Investment Commentary
Third Quarter 2018

Solid economic fundamentals and earnings growth continue to support and reward risk assets. Growth in the U.S. has outpaced growth internationally this year and credit conditions remain benign. As such, 2018 is on pace to reflect record U.S. corporate earnings as well as a record level of mergers and acquisitions activity. Corporate stock buybacks remain robust but investor sentiment, especially retail investor sentiment, remains skeptical of the current bull market. We continue to believe the economic data supports our contention that we are in the early stages of what we consider "late cycle" here in the U.S. The data also supports our belief that global markets are likely several years behind the U.S. in terms of recovery and continue to offer an excellent opportunity at current prices. We provide more on our thesis for that asset class below.

We employ an institutional approach to thinking about markets and opportunities. We try to be disciplined about how we review, evaluate, and communicate our thoughts on the supportive underlying data. Our approach does not eschew hunches, best guesses, and near-termism. We focus on data and cycles. That institutional approach requires us to evaluate performance not over weeks or months but rather over a more reasonable period of evaluation. A three-year period is generally what institutions utilize when evaluating a strategy's success or failure. We agree with this approach. We believe that the three-year cumulative return data for the various asset classes highlighted below best captures the underlying economic fundamentals for the most recent past. It is nothing more than - nor less than - a snapshot of where we have been.

3yr cumulative returns*	
S&P500	+55.4%
Russell 2000	+52.8%
MSCI EAFE (developed markets)	+27.1%
MSCI Emerging Markets	+36.5%
U.S. Aggregate fixed income	+3.9%
U.S. Corporate fixed income	+9.6%

*(index total returns thru September 30, 2018)

Where the markets go from here will largely be dictated by both the availability and cost of credit. Credit is what fuels corporate investment and funds labor growth. Credit is the essential fuel that drives the economy. Despite recent increases in yield, credit remains both low in price and available in quantity. The world continues to be awash in liquidity. Private credit standards continue to be more accommodative than restrictive. That can be seen in both the FRB Bank Lending Survey data as well as in investment grade and high yield credit spreads, both of which are low and stable. The Fed has clearly embarked on a very slow, multi-year rate hiking cycle. The Fed has openly expressed their commitment to take short rates back to something that looks like neutral prior to the next recession. The prior three economic cycles peaked when real rates were +500bps, +450bps, and +300bps respectively. With real interest rates today still hovering near zero, we believe the Fed remains very early in this rate hiking cycle. Global central banks are still participating in quantitative easing while the Fed is raising rates and

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simultaneously trying to reduce the size of its $4.5 trillion balance sheet. We expect the Fed to go low, slow and steady in hiking rates from here. The Treasury curve as measured by 10y v. 2y is nearly as flat as it has been since 2008. But being "flat" and being "inverted" are two very different things. The "all-important" shape of the yield curve has recently steepened. In 2019 we will see the U.S. federal government report a substantial fiscal deficit which will likely be funded by long dated Treasuries. Investors should not be surprised to see the Treasury curve actual steepen from here, signaling yet another new leg to this now 113 month long economic expansion.

The availability of very inexpensive credit has fueled measurable economic growth in the U.S. during 2018. It has clearly been a year of economic acceleration. Recent ISM manufacturing data was recorded at 58, comfortably above the > 50 index reading needed to signal economic expansion. Average hourly earnings continue their slow grind higher. September's average hourly earnings gain was +2.7%. Despite an unemployment rate of 3.7%, wages remain well in check due to secular issues such as technological gains and globalization. Measurable inflation, which should be visible so late in a cycle, is difficult to find. Even with such a low unemployment rate, job openings data remains robust as corporate America continues its hiring boom. In short, the data continues to be supportive of both economic activity and earnings growth.

But a higher level of economic activity has come at the expense of global equity markets. Higher bond yields here in the U.S. have translated into a stronger USD and more expensive funding rates for countries running both fiscal and trade deficits. As such, returns in both developed international and emerging markets have suffered this year. Despite the headwinds of higher yields and a stronger USD, we continue to believe that a multi-year opportunity exists in owning more international equities. Global developed markets continue to enjoy very low interest rates and mid-to-high earnings growth. Emerging markets represent roughly 80% of the world's population and 40% of the world's GDP but only 20% of the world's market capitalization. Our belief is that this relationship will converge over the long term. Lastly, since the darkest days of the great Recession, the S&P500 has risen roughly +280% while both developed international and emerging markets have risen just +120%. We believe international equities are under-owned and attractively priced. Both sectors have certainly been "on sale" recently and we believe investors adding amid the current turmoil will be rewarded.

The promise we make to our clients is that we will continue to monitor the markets closely, be disciplined with data and communicate often. A disciplined process will lead to performance and attaining goals over time.

We thank our clients for their continued trust and support.

Richard J. Barrett
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October 2018

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