



PACIFICAWEALTH

GROWING MORE THAN WEALTH

Q2

Quarterly Market Review
Second Quarter 2018



Market Summary

Index Returns

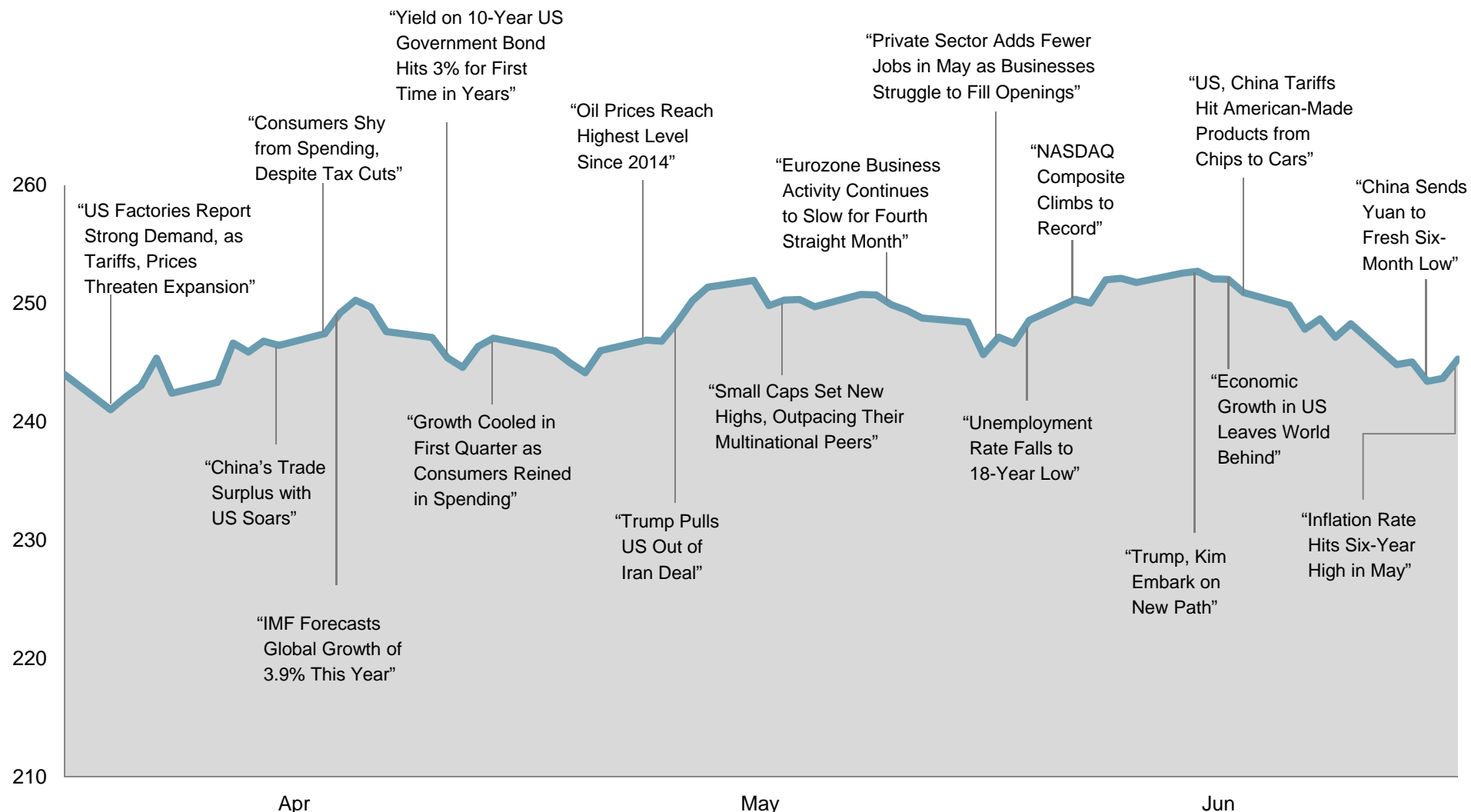
	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Q2 2018	STOCKS				BONDS	
	3.89%	-0.75%	-7.96%	6.05%	-0.16%	0.48%
Since Jan. 2001						
Avg. Quarterly Return	2.0%	1.5%	3.0%	2.6%	1.1%	1.1%
Best Quarter	16.8%	25.9%	34.7%	32.3%	4.6%	4.6%
	Q2 2009	Q2 2009	Q2 2009	Q3 2009	Q3 2001	Q4 2008
Worst Quarter	-22.8%	-21.2%	-27.6%	-36.1%	-3.0%	-2.7%
	Q4 2008	Q4 2008	Q4 2008	Q4 2008	Q4 2016	Q2 2015

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]). S&P data © 2018 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2018, all rights reserved. Bloomberg Barclays data provided by Bloomberg. FTSE fixed income © 2018 FTSE Fixed Income LLC, all rights reserved.



World Stock Market Performance

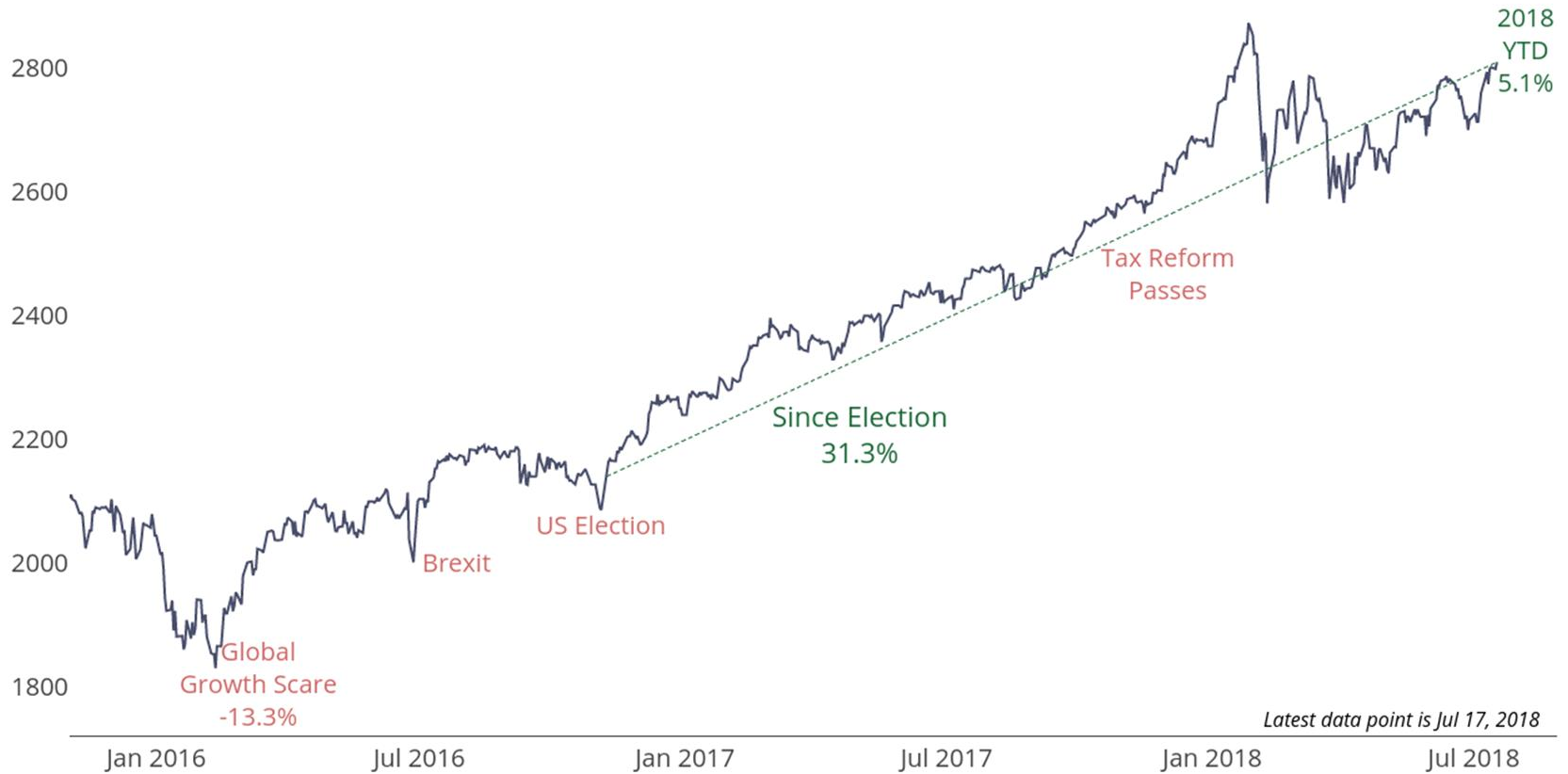
MSCI All Country World Index with selected headlines from Q2 2018



