Veratis ADVISORS

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Quarterly Commentary

We are passionate educators and we believe this commentary is helpful in providing a high level summary of the stock and bond markets on a quarterly basis. However, it is important that investors refrain from market timing as this can have a potentially negative impact on one's long-term wealth accumulation. Instead, investors should continue to make allocation decisions based on their unique time horizon and risk tolerances. All charts referenced herein are provided on page 3 of the commentary.

U.S. Economy

- The U.S. economy continues to grow at a modest pace with some signs of short-term improvement. The expectation for 1st quarter (year-over-year) growth currently stands at 2.0% according to estimates from the Federal Reserve Bank of Atlanta, and some economists believe U.S. economic growth could reach 3.0% in 2018. *Expectations for the 1st quarter are an improvement from the last two years when 1st quarter GDP was 0.6% and 1.2% in 2016 and 2017, respectively (see Chart 1).*
- Historically, the average length of an economic expansion is 47 months, and as of March, we are in the 105th month of the current expansion. *The slower pace in which growth has occurred is a contributor to the longevity of the recovery.*
- Employment is a key contributor to current conditions. The labor force participation rate is slowly improving and unemployment at 4.1% is below the 50-year average of 6.2% and the recent peak of 10.0% during the Financial Crisis. In addition to employment, business and consumer confidence is rising and U.S. manufacturing data continues to be favorable.
- Given the recent acceleration in growth, investors are focused on inflation. The latest reading of 2.4% is above the Federal Reserve's (Fed) target of 2%.
- The dollar has continued to decline in 2018, a continuation of the general trend over the past year. The U.S. dollar index is down -10.5% from a year ago (*see Chart 2).*
- Oil prices continued to rise in the 1st quarter, and the advance over the last 12 months has been 29% (*see Chart 3).* Contributing factors include the continued decline in the dollar, improvements in economic growth, and lower oil inventories.

U.S. Stocks

- While economic growth steadily advanced and corporate profits are at all-time highs, it was a volatile period within the equity market. The Russell 3000 (total U.S. stock market) started off strong, but reversed gains and finished down -0.6% in the 1st quarter. A more fully priced market, geopolitical tension, continued tightening from the Fed, and regulatory concerns involving certain Technology companies have been some of the drivers.
- The performance gap between growth and value continues to lean heavily in growth's favor. The Russell 3000 Growth Index outperformed its value counterpart by 4.3%.
- Opposite of what occurred in 2017, performance improved down the market cap spectrum (*i.e.* micro caps performed better than small caps, small caps better than mid caps, and mid caps better than large caps).
- Only three sectors finished the quarter in positive territory - Technology, Consumer Cyclical, and Financial Services. Among the weakest-performing were less economically sensitive sectors such as Real Estate, Communication Services, and Consumer Defensive.

(Continued on page 2)

Benchmark Performance	Sector	Quarter	YTD	1-Year Average	3-Year Average	5-Year Average	10-Year Average
Index : Russell 3000 TR USD	Total US Stock	-0.64	-0.64	13.81	10.22	13.03	9.62
Index: S&P 500 TR USD	Large Blend	-0.76	-0.76	13.99	10.78	13.31	9.49
Index: Russell 2000 TR USD	Small Cap Stock	-0.08	-0.08	11.79	8.39	11.47	9.84
Index: MSCI ACWI Ex-US IMI NR USD	Total Foreign Stock	-1.06	-1.06	17.10	6.75	6.24	3.06
Index: Barclays Aggregate Bond TR USD	Bond	-1.46	-1.46	1.20	1.20	1.82	3.63
Index: US Treasury Bill 3-Month	Stable Value	0.41	0.41	1.23	0.59	0.37	0.32

Data Source: Morningstar March 31, 2018;

