Updated Market Commentary

October 2018

October Correction Update

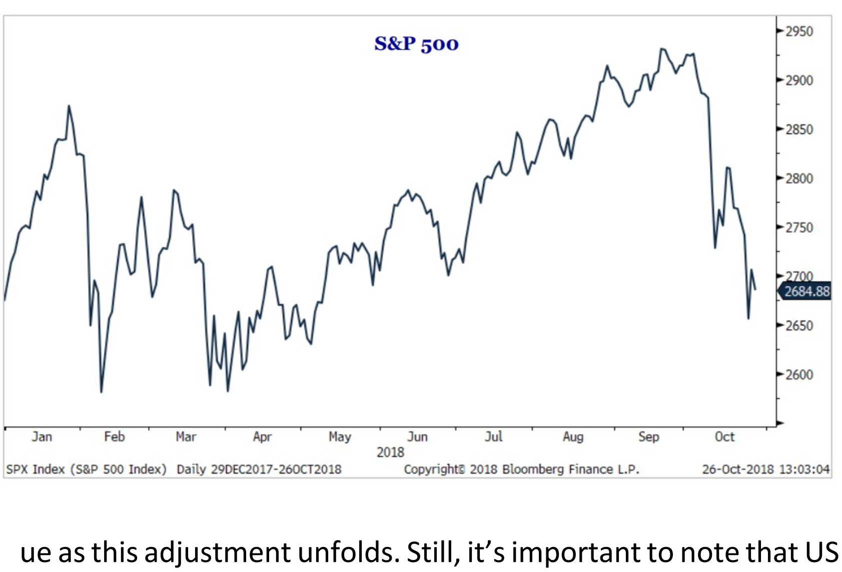
It has been a rocky 2018, but that was especially true this past month. Stocks sold off sharply on Wednesday and shortly rebounded on Thursday, only to plummet Friday morning. The Dow declined more than 300 points Friday, while the S&P 500 index landed in correction territory for the year.

- The recent rapid rise in interest rates has put investors on the defensive and the Federal Reserve has stated they plan on maintaining their Fed Funds rate increase as long as the US economy can withstand it.
- Global Stocks have fallen approximately 9% in October; while International and Emerging Markets led the declines earlier in the month, US Stocks have now followed suit.
- Volatility in October has helped wipe out most of this year’s returns and put the majority of asset classes into negative territory.
- Future earnings warnings and disappointing quarterly results continued to weigh on the market, stoking investors' jitters over future growth in corporate profits

Is this a Normal Sell off?

We believe the October sell-off was mainly driven by a few key concerns:

MARKET SELL-OFF INTENSIFIED THIS WEEK

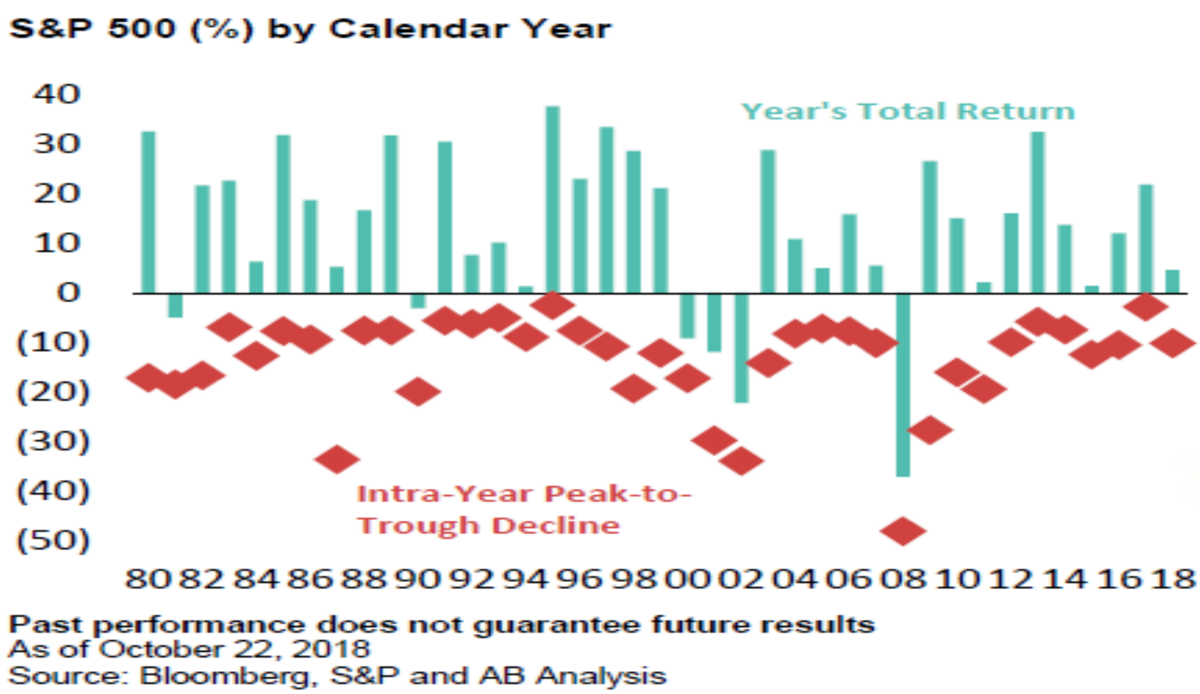


- Recent rapid rise in interest rates
- profit taking in the market growth stock leaders
- GDP slowed a bit from the 2nd quarter
- International markets took a breather, led by China and earnings warnings related to trade concerns.

The market is trying to calibrate where valuations should be, given heightened uncertainty around the pace of expected earnings growth. We expect volatility to continue as this adjustment unfolds. Still, it’s important to note that US earnings growth is decelerating, not declining, and the sell-off will create more attractive valuations globally.

Intra-Year Sell Offs

Ten percent (10%) Intra-year sell-offs are normal for equity markets but it just feels worse because markets have been extremely calm for years. This is not the first time the market has sold of this year. February had an intra-year correction of ~10% and followed that up in April and May, which were spent in negative territory. Since 1980, the S&P 500 has only finished negative 6 out of those 38 years. This is the longest bull market in history and at some point it has to come to an end. We are not saying the markets will end negative this year, however, we feel there will be an increase in normal volatility.



The Big Question "What is going on and what has changed in October?"

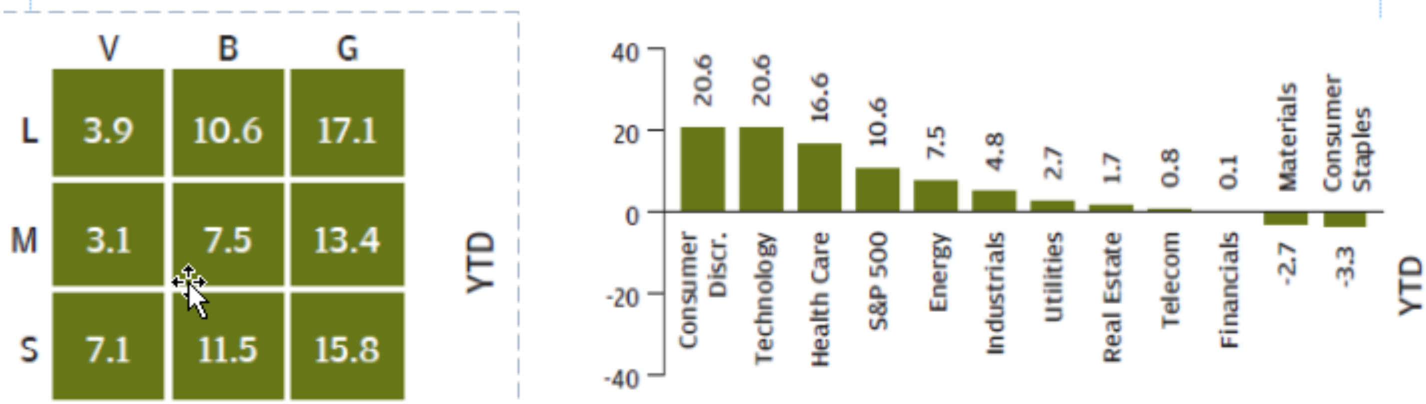
- Fundamentals remain healthy, however, they are not as solid as in the beginning of the year.
- The markets closed at all-time highs at the end of September.
- Consumer confidence was at its highest levels since the financial crisis of 2008/2009.
- Money flow continued toward Technology and Healthcare (Biotech) companies, in particular the high-growth FANNG stocks (Facebook, Amazon, Apple, Netflix and Google). Amazon alone was down approximately 8% on Friday.
- One thing to remember is when market leaders are sold indiscriminately, all sectors feel the "pain".

Where is the pain?