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Graph Source: MSCI ACWI Index [net div.], MSCI data © MSCI 2018, all rights reserved. It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

S&P 500 Performance



- The market's strong performance in 2017 was a result of healthy global growth and a surge in corporate profits.
- However, the market has faltered recently due to concerns over rising inflation and interest rates.
- Global growth still appears to be strong but market volatility has risen significantly.

Source: Standard & Poor's

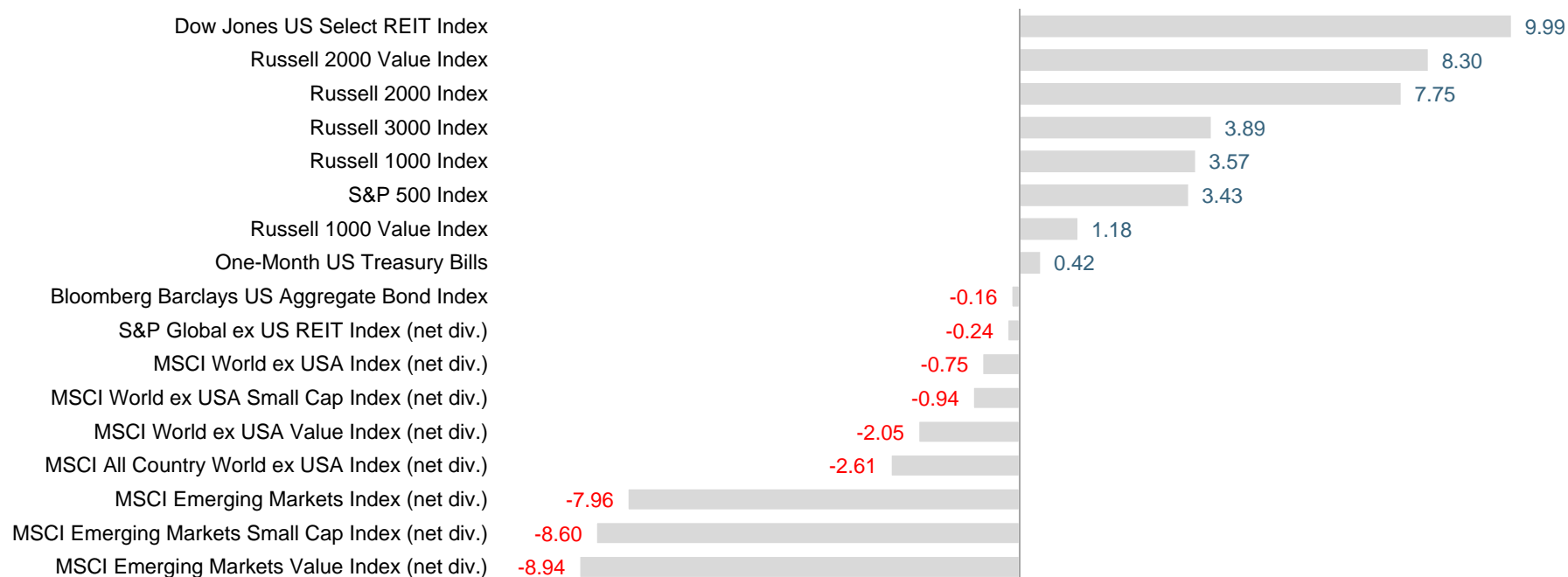


World Asset Classes

Second Quarter 2018 Index Returns (%)

Looking at broad market indices, the US outperformed non-US developed and emerging markets during the second quarter.

Small caps outperformed large caps in the US but underperformed in both non-US developed and emerging markets. The value effect was negative in the US as well as markets outside the US.



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US Stocks

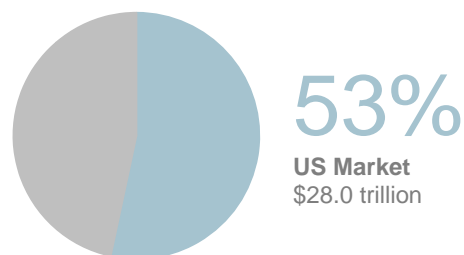
Second Quarter 2018 Index Returns

The US equity market posted a positive return, outperforming both non-US developed and emerging markets in the second quarter.

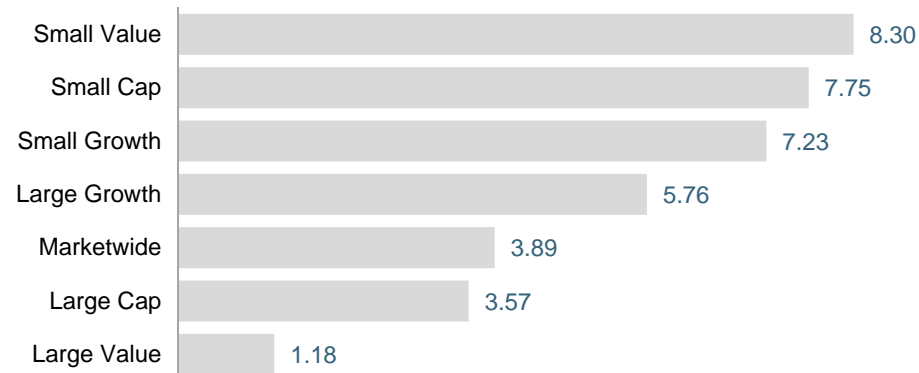
Large cap value stocks underperformed large cap growth stocks in the US; however, small cap value stocks outperformed small cap growth.

