GREENLEAF TRUST

Perspectives

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2019 Mid-Year Market Review

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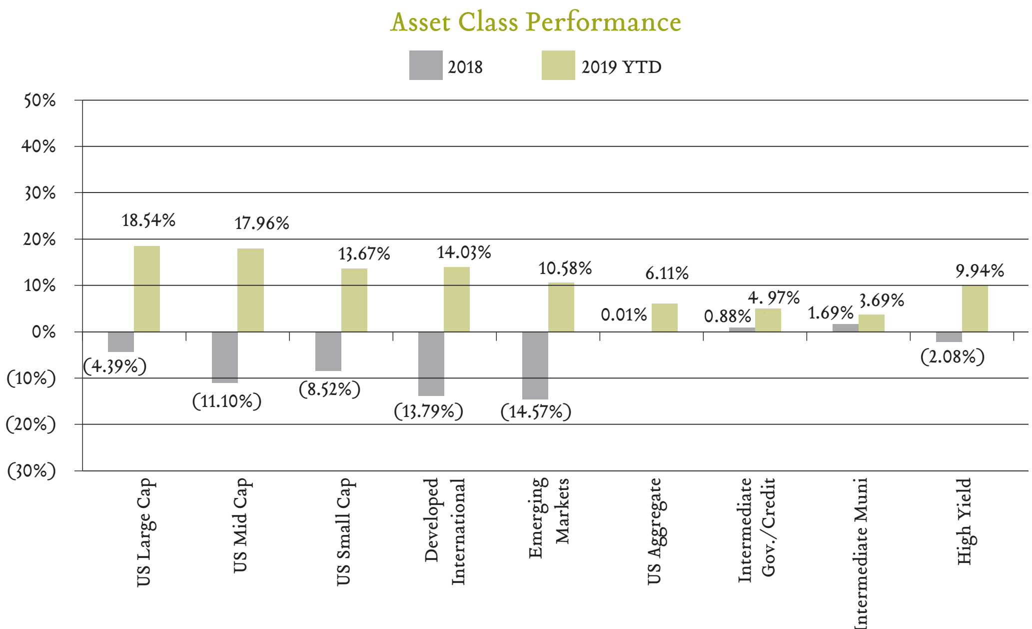

In our 2018 year-end seminar we recapped a period where almost every major asset class posted disappointing returns as investors grew increasingly concerned by the prospect of a global economic slowdown. We also provided our outlook for the key themes we expected to influence markets in the near- term, and the capital market assumptions shaping our longer-term expectations. Having recently passed the half way mark in 2019, we offer some perspective on the start to the year and our outlook.

Throughout 2018, but particularly in the 4th quarter, investors became increasingly anxious about the prospect of a recession, reacting sharply to any data point or headline that could signal a slowdown. While many of the economic concerns contributing to the 2018 experience remain, most asset classes have recovered significantly in the first half of 2019.

- Global Equities: In 2018, global equities declined 9%. Domestic large caps fared "best" (down 4%) while developed international and emerging market stocks posted double-digit declines. Year-to-date, global equities are up more than 16% led by domestics (+18%) and followed by developed international (+14%) and emerging markets (+11%).
- Fixed Income: In 2018 rates were largely on the rise. From a starting yield of 2.40% on the US 10-year treasury, rates peaked at 3.24% in November and closed the year at 2.68%. As a result, bond returns were either flat or negative in 2018. In 2019, rates have moved lower, briefly falling below 2.00%. As a result, bond markets have rallied significantly year-to-date. Key sources of uncertainty in 2018 included Federal Reserve Policy and US/China trade negotiations. Unsurprisingly, these themes continued to carry significant influence year-to-date.
- Federal Reserve: The Fed raised interest rates four times in 2018 and projected two additional rate hikes in 2019 when the year started. Investors have been paying close attention to Fed language and posturing given a significant disconnect between the Fed's outlook and forward rate expectations implied by the bond market. By the end of the first quarter, policymakers reduced expectations from two rate increases to zero. Policymakers continue to forecast no rate changes in 2019, but the market is pricing in 2-3 cuts this year. Increasingly dovish rhetoric from the Fed suggests an accommodative bias, but we expect continued application of the flexible, data-driven approach to decision-making.
- Trade Policy: Evolving US trade policy and its reception by trading partners introduced uncertainty and fears of

an all-out trade war between the US and China in 2018. In December, President Trump agreed to delay threatened tariff increases while negotiations proceeded. By the beginning of May, a trade deal seemed imminent when officials unexpectedly moved to increase tariffs, citing slow progress in trade talks. President Trump and China's Xi Jinping recently met on the sidelines of the G20 Leaders Summit where they agreed to resume negotiations and hold off on implementing additional tariffs. Visibility is limited, but we believe a negotiated deal remains the most likely outcome.

Having crossed the ten-year mark in June, the current economic expansion is officially the longest on record. Exiting 2018, we were perplexed by markets that seemed to anticipate immediate recession despite data that described a healthy economic backdrop. We have continued to monitor key recession indicators in 2019 and consistent with our late-cycle positioning, we observe some mixed signals.

- Yield Curve: An inverted yield curve (short-term yields exceed longer-term yields) has historically been a useful indicator of future economic growth. The yield curve inverted 4-24 months prior to each of the last seven recessions – there were also two false positives. In March of this year the yield curve inverted, triggering this indicator for the first time since the great recession. The curve remains inverted today.
- Unemployment: The labor market is another indicator of recession risk as rising unemployment can foreshadow economic contraction. The unemployment rate has historically bottomed nine months before the onset of a recession. Unemployment currently stands at a 49-year low of 3.6%, but it is difficult to identify a trough in real time.
- Real Retail Sales: Consumer spending makes up the majority of US GDP, so real year-over-year declines in retail spending can indicate that a recession is near. In December 2018, real retail sales declined 0.3% triggering this indicator, but growth has rebounded in 2019 averaging +1.4% year-to-date.

In 2018, real US GDP grew 2.9%, up from 2.2% in 2017 and 1.6% in 2016. It would be unrealistic to expect the economy to sustain 3.0% growth in 2019, which by definition, means that we expect growth to slow this year. In the first quarter of 2019, real GDP increased 3.1% and forecasts suggest growth closer to 2% in the second quarter. We expect a full year growth rate of 2.0%-2.5% - slower than 2018, but not recessionary.

As for the market experience going forward, we share our updated capital market assumptions below. Our forecasts represent our expectations for average annualized returns for each asset class over the next ten years. Over the next decade, there will be years where returns exceed our expectations and years where returns trail our expectations. We believe any attempt to pick and choose which years to participate is a fool's errand.

Asset Class	10 Year Expected Return (Nominal)	10 Year Expected Risk
US Large Cap	5.0%	14.0%
US Small Cap	7.5%	19.0%
Developed International Equities	6.5%	17.0%
Emerging International Equities	8.5%	22.0%
Core Fixed Income	2.5%	4.5%
Non-Core Fixed Income	4.1%	10.0%
Diversified Alternatives	5.1%	7.5%
Cash	2.1%	0.5%

Source: Greenleaf Trust, as of 6/30/2019

We continue to recommend most of our clients hold a full weight to global equities in accordance with their individualized risk profile and we remain marginally more constructive on international equities. Concurrently, we are less constructive on the outlook in fixed income markets and believe a modest underweight in favor of an allocation to diversifying strategies (alternative assets) remains prudent.

Despite an ever-changing landscape, our disciplined approach and long-term orientation serve us well in our quest to create comprehensive investment solutions that help our clients reach their financial goals. Investment decisions are made in alignment with our documented investment philosophy and always with the intention of serving our clients' best interests.