



Capital Cities

INSTITUTIONAL INVESTING MADE PERSONAL

2018 Review/2019 Outlook

February 2019



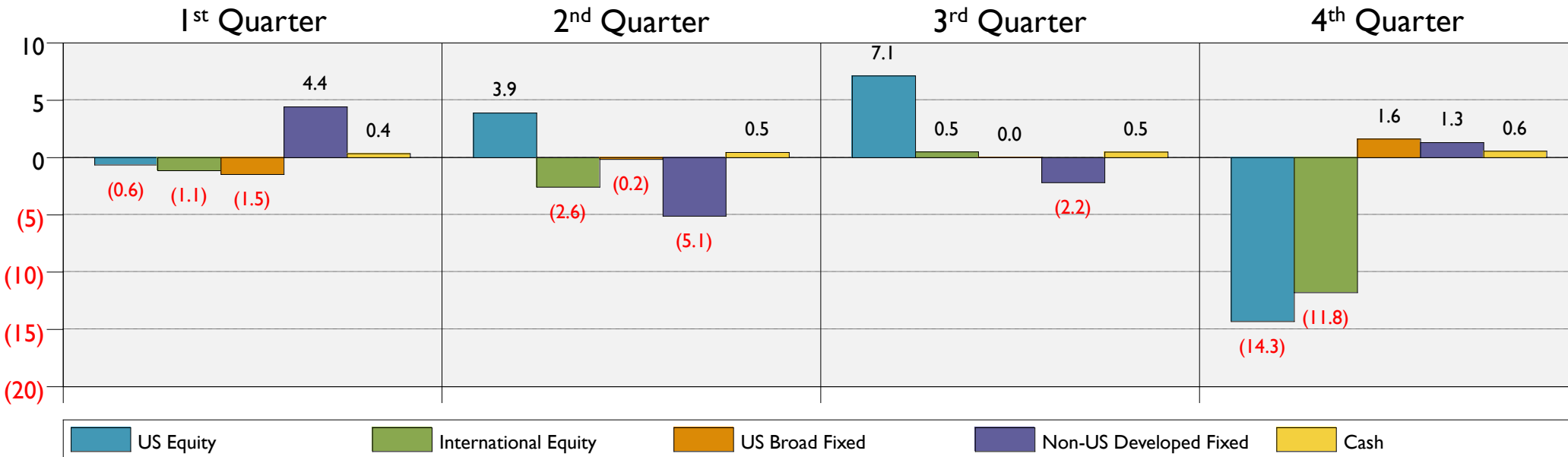
The Market Environment

The return of volatility in 2018 has impacted the outlook for 2019

2018 started out as 2017 left, with record low volatility and soaring asset prices. The S&P 500 hit a then record high in mid-January before volatility was reintroduced in February.

The middle of the year was marked by strong earnings and economic growth, record-setting share repurchases, and a tech mania not seen since 2001.

