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FINANCIAL GROUP

Q2 2019 Market Synopsis

Economic & Market Update:

The second quarter of 2019 was marked by two main events; increased volatility and a further significant decline in interest rates. From beginning to end, the quarter was positive for the US Stock market, with other risk assets experiencing mixed results. Bonds and other interest rate sensitive securities had a very strong quarter. The SP500 hit a then all-time high of 2,945 on May 1st before dropping 6.8% to 2,744 on June 3rd. This was an abrupt move downward that coincided with a seemingly worsening trade relationship with China. The SP500 finished the roller coaster quarter up 4.2%.

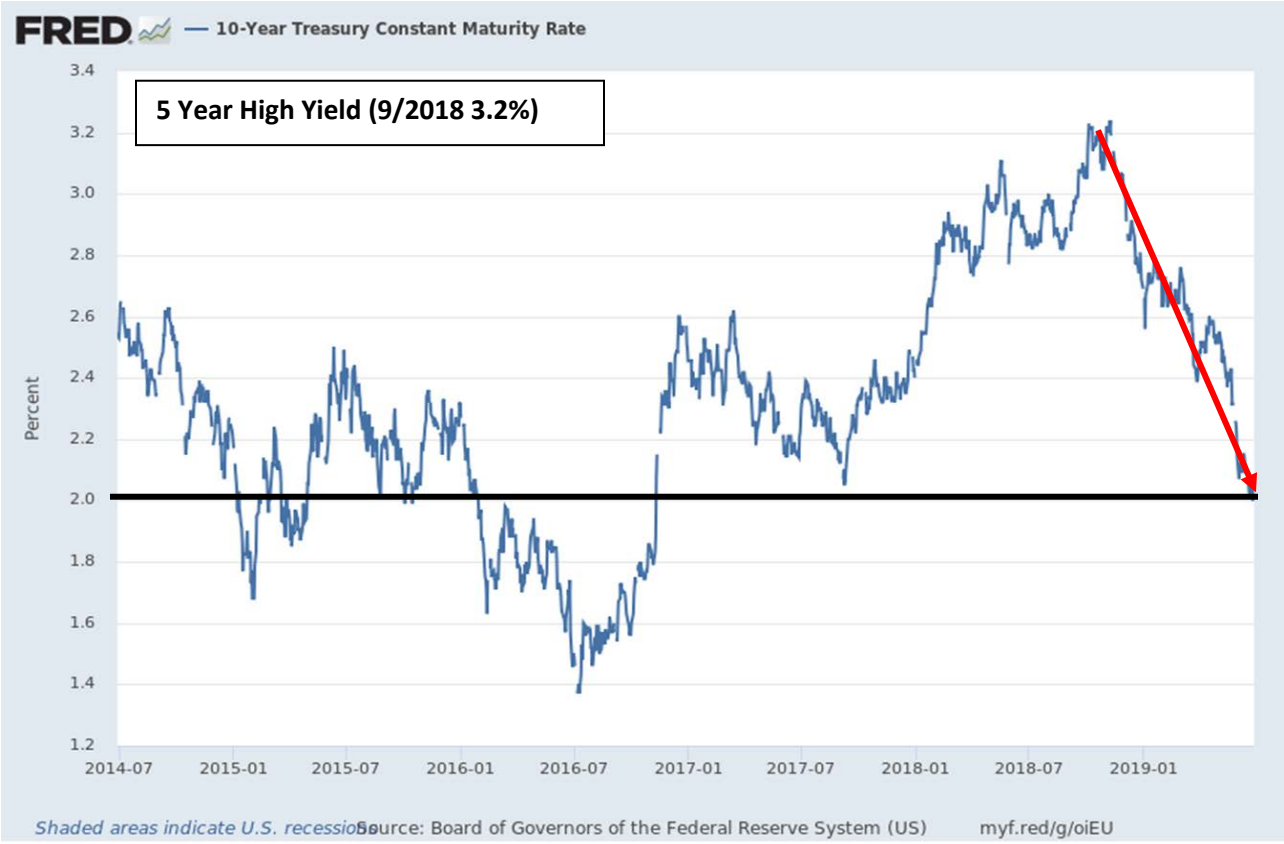
The 10-year Treasury yield dropped significantly from 2.5% on April 1st, to 2% at the end of June. This decline in rates is a continuation of the extreme move lower that began last fall, which brought the 10 year yield from 3.2% last October to around 2.0% currently.