There was a positive size premium, as small cap stocks generally outperformed large cap stocks in the US.

World Market Capitalization—US



Ranked Returns for the Quarter (%)



Period Returns (%)

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Small Growth	9.70	21.86	10.60	13.65	11.24
Small Cap	7.66	17.57	10.96	12.46	10.60
Large Growth	7.25	22.51	14.98	16.36	11.83
Small Value	5.44	13.10	11.22	11.18	9.88
Marketwide	3.22	14.78	11.58	13.29	10.23
Large Cap	2.85	14.54	11.64	13.37	10.20
Large Value	-1.69	6.77	8.26	10.34	8.49

* Annualized

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: Marketwide (Russell 3000 Index), Large Cap (Russell 1000 Index), Large Cap Value (Russell 1000 Value Index), Large Cap Growth (Russell 1000 Growth Index), Small Cap (Russell 2000 Index), Small Cap Value (Russell 2000 Value Index), and Small Cap Growth (Russell 2000 Growth Index). World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. Russell 3000 Index is used as the proxy for the US market. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2018, all rights reserved.

International Developed Stocks

Second Quarter 2018 Index Returns

In US dollar terms, developed markets outside the US underperformed the US but outperformed emerging markets during the second quarter.

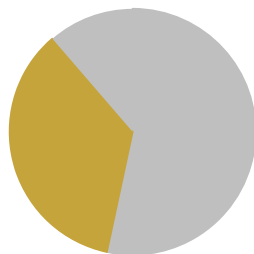
Value underperformed growth in non-US developed markets across large and small cap stocks.

Small caps underperformed large caps in non-US developed markets.

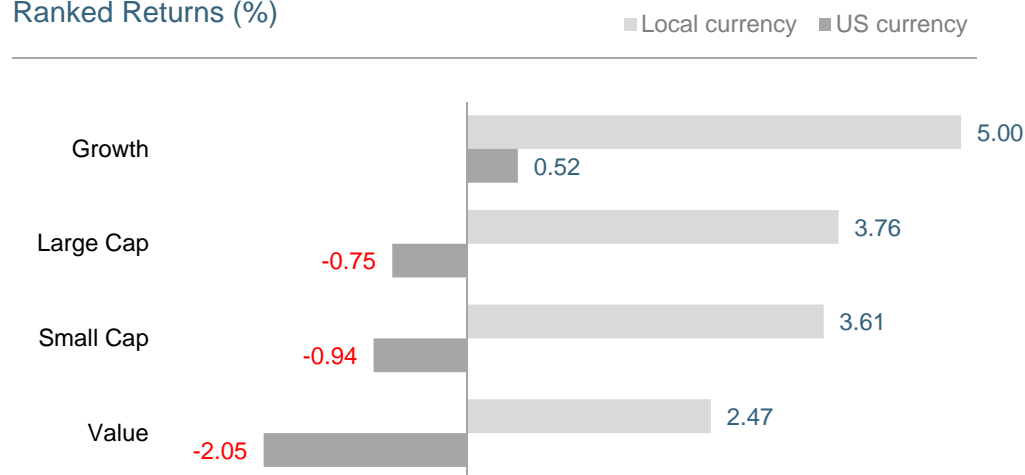
World Market Capitalization—International Developed

35%

**International
Developed
Market**
\$18.5 trillion



Ranked Returns (%)



Period Returns (%)

Asset Class	YTD	1 Year	* Annualized		
			3 Years*	5 Years*	10 Years*
Growth	-1.05	9.26	5.95	7.11	2.92
Small Cap	-1.44	11.87	9.45	10.28	6.09
Large Cap	-2.77	7.04	4.87	6.23	2.63
Value	-4.53	4.80	3.70	5.27	2.29

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Emerging Markets Stocks

Second Quarter 2018 Index Returns

In US dollar terms, emerging markets posted negative returns in the second quarter, underperforming developed markets including the US.

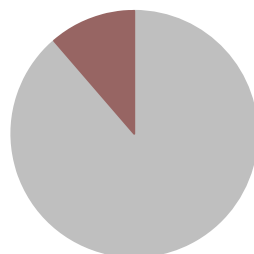
The value effect was negative in large caps; however, value and growth stocks had similar performance among small cap stocks within emerging markets.

Small caps underperformed large caps in emerging markets.

World Market Capitalization—Emerging Markets

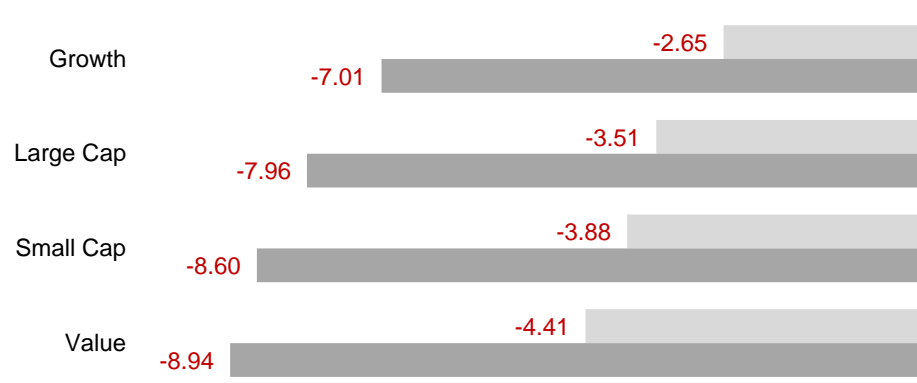
11%

Emerging Markets
\$5.9 trillion



Ranked Returns (%)

Local currency US currency



Period Returns (%)

* Annualized

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Growth	-5.88	11.92	8.34	7.16	3.28
Large Cap	-6.66	8.20	5.60	5.01	2.26
Value	-7.47	4.28	2.76	2.77	1.14
Small Cap	-8.45	5.64	2.55	4.32	4.44

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Fixed Income

Second Quarter 2018 Index Returns

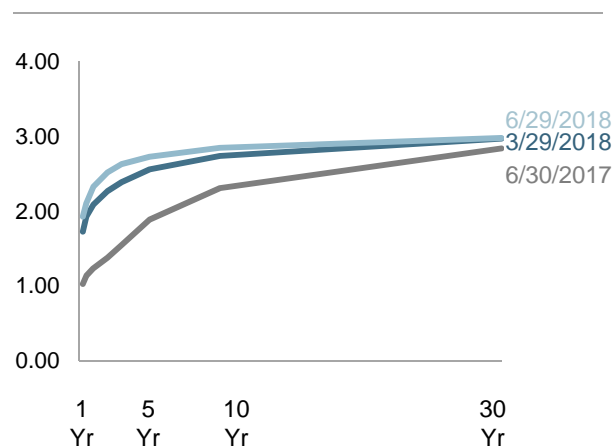
Interest rates increased in the US during the second quarter. The yield on the 5-year Treasury note rose 17 basis points (bps), ending at 2.73%. The yield on the 10-year T-note rose 11 bps to 2.85%. The 30-year Treasury bond yield climbed 1 bps to 2.98%.