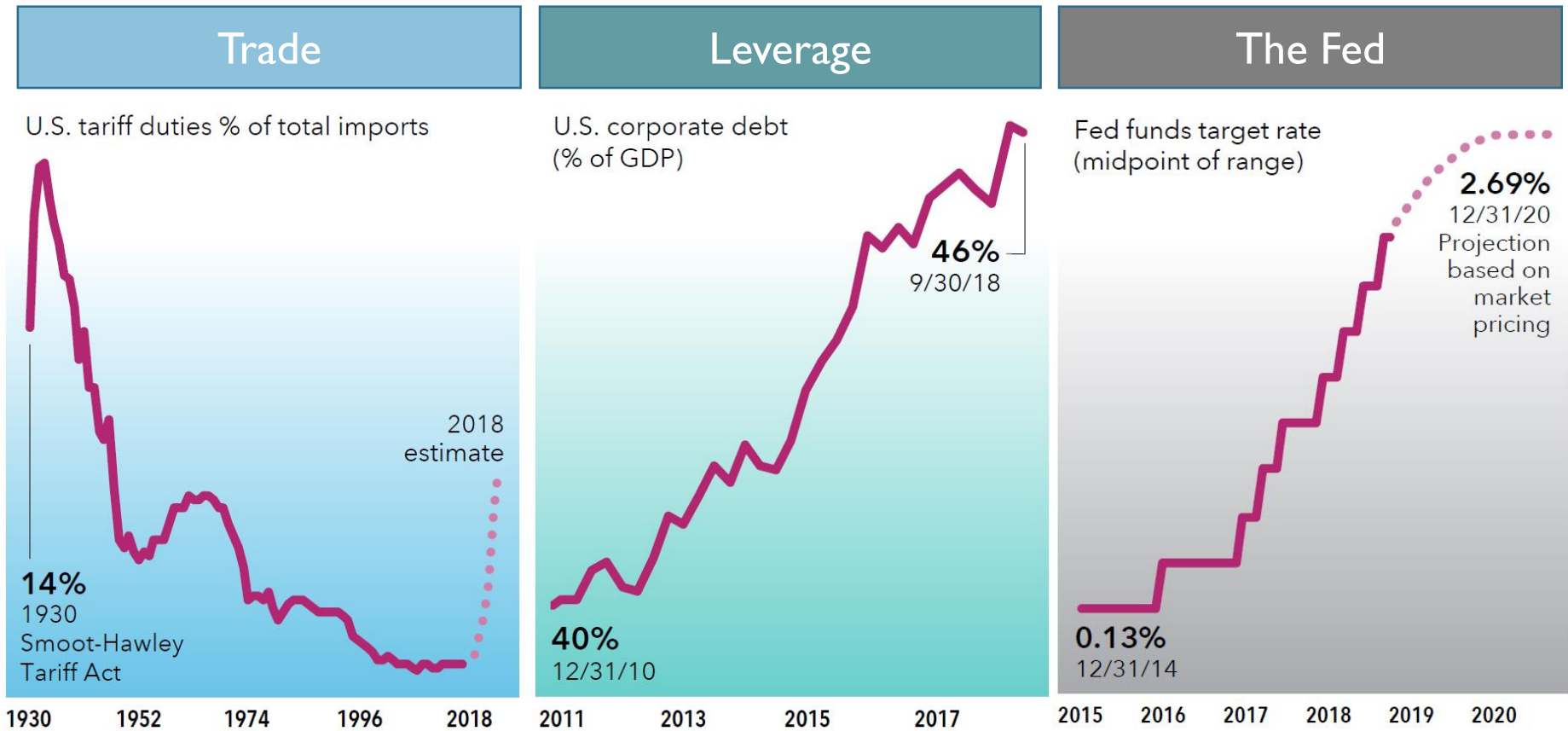
Closing out the year, inflation expectations waned while the Fed continued on its path towards normalization, removing liquidity and causing investors to de-risk.



Looking ahead, tighter global monetary policy, trade negotiations, and geopolitical hurdles, could lead to slower growth and further volatility in 2019.