U.S. Bonds

- Jerome "Jay" Powell was sworn in as the new Fed chairman in February. It is expected that his leadership will not trigger a shift away from the gradual, data dependent approach that has been in place in recent years. With this said, the Fed voted to increase rates by a quarter percentage point to a target range of 1.50 to 1.75% in their latest March meeting (supported by the fact that their economic growth and inflation targets were being met).
- Beyond expected gradual increases in short-term rates, the Fed is also reducing its balance sheet by $30 billion a month. At the same time, it is issuing new debt to finance tax cuts, which increases the supply of U.S. Treasuries. Moving forward, this may put further upward pressure on long-term rates if demand does not keep up with supply. *An aging population in the U.S. helps to counteract this potential concern given their growing need for the protective traits of bonds.*
- The 10-year Treasury yield rose to 2.7% from 2.6% at the beginning of the year, and broadly speaking, the rising interest rate environment negatively impacted fixed income returns. The Bloomberg Barclays U.S. Aggregate Bond Index fell by -1.5%.
- From a sector standpoint, Treasury-Inflation Protected Securities (TIPS) and High-Yield bonds led the fixed income market as inflation rose and investors continued to search for yield. The lowest returns were posted by investment-grade corporate bonds and municipals. This was caused by a high level of corporate issuance and concern related to a potential change to the tax-exempt status of certain municipal bonds (*see Chart 4).*

Foreign Economies

- Synchronized global growth continued in the 1st quarter as signs of improvement have been evident on several fronts within the major foreign economies. This statement is supported by a meaningful improvement in manufacturing statistics over the past two years. With this said, current trade negotiations could have a meaningful impact on select countries and the globe over time.
- The Eurozone has posted stronger economic results in recent quarters as the effects of accommodative monetary policy and positive economic momentum are having a down-stream impact. In fact, the latest GDP data represented the region's strongest growth in a decade.
- Japan posted solid economic results during the quarter, as well, marking an 8th consecutive quarter of growth (the longest streak in 25+ years). Unemployment fell to 2.5%, wage growth is on the rise, and year-over-year GDP growth was 2.0%, representing a +1.2% difference from the 20-year average.
- Regarding Emerging Markets (EM), a continued rebound in commodity prices and a weaker U.S. dollar has had a positive impact (generally) on EM economic and market performance.
- Many economists feared that China's transition from an investment-led to a consumer-led economy would have a greater impact (negatively) on growth than it has had thus far. The latest GDP data signaled a 6.8% growth rate, which was ahead of consensus estimates.

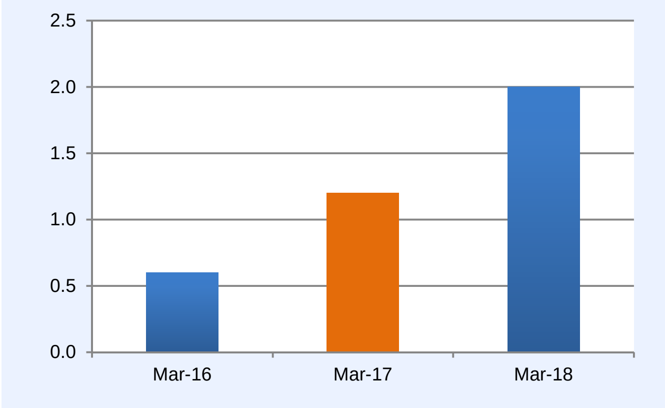
Foreign Stocks

- While economic conditions are improving, the earnings of foreign companies on a broad measure have yet to return to levels achieved prior to The Financial Crisis.
- Lower overall valuations (created by an extended period of underperformance - see chart 5) and the potential for further improvement in earnings leave many money managers with the belief that on a relative basis, foreign stocks are more attractive. However, certain foreign economies remain in a fragile state and geopolitical events can cause above average volatility in less stable markets. *Investors should continue to appropriately diversify their portfolios given these factors.*
- Following a period of outperformance relative to domestic stocks, foreign indexes underperformed domestic indexes by a narrow margin during the quarter. The MSCI ACWI ex-U.S. IM Index (total foreign market) shed -1.1%, which trailed the Russell 3000 Index by -0.4%. Trade negotiations and tensions in North Korea and the Middle East were the primary drivers of volatility in the foreign equity markets.
- Similar to what was experienced in the domestic market, growth outperformed value and smaller cap stocks outperformed larger cap stocks overseas.
- Emerging Markets stocks were a bright spot in the global equity market and one of the only segments that produced a positive return in the 1st quarter. The MSCI EM IM Index gained 1.3%, outperforming its Developed Market counterpart by 2.5%.

