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Nauset Market Commentary
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Market Performance Recap: **US Stocks Surge to New Highs**

Positive economic data in growth, employment and wage growth pushed US stock indices to new highs in Q3. The Russell 1000 US stock index posted +7.4% gains in Q3 led by tech, healthcare and consumer services. Real estate, basic materials and energy stock sectors lagged. A strong US dollar hurt international stocks as MSCI EAFE index was up only slightly at +1.3%, and MSCI Emerging Markets index fell -1.1% for a YTD decline of -7.7%. Rising yields and a September Fed rate hike muted bond returns as the Barclays Intermediate Gov't/Credit bond index inched up +0.2%.

Economic & Market Discussion: **Speed Traps**

The US economy is humming along with strong growth, record corporate earnings and excellent market performance. The robust growth is driven by three key factors – corporate tax breaks, low nominal borrowing rates and consumer spending fueled by recent wage growth. However, as we have seen at the start of Q4, there are significant headwinds that may slow the ride or worse.

- Rising Rates – A decade of accommodation – meaning cheap money – is ending in several ways. The Fed is hiking short-term rates on a quickening pace over the past year and liquidity is being removed from the system as the government winds down its bond purchase program. The question is: where is the pain point when higher borrowing costs for businesses and consumers choke off future growth? An inverted yield curve – when short-term rates are higher than long-term rates – may be the key signal. The chart below shows that every recession for the past 60 years was presaged by an inverted yield curve. While the yield curve has flattened, it has not yet inverted. We are watching rates closely with history showing us that an inversion likely means recession is not far off.

Inverted Yield Curve (10-Yr minus 1-Yr) and Recessions (1956-Present)

Recession Start	Recession End	Inverted Curve Before Recession?	First Yield Curve Inversion	Lead (Months)
Aug-57	Apr-58	Yes	Dec-56	8
Apr-60	Feb-61	Yes	Sep-59	7
Dec-69	Nov-70	Yes	Dec-67	24
Nov-73	Mar-75	Yes	Mar-73	8
Jan-80	Jul-80	Yes	Sep-78	16
Jul-81	Nov-82	Yes	Sep-80	10
Jul-90	Mar-91	Yes	Feb-89	17
Mar-01	Nov-01	Yes	Apr-00	11
Dec-07	Jun-09	Yes	Jan-06	23
Average Lead Time				**14**

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- Trade Issues – President Trump's tariff actions, particularly with China, continue to roil the investment markets. The uncertain outcome to various trade disputes is an overhang to investment markets. The recently revised NAFTA trade pact did relieve some pressure with our largest trading partners. However, the larger trade war with China continues to intensify with significant economic and investor sentiment damage possible to the US.
- Politics & Policy – The mid-term elections are only a few weeks away. While the immediate impact on the US economy may be marginal, the potential for policy uncertainty in key areas of trade, taxes, and immigration could be disruptive to the current economic course. While we believe that the fundamentals of the current economic expansion will likely overshadow any short-term political angst, a bout of volatility could certainly prevail post-election.

Portfolio Strategy: **Keeping Our Re-Balance**

Our current strategy features a slight overweight to stocks versus bonds. We continue to regularly rebalance portfolios according to each portfolio's asset allocation policy. Rebalancing is a key component of our risk-managed investment approach. Here are our thoughts on specific allocation areas.

- US Focus on Equity – We hold a slight stock overweight on US stocks with an emphasis on tech, finance and health care sectors, while maintaining an allocation to both non-US developed and emerging market equity areas.
- Fixed Income Defense – As rates continue to rise, we consolidated our fixed income allocation to two bond funds earlier this year - high-quality corporate bond fund and a non-traditional multi-sector bond fund. As a result, we have a reduced or zero direct allocation to high yield and emerging market bonds.
- Prepared for Volatility – To manage risk, we hold alternative and real asset investments in most portfolios to seek returns with low correlations to major market movements. We expect these two areas plus cash holdings to buffer portfolio volatility while diversifying sources of return over time.

Market Performance   % Change for Periods Ended 9/30/2018

Market Index	Third Quarter	2018 YTD	1-Year	3-Year Annual.	5-Year Annual.
Russell 1000	7.42	10.49	17.76	17.07	13.67
MSCI EAFE – Non-US	1.35	-1.43	2.74	9.23	4.42
Russell 2000	3.58	11.51	15.24	17.12	11.07
MSCI Emerging Markets Equity	-1.09	-7.68	-0.81	12.36	3.61
DJ US Real Estate	0.65	2.07	4.69	8.94	9.39
NASDAQ 100	7.14	16.56	23.87	20.31	16.36
Barclays Gov't/Credit Interm. Bond	0.21	-0.76	-0.96	0.91	1.52
Wilshire Liquid Alternative	1.02	-0.55	0.96	1.90	1.37
3-Month T-Bill	0.50	1.29	1.57	0.80	0.49