Performance Drivers

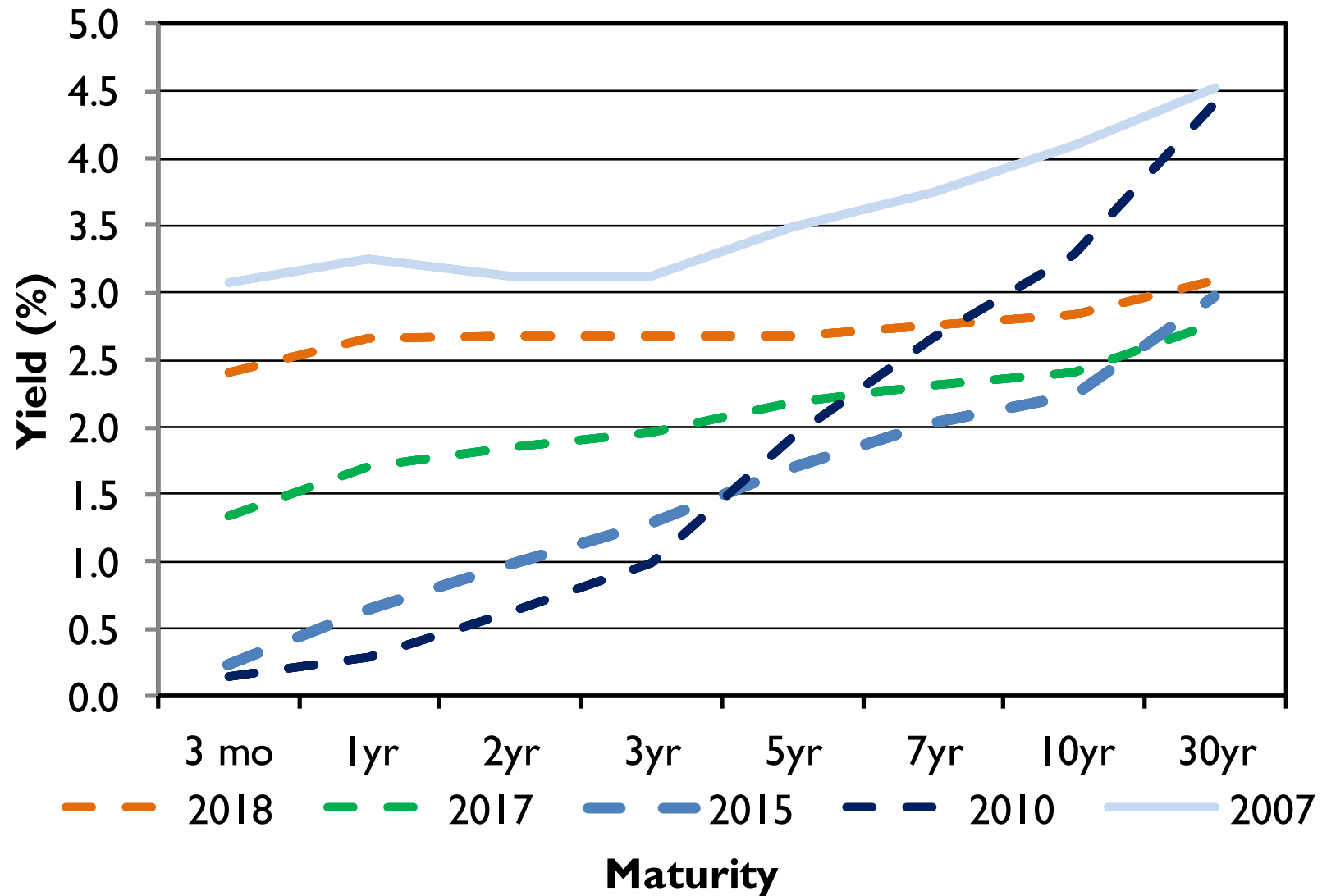
Three main factors drove market sentiment during 2018



Sources: Bloomberg, Federal Reserve, Peterson Institute for International Economics, Thomson Reuters. Fed funds target rate projections based on pricing in the futures markets as of 11/30/18.

U.S. Treasury Yield Curves

The yield curve flattened in 2018



Resulting Investment Returns

Time horizon matters

Equity

- U.S. stock returns were negative for the first time since 2008 though generally outperformed international stocks.
- Large-cap stocks held up better than their small-cap peers.
- The long-term returns of U.S. stocks have been strong and have outpaced bonds over five-, ten- and fifteen-year periods.