Foreign Bonds

- While the U.S. is generally ahead in the tightening cycle, foreign central banks are starting to curb their stimulative efforts. The global transition from a highly accommodative monetary environment to a gradual tightening cycle is illustrated in *Chart 6*.
- Foreign bonds performed strongly with a 3.6% quarterly return as represented by the Bloomberg Barclays Global Aggregate ex-U.S. Index. This is proof that the U.S. and foreign interest rate environments are in a different stage of the cycle. Foreign bonds outperformed U.S. bonds by 5.1% for the quarter.
- Regarding Emerging Markets bonds, currency played a more meaningful role than it did for broader foreign bond indexes. Most U.S. investors gain exposure to EM bonds in dollar terms, and those who invested using dollars experienced slightly negative returns during the quarter (-1.7%). However, in local currency terms, EM bonds posted a gain of 4.4% as investors continued to seek yield in higher risk areas.

Chart 1 - U.S. Real GDP



Source: Source: U.S. Bureau of Economic Analysis. Represents seasonally adjusted annual rates. 1st quarter 2018 GDP is a projection from the Federal Reserve Bank of Atlanta, but this may change as accurate and official data are received.

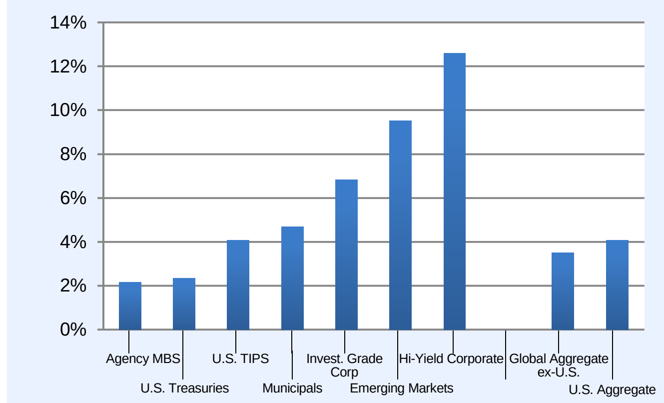
Chart 2 - U.S. Dollar

Source: CNBC. Represents the data from the DXY U.S. Dollar Currency Index.

Chart 3 - Oil Prices

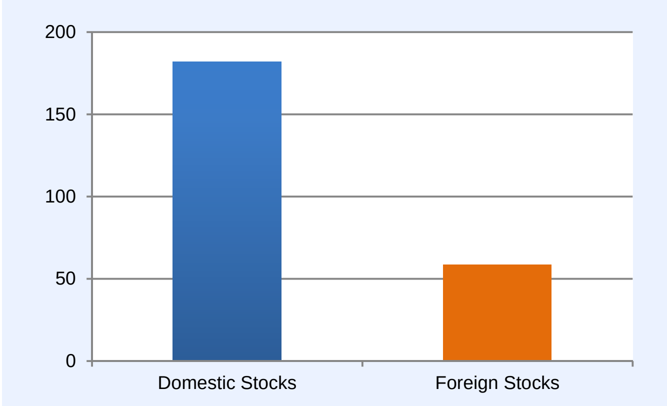
Source: CNBC. Represents West Texas Intermediate (WTI) oil price data.

Chart 4 - Fixed Income Returns



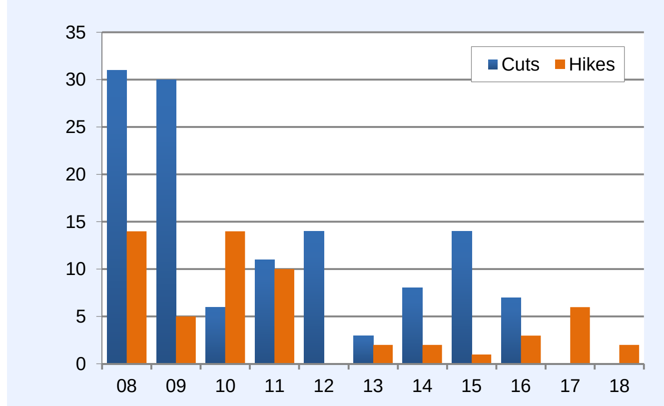
Source: Morningstar Direct. Represents annualized fixed income returns by sector, as well as the broad domestic and foreign bond markets, since the market bottom on March 9, 2009.

Chart 5 - Domestic vs. Foreign



Source: Morningstar Direct. Represents the cumulative returns for the broad domestic and foreign stock markets since January 1, 2010.

Chart 6 - Central Bank Action



Source: JPMorgan Guide to the Markets. Represents the number of rate changes of the top 10 central banks since 2008.

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