*Q3 2018 Market Synopsis & *Special Market Comment**

Given recent stock market volatility, within this newsletter **we will provide an abbreviated Q3 update along with an overview of the October stock market correction**.

Economic & Market Update/Comments:

The third quarter was very good for the US stock market, **as the S&P500 gained 7.7%,** including dividends. Volatility was also very subdued with the VIX (most popular measure of stock volatility), ranging from 12-15. During the summer, the stock market essentially went straight up with almost no drawdowns, while real estate, foreign stocks, and bonds were little changed.

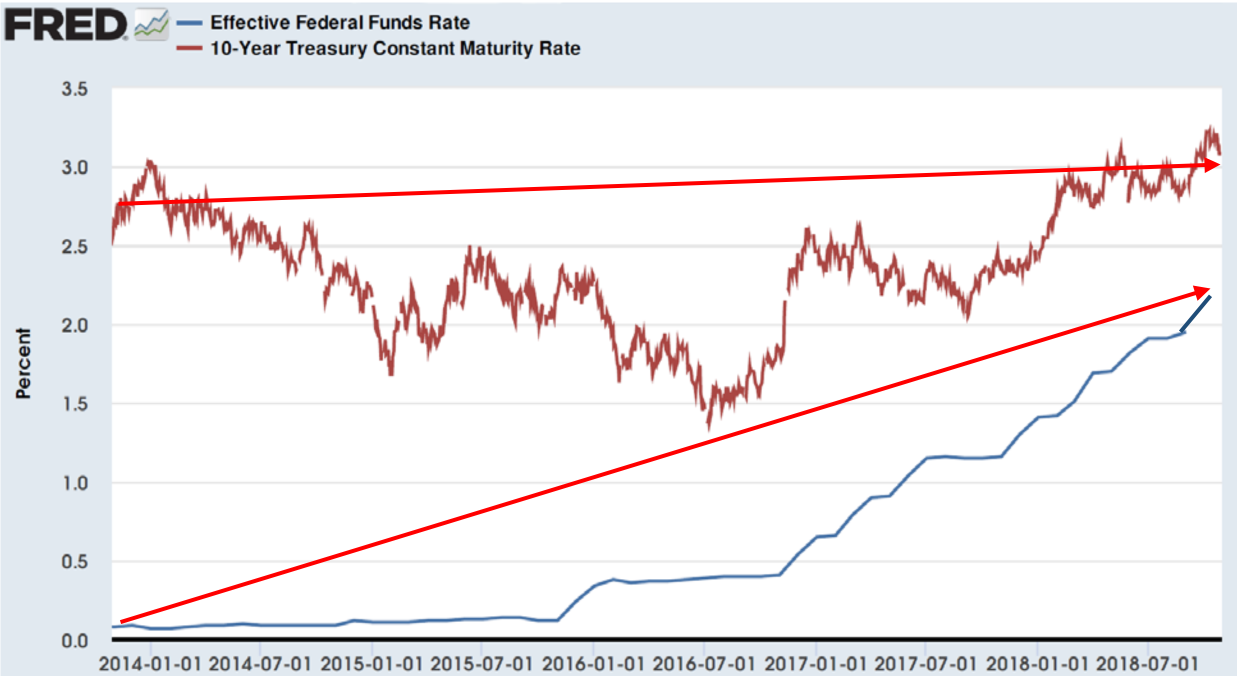
The 10-year Treasury yield also had a low volatility quarter with rates steady around 2.8% until the last 2 weeks in September, when yields started to ramp up to finish the month at 3.06%. This increase in rates hurt bonds and foreign stocks starting in late September, and this trend accelerated significantly in October.

Select 2018 YTD Asset Class Returns (YTD 9/30)	
S&P 500 (US Stock Market)	+ 10.4%
Private Equity (GBP Capital)	+ 7.2%
Private Real Estate Credit (Mosaic Fund)	+ 6.0%
Insurance Linked Securities (XILSX/SRRIX)	+ 5.0%
S&P GSCI (Broad Commodity Market)	+ 4.3%
Alternative Lending (LENDX/RMPLX)	+ 3.5%
High Yield Bonds	+ 2.5%
DJ US Real Estate (US Real Estate)	+ 1.7%
MSCI EAFE (Foreign Developed Stock Market)	- 1.3%
US Mid/Long Treasury Bonds	- 2.8%
All Asset Risk Variance (AVRPX)	- 7.1%
MSCI Emerging Market (Emerging Stock Market)	- 8.0%

The FED continued to hike yields during the period, with the fed funds rate now at 2.25%. It is likely Powell and the committee will hike in December to make it a full four hikes in 2018, with the big question mark being how many hikes will be implemented next year. In our opinion, the pace and number of rate hikes in 2019 are the largest factors in determining how financial markets perform going forward.

