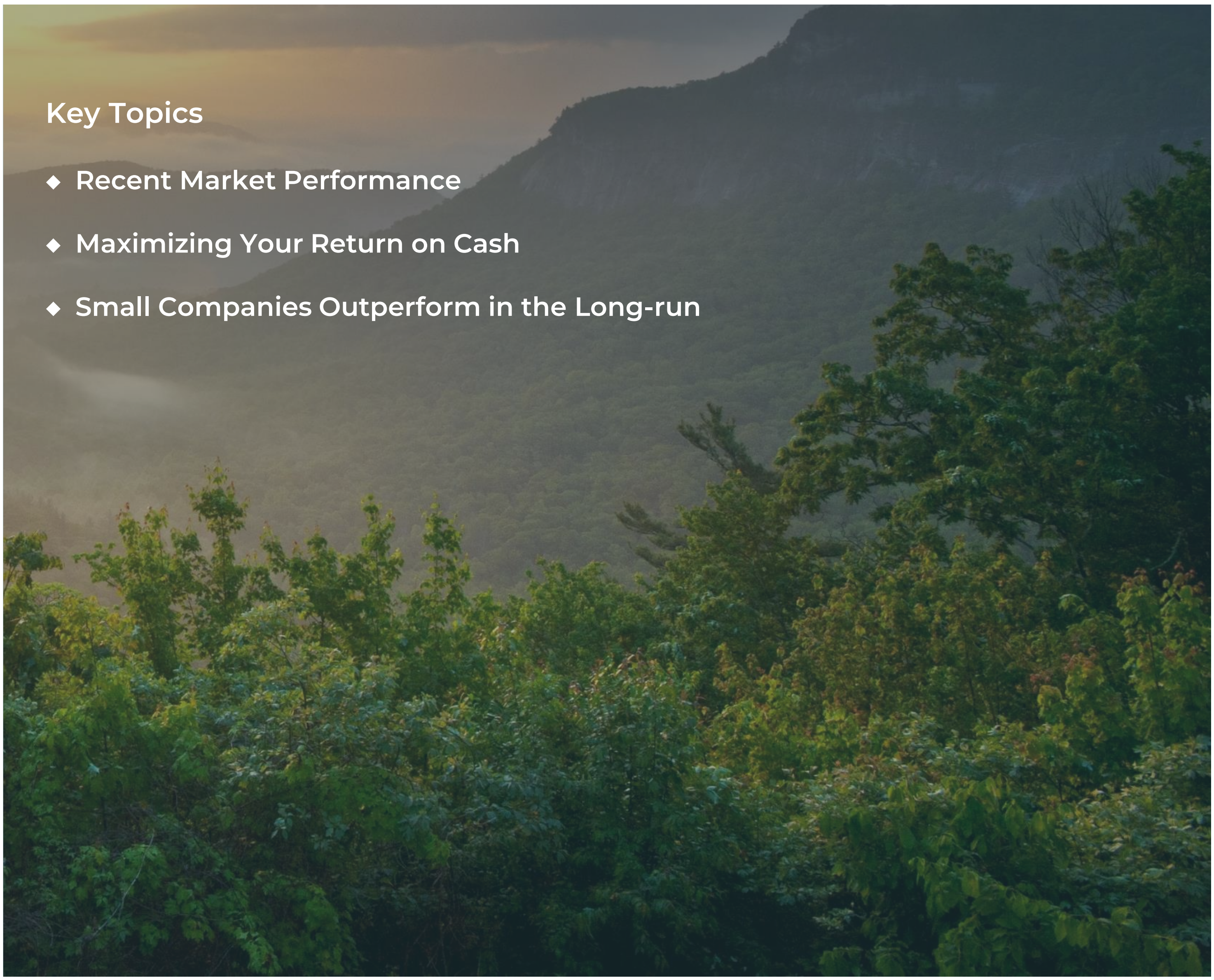
BlackDiamond Financial

# INVESTMENT INSIGHTS

## SECOND QUARTER 2018



### Key Topics

- Recent Market Performance
- Maximizing Your Return on Cash
- Small Companies Outperform in the Long-run


## Earnings Growth Provides Catalyst for Higher Stock Prices

Rapidly increasing earnings and strong economic results pushed U.S. stocks higher in the second quarter. Led by rising corporate earnings, a growing economy, and the energy sector's 14.3% gain, the S&P 500 was up a solid 3.4% this quarter. S&P 500 earnings increased by 26% in the first quarter representing the largest quarterly percentage gain since 2011. In addition, unemployment declined to 3.8%, the lowest level in 18 years, and most economic indicators remain positive.

International stocks declined 2.6% this quarter, primarily due to a 5.1% appreciation of the U.S. dollar and concern that rising tariffs will negatively impact global trade. Emerging markets were the worst performing asset class declining 9.1%. On the other hand, small company U.S. stocks rose 7.7%, prompted by continued benefits from the new tax law and their domestic focus that insulates them from geopolitical conflict.

Interest rates continued to rise this quarter causing intermediate-term bonds to fall by a modest 0.2%. Short-term Treasuries increased by 0.4%, which were one of the few segments of the bond market that ended the quarter in positive territory. Despite rising interest rates, real estate reversed course from its sharp decline in the first quarter to rise 8.8% this quarter.