The 1-month Treasury bill yield rose 14 bps to 1.77%, while the 1-year Treasury bill yield increased 24 bps to 2.33%. The 2-year Treasury note yield finished at 2.52% after increasing 25 bps.

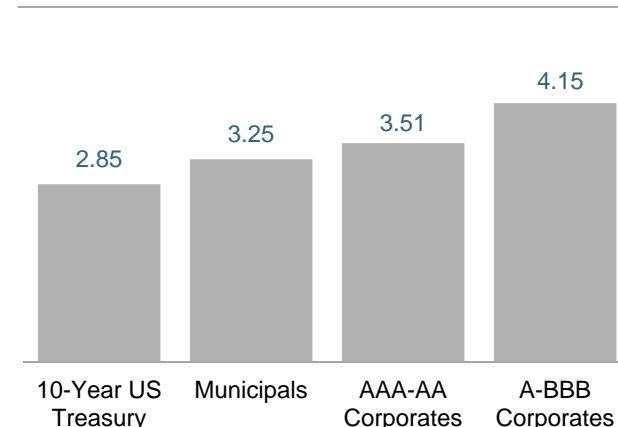
In terms of total return, short-term corporate bonds gained 0.29%, while intermediate-term corporate bonds declined 0.10%.

Short-term municipal bonds added 0.66%, while intermediate-term munis returned 0.81%. Revenue bonds performed in-line with general obligation bonds, returning 0.90% and 0.87%, respectively.

US Treasury Yield Curve (%)



Bond Yields across Issuers (%)



Period Returns (%)

* Annualize

Asset Class	QTR	YTD	1 Year	3 Years*	5 Years*	10 Years*
Bloomberg Barclays US High Yield Corporate Bond Index	1.03	0.16	2.62	5.53	5.51	8.19
Bloomberg Barclays Municipal Bond Index	0.87	-0.25	1.56	2.85	3.53	4.43
Bloomberg Barclays US TIPS Index	0.77	-0.02	2.11	1.93	1.68	3.03
ICE BofAML 3-Month US Treasury Bill Index	0.45	0.81	1.36	0.68	0.42	0.35
ICE BofAML 1-Year US Treasury Note Index	0.40	0.65	0.92	0.64	0.49	0.77
Bloomberg Barclays US Government Bond Index Long	0.26	-2.97	-0.13	3.40	4.56	6.02
FTSE World Government Bond Index 1-5 Years (hedged to USD)	0.24	0.41	0.89	1.18	1.33	2.08
Bloomberg Barclays US Aggregate Bond Index	-0.16	-1.62	-0.40	1.72	2.27	3.72
FTSE World Government Bond Index 1-5 Years	-2.66	-1.06	0.73	1.19	-0.58	0.63

One basis point equals 0.01%. Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Yield curve data from Federal Reserve. State and local bonds are from the S&P National AMT-Free Municipal Bond Index. AAA-AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA-AAA rated. A-BBB Corporates represent the Bank of America Merrill Lynch US Corporates, BBB-A rated. Bloomberg Barclays data provided by Bloomberg. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld). FTSE fixed income indices © 2018 FTSE Fixed Income LLC, all rights reserved. ICE BofAML index data © 2018 ICE Data Indices, LLC.



Impact of Diversification

Second Quarter 2018 Index Returns

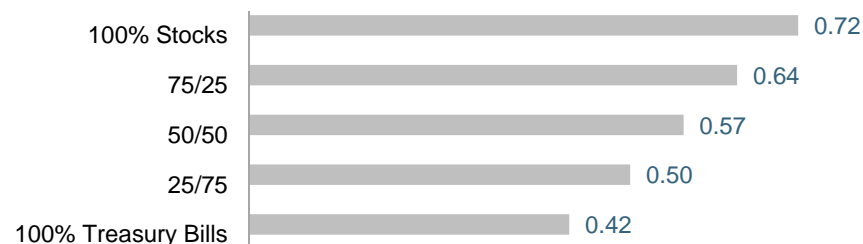
These portfolios illustrate the performance of different global stock/bond mixes. Mixes with larger allocations to stocks are considered riskier but have higher expected returns over time.

Period Returns (%)

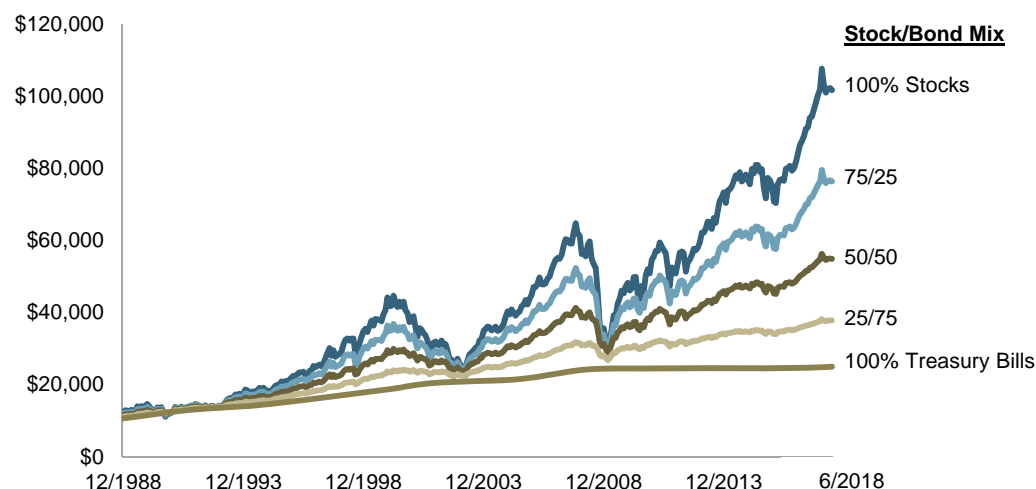
* Annualized

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*	10-Year STDEV ¹
100% Stocks	-0.13	11.31	8.78	10.00	6.37	16.41
75/25	0.14	8.79	6.79	7.61	5.09	12.30
50/50	0.38	6.27	4.75	5.21	3.64	8.19
25/75	0.59	3.77	2.69	2.79	2.03	4.09
100% Treasury Bills	0.76	1.27	0.59	0.36	0.27	0.13

Ranked Returns (%)