Below: Chart of Fed Funds Rate & 10 Year Treasury Yield (5 Years)

Over the past 5 years, 10-year Treasury yields (red line) are only up slightly, while the FED continues to hike short term rates (blue line) and are up significantly. We continue to monitor both of these rates and their likely future path.



The major factors which impacted markets in Q3 2018 are highlighted below:

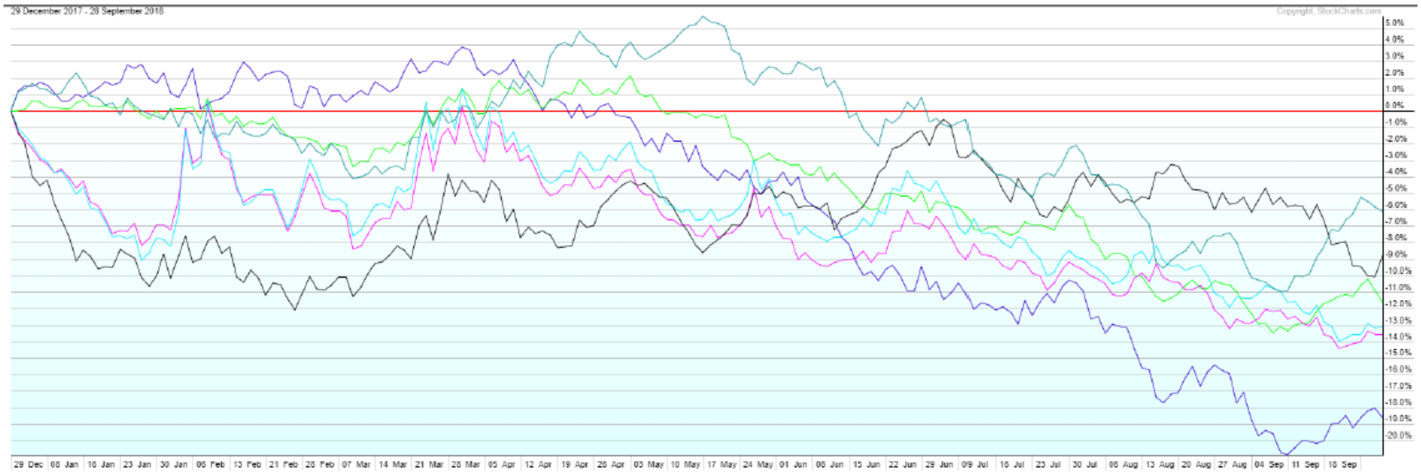
- **Trade War Fears/Tariff Headlines:** Despite almost constant trade war headlines and fears through the quarter, there was essentially no translation into the financial markets. In fact, partly because of significant trade progress made with Mexico, Canada, Korea, Japan, and Europe; stocks increased significantly in the quarter.

- **Continued US Corporate Earnings/Revenue Growth:** From Q2 2017 to Q2 2018 US stock market earnings increased 21%, while revenues increased 8%. These are great growth numbers fueled by tax reform, deregulation, near record low unemployment, and very high consumer confidence.

- **Divergence of US & Foreign Stocks:** Related to the above point, the difference between the US economy and foreign markets has become stark as measured by stock market performance. At the end of the 2nd quarter the difference between US and Emerging stock performance was about 18%.

Below: Chart of US Stocks vs. other major asset classes in 2018

Below (keeping US Stocks constant; red line); all other asset classes are performing worse on a relative basis, with many down on the year. With rates rising and the US representing both a 'safe haven' and a superior economy in 2018 vs. the rest of the world this outperformance continues. ***All asset classes are down 6% to 19% relative to US Stocks for 2018.***



Traphagen 2018 Portfolio Changes & Performance Update

Prior to October, 2018 was a year characterized by a strong US stock market, while all other asset classes were near breakeven or down on the year. This is due to slowing international economic growth, rising interest rates/US Dollar, robust domestic earnings growth, and trade fears (especially with China). Along with significant help from our alternative and private investment sleeves, this equated to our portfolios returning between 1% and 5% through the end of September.