Select 2019 YTD Asset Class Returns (6/30/2019)	
Nat Gas/Oil Pipeline Companies (TPYP)	+ 22.7%
S&P 500 (US Stock Market)	+ 18.5%
DJ US Real Estate (US Real Estate)	+ 18.5%
MSCI EAFE (Foreign Developed Stock Market)	+ 13.9%
MSCI Emerging Market (Emerging Stock Market)	+ 10.0%
High Yield Bonds	+ 9.9%
US Mid/Long Treasury Bonds	+ 6.7%
TIPS (Treasury Inflation Bonds)	+ 6.0%
Private Farmland, Timberland, Infrastructure (VCRRX)	+ 5.0%
Private Real Estate Credit (Mosaic)	+ 4.8%*
Alternative Lending (LENDX/RMPLX)	+ 1.7%
Insurance Linked Securities (XILSX/SRRIX)	- 0.1%

** GPB Capital Holdings II performance discussed in detail on page 4/5*

As mentioned last quarter the Fed made a historic shift in policy between December 2018 and January 2019. The scope of this shift continues to increase as we move through 2019. In December 2018, the Fed's outlook was for 2-3 more rate hikes in 2019 and a continued run-off of balance sheet assets (another form of financial tightening). As of July 2019, their outlook now involves ending the balance sheet reduction and the likelihood of ***one to two rate cuts*.**

Below: *5 Year history of the 10 Year Treasury Note Yield*



The major factors which impacted markets in Q2 2019 are highlighted below:

- **Lower Mid/Long Term Interest Rates:** As mentioned above, we think the dramatic decline in interest rates since late last year was the major factor contributing to positive returns across almost all asset classes in 2019. From this point, we anticipate interest rates will be range bound with the vast majority of the downward trend behind us.

- **Volatility of Trade Relations/News:** During most of Q1 and the beginning of Q2 trade worries faded into the background and the stock market continued to march forward. Within the first couple days of May, President Trump tweeted seemingly pessimistic remarks about China and Mexican trade prospects and the market responded quickly. During the month of May, the SP500 and foreign markets experienced a notable pullback of around 6.8%. Starting in early June however, these trade jitters were once again shaken off, with the hope of progress between Trump and Xi at the G20 summit.

Below: *2019 Chart of the SP500; Shaded box begins with 'pessimistic' Trump trade tweet; pullback of around 6.8% lasted through May*

- **Slowing of Corporate Profit & Economic Growth:** After 3% GDP growth in the US and a huge bump in corporate earnings of around 25% in 2018, we are seeing a marked slow-down in both these metrics. It is still early in the year, but it seems likely we will see close to 2% GDP growth in the US, with much of the globe slowing more. Corporate earnings growth looks to grind to a halt, with earnings before taking buybacks into account near flat year over year. Although these metrics are slowing materially, GDP is still expected to be solidly positive. In addition, after a tremendous year last year for corporate earnings growth, there is nothing too concerning with a consolidation period.

Traphagen 2019 Portfolio Changes & Performance Update

With the help of a historic Fed policy reversal and much lower long term interest rates the vast majority of portfolio components are working very well. Bonds are performing well above long term expectations of around 3%, with returns through June between 5% and 10%. These returns were helped both by the drop in rates and a compression of corporate bond spreads. We do not see much value or additional return left within the bond market. Risky assets continue to do well, with US large cap stocks and pipeline companies being the standouts here. Almost all of our alternative/private investments are performing in line or above expectations, with GPB Capital a unique case which we will comment on specifically.

Below you will find a summary of major changes we made to portfolios in mid 2018 and early 2019:

- **Increase in pipeline company exposure:** This continues to prove to be a great investment as pipeline companies are the best performing asset in portfolios this year. Through mid-July (our pipeline index ETF; TPYP) is up roughly 25% and most clients hold around a 5% total allocation to the position.

- **Introduction of private real estate:** TIPWX (national private real estate) was one of our new private/alternative investments purchased early this year and it continues to perform well with almost no volatility. Through mid-July this fund is up 3.5%, on pace for a 6% to 7% year.

- **Replacement of Preferred Equity/High Yield Bonds with Low Volatility US Stocks (USMV):** In late May and early June we replaced a large amount of higher yielding (but in our opinion over valued) preferred equity and high yield bonds with low volatility US stocks. USMV is a fund that allocates to stocks which have low correlation to each other in various industries with a screen for quality. Over the past 1 ½ months the net return benefit of this trade has been about 5.5%.

- **Introduction of Private Municipal Bonds:** For investors in higher tax brackets, we continue to be pleased with our new private tax free bond fund. Through mid-July the fund is up 2.9%, and on pace for a 5% to 6% largely tax free 2019 return.