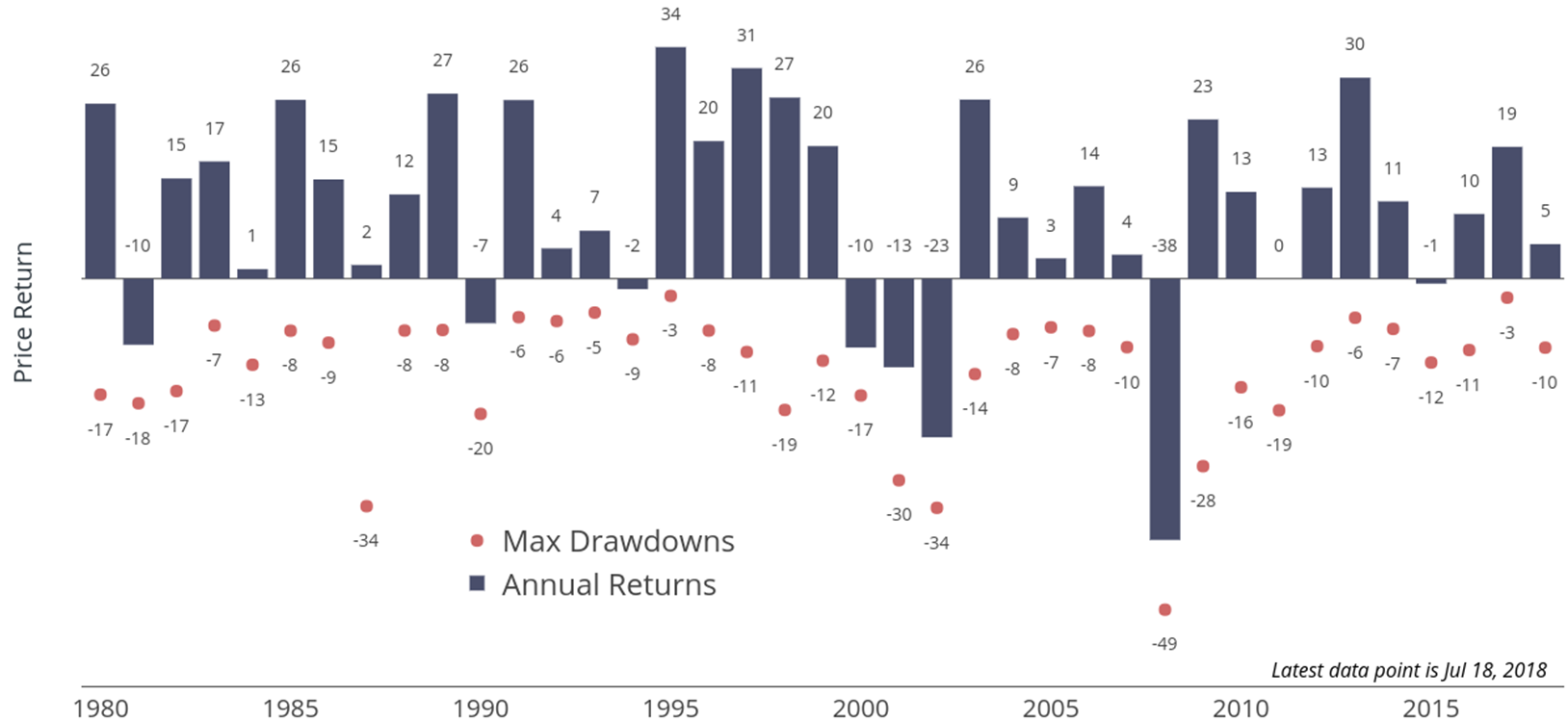


Growth of Wealth: The Relationship between Risk and Return



1. STDEV (standard deviation) is a measure of the variation or dispersion of a set of data points. Standard deviations are often used to quantify the historical return volatility of a security or portfolio. Diversification does not eliminate the risk of market loss. Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio. Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals. Data © MSCI 2018, all rights reserved. Treasury bills © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld).

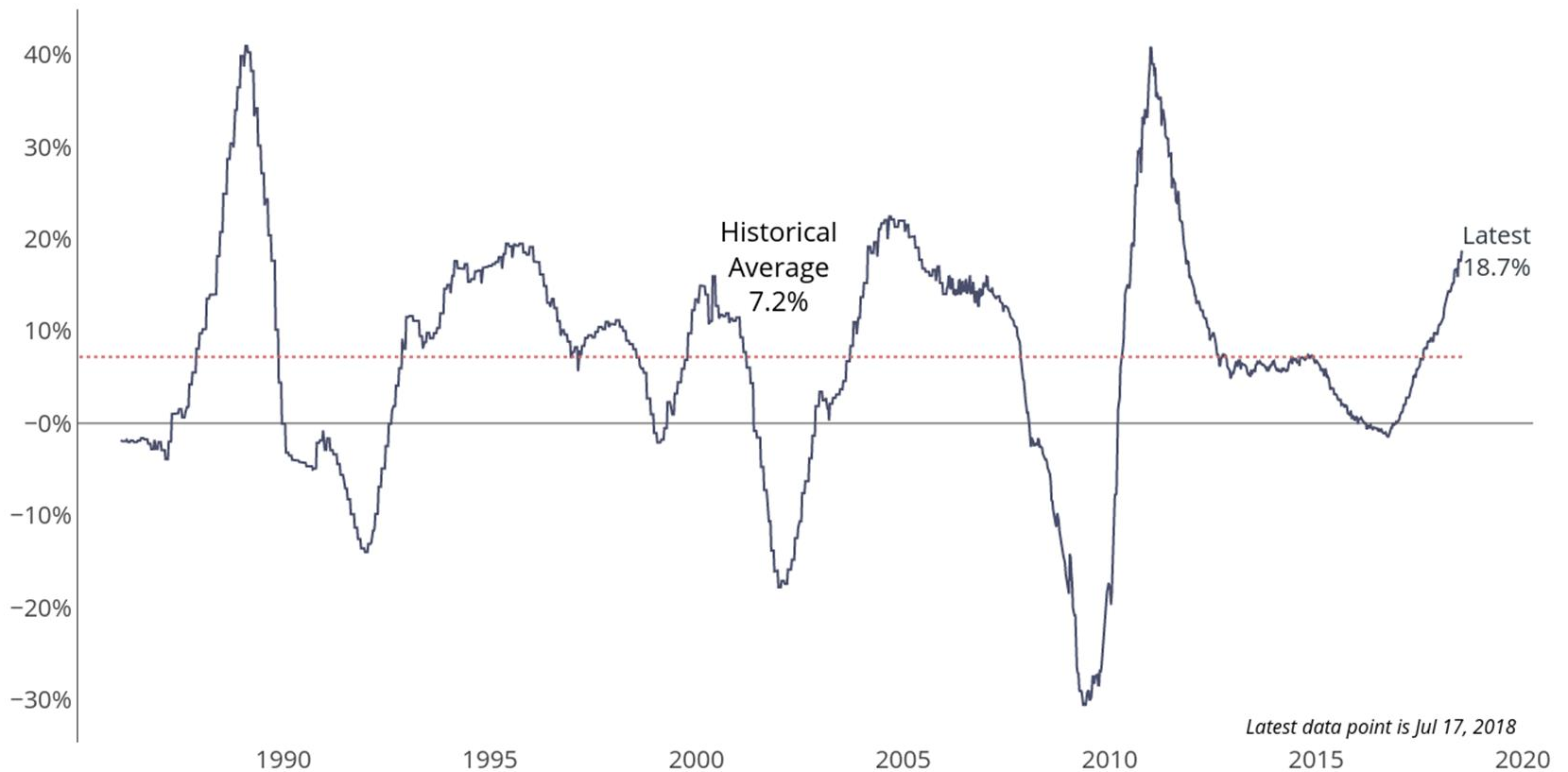
Annual Returns and Pullbacks



Latest data point is Jul 18, 2018

- This chart shows the performance of the stock market (bars) and the largest intra-year decline (dots) each year.
- The average year experiences a stock market drop of -13.5%. However, most years still end in positive territory, averaging 9% gains.
- Withstanding these short-term moves requires discipline. Investors are often rewarded for staying invested through short-term volatility.