You will find below a summary of major changes we made to portfolios from late 2017 through this June:

- **Introduction of Private Equity Fund (GPB Capital):** Through October, **this has been the top performer in the entire portfolio, returning just over 7%** (purely from the monthly dividend). We continue to monitor the underlying progress of the portfolio, which now consists of the 13th largest private auto dealership group and 7th largest pure-play physical therapy corporation in the nation. Additional large acquisitions have been made in waste management, IT, and debt securities. *(for accredited investors)*

- **Introduction of Private Real Estate Credit:** Through Q3, the Mosaic fund is the second highest performing asset, returning 6%. They continue to build and diversify their portfolio with loans on properties across the country. They did take a write down and sell a NYC residential property amid a weakening Manhattan market. *(for accredited investors)*

- **Addition of Diversified Real Assets Fund (VCRRX):** We added the Versus real asset fund in June and it is near breakeven since that time, despite the recent correction. This fund is a combination of infrastructure, private farmland, and private timberland. We continue to like the low volatility and low correlation of this strategy relative to almost all other asset classes.

- **Reorganization of Insurance Linked Security Allocation (XILSX, SRRIX):** The move we made earlier this year from Stone Ridge to Pioneer within our insurance exposure is paying dividends already. Through 2018, with a couple of US hurricanes under our belt, we have seen performance divergence between the two funds. The Pioneer fund (XILSX) is up 6% for the year, while Stone Ridge (SRRIX) is up 2%. At the end of the year we might transition the last of our Stone Ridge allocation to Pioneer.

2018 Market and Economic Outlook Update:

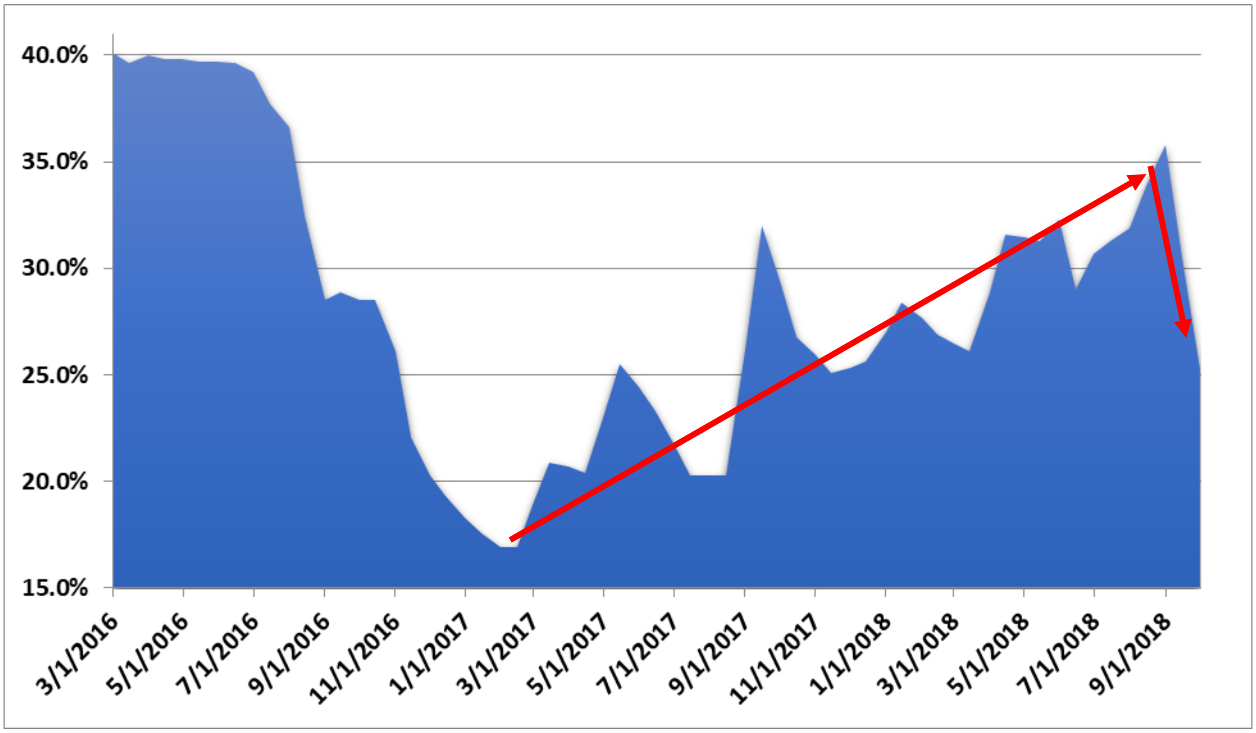
As short term and long term interest rates continue to rise, we look to make additional changes to our portfolios over the next year. We see cash or ‘near cash’ as a viable asset class now, with yields from 2.5% to 3.0% available on high grade/short term floating rate bonds. In addition, we can see opportunities in mid/long term high quality bonds if Treasury rates approach or exceed 3.5%. At that point, we can get a low risk 3.5% yield with the possibility of some capital appreciation if interest rates stabilize or drift down.

