Cherry Bekaert Wealth Management

Market Update: The Quarter in Review

Useful Information for Your Business & Financial Success

Summary

Third Quarter 2018

Looking at broad market indices, the U.S. outperformed non-U.S. developed and emerging markets during the quarter. Small caps underperformed large caps in the U.S., non-U.S. developed, and emerging markets. The value effect was positive in emerging markets but negative in the U.S. and non-U.S. developed markets. REIT indices underperformed equity market indices in both the U.S. and non-U.S. developed markets.

U.S. Stocks

The U.S. equity market posted a positive return, outperforming both non-U.S. developed and emerging markets. Value underperformed growth in the U.S. across large and small cap stocks. Small caps underperformed large caps in the U.S.

International Developed Stocks & Emerging Stocks

In U.S. dollar terms, developed markets outside the U.S. underperformed the U.S. but outperformed emerging markets during the quarter. Large cap value stocks underperformed large cap growth stocks in non-U.S. developed markets; however, small cap value outperformed small cap growth. Small caps underperformed large caps in non-U.S. developed markets.

In U.S. dollar terms, emerging markets posted negative returns for the quarter, underperforming developed markets including the U.S. The value effect was positive, particularly in large caps in emerging markets. Small caps underperformed large caps.

Fixed Income

Interest rates increased in the U.S. during the third quarter. The yield on the 5-year Treasury note rose 21 basis points (bps), ending at 2.94%. The yield on the 10-year Treasury note increased 20 bps to 3.05%. The 30-year Treasury bond yield rose 21 bps to 3.19%. On the short end of the yield curve, the 1-month Treasury bill yield increased 35 bps to 2.12%, while the 1-year Treasury bill yield rose 26 bps to 2.59%. The 2-year Treasury note yield finished at 2.81% after an increase of 29 bps.

In terms of total return, short-term corporate bonds gained 0.71%, while intermediate-term corporates returned 0.80%. Short-term municipal bonds declined 0.11%, while intermediate-term munis dipped 0.06%. Revenue bonds (–0.16%) performed in line with general obligation bonds (–0.14%).

The Impact of Inflation

June 2018

When the prices of goods and services increase over time, consumers can buy fewer of them with every dollar they have saved.

This erosion of the real purchasing power of wealth is called inflation. Inflation is an important element of investing. In many cases, the reason for saving today is to support future spending. Therefore, keeping pace with inflation is a crucial goal for many investors. To help understand inflation's impact on purchasing power, in 1916, nine cents would buy a quart of milk. Fifty years later, nine cents would only buy a small glass of milk. And more than 100 years later, nine cents would only buy about seven tablespoons of milk. How can investors potentially prevent this loss of purchasing power from inflation over time?

Investing for the Long Term and Other "Tips"

As the value of a dollar declines over time, investing can help grow wealth and preserve purchasing power. Investors should know that over the long haul stocks have historically outpaced inflation, but there have also been short-term stretches where this has not been the case. For example, during the 17-year period from 1966–1982, the return of the S&P 500 Index was 6.8% before inflation, but after adjusting for inflation it was 0%. Additionally, if we look at the period from 2000–2009, the so-called "lost decade," the return of the S&P 500 Index dropped from –0.9% before inflation to –3.4% after inflation.

Despite some periods where stocks have failed to outpace inflation, one dollar invested in the S&P 500 Index in 1926, after accounting for inflation, would have grown to more than $500 of purchasing power at the end of 2017 and would have significantly outpaced inflation over the long run. The story for US Treasury bills (T-bills), however, is quite different. In many periods, T-bills were unable to keep pace with inflation, and an investor would have experienced an erosion of purchasing power. After adjusting for inflation, one dollar invested in T-bills in 1926 would have grown to only $1.51 at the end of 2017.

While stocks are more volatile than T-bills, they have also been more likely to outpace inflation over long periods. The lesson here is that volatility is not the only type of risk that should concern investors. Ultimately, many investors may need to have some of their allocation in growth investments that outpace inflation to maintain their standard of living and grow their wealth.

One additional tool available to investors who are concerned about both stock market volatility and inflation are Treasury Inflation-Protected Securities (TIPS). TIPS are guaranteed by the US Treasury and as such are considered by the marketplace to have low risk of default. The Treasury issues TIPS with a variety of maturities, and these securities are easily bought and sold. Unlike traditional Treasury securities such as T-bills, TIPS are indexed to inflation to protect investors from an erosion in purchasing power. As inflation (measured by the consumer price index) rises, so does the par value of TIPS, while the interest rate remains fixed. This means that if inflation unexpectedly rises, the purchasing power of any principal invested in TIPS should also increase[1]. Although they may not offer the long-term growth opportunities that stocks do, their structure makes TIPS an effective risk management tool for investors who are concerned with managing uncertainty around future purchasing power.

Conclusion

Inflation is an important consideration for many long-term investors. By combining the right mix of growth and risk management assets, investors may be able to blunt the effects of inflation and grow their wealth over time. Remember, however, that inflation is only one consideration among many that investors must contend with when building a portfolio for the future. The right mix of assets for any investor will depend upon that investor's unique goals and needs. A financial advisor can help investors weigh the impact of inflation and other important considerations when preparing and investing for the future.