S&P 500 EPS Growth Rate



Latest data point is Jul 17, 2018

- The rebound in corporate earnings following the global financial crisis was swift, driving the stock market higher in the process.
- Earnings growth was consistently high for most of this market cycle, near the long-run average of 7%.
- Earnings growth fell into negative territory following the macroeconomic shocks of 2014 but has recovered.

Source: Thomson Reuters

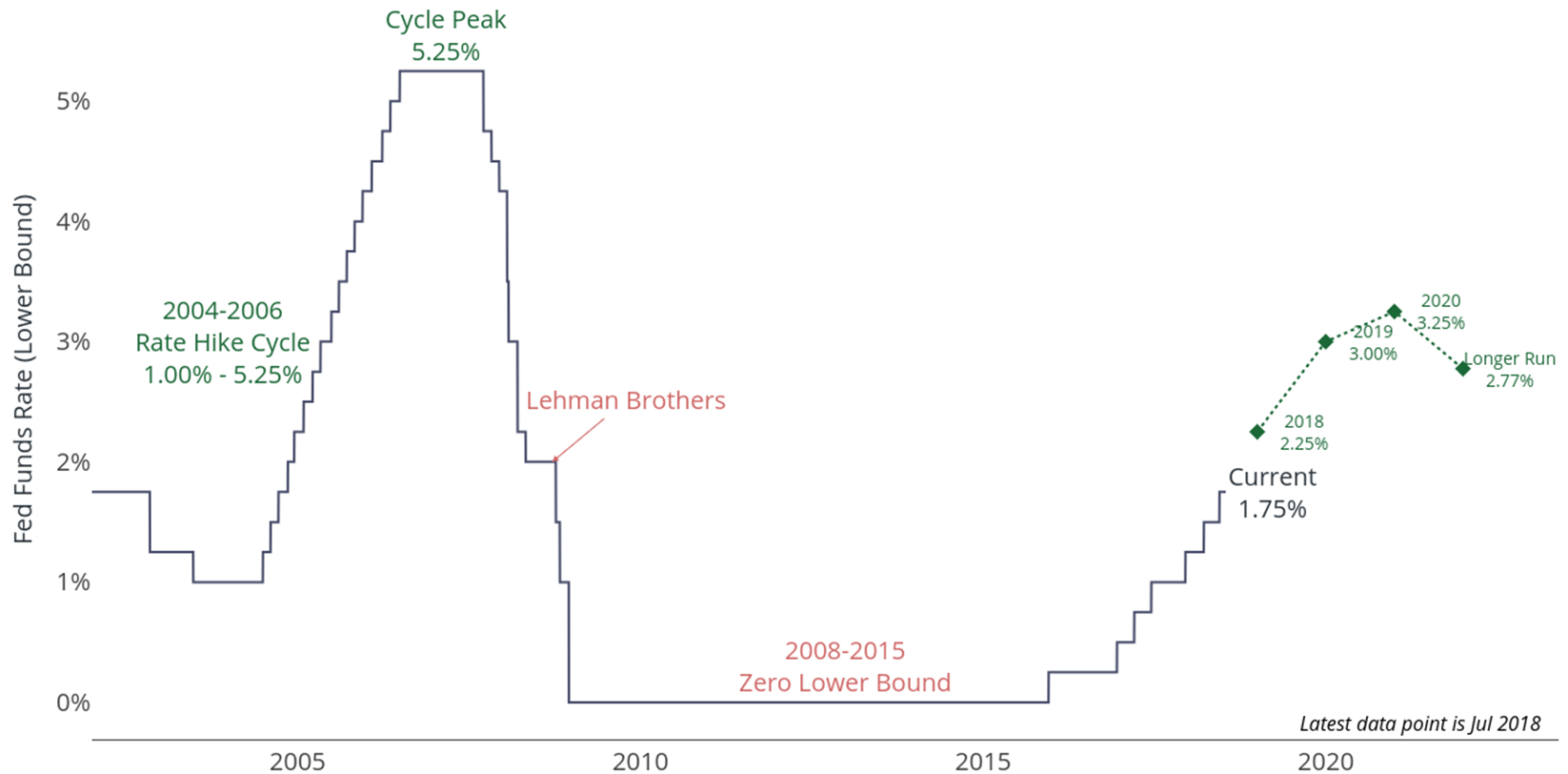
Historical Interest Rates



- Interest rates have been on a declining trend since the 1970's, resulting in a multi-decade bull market for bonds.
- However, interest rates have been at historic lows since 2009. Short-term rates were in negative territory in many parts of the world.
- With the Fed now raising short-term interest rates and U.S. economic growth steady, long-term interest rates should slowly climb higher.

