SIA Perspectives

Stegner Investment Associates, Inc. **2nd Quarter 2018**

Our *SIA Perspectives* is written each quarter to share with our Clients highlights of key events taking place in financial markets that impact our investment strategies. This written communication complements the information that we share during our meetings. Both efforts are designed to engage Clients and to help them learn more about our time-tested, disciplined and successful investment strategies.

What Has Happened to Financial Markets in 2018?

Our first *SIA Perspectives* of 2018 detailed the mixed and volatile returns for most financial markets during the first three months of the year. It highlighted a great start to the year for stocks, with big gains in January, that were then offset by declines beginning in late February. Bond prices bounced higher and then ended lower for the quarter. After the relative calm of 2017, this volatility surprised investors.

The trend of volatility continued in the 2nd quarter as political leaders took center stage by attending high profile group events like the NATO and the G-7 summits, while conducting historic one-on-one meetings. The tension surrounding these events rattled financial markets. They made headline news and were heavy on pageantry, but light on specifics.

May 22nd

Trump meets with Moon Jae-in

May 26th

Kim Jong-un meets with Moon Jae-in

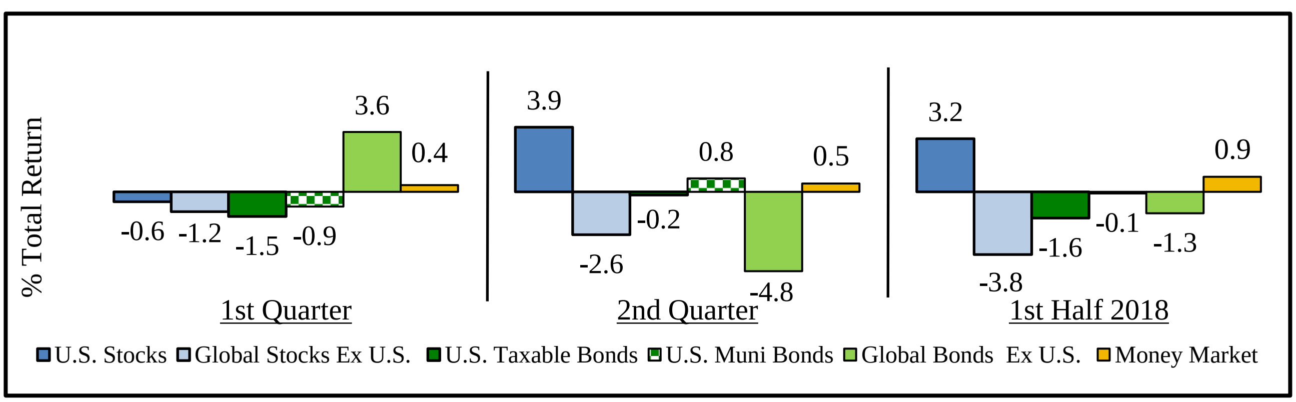
June 12th

Kim Jong-un meets with Trump

June 19th

Kim Jong-un meets with Xi Jinping

Meanwhile, earnings news from U.S. based companies, plus improving job growth in the U.S., propelled domestic stock markets to new highs during the 2nd quarter. Financial markets overseas suffered as the U.S. dollar strengthened versus most currencies. As investors sought safety, they were attracted to the increasingly competitive yields offered by money market funds, as indicated in the chart below.

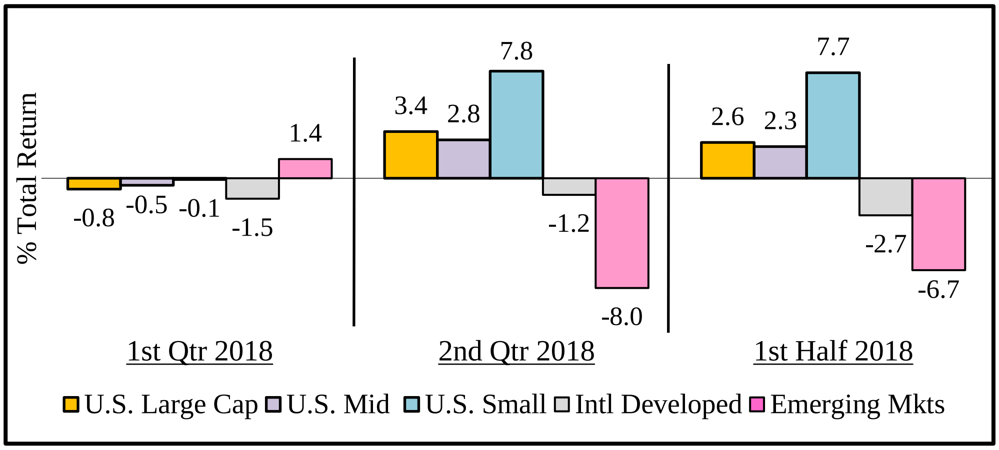


Representative benchmarks for all charts are detailed on the last page of this SIA Perspectives.

