THIRD QUARTER 2018 REVIEW AND OUTLOOK EXECUTIVE SUMMARY

Portfolio Themes

- **Quality Tilt:** As the bull market progresses, we prefer equities with stronger balance sheets and consistent margins.
- **Overweight to Information Technology:** The Information Technology sector is heavily skewed toward large, high-quality firms—a segment we expect to outperform in the later stages of a bull market. The sector should also benefit from robust global IT spending driven by the growing demand for products and services related to mobile, cloud computing and the "Internet of Things."
- **Overweight to Health Care:** Health Care should benefit from increasing investor preferences for larger, higher quality companies with long term growth prospects. Within the sector, M&A, rapid EM growth and strong research and development pipelines are leading to record drug approvals and healthy sales growth.

Market Outlook

- **Growing Investor Confidence:** Investor optimism typically increases as a bull market matures. Recent correction angst notwithstanding, US sentiment has improved but is not yet euphoric. Meanwhile, growing optimism in the US remains unmatched by European investors.
- **Strong Economic Drivers:** In both developed and emerging markets, economic drivers remain strong. We believe these fundamentals will come to the forefront as sentiment improves.
- **Global Political Gridlock:** In much of the developed world political gridlock persists decreasing the likelihood sweeping legislation potentially hurting equities passes. With US midterms in Q4 the president's party typically loses power increasing gridlock. US equities have risen in 87% of midterm year Q4s—and each of the two subsequent quarters.

Global equities continued rebounding in Q3, with the MSCI All Country World Index rising 4.3% and finishing near all-time highs.[i] In Q3, political developments drove headlines and spurred fears within developed economies. Tariffs, widening Italian budget deficits and the emergence of populist political figures are a few notable examples. Within the United States, focus shifts to midterm elections and equities' overwhelming tendency to rise in the surrounding quarters—as well as the third year of a president's term. Overall, gridlock dominates the developed world, decreasing the likelihood sweeping legislation potentially hurting equities passes. As investors gradually appreciate this, we believe it will allow them to refocus on positive economic fundamentals in most of the developed world, warming sentiment. In short, we believe equities still have plenty of fuel to rise for the foreseeable future.

Since 1926, US equities have risen in 87% of midterm year Q4s and each of the following two quarters individually—far more frequent gains than the typical quarter.[ii] Better still: Even in the eight instances when at least one quarter was negative, cumulative returns for these nine months were still positive in six. Only twice have equities fallen cumulatively between the midterm year Q4's start and the following Q2's end: Q4 1930 – Q2 1931, during the Great Depression, and Q4 1938 – Q2 1939, as Hitler's territorial ambitions grew. All the other nine-month periods were up, an overall 91.3% frequency of positive returns.[iii]

We believe midterm elections drive this positivity for a simple, underappreciated reason: They tend to increase political gridlock, preventing radical legislation. As we will discuss in the full Review & Outlook, whether Democratic or Republican, the president's party tends to lose relative power in midterms, hindering controversial legislation and reducing political risk. The absence of this negative is positive. Yet investors fail to see this, frustrated by the lack of action

i Source: FactSet, as of 9/28/2018. MSCI All Country World Index Return with net dividends, 6/29/2018 – 9/28/2018
ii Source: Global Financial Data, Inc., as of 9/20/2018. S&P 500 Total Return Index, 1/1/1926 – 12/31/2017.
iii Ibid.

justifying their vote. We think this is why we haven't seen anyone else mention the 87% frequency of positive returns which we have referred to as the 87% Miracle.

While the frequency of positive returns during this period centers on US politics, it is bullish for the world. As we will show in the full Review & Outlook, US and global equities have been highly correlated during this bull market. Europe moves nearly in lockstep with the US. Though correlations measure only direction, this shows good times for US equities are generally good times for the developed world overall, extending the 87% positive effect globally.

Looking ahead, we expect a resurgence in European equities. False fears and political uncertainty obscure strong fundamentals. Monthly economic data, like IHS Markit's purchasing managers' indexes, are now higher in Europe than the US—yet few notice. Italian budget worries, Brexit bickering, ascendant populists and other forces have dampened sentiment, along with fears of more European Central Bank (ECB) quantitative easing (QE) "tapering." We think the end of QE is bullish. Last quarter, we showed why ending QE should help, rather than hurt the eurozone. We are surprised markets haven't yet seen this. Data released during Q3 further prove the point, as we will detail in the full Review & Outlook. From ending QE to Brexit, we anticipate widespread relief as these things most fear finally happen and don't bring disaster—much as widely feared Fed rate hikes didn't hurt US equities. The more they get on with it, the more investors can get over it, freeing equities from uncertainty.

Overall, there is much for investors to like these days. Double-digit earnings growth continues, powered by robust revenues—a sign tax cuts alone aren't responsible for rising corporate profits. Positively, the US and most developed nations are politically gridlocked. The "Goldilocks" economy persists, with moderate growth and mild inflation across the globe. Troubles in Argentina and Turkey steal headlines, but Frontier and Emerging Markets overall are growing, boosting demand for goods and services from the developed world. The US and Chinese economies are shrugging off tariffs, with most indicators showing growth. Several new trade agreements are in progress, including some involving the US—defying protectionism fears.

In short, we expect positive returns to continue through 2019's first half at least. The third year of a US president's term is historically the most consistently positive, with the highest average return. The 91.3% average is the gateway to this. A correction (a sharp, sentiment-fueled drop of -10% or worse) is always possible, but large corrections typically don't occur during US presidents' third years or during the midterm miracle. Any declines seem likely to be small and short-lived.

Should you have any questions about any of the information in the Third Quarter 2018 Review and Outlook, please contact us at (800) 851-8845 or FisherInstitutional@fi.com.

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