Source: Federal Reserve

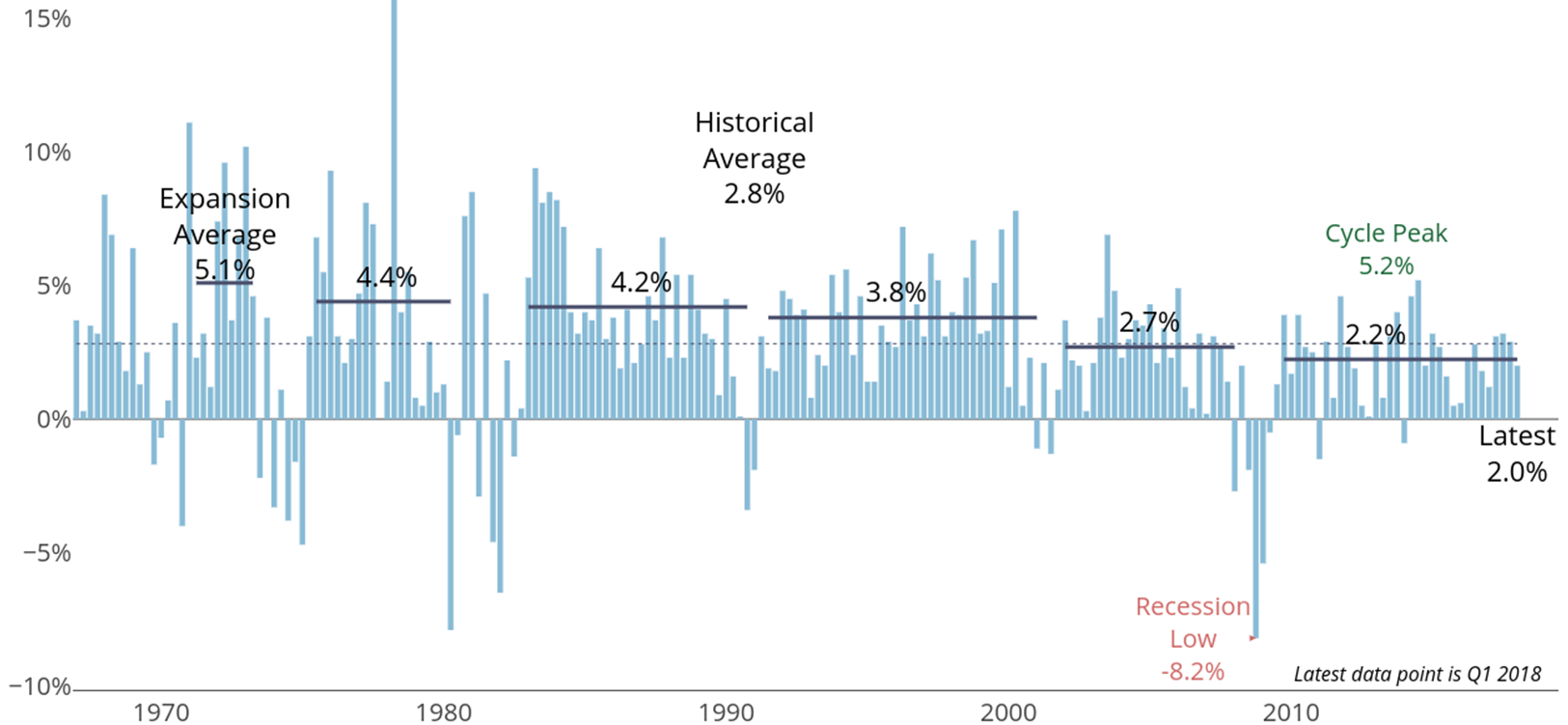
Federal Funds Rate



- The federal funds rate is the Fed’s main policy tool. It was held at zero percent from 2008 to 2015.
- By raising and lowering the rate, the Fed seeks to keep the economy growing at a steady pace with stable inflation and full employment.
- The Fed began raising rates again in December 2015 due to a healthy economic outlook.

Source: Federal Reserve

U.S. GDP Growth

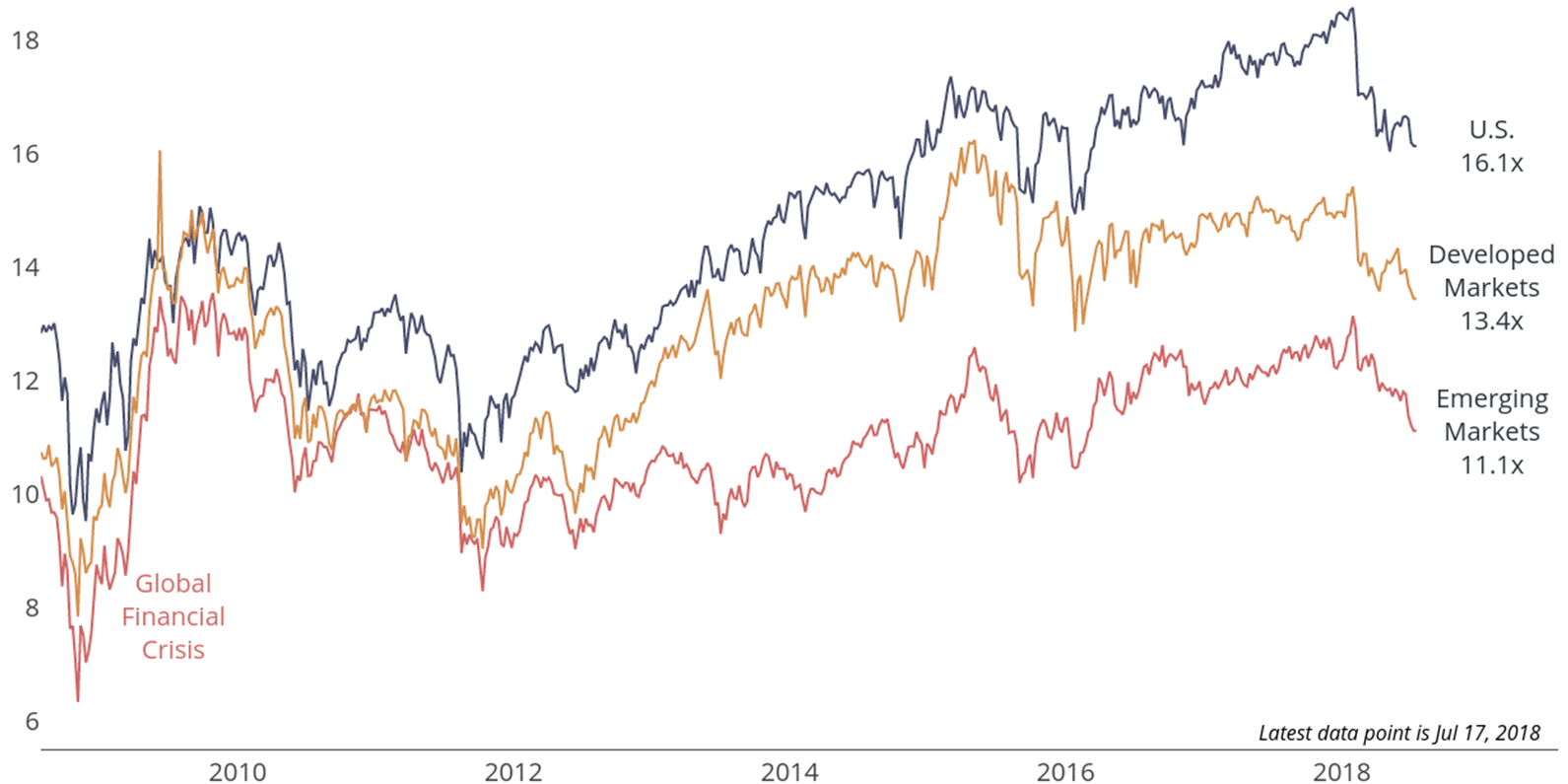


- Economic growth has been steady this cycle, averaging 2.2% on a quarterly basis.
- However, the recovery has been slower than past economic cycles. Growth has not accelerated as many had hoped.
- Reasons for the growth slowdown include demographic trends, the severity of the financial crisis, and slow productivity growth.

