TIMONIER

Wealth Beyond Financial™

From the Engine Room

4th Quarter 2018

2018 Annual Market Review

This report features Timonier's quarterly client letter, world capital market performance and a timeline of events for the last quarter. It begins with a global overview, then features the returns of stock and bond asset classes in the US and international markets.

The report also illustrates the impact of globally diversified portfolios and features a quarterly topic.

"The best way to predict the future.... is to create it!"

A New Year's Resolution for Health and Wealth: Focus on the Inside Value

"You have the power over your mind – not outside events.
Realize this, and you will find strength."
Marcus Aurelius

Two thousand eighteen will go down as one of the most unique years in my career as a financial advisor. The fourth quarter in particular, brought forth why the ideals of a multi-disciplinary collaborative group of advisors is necessary in achieving our clients' goals. Teamwork and communication was paramount. The newly minted tax reform bill brought challenges to tax deducting our contributions to charities in 2018. In some cases, family foundations were established in the form of a Donor Advised Fund to maximize their benevolent activities. The simplified and lower tax brackets also brought with it added planning opportunities for retirees to maximize their lifetime after tax income from retirement accounts by converting their traditional IRAs to Roth IRAs. Making distributions ***before*** the required minimum distribution years is advantageous when lower tax rates can be realized on these inevitable withdrawals. Additionally, the Roth IRA vehicle protects those assets from ever being taxed again, even through the owners' lifetime. After 10 years of stock market gains, volatility to the downside made its impact on market prices, particularly in the fourth quarter. Segments of world stock markets reached Bear Market declines during a time when investment fund managers were making year end capital gain distributions. There is nothing more frustrating to an investor than to watch a decline in their portfolio values AND have to pay large capital gains taxes. So, we were busy harvesting losses where we could, culling through thousands of tax lot positions in our client's taxable portfolios to offset these projected gains. The unpredictable wide swings in daily investment values made coordinating these strategies professionally challenging. All the while, we were mindful to rebalance the portfolios to their target asset allocations to take advantage of divergent returns in the global markets. These were the core strategies we focused on, but there were many other aspects and planning techniques that utilized our teams' talents to benefit our clients at year end. And while the surface of the river was violently churning away, the underlying currents of American business was flourishing in downstream waters. It was one of the truly great years in the history of the American economy, and by far the best since the Great Financial Recession a decade ago. Paradoxically, it was also a year in which the equity market could not get out of its own way. It is in times like these, that the wisdom of ***focusing on only those things you can control*** became our mantra. We await the fruits!

It is impossible to cite all the major metrics of the economy which blazed ahead in 2018. It was far more than a plow horse economy. Worker productivity, which is the long-run key to economic growth and a higher standard of living, surged. Wage growth accelerated in response to a rapidly falling unemployment rate. Household net worth rose above $100 trillion for the first time, yet household debt relative to net worth remained historically low. Finally, and maybe the most stunning metric of them all, for the first time in American

history, the number of open job listings exceeded the number of people seeking employment. A sorely needed revamped immigration policy would fill this void and enhance our economy's health…but I digress.

Earnings of the S&P 500 companies, paced by a robust GDP (Gross Domestic Product) and significant corporate tax reform, grew by more than 20%. Cash dividends set a new record; in fact, total cash returned to shareholders from dividends and share repurchases reached $7 trillion! The US economy isn't acting anything like its expansionary age. Its vital signs are strong.

But the stock market had other things on its mind. Having gone straight up without a correction throughout 2017, the S&P 500 came roaring into 2018 at a price of 2,674…probably somewhat ahead of itself, as it seemed to be pricing in the future effect of corporate tax cuts in one gulp. There ensued in February a 10% correction, followed by several months of consolidation. The advance resumed as summer waned, with the Index reaching a new all-time high of 2,931 in late September. It then went into a savage decline, falling to the threshold of bear market territory: S&P 2,351 on Christmas Eve, off 19.8% from the September high. A rally in the last week of trading carried it back up to 2,507, but that still represented a solid six percent decline on the year, ignoring dividends. Two thousand eighteen thus became the tenth year of the last 39 (beginning with 1980) in which the Index closed lower than where it began. At the long-term historical rate of one down year in four, that's actually just par for the course.

The major economic and market concerns as the year turns is trade policy, which in the larger sense is an inquiry into the mind of President Trump. I think it is fair to say, as the economist Scott Grannis recently did, that "Trump has managed to reduce tax and regulatory burdens in impressive fashion, but his tweets and his tariff threats have created unnecessary distractions and unfortunate uncertainties, not to mention higher prices for an array of imported consumer goods."

