly higher throughout the period, ending the quarter at 3.05%. Yields continue to rise into the fourth quarter, and the yield curve has steepened slightly. This marked the fifth consecutive quarterly increase in the bond benchmark yield, and a 20-basis point increase over the prior quarter. As a result, bond results were mixed for the quarter, with high yield (below investment grade) bonds outperforming taxable high-quality bonds in a rising rate environment.

Index	Third Quarter 2018	Year to Date
Bloomberg Barclays Aggregate Bond	+0.0%	-1.6%
Bloomberg Barclays Municipal Bond	-0.2%	-0.4%
Bloomberg Barclays High Yield	+2.4%	+2.6%

During the third quarter, we sold one of our theme positions focused on a recovery in residential housing. This has been one of our equity themes since 2013, and while the consumer remains strong and housing demand robust, our long-term conviction in this strategy has diminished due to increasing interest rates (affecting mortgages), rapidly increasing housing prices nationwide and a high level of sensitivity of the theme to any dips in consumer data. We are currently researching a number of potential new investments, including a large cap dividend growth strategy that represents a core U.S. position with less technology weighting than the broad U.S. indices. This difference is important because the technology sector has been driving U.S. large cap index returns and currently represents the largest weighting of the index for that sector since the late 1990s. While our strategy currently has a sizable weighting to these core U.S.

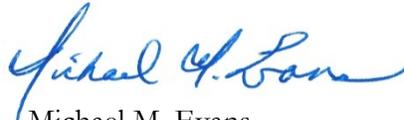
investments compared to our style historically, we feel it is prudent to diversify additional core U.S. exposure away from the most rapidly appreciating segments, which may experience more pricing fluctuations on the downside than the broader market.

As we have discussed in previous quarterly letters, the economic and corporate data that we track and review on a weekly basis remains strong, despite an economy in its 10th year of expansion. As the economy and markets move closer towards the later stages of this cycle, we have taken steps to increase our allocation to core large cap U.S. equities, which exhibit strong fundamentals. While headlines are dominated by talk of increased tariffs and trade skirmishes, we are encouraged by the steps recently taken and achieved in the North American trade deal. Positive fundamentals, including those that lead shifts in market cycles, guide us to believe that this market cycle has further to run. As a result, we remain overweight to stocks compared to bonds. Diversification remains an important tool that can be implemented by investors to protect portfolios during periods of market stress, similar to what occurred in January/February and again thus far in early October. The market volatility experienced in the last week is a reminder of the importance of remaining steadfastly diversified across capitalization and geography as a risk mitigation tool. We continue to diligently track the data that drives market cycles and stock valuations, and we strive to maintain a purposeful balance between capturing appreciation available to investors in late stage cycles and prudently preparing for the future.

Sincerely,



Terry L. Pfeffer
Sr. Vice President/Finance



Michael M. Evans
President



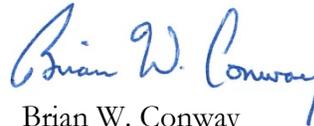
Michael C. Loch
Vice President/Director of Research



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