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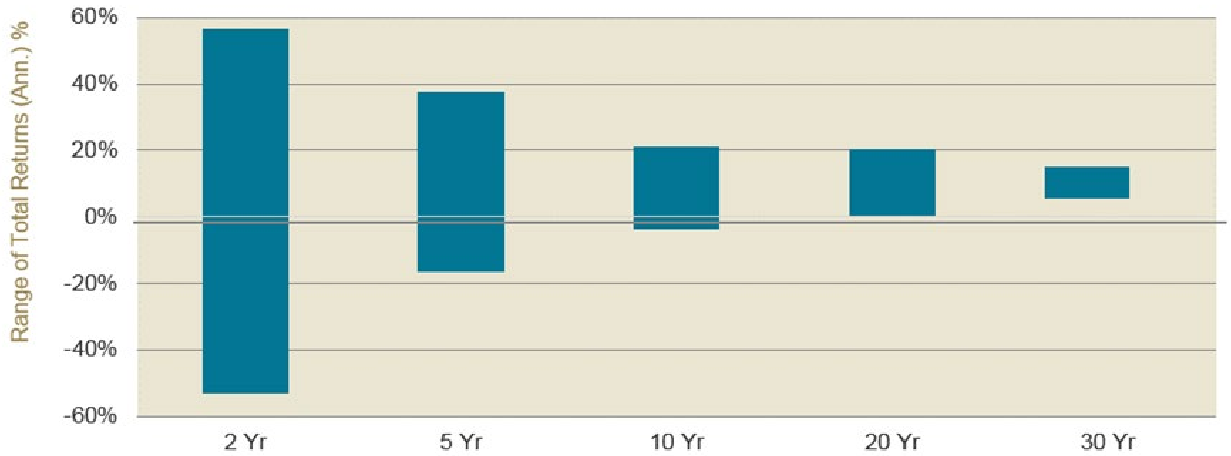
Clear Harbor Flash:
Thoughts on The Most Recent Bout of Market Volatility

What a difference a month makes. The rosy outlook for corporate America did not fade this month. However, the equity markets both home and abroad faltered over the last five weeks as uncertainty over the sustainability of earnings growth fueled speculation that the equity bull market in the US has run its course. Continued dollar strength and geopolitical uncertainty has weighed on Emerging Markets, a trend that commenced in January of this year. And geopolitical uncertainty from London to Berlin to Rome has weighed on consumer and business optimism in Europe, sending benchmarks markedly lower over the course of the month and year.

While we do not welcome a rise in market volatility, it is a normal component of a functioning equity market. In fact, an asset class devoid of volatility over the long run should lack the potential to bear significant fruit to investors. For example, a Treasury bill that matures in 3 months has extraordinarily low-price volatility while a growth stock represents many multiples of anticipated price movement. It is for this reason that a growth stock's anticipated long-term return profile and current price assumes a significantly higher total return than that of a Treasury Bill. I use these two examples as proverbial "book ends" for illustration purposes.

History provides a useful tutorial here as the chart below illustrates that equity markets can generate very wide return dispersions in the near term (i.e. a 2-year period) and a significantly more narrow and positive band in the long run. As we all know, a portfolio that does not incorporate your emotional risk tolerance can capture more of the negative near-term results and less of the long-term positive outcomes. We are not just providing a thesis for why equities remain an extraordinary investment over the long run but also why owning other complementary and non-correlated asset classes may lower your blood pressure and enhance your ability to remain invested.

Range of Total Returns for U.S. Stocks Over Various Rolling Periods (1926-2015)



Source: Brandes Investment Partners, S&P Dow Jones Indices as of 12/31/2015. US Stocks represented by the S&P 500 Index. Rolling periods represent a series of overlapping, smaller time periods within a single, longer-term period. For example, over a 20-year period, there is one 20-year rolling period, eleven 10-year rolling periods, sixteen 5-year rolling periods, and so forth. Past performance is not a guarantee of future results. One cannot invest directly in an index.

Equities	Week	YTD	12 Months	Div. Yield
U.S. Large Caps	-3.9%	-0.6%	3.8%	2.0%
U.S. Small Caps	-3.8%	-2.4%	0.3%	1.3%
Non-U.S. World	-3.7%	-12.7%	-9.4%	3.5%
Non-U.S. Developed	-3.9%	-11.2%	-8.3%	3.7%
Japan	-4.6%	-8.7%	-4.5%	2.5%
Emerging	-3.3%	-17.2%	-13.2%	3.2%
Asia ex-Japan	-3.7%	-17.9%	-14.2%	3.1%

Bonds	Week	YTD	12 Months	Yield
U.S. Treasuries	0.7%	-1.7%	-1.1%	3.1%
U.S. TIPS	0.4%	-1.7%	-0.1%	3.2%
U.S. Investment Grade	0.3%	-3.2%	-2.0%	4.2%
U.S. High Yield	-0.7%	0.9%	0.9%	6.9%
U.S. Municipals	0.3%	-0.8%	-0.3%	3.0%
Non-U.S. Developed	0.1%	-3.7%	-1.1%	1.0%
EM $ Bonds	-0.2%	-4.7%	-3.4%	6.7%