These and other uncertainties—perhaps chief among them Fed policy and an aging expansion—were weighing heavily on investor psychology as the year drew to a close. For whatever it may be worth, my experience has been that negative investor sentiment—and the resulting equity price weakness—have usually presented the patient, disciplined long-term investor with enhanced opportunity. As the wise and witty Sage of Omaha, Warren Buffet, wrote in his 1994 shareholder letter, "Fear is the foe of the faddist, but the friend of the fundamentalist."

* * * *

Capitalism is comprised of two operating systems or components. One is the ground level exchange of goods and services among citizens of the planet. It is going to work each day inspired to build, solve problems, and create new worlds ignorant of an outside observer judging it. The other is the observer, which is the measuring stick in evaluating how well the ground level is operating. And, the measuring stick or gauge is the stock markets. *In the long run*, the weighing machine for how well publicly traded companies

are doing is in their EARNINGS. This is reflected in the stock price. The better the earnings, the better the prices. However, *in the short run*, the weighing machine for these prices can be reflected in EMOTIONS and investor sentiment. The survival instincts of an ancient Reptilian brain to which we are all hardwired, are not equipped to make good financial decisions under stressful conditions. It reacts from a fight or flight instinct to its immediate environment. Twenty eighteen will go down as an emotional year!

Managing the exchange of goods and services of 7.4 billion people is quite magical to observe. Of course, such a system will create unintended imbalances from time to time. Such a system (people…ok politicians) will make unconscious choices which will be detrimental to the whole. But humans are an amazing species that have the unique talent of solving these temporary imbalances and problems. In fact, they thrive and profit from providing these solutions. Our economies around the globe are expanding. By example, India and China with their combined populations of 2.3 billion people, had no economically middle-class citizens in 1994. Today they have 12 and 30 percent respectively. Within the next twenty years they will grow to have 79 and 72 percent of their citizens in the middle class of the economic spectrum. The economic pie is expanding and that is healthy for all on this planet. We are all connected.

The Emerging Markets which are represented mostly by Pacific Rim countries, creates more than 40% of global economic output. By comparison, the US represents 24% of global GDP. Furthermore, the Emerging Markets is home to two thirds of the worlds' population with more than 82% of the worlds' millennials. These countries governments are also financially viable. The government debt to GDP of these countries are half that of their more developed market counterparts, including the United States. And, not only is our existing global population becoming more economically healthy, there are 2.5 billion more citizens that will be added to the planet over the next 30 years. There will be many more people desiring to contribute to all societies, to share their talents, and in turn will have needs and wants of their own in the form of goods and services. There will be many more problems ahead…and many more Opportunities to solve them, by a Capital Markets system. Participating in this system as a shareholder of global companies will guarantee your financial health and wellness.

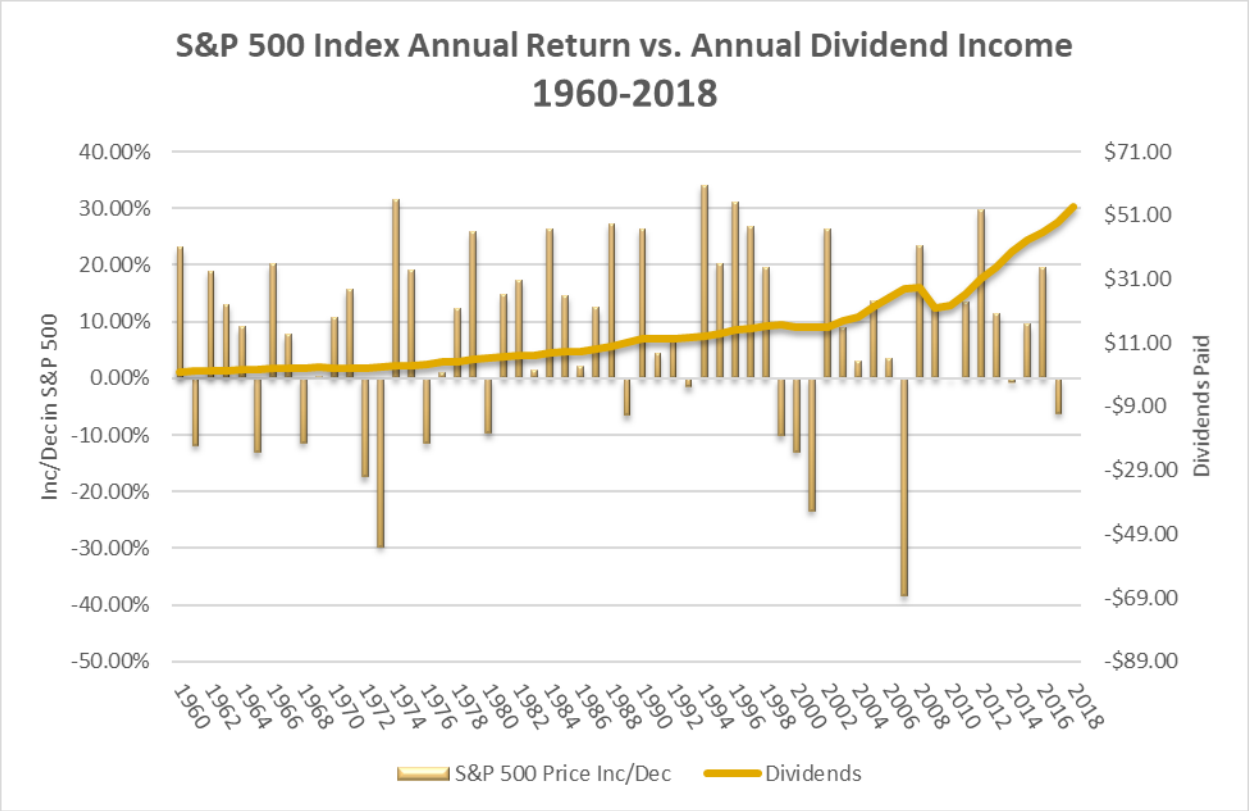
We have all been programmed to think the way we do about investing through the hypnotic messaging of Wall Street, Bank Street, and Insurance Street. When most of us see the price volatility of the stock markets as we did in 2018, we believe that the ground level economy is suffering. We worry that our investments will fail our financial needs of support. It is what keeps us up at night. Stress seeps into our minds and bodies creating internal imbalances manifesting into dis-eases and ill-advised choices with investment decisions. **There is no doubt that investing in stock markets carries with it the inherent nature of short term PRICE volatility. But is this concerning issue deserving of the attention it receives?**