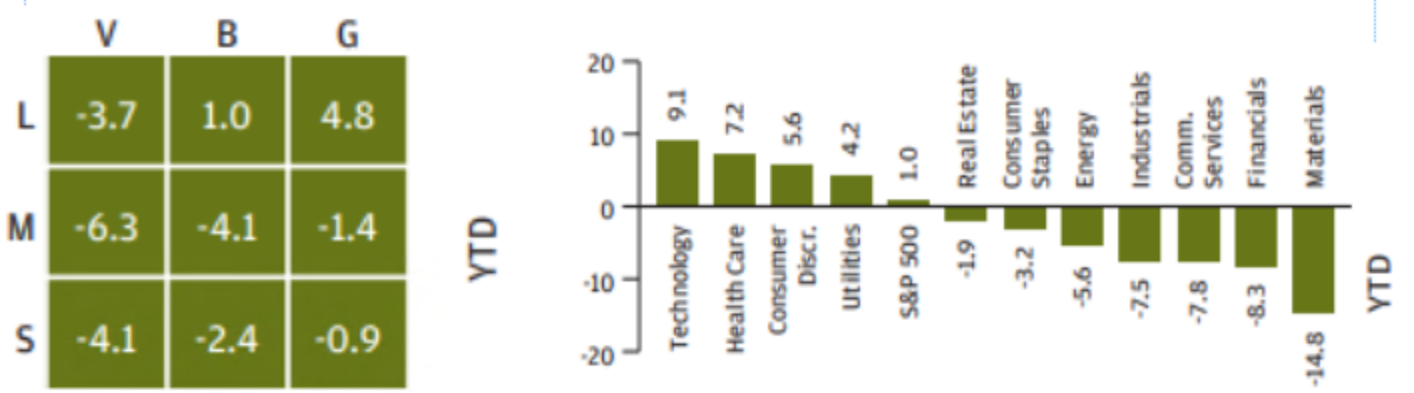
The market is measured by the S&P 500 and Dow Jones Industrial Average, but we really need to dive a little deeper into what makes up those indexes. Moving into the 4th quarter:

- Growth (Russell 1000 Growth), up +17.1% YTD, was gaining more momentum over Value (Russell 1000 Value), up +3.9% YTD, for the second straight year.
- Bonds and International Equities, as measured by the Barclays US Aggregate Bond index and the MSCI EAFE Index, were both down -1.6% and -1.4% respectively, with Emerging Markets leading the way down –7.4% (MSCI EM).
- High quality value stocks have been abandoned for high growth stocks this year. The charts below show the comparisons of “Style” and “Sector“ shifts at the end of the 3rd quarter and Friday’s close (October 26th).
- A slight shift from Growth to Value has begun as investors flee growth to the higher quality value and dividend paying stocks.

S&P 500 style and sector Returns YTD through the 3rd Quarter



S&P 500 style and Sector Returns Through the close October 26th.



What should I do or expect?

Investments have risks and investors seem to forget that fact until the markets give some of their paper gains back. Market drops represent opportunities: assets are on sale. Investing 101 says buy low and sell high. However, many investors want to buy more when things feel good (market highs) and abandon an investment strategy when things are out of favor (selling low). Unfortunately, this year is shaping up to be negative for investors as Bonds are down and International markets are well in the red. The only positive light was the US market, which has been a dominant factor since the financial crisis of 2008/2009, and may have finally succumbed to the pressures of a slight global slowdown and rising interest rates. Last year, International markets led the way and many analysts felt this momentum would continue into 2018 as they were not far behind the US recovery from the financial crisis. Unfortunately, slowing GDP, trade wars, slowing economic data out of China, and rising interest rates has brought pressure on all fronts.

Going back over almost 100 years, the markets have been positive about 75% of the time. The 25% negative, however, seems to be a heavy burden on portfolios and sets the tone for investors' emotions. One thing is true, markets turn negative when we least expect it and when things seem to be going extremely well. What is important to keep in mind is to focus on long-term goals, a properly allocated and diversified portfolio, and making appropriate adjustments when necessary. If this is done, we believe, investors will be rewarded over the longer term.

The headlines are giving mixed messages. Is this just a hiccup in the long expanding US bull market or the end of the bull market? History has shown that rising rates have generally cooled the markets in the short-term but helped over longer periods of time.

Make sure you maintain a sound and diversified portfolio that is tailored for your specific risks, goals and time horizon. Do not get caught up in the media hype and headlines that play on emotions. Markets will go down and markets will go up. Your team at XML Financial Group are continually monitoring the financial and economic data and when appropriate, work to make adjustments to your portfolio that are suitable.

- *The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.*

- *The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.*

- *The Barclays Capital Aggregate Bond Index is an unmanaged market capitalization-weighted index of most intermediate term U.S. traded investment grade, fixed rate, non-convertible taxable bond market securities including government agency, corporate, mortgage-backed and some foreign bonds.*

- *The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada*

- *The MSCI EAFE EM Index consists of 23 economies including Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and the United Arab Emirates. The MSCI is a float-adjusted market capitalization index*