From: Kevin Prendergast
To: Kevin Prendergast
Subject: Feeling Skinnier
Date: Wednesday, November 21, 2018 3:56:08 PM

Good evening EFG Family and Friends,

Hope your holiday preparations are going well.

Global stock market performance for the months of October and November has many of us feeling a little skinnier than we'll probably feel tomorrow night. While these temporary periods are uncomfortable, as believers in diversified portfolio construction, we know they are a necessary part of our investment process.

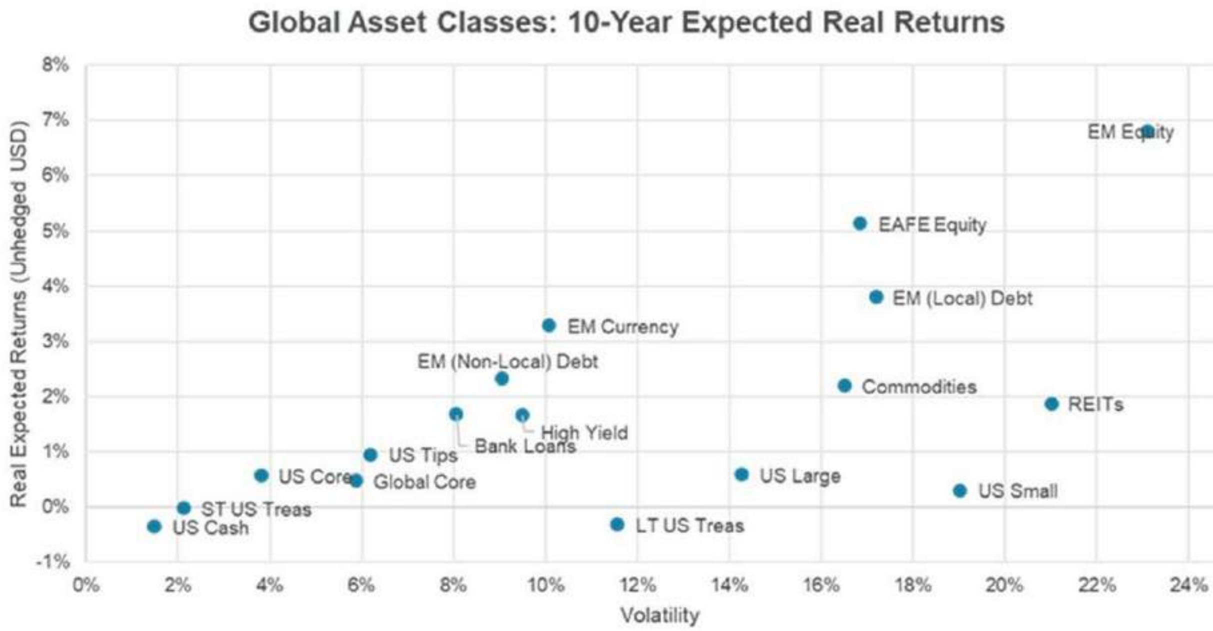
Last week, my wife and I visited my parents in North Carolina. After dinner on Friday night, we flipped on the local PBS affiliate for NewsHour. During the market update segment, the show's host recapped the day's performance of the S&P 500, Dow Jones Industrial Average, and Nasdaq, implying these three indexes represented "the markets." This approach to financial market commentary is common amongst mainstream media outlets and is, in our view, a disservice to the investing public. The problem with reporting on these three indexes alone is that doing so omits significant portions of investor portfolios. The S&P 500, Dow Jones Industrial Average, and Nasdaq do not represent the performance of cash equivalents and bonds, be they foreign or domestic, government or corporate, and these three indexes do not tell us about stocks of companies domiciled outside the US. Together, these omitted asset classes often make up more than half of investor portfolios!

While it would probably drive the graphics people at TV networks nuts, the chart below is what they should be showing. Specifically, it demonstrates the returns of a broad swath of asset classes often contained within a diversified portfolio. The time period captured by this chart is October 1, 2018 through November 20, 2018. Bonds for example, as represented by the Bloomberg Barclays indexes, provided valuable downside protection during this period. Moreover, international stocks as represented by the MSCI indexes generally outperformed US stocks (S&P, Russell) on a relative basis. Within the US, Value, which we favor in our TOPS portfolios, outperformed Growth on a relative basis.

Bloomberg Barclays Global Aggregate X - US	(0.65%)
Bloomberg Barclays High Yield US Corporate	(3.14%)
Bloomberg Barclays US Aggregate	(0.26%)
Bloomberg Barclays US TIPS	(0.90%)
Bloomberg Commodity	(3.60%)
Consumer Price Index - Unadjusted	0.18%
MSCI EAFE Net	(9.00%)
MSCI EM (Emerging Markets) Net	(6.95%)
Russell 2000	(12.06%)
S&P 400 MidCap	(9.60%)
S&P 500 Composite	(9.41%)
S&P 500 Growth	(12.05%)
S&P 500 Value	(6.19%)
S&P Global X - US REIT	(3.07%)
Wilshire US REIT	1.00%

While it may not seem like a major victory to be down, but down less than the S&P 500, the less our portfolio values decline during inevitable periods of negative performance, the less they must gain during the ensuing recovery before resuming the march to new highs. One of the reasons we invest is because stocks as a whole generally go up far more often than they go down. Historically in the US for example, stocks generate positive returns about 70% of the time on a calendar year basis. The reason we remain invested through these difficult periods is because despite the efforts of hardworking investment professionals everywhere, there is no way to consistently predict when stock market downturns will begin and end.

The good news is that since the S&P 500, specifically the "Growth" stocks within the S&P 500, dramatically outperformed the omitted asset classes named above following the financial crisis of 2007 – 2008, it's reasonable to expect the next 10 years to look different. To that end, our baseline capital market assumptions, illustrated by the chart below, have us feeling very good about our chances to outperform the S&P 500 going forward, particularly on a risk-adjusted basis. The "US Large" data point, often represented by the three commonly used indexes discussed in the media, is projected to demonstrate above average risk as measured by volatility (standard deviation), while producing below average "real" (after inflation) returns. As a result, we expect our TOPS portfolios to outperform the S&P 500 over the next 10 years, after lagging the S&P 500 over the past 10 years.



Source: These expected returns are calculated by Research Affiliates LLC using data provided by MSCI Inc., Bloomberg, and Barclays. Data as-of 04/30/2017.

We quoted Winston Churchill in our post-Midterm Election commentary earlier this month and find ourselves quoting the British Bulldog again: "The pessimist sees difficulty in every opportunity. The optimist sees the opportunity in every difficulty."

Have a very happy and safe Thanksgiving with your families.

KP

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