Source: U.S. BEA, NBER

Global Equity Valuations

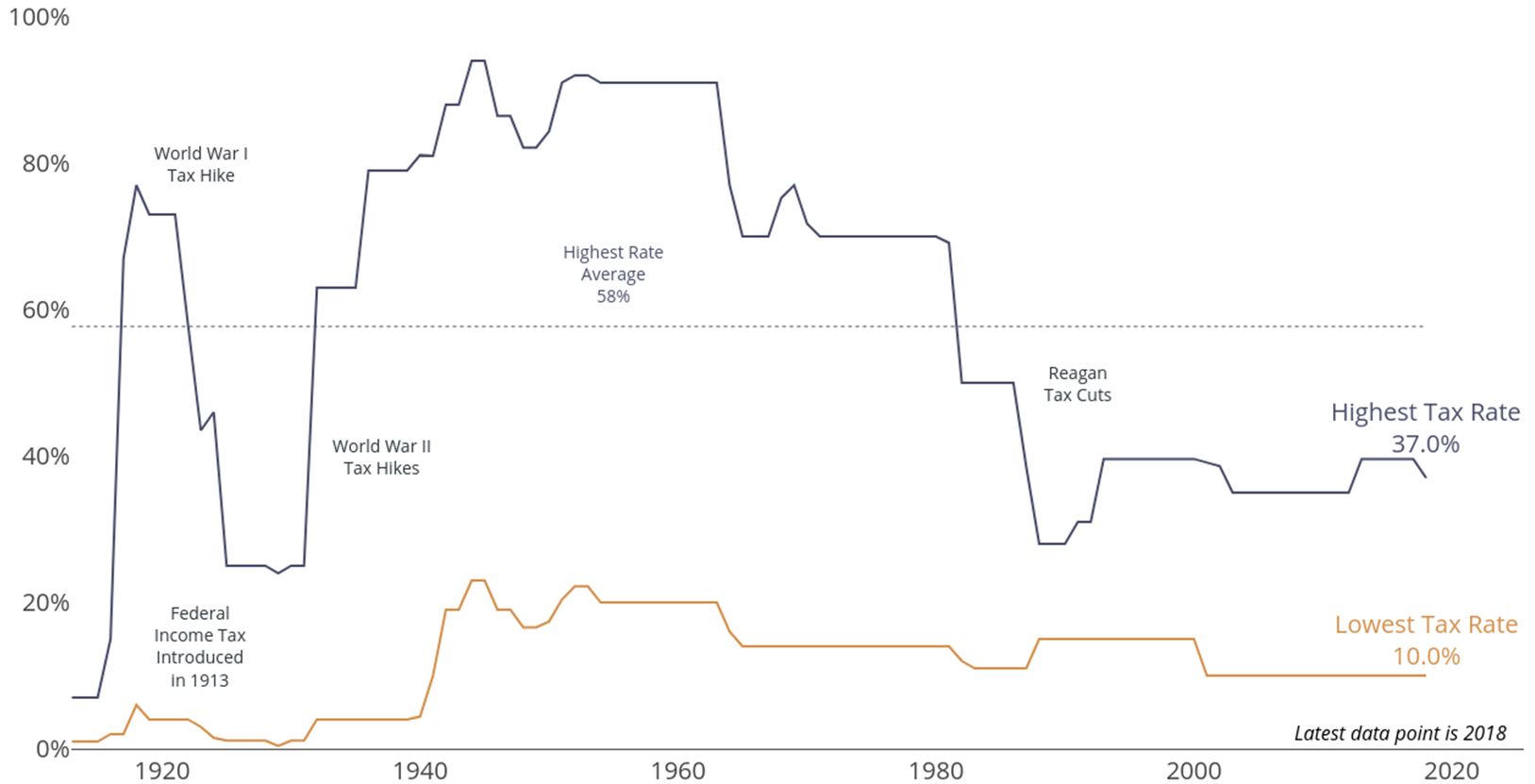
Forward P/E Ratios for the S&P 500, MSCI EAFE and MSCI EM



- The stock markets of the major regions have taken very different trajectories since 2008.
- The U.S. market has risen dramatically, leading to stocks that are at above-average valuations.
- International stocks, on the hand, are still cheaper in relative terms. Emerging markets especially have only recently begun to rally.

Individual Income Tax Rates

Historical Highest and Lowest Tax Brackets



- The administration passed a tax reform bill at the end of 2017, changing a number of tax rates.
- The highest tax rate will now fall to 37%. There will still be 7 brackets.
- Historically, the top tax rates have been much higher, especially during wartime.

Source: Treasury Department, IRS

Asset Class Performance

Total Returns

Investing

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
EM 56.3%	EM 26.0%	EM 34.5%	EM 32.6%	EM 39.8%	Fixed Income 7.9%	EM 79.0%	Small Cap 26.3%	Fixed Income 7.7%	EM 18.6%	Small Cap 41.3%	S&P 500 13.7%	S&P 500 1.4%	Small Cap 26.6%	EM 37.8%	Small Cap 12.7%
EAFE 39.2%	Small Cap 22.7%	Commodities 21.4%	EAFE 26.9%	Commodities 16.2%	Balanced -24.0%	EAFE 32.5%	EM 19.2%	S&P 500 2.1%	EAFE 17.9%	S&P 500 32.4%	Fixed Income 6.0%	Fixed Income 0.5%	S&P 500 12.0%	EAFE 25.6%	S&P 500 6.2%
Small Cap 38.8%	EAFE 20.7%	EAFE 14.0%	S&P 500 15.8%	Balanced 11.9%	Small Cap -31.1%	S&P 500 26.5%	Commodities 16.8%	Small Cap 1.0%	Small Cap 16.3%	EAFE 23.3%	Small Cap 5.8%	EAFE -0.4%	Commodities 11.8%	S&P 500 21.8%	Balanced 0.7%
S&P 500 28.7%	Balanced 12.1%	Balanced 10.3%	Small Cap 15.1%	EAFE 11.6%	Commodities -35.6%	Balanced 26.3%	S&P 500 15.1%	Balanced -1.2%	S&P 500 16.0%	Balanced 12.6%	Balanced 4.9%	Small Cap -2.0%	EM 11.6%	Balanced 16.8%	Fixed Income -1.4%
Balanced 24.3%	S&P 500 10.9%	Small Cap 7.7%	Balanced 14.5%	Fixed Income 6.6%	S&P 500 -37.0%	Small Cap 25.6%	Balanced 12.6%	EAFE -11.7%	Balanced 11.5%	Fixed Income -2.0%	EM -1.8%	Balanced -3.0%	Balanced 8.2%	Small Cap 13.2%	EAFE -1.7%
Commodities 23.9%	Commodities 9.1%	S&P 500 4.9%	Fixed Income 3.9%	S&P 500 5.5%	EAFE -43.1%	Commodities 18.9%	EAFE 8.2%	Commodities -13.3%	Fixed Income 3.8%	EM -2.3%	EAFE -4.5%	EM -14.6%	Fixed Income 2.4%	Fixed Income 3.6%	Commodities -5.2%
Fixed Income 0.6%	Fixed Income 3.8%	Fixed Income 2.3%	Commodities 2.1%	Small Cap -0.3%	EM -53.2%	Fixed Income 3.0%	Fixed Income 6.4%	EM -18.2%	Commodities -1.1%	Commodities -9.5%	Commodities -17.0%	Commodities -24.7%	EAFE 1.5%	Commodities 1.7%	EM -6.0%

Latest data point is Jul 18, 2018

- Diversifying properly across a variety of asset classes is the most important way for clients to weather market volatility.
- The balanced portfolio approximates a 60/40 stock/bond allocation. By design, it performs steadily through both good and bad markets.
- It's impossible to predict which asset classes will outperform from year to year. There are significant opportunities beyond just U.S. stocks.

Source: Thomson Reuters

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