BlackDiamond Financial

INVESTMENT INSIGHTS

THIRD QUARTER 2018

Key Topics

- Recent Market Performance
- Slower Pace of Economic Recovery Elongates Growth Cycle
- Global Portfolios Enhance Investing Outcomes

Robust Economy Spurs U.S. Stocks to All-time Highs

An idyllic U.S. economy including significant growth, low unemployment and moderate inflation helped drive stocks to record highs during the third quarter. Large U.S. stocks were the clear winners amongst equity asset classes and rose 7.7%. S&P 500 earnings increased by 26% in the second quarter providing justification for stock increases. The S&P 500's forward price to earnings ratio ended the quarter at 16.4x, close to its long-run average of 15.1x.

International stocks continued to lag their U.S. counterparts as trade concerns accelerated and only increased by 0.7% this quarter. High debt and budget deficits contributed to emerging markets declining 1.1% and again being the worst performing asset class. Emerging markets are consistently one of the most volatile asset classes and have dropped almost 20% in seven of the last nine years before quickly rebounding. While volatile, emerging countries have provided compelling long-term returns and add diversification to a balanced portfolio.

Interest rates continued to gradually increase this quarter causing a headwind for intermediate-term bonds and a negligible return. Short-term Treasuries remain a solid safe haven and increased by 0.5%. Due to the flattening yield curve where the spread between yields on two and 10-year bonds is just 0.24%, investors have little incentive to buy anything but short-term bonds. Rising interest rates and a softening real estate market caused real estate stocks to rise by just 0.7% this quarter.

Comparative Returns

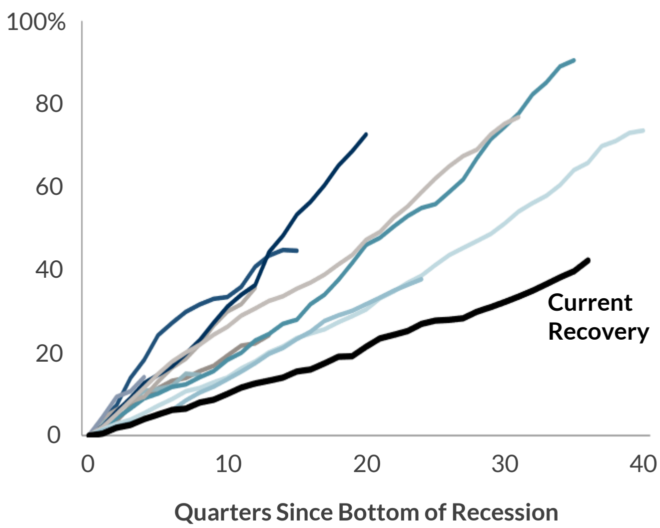
			Annualized Performance			
	Q3 2018	YTD	1 Year	3 Years	5 Years	10 Years
Large Cap U.S. Stocks(1)	7.7%	10.6%	17.9%	17.3%	14.0%	12.0%
Small Cap U.S. Stocks(2)	3.6%	11.5%	15.2%	17.1%	11.1%	11.1%
International Stocks(3)	0.7%	-3.1%	1.8%	10.0%	4.1%	5.2%
Real Estate(4)	0.7%	0.5%	2.1%	7.7%	8.8%	7.4%
U.S. Bonds(5)	0.0%	-1.6%	-1.2%	1.3%	2.2%	3.8%

(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 Bloomberg Barclays Aggregate Bond index, which includes a representation of the performance of the entire U.S. investment grade bond market

Slower Pace of Economic Recovery Elongates Growth Cycle

This quarter marked the longest bull market run in the history of the S&P 500 and the second longest uninterrupted expansionary period for U.S. economic growth. Some investors question how long stocks can continue to rise without a bear market, defined as a 20% decline in stocks, and worry a decline is inevitable based purely on the length of this bull market. Aside from the Great Depression, the magnitude of the 2008 recession and concurrent stock market decline was unprecedented. This has contributed to the slowest economic recovery in the last 70 years with annual economic growth averaging a tepid 2% per year.

Cumulative GDP Growth Post-Recessions

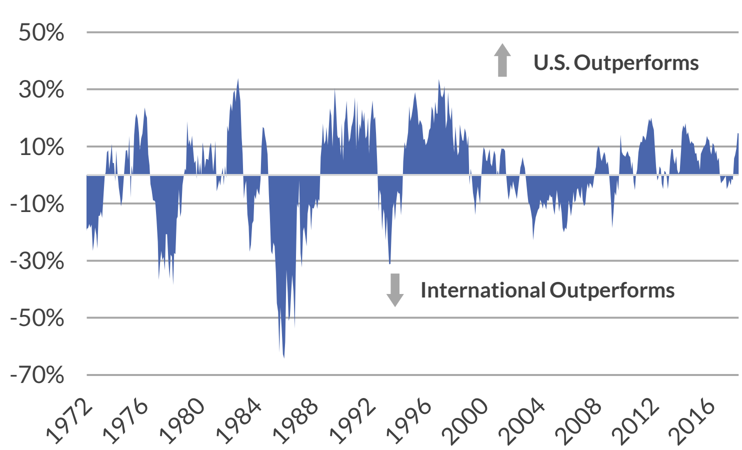


The sluggish recovery has prevented the economy from over-heating and kept inflation low. In addition, technological innovation and foreign economic struggles have contributed to tame inflation. A byproduct of moderate inflation has been an accommodative Federal Reserve that has been slow to raise interest rates. Historically, quickly rising interest rates has been one of the biggest factors causing recessions and bear markets. The Federal Reserve's gradualism, benign inflation, and moderate economic growth may help extend the bull market further into record territory.

Globally Diversified Portfolios Enhance Investing Outcomes

Historically, globally diversified investment plans have provided superior risk adjusted returns compared to domestic-only strategies.[(1)] However, due to their mediocre performance over the past ten years, some investors wonder whether international investing still makes sense. The relative performance between U.S. and international stocks tends to be cyclical. In most cases, when U.S. stocks outperform over a 10-year period, international stocks outperform over the next 10-year period, suggesting a cyclical change may soon occur. In addition, international stocks are currently less expensive than U.S. stocks and trade at a forward P/E multiple of 13.1x, a 20% discount to U.S. stocks. Despite their recent subpar performance, international stocks continue to be a valuable asset that most investors should own.

Periods of Outperformance



(1) "Considerations for Investing in Non-U.S. Equities", The Vanguard Group, Inc. March 2012.
Top Left: BEA, NBER, ISM, Haver Analytics®, Credit Suisse. Note: 1949 to present; Cumulative nominal GDP since trough indexed to 100.
Bottom Right: Morningstar. U.S. represented by S&P 500 index, International represented by MSCI EAFE index. Annualized monthly data through 9/28/2018.

BlackDiamond Financial

ABOUT US

Black Diamond Financial, LLC is a fee-only registered investment advisor with a unique focus on preserving and enhancing wealth. Our mission is to help you achieve your financial goals by using low cost, tax efficient investment strategies designed to outperform active stock pickers. 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.

CONTACT US

Baltimore

305 W Pennsylvania Ave.
Towson, MD 21204

Bend

780 NW York Drive, Suite 208
Bend, OR 97703

New York City

175 Varick St., Suite 349
New York, NY 10014