What Happened to Global Stocks?

Performance of smaller U.S. based companies led stocks higher during the 2nd quarter as corporations reported excellent year-over-year earnings. Key factors that led to these improved profits included the reduction in corporate tax rates and continued increases in sales. In turn, results for the 1st half of the year were positive in the U.S., with most of the price movement occurring in the month of May.

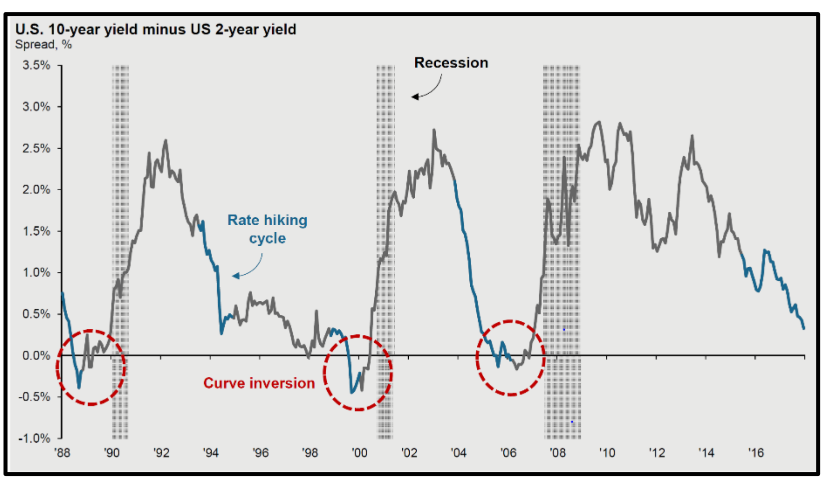
However, international markets were hit in the 2nd quarter due to continued political uncertainties, including the announcement of new governments in Italy and Spain and the implementation of steel and aluminum tariffs by the U.S. Investors fretted about the impact of the new tariffs and worried about the effects of the U.K.'s withdrawal from the European Union.



What Happened to Global Bonds?

Also during the 2nd quarter, investors continued to focus their attention on the actions of the U.S. Federal Reserve (the Fed) and its intent to continue raising the benchmark Fed Funds rate at a steady, measured pace. As expected, in June they announced another increase of 0.25%, which brought the total number of increases to seven since 2015.

Last quarter's *SIA Perspectives* highlighted that short-term rates were moving higher while longer-term rates remained stubbornly at the same level. This yield curve "flattening" continued during the 2nd quarter and landed at its flattest level in 11 years. The chart below provides an illustration of the impact to bond investors of this move, as measured by the yields offered in the U.S. Treasury bond market. The chart also indicates the net difference between the interest paid on a 10-year U.S. Treasury bond of 2.9% versus the interest paid on 2-year Treasuries of 2.5%. The spread of only 0.4% at the end of the 2nd quarter was well-below historic averages.



With expectations for higher interest rates, most taxable bond market benchmarks generated small losses this year. Money market returns to-date in 2018 show the impact of the Fed's move to influence short-term interest rates as these funds provided investors with reasonable returns after years of providing only slight returns.

2017	BONDS & MONEY MARKET	Total Return 1st Quarter 2018	Total Return 2nd Quarter 2018	1st Half 2018
3.5%	Taxable U.S.	-1.5%	-0.2%	-1.6%
10.5	Taxable Global-ex U.S.	3.6	-4.8	-1.3
4.3	Municipal Intermediate	-0.9	0.8	-0.1
1.0	Money Market	0.4	0.5	0.9

With improving bond yields at the shorter-end of the yield curve, the dividends offered by stocks became less attractive and enticed investors to rebalance their portfolios and to pour money into U.S. bonds at a record pace. The table below on the left highlights the magnitude of the fund flows into bond mutual funds and exchange traded funds (ETFs) over the past eighteen months.