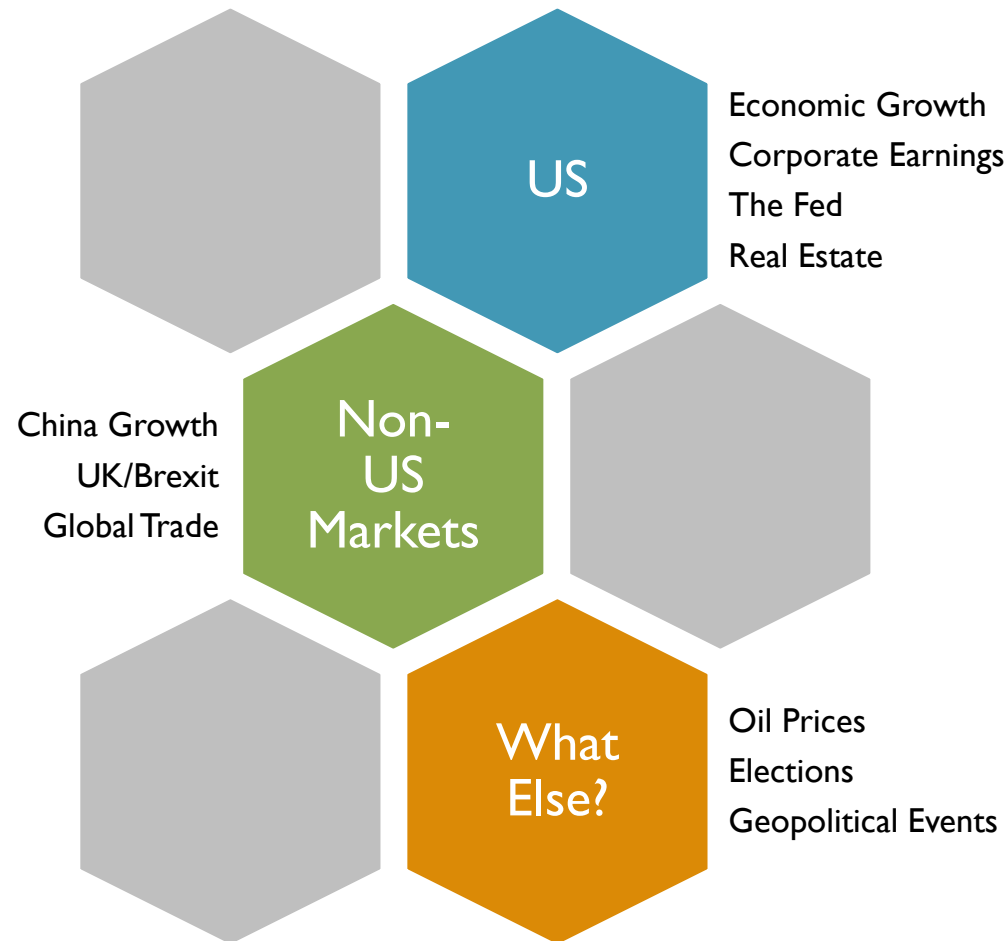
Fixed Income

- The Federal Reserve hiked the Fed Fund rate four times during 2018 and forecasts are suggesting two more hikes in 2019.
- The U.S. Dollar strengthened relative to foreign currencies and foreign bonds underperformed domestic counterparts.
- Returns on cash have ticked up; however, remain low relative to historical levels.

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Average Annual Return			
																Five Years 2014-2018	Ten Years 2009-2018	15 Years 2004-2018	
<u>Broad U.S. Stock Market</u>																			
Russell 3000 Index	11.95	6.12	15.72	5.14	(37.31)	28.34	16.93	1.03	16.42	33.55	12.56	0.48	12.74	21.13	(5.24)	7.91	13.18	7.89	
<u>Large Cap U.S. Stocks</u>																			
S&P 500	10.88	4.91	15.79	5.49	(37.00)	26.47	15.06	2.11	16.00	32.39	13.69	1.38	11.96	21.83	(4.38)	8.49	13.12	7.77	
<u>Small Cap U.S. Stocks</u>																			
Russell 2000 Index	18.33	4.55	18.37	(1.57)	(33.79)	27.17	26.85	(4.18)	16.35	38.82	4.89	(4.41)	21.31	14.65	(11.01)	4.41	11.97	7.50	
<u>Non- U.S. Stock Markets</u>																			
MSCI EAFE US\$	20.25	13.54	26.34	11.17	(43.38)	31.78	7.75	(12.14)	17.32	22.78	(4.90)	(0.81)	1.00	25.03	(13.79)	0.53	6.32	4.74	
MSCI Emer Markets	25.95	34.54	32.59	39.78	(53.18)	79.02	19.20	(18.17)	18.63	(2.27)	(1.82)	(14.60)	11.60	37.75	(14.25)	2.03	8.39	8.26	
<u>Fixed Income Markets</u>																			
BC Aggr Bond	4.34	2.43	4.33	6.97	5.24	5.93	6.54	7.84	4.21	(2.02)	5.97	0.55	2.65	3.54	0.01	2.52	3.48	3.87	
Citi Non-US Gov	12.14	(9.21)	6.95	11.46	10.11	4.38	5.22	5.17	1.51	(4.56)	(2.68)	(5.54)	1.80	10.33	(1.82)	0.28	1.27	2.81	
<u>Cash Market</u>																			
90 Day T-Bill	1.33	3.07	4.85	5.00	2.06	0.21	0.13	0.10	0.11	0.07	0.03	0.05	0.33	0.86	1.87	0.63	0.37	1.32	
<u>Inflation</u>																			
CPI-U	3.26	3.42	2.54	4.08	0.09	2.72	1.50	2.96	1.74	1.50	0.76	0.86	2.07	2.11	1.91	1.51	1.80	2.09	