Commodities	Week	YTD	12 Months	Level
Brent Crude Oil	-2.7%	16.1%	30.9%	$77.62
Gold	0.6%	-5.3%	-2.6%	$1,234
Copper	-1.0%	-15.0%	-11.8%	$6,160

Currencies	Week	YTD	12 Months	Level
Euro/USD	-1.0%	-5.0%	-2.1%	1.14
USD/Yen	-0.6%	-0.7%	-1.8%	111.91
Pound/USD	-1.9%	-5.1%	-2.5%	1.28

Data Source: Blackrock; as of close of business October 26, 2018

As of today, Q3 US corporate earnings have come in reasonably strong, rising at a more than 25% annualized rate, with approximately 80% of companies reporting beating analyst expectations while 46%

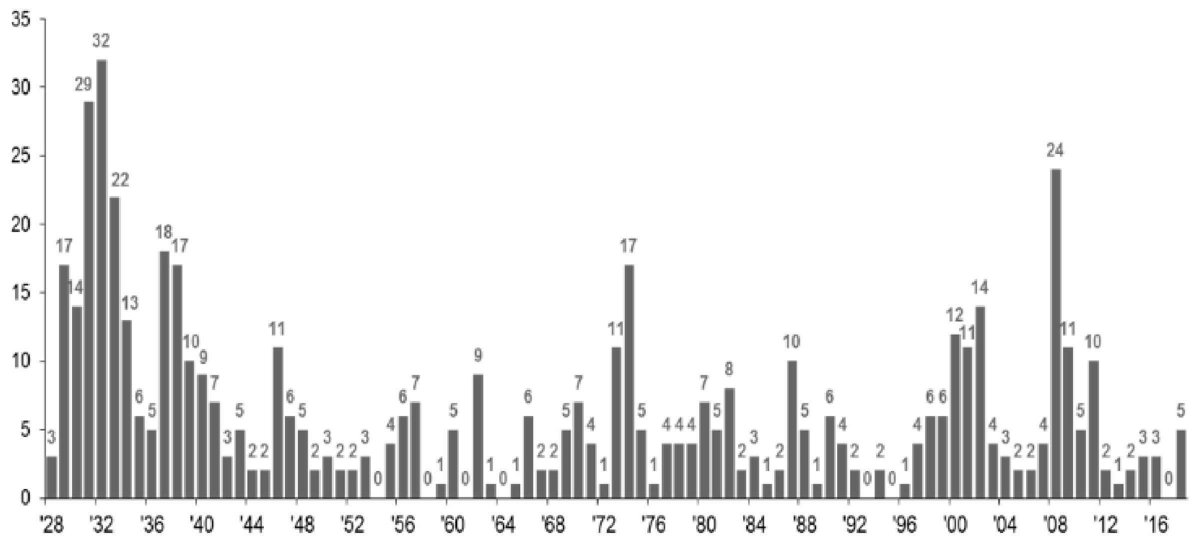
of companies outpacing revenues expectations. On average, Companies were able to expand their margins even as unemployment rests at levels not seen in over 50 years.

Market observers appear to be questioning whether these trends have peaked. Indeed, it is the step change in expectations that often tends to auger a change in market trajectory. Expectations that EPS growth will falter into Q4 and beyond seem to be spooking the market this Halloween week.

Economists are also starting to discount S&P 500 earnings estimates due to the belief that the US/China trade skirmish could very well reduce operating earnings for the S&P 500 by up to 5%.

The US equity market has corrected more than 5% 23 times since the March 2009 Great Recession low. We do and should expect these corrections to remain a part of a healthy and functioning market. They cannot cleanse excesses in the real economy but can awaken complacent speculators and provide a healthy foundation from which the market can expand. While the technical and economic data suggests that the trends since late September are not fundamentally driven, we remain at the watch for all of our clients.

Number of 5% pullbacks in the S&P 500 experienced per year



Source: Standard & Poor's, FactSet, J.P. Morgan Asset Management. For Illustrative purposess only. Returns are based on price index only and do not include dividends. Data are as of 10/24/2018.

The bear market thesis is predicated on several possible scenarios:

- A FED that remains stubbornly hawkish in the face of benign inflation and incrementally weaker yet positive economic data.
- A perception that a recession is around the corner and that Leading Economic Indicators have or could peak in the very near term.
- An overheated labor market could bear witness to rising inflation expectations and margin contraction.

- Geopolitical uncertainty and Congressional gridlock could lead to inaction at a time when the economy may require a willingness for policy makers to pull fiscal levers in order to maintain economic momentum.
- A prolonged and deep trade war between the US and China could reduce US and global GDP estimates greater than analysts have estimated.

The S&P 500 has experienced an average correction of 14% each year over the past 38 years[i] and yet has risen on average by 11% per year over the same period, providing a positive return in 29 of those 38 years and a compounded return of 5,134%!

We have not yet managed to find anyone in the investment universe who was able to predict when these various corrections and even recessions emerge and fade. Instead, our work focuses on guiding clients not only through various phases in their financial lives but also the critically important process of creating and designing a portfolio that can address near term and long term financial considerations.

It is at moments precisely like these that a clear understanding of personal risk, objectives and strategies must remain aligned. Please do not hesitate to reach out to your advisor here at Clear Harbor to discuss further. I welcome your comments and questions.

Sincerely,

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[i] JP Morgan