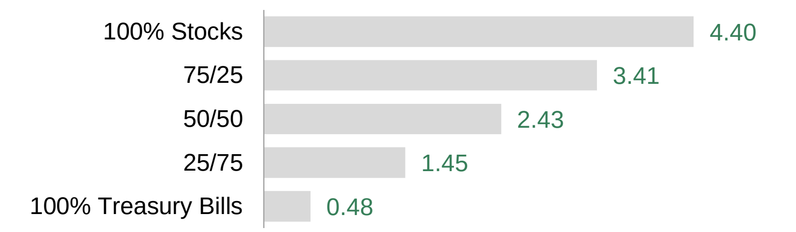
1. Market prices incorporate market participants' expectations about the future. Therefore, market participants' expectations about future inflation should be incorporated into current prices. These expectations are referred to as expected inflation. Unexpected inflation refers to unexpected changes in inflation that deviate from prior market expectations. Unexpected inflation should be considered a primary driver of inflation risk.

Impact of Diversification

Third Quarter 2018 Index Returns

These portfolios illustrate the performance of different global stock/bond mixes and highlight the benefits of diversification. Mixes with larger allocations to stocks are considered riskier but have higher expected returns over time.

Ranked Returns (%)

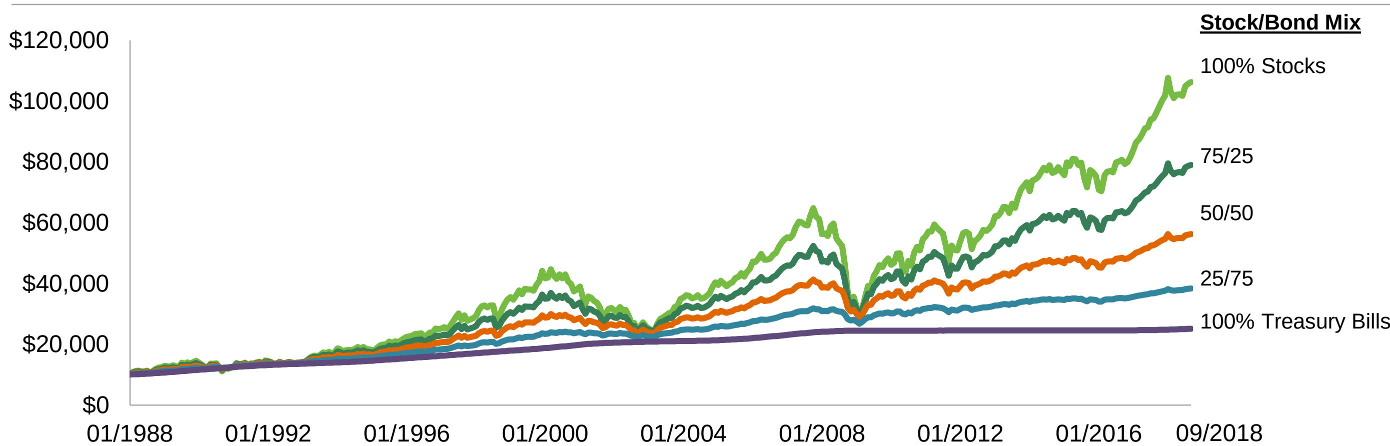


Period Returns (%)

** Annualized*

Asset Class	QTR	1 Year	3 Years*	5 Years*	10 Years*	10-Year STDEV[1]
100% Stocks	4.26	10.35	14.02	9.25	8.77	15.83
75/25	3.56	8.14	10.64	7.08	6.85	11.87
50/50	2.82	5.93	7.31	4.89	4.78	7.91
25/75	2.05	3.71	4.01	2.68	2.58	3.95
100% Treasury Bills	1.24	1.50	0.75	0.45	0.27	0.14

Growth of Wealth: The Relationship between Risk and Return



1. STDEV (standard deviation) is a measure of the variation or dispersion of a set of data points. Standard deviations are often used to quantify the historical return volatility of a security or portfolio.

Diversification does not eliminate the risk of market loss. **Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio.** Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals. Data © MSCI 2018, all rights reserved. Treasury bills © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).

Market Summary

Index Returns

Q3 2018	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
	STOCKS				BONDS	
	7.12%	**1.31%**	**-1.09%**	**-0.03%**	**0.02%**	**-0.17%**

Since Jan. 2001	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Avg. Quarterly Return	2.0%	1.5%	2.9%	2.6%	1.1%	1.1%
Best Quarter	16.8% **Q2 2009**	25.9% **Q2 2009**	34.7% **Q2 2009**	32.3% **Q3 2009**	4.6% **Q3 2001**	4.6% **Q4 2008**
Worst Quarter	-22.8% **Q4 2008**	-21.2% **Q4 2008**	-27.6% **Q4 2008**	-36.1% **Q4 2008**	-3.0% **Q4 2016**	-2.7% **Q2 2015**

Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond ex US Market (FTSE WGBI ex USA 1−30 Years [hedged to USD]). Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.

Past performance is not a guarantee of future results. This information is provided for educational purposes only and should not be considered investment advice or a solicitation to buy or sell securities. There is no guarantee an investing strategy will be successful. Diversification does not eliminate the risk of market loss.

Investing risks include loss of principal and fluctuating value. Small cap securities are subject to greater volatility than those in other asset categories. International investing involves special risks such as currency fluctuation and political instability. Investing in emerging markets may accentuate these risks. Sector-specific investments can also increase these risks.

Fixed income securities are subject to increased loss of principal during periods of rising interest rates. Fixed income investments are subject to various other risks, including changes in credit quality, liquidity, prepayments, and other factors. REIT risks include changes in real estate values and property taxes, interest rates, cash flow of underlying real estate assets, supply and demand, and the management skill and creditworthiness of the issuer.

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

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