Looking ahead to 2019

Forces potentially impacting the investment markets



Volatility could continue in 2019, given the wide array of economic, political and market-related scenarios that could unfold. Predicting outcomes, however, is impossible. Adherence to an appropriate, well-defined asset allocation remains the prudent course of action.

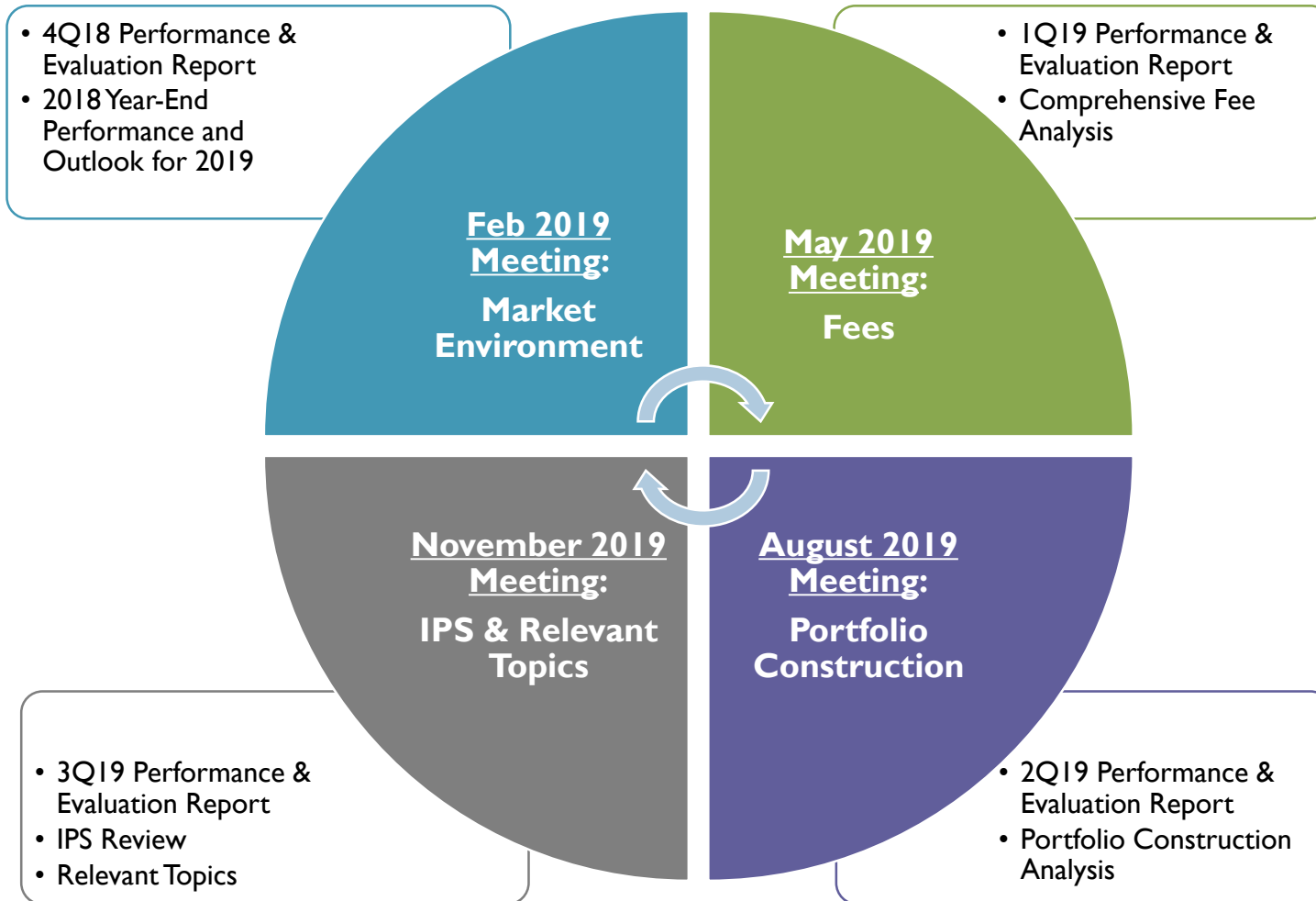
Capital Cities' Emphasis on Diversification