We remain generally constructive on the US stock market in the short to intermediate term (6-9 months) as unemployment is very low, tax reform and deregulation continue to spur confidence in the US economy, and 2018 corporate earnings growth looks good. Two significant risks are in our sights however, with either one capable of derailing the rally.

The first is a long term/severe trade/cold war with China. If there is no resolution to this dispute for years, we can see a significant global economic disruption that will most likely hurt foreign markets, but also begin to impact the domestic stock market as well.

Also, just as important as China, is the risk the FED hikes rates too quickly (like they did in 2006-2007) and stops the recovery in its tracks. We see some issues already with auto sales slowing, some real estate markets weakening, and mortgage applications down significantly with a 30 year fixed mortgage near or above 5%. In addition, higher rates will also put pressure on corporate borrowing costs and profit margins. We continue to monitor the FED, and any hints they give in regards to their 2019 rate strategy.

Below is a chart of the **Traphagen Recession Index (TRI) 3/2016 – 9/2018**



The TRI can be interpreted as the chance of a recession beginning over the next 12 months. The index had been gradually increasing for more than a year, but over the past couple months actually dropped off significantly to around 26. If this measure increases above ~ 45, we could start to take some more defensive positions in the portfolio.

As always, we greatly appreciate the privilege of managing your investment assets, and we hope all had a great summer and are looking forward to spending time with friends and family during the fast approaching holiday season.

As mentioned previously on the next page you will find our special update on the recent October stock market correction.

Best regards,
Your Traphagen Investment Team

** Special Market Comment (October 2018 Stock Market Correction)**

Since the end of the third quarter **the US and global stock markets have experienced one of the worst months since the 2008 financial crisis.** From October 1st through October 30th the SP500 was down 10% at the lows (which is the threshold for an official 'correction'). Global stocks fared slightly worse, with foreign stocks down 11% to 13%. No asset class was spared, with real estate, commodities, and high yield bonds down 3% to 11%. Even high quality bonds were breakeven to down slightly as interest rates we up in the period.

A couple important points to consider:

- On average **a 10%+ stock market correction happens about once per year and are a 'normal' occurrence in stock market investing**; in addition they are needed to eliminate excess speculation and positive sentiment from the market
- Traphagen (and other long term investors) see these corrections as buying opportunities to pick up quality companies, sectors, or indices at cheaper prices
- Although corrections are painful to go through, **all our clients have a material amount of their portfolios in alternative/private investments that have little to no correlation with the stock market**. This gives us the opportunity in larger stock pullbacks (20%+) to take these 'protected' funds and redeploy into stocks at much lower prices
- An average Traphagen 'balanced' client, from the recent market top in late September through the October lows, is down 4.1%, while the global stock market is down 10%. An average 'capital preservation' client in the same time period would only be down 3%
- These corrections are impossible to time and if you attempt to trade around it, you will get hurt. If you happened to sell near the recent lows, **over the past 2 days you would have missed an almost 3% stock market recovery**
- Traphagen is not sure if the current stock market correction is over, but if the worst is behind us, it will be nothing more than a blip in the continuing bull market. If more significant downside is yet to come, we will use the opportunity to reallocate assets from unaffected alternatives and bonds to quality companies at much lower prices

Below you will find an overview of yearly stock total returns and intra-year pullbacks (1980-2016). Notice despite almost every year having a 5%-10% correction or worse (average correction of 14%), if you simply hold through these periods you would have received an 8% yearly return. Red numbers indicate max drawdown in each year, grey numbers indicate total yearly performance.