- **Versus Real Assets Fund (VCRRX):** We have now been invested within the Versus real assets fund for about 1 year and are pleased with performance. In a mostly down 2018, the fund had a 0.6% gain, while so far this year the fund is up 5.5%.

Private Investment Update *(for accredited investors only; $1M+ with Traphagen)*

Private Equity (GPB Capital): Significant progress has been made in the first half of 2019 for GPB II Fund holders. Deloitte completed their valuation analysis and published the 12/31/2018 values for the funds in June. Deloitte marked down the fund values by about 25%, however, **our clients are down between 11% and 16%** (roughly in line with small cap publicly traded stocks) when adjusting for distributions and share class (as there were no commissions paid by our clients). GPB management expects a material increase in value with the next price mark (as of 6/30/19; scheduled for release 9/30/19).

On the operations side, GPB sold one of their IT companies (DeepBlue) to Comcast for a more than 100% profit in early May. Management has communicated the balance of the

portfolio is performing well in 2019, with the automotive division showing a marked improvement over the prior year.

We continue to await the completion of the audits through 2018 which Eisner Amper is targeting for 9/30 completion. Once complete, the company will have more flexibility in terms of dividend payments, information dissemination to investors, corporate borrowings, and deal structuring.

Along with this progress, we wanted to comment on two challenges GPB has faced over the past month.

First, many of our clients have received a letter from a law firm attempting to solicit claimants over the past week. This letter contains allegations made over a year ago by an individual GPB is actively suing for breach of contract. There is no new information in this letter and GPB has issued a response on 7/15/2019 strongly denying these allegations. In addition, we have just been informed that GPB has issued a 'cease and desist' demand to this law firm. If any of our clients received this letter and have questions, please do not hesitate to contact your Traphagen wealth advisor or Eric Mancini (our director of investment research) for more information.

Further, Fidelity may not continue to hold the GPB security on their platform starting later this year. Accordingly, Traphagen would choose another custodian to hold that position on your behalf. Your wealth advisor will be in contact with you if any action is needed over the next month or so.

While disappointed with 2018 performance (specifically within the auto division) and the challenges management is facing, overall we remain optimistic on the strategy, the underlying assets, and companies within the GPB II Fund. We expect the next price mark to be materially higher than the current mark for a combination of reasons, and operations across all industries within the fund have improved over the first 6 months of 2019. In addition, management expects dividends to be reinstated once the audit is completed.

Private Real Estate (Mosaic): We continue to be extremely pleased with the performance of our private real estate credit fund (Mosaic). As we previously mentioned, in a very tough 2018, this was by far the best performing security in the portfolio with a 9.5% net return. The Q1 2019 final return number was 2.3%, and our estimate for Q2 is between 2.5% and 3.0%. In addition to good performance, the fund continues to grow in terms of assets and loans. The fund itself is up to $440M with more money invested in the form of co-investments and separately managed accounts within the same strategy. The total number of loans in the fund now exceeds 30, with Q2 2019 being a record quarter in terms of loan originations. Nine loans were originated in Q2 2019 alone.

A recent example of a very large project that Mosaic has funded is the construction of a new Ritz Carlton in Portland, Oregon. This is the first five star hotel in the city and has received significant positive press. Construction is scheduled to be complete in 2023.

2019 Market and Economic Outlook Update:

We continue to hold short term bonds and cash as we are able to earn around 2.5% to 3.0% in interest with little rate risk in more conservative portfolios. In addition, we have moved out of highly valued preferred equity and high yield bonds and into low volatility US stocks which we believe have a better risk/return profile.

There continues to be mixed signals for the global economy in the intermediate term (9-12 months). On the plus side, unemployment remains very low, consumer confidence is high, consumer spending is robust, and interest rates are stable and low. Just as important, it seems the Fed (and worldwide central banks) 'have our back'. We now expect the Fed to cut interest rates by about half of one percent in 2019.

As a partial counterbalance to these positives, US and foreign economies have slowed and US corporate earnings growth looks to be near 0% in 2019. With stock valuations materially higher than late last year, we believe it could be tough to get further significant stock returns in the back half of 2019. We do however, expect additional returns from dividends, bond interest, and the alternative suite.

The TRI (Traphagen Recession Index) can be interpreted as the **chance of a recession beginning over the next 12 months.** This measure is near its high (currently around 49%), but it has seemed to have leveled off recently. We consider this metric elevated, but shy of levels where we would look to take more defensive action. We continue to monitor this closely and will make portfolio changes if warranted.

As always, we greatly appreciate the privilege of providing financial guidance and managing your portfolios. We hope you all have a wonderful summer.

Best regards,
Your Traphagen Investment Team