Review of Portfolio Components

Asset Categories	Strategic Role	Looking Back at 2018	Looking Ahead
Passive US and Non-US Equity	Inexpensive, broad exposure, return generator	Reached all-time highs before ending the year in negative territory	Passive exposure provides low-cost diversification and return; long-term allocation necessary given inability to time markets
Active Equity	Diversification, exposure to niche markets, utilization of manager expertise to seek downside protection or higher returns	Ended the year down with mixed relative performance. The reintroduction of volatility has generally been a welcome sign to active managers	Active stock selection and sector/region rotation could provide downside protection and while recent volatility has improved the opportunity set
Core/Core Plus Fixed Income	Active, broad exposure complemented by "plus" sectors meant to generate reasonable return and demonstrate less volatility than Equity	Generally muted but positive returns due to Fed action and the reintroduction of volatility led to spread widening	Continued Fed action likely to put pressure on returns; spreads remain relatively tight limiting the potential for high capital appreciation
Opportunistic Fixed Income	Focused exposure seeking higher return (with higher volatility) given exposure to higher yielding sub-styles (IG and HY Credit, Non-US, EM, etc.)	Concluded the year in negative territory as spreads widened significantly in the fourth quarter	Uncertainty surrounding the path of normalization and health of the global economy could lead to greater volatility
Unconstrained/Flexible Fixed Income	Flexible strategies that are not tied to benchmarks, goal is to provide return, with an emphasis on absolute return over a cycle	Strong relative results (compared to Broad Fixed) given positioning of managers to avoid interest rate risk and focus on quality	Active managers will need to balance being defensive with seeking return
Short Duration Fixed Income	Conservative strategies designed to provide a liquidity backstop, preservation capabilities and a higher return than Cash	Limited return given impact of Fed action on the short end of the yield curve	Higher returns possible given higher yields in the short-term space, but volatility possible based on Fed policy
Cash	Liquidity, ease of rebalancing, preservation	Top performing asset class during the year (though modest)	Continued improvement of return potential is possible and opportunity cost could decrease
Diversifying Assets	Utilize Equity, Fixed Income and Real Assets in a manner not neatly defined by an Equity or Fixed Income "box"; Diversification relative to Equity and Fixed Income; Real Return	Mixed results for different strategies: Macro/tactical strategies mixed given manager views, equity-correlated strategies were down, hedging strategies were mixed	Expect diversification benefit, which likely means underperformance in bull Equity markets; potential for relative outperformance if Equity market falls

2019 Fiduciary Oversight Calendar

Balancing ongoing performance analysis with comprehensive oversight



Capital Cities is a fiduciary and your advocate. Our Investment Committee continuously monitors your portfolio, and anything that could impact it.

- Market Environment
- Regulatory Environment
- Investment Structure per Policy
- Custodians/Program Managers/Recordkeepers
- Investment Managers
- Qualitative and Quantitative Investment Characteristics
- Industry Trends
- Ongoing Fiduciary Duties
- Fees
- Educational Needs