Adding to this flow were foreign investors still faced with negative short-term yields in their local markets, and relatively puny yields on longer-term bonds (as indicated in the chart on the right below). Given that foreign investors need to buy U.S. dollars to purchase U.S. bonds, the value of the U.S. dollar increased. Also of note, is that investors favored placing monies into world stocks versus U.S. stocks in the 1st half of the year, during a period of U.S. stock outperformance.

2017	$ Fund Flows *In billions*	1st Half 2018
14	U.S. Stocks	**-1**
243	World Stocks	97
391	Taxable Bonds	106
33	Tax-Free Bonds	8

As of 6/30/18	Benchmark Index % Yield
Japan	0.2
Germany	0.6
Global ex-U.S.	1.2
U.K.	1.8
Italy	2.0
U.S.	3.3
Emg Mkts (local)	6.6

What is Our Role as Investment Consultants?

This quarter we continue our introduction of the value-added practices our firm provides as investment consultants.

"Cost Effective Implementation" is the fifth practice in our series, following the four outlined previously in our *SIA Perspectives* that included:

1. Behavioral Coaching
2. Rebalancing
3. Total Return versus Income Investing
4. Asset Allocation

What is Cost Effective Implementation?

Cost effective implementation is a practice that we employ to address the cost of investing that includes management fees, trading costs and turnover – all of which impact an investment's percentage total return.

Our fund manager selection process and ongoing reviews of our managers incorporates the analysis of annual fees paid to a fund and ensures that performance over the long-term offsets the costs incurred.

Outlook for the Rest of 2018?

Financial market performances should be positive for the remainder of the year. Expected strong growth in the U.S., due to tax cuts for both corporations and individuals, and slowly trending higher inflation should allow the Federal Reserve to continue its path of slowly raising interest rates.

The rhetoric from world leaders may continue to cause volatility in financial markets in 2018 as threats to impose sanctions, withdraw from treaties, levy tariffs and instigate trade wars are tossed about.

Any "boomerang effect" – when an opposite reaction than expected occurs – could unsettle markets and force the Fed to increase interest rates more quickly than expected. Consequently, this could drive the U.S. dollar higher and dampen investment performance.

The most preferable path is one that allows the growth expectations in the U.S., provided by the stimulus, to spill over into other parts of the world. Tax-cuts to corporations and individuals may be spent by them on more global goods and services. In this environment, the current economic cycle will last longer than many expected, and stock market gains can continue. Interest rates will climb slowly, and credit markets will be stable.

Behind the Scenes at SIA

SIA is guided by key principles to enhance and improve our investment consulting services. So far in 2018, we have implemented several key initiatives towards this goal by:

- Expanding our investment and industry knowledge through in-person and off-site meetings with fund managers and their firm representatives. During the 2nd quarter we held meetings with several of our existing managers including Vanguard, Oppenheimer, JP Morgan, American Beacon and T. Rowe Price. During the quarter we investigated new investment opportunities with Invesco, Cohen & Steers, Harding Loevner and Blackstone.

- Beth Peabody agreeing to serve as one of only eleven advisors nationally to Vanguard Group's newly formed Registered Investment Advisory (RIA) Council. The Council members provide guidance to Vanguard in their commitment to serve the investment community. In fact, at Beth's suggestion, Vanguard has instituted a policy to let RIAs know in advance the date of implementation when they expect to close a fund to new investors.

- Enhancing our breadth of client services by meeting with other registered investment advisors at conferences conducted by Morningstar, JPMorgan and Charles Schwab.

- Creating an environment where our ten Associates can learn, mentor and grow professionally and personally. Four are enrolled currently in programs to further their industry knowledge including the Chartered Financial Analyst (CFA) and the Certified Financial Planner (CFP) designations.

- Working diligently on our next five-year strategic plan to ensure that our firm continues to provide Clients with an extraordinary level of investment consulting services.

Thank you for sharing our story with others who also might benefit from our investment consulting services.

The Associates of SIA wish you a very happy Summer!

Benchmark Indexes used in this SIA Perspective include: Dow Jones Total US Stock Market Index, MSCI ACWI- ex US, Bloomberg Barclays US Aggregate Bond, Global Ex-US and Municipal Bond Index, US Treasury Bill Index, S&P 500 Index, Russell Mid Cap and Small Cap Index, MSCI EAFE and EM Indexes.*