## Comparative Returns

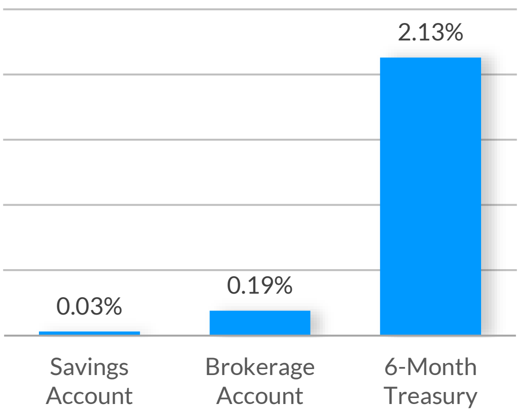
| | | | Annualized Performance | | | |
|---|---|---|---|---|---|---|
| | Q2 2018 | YTD | 1 Year | 3 Years | 5 Years | 10 Years |
| **Large Cap U.S. Stocks(1)** | 3.4% | 2.6% | 14.4% | 11.9% | 13.3% | 10.1% |
| **Small Cap U.S. Stocks(2)** | 7.7% | 7.7% | 17.5% | 11.2% | 12.5% | 10.5% |
| **International Stocks(3)** | -2.6% | -3.8% | 7.3% | 5.1% | 6.0% | 2.5% |
| **Real Estate(4)** | 8.8% | 0.0% | 2.2% | 7.6% | 7.9% | 8.0% |
| **U.S. Bonds(5)** | -0.2% | -1.6% | -0.4% | 1.7% | 2.3% | 3.7% |

1. Measured by the S&P 500 index, which includes 500 of the largest U.S. companies in all sectors of the economy
2. Measured by the Russell 2000, which includes the 2000 smaller stocks of the Russell 3000 index
3. Measured by the MSCI ACWI ex-U.S. index, which includes large and mid-capitalization stocks from developed and emerging international markets
4. Measured by the MSCI U.S. REIT index, which includes domestic publicly traded real estate stocks
5. Measured by the Barclays Aggregate Bond index, which includes a representation of the performance of the entire U.S. investment grade bond market

## Maximizing Your Return on Cash

At its June meeting, the Federal Reserve raised the federal funds rate by 0.25% to a range of 1.75% to 2.00%. As short-term interest rates rise, so do the rates investors receive on short term fixed income holdings, such as cash in savings accounts, money market funds, and Treasury bills (cash equivalents). Just two years ago, investors received nearly nothing on their short-term cash holdings. Today, the investing landscape has significantly changed in favor of investors who can now earn over 2.0% annually by owning Treasury bills.

**Interest Rates on Cash Equivalents**

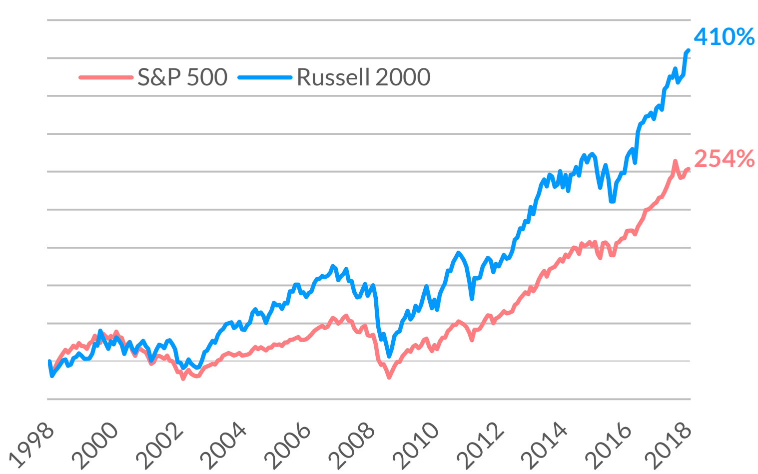



While short-term interest rates have risen quickly, most financial institutions have been very slow to increase the interest paid on bank accounts, CDs and money market funds. In fact, many banks pay less than 0.2% on cash held in savings and brokerage accounts. In many instances, banks generate most of their earnings from the spread between interest paid to investors and the interest they earn on deposits. One of the best ways for investors to maximize interest earnings on cash is by owning short-term Treasury bills. Not only do Treasuries yield attractive interest rates, but they are guaranteed by the U.S. government and the interest earned is free from state and local income taxes.

## Small-Cap Stocks Outperform in the Long-term

Many individual investors only hold large, well-known stocks that are household names such as Apple and J.P. Morgan. In aggregate, these large companies tend to be solid investments and have returned an average of 10% per year over the last 80 years[1]. While this level of returns is impressive, small company stocks, typically those with valuations under $2 billion, returned 12% per year over the same time period. The graph below shows how small company stocks have outperformed large company stocks over the last 20 years. While small company stocks have performed well, there is no free lunch when investing. The super charged growth of small companies comes with a cost, higher volatility. For example, in market selloffs, small company stock prices often fall more than large companies'. Small company stocks can be an important portfolio component for high returns, as long as their risks are fully understood.

**Large vs. Small Company Stock Growth**




*(1) Source: Morningstar and Ibbotson*
*Data: Yahoo Finance, S&P 500 TR, FRED, Russell 2000*

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## ABOUT US

Black Diamond Financial, LLC is a fee-only registered investment advisor with a unique focus on preserving and enhancing wealth through index investing strategies. Our mission is to help you achieve your financial goals by using low cost, tax efficient investment strategies designed to outperform 90% of funds. We create individualized investment portfolios for each client that are risk-appropriate, returns-optimized, and tax-efficient. Furthermore, we believe cost is a critical factor in any successful investment strategy and therefore offer fully transparent pricing that is well-below industry standard. As an employee-owned firm focused on our fiduciary duty, we make our clients' interests our highest priority.

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