If you are programmed to focus on the public's pricing of your investments, you are focusing on the wrong value of why you own the financial assets you do! As mentioned above the long term weighing machine for pricing the businesses we own is their

earnings. Earnings have grown year over year on the average of about 7.00% since World War II. Quite typically as a group, the S&P 500 companies pay out about 41% of their earnings in the form of a dividend to their shareholders…YOU. As investors, we accumulate shares of companies during our working years in order to receive their dividends to support the income needs in our retirement years.

Every now and then during our working years, stock prices fall temporarily giving us investors a chance to buy even more shares than the savings were able to buy before the price declines. When prices decline during the retirement phase of our life…well, we are simply *un*-phased! Because, these companies are still paying us a portion of their earnings in the form of a dividend that is quite consistent and rising over time. Focusing on how many **SHARES** of businesses you own…and focusing on the **DIVIDENDS** that are being generated to you in the form of income are THE ONLY THINGS YOU SHOULD EVER PLACE ANY VALUE IN. *It's not market prices!!!!!*

I offer the chart below to illustrate my point. You are looking at the price only returns of the S&P 500 companies going back to 1960. You will obviously note, that there are many periods of price declines with the returns noted on the left side of the chart. Also, on the chart is the annual dividends paid by the companies in the S&P 500. It is illustrated by the gold line, with their values illustrated on the right side of the chart.



Source: Sterns School of Business at NYU (the S&P 500 illustrated is a price only index which excludes dividends from the return)

For a historical backdrop, the US economy experienced eight recessions during the period charted, 1960 to present. A recession is defined by having a negative GDP for at

least two straight quarters (aka…economic decline). Stock prices typically also decline during recessions. Stock prices can also have declines without recessions and these are called Bear Markets. A Bear Market is when stock prices decline by 20.0% from their previous highs. In addition to the eight recessions, we have had two additional Bear Markets these past 58 years. One was the Cuban Missile Crisis which began in December 1961 where the markets declined 28% over the following 6 ½ months. The other was the Flash Crash of October 19, 1987 where the markets declined 34% caused by programmed trading that is also systemic to todays' modern trading issues.

Through all recessions and all bear markets, dividend income held steady with one exception. Through most market declines, dividends have ironically risen. I'll address the severe ones specifically. There have been three powerful stock market selloffs since 1960. The 1973 to 1974 recession saw the S&P 500 companies decline in price by 49%. During this period, the dividends of these companies *actually rose!* During the 2000 to 2002 Technology Dotcom selloff which saw the S&P 500 companies decline in price by 50% and large cap growth stocks decline by 90%, dividend payout modestly declined over a two-year period by 5.6%. Finally, The Great Recession of 2008 saw the S&P 500 companies decline in price by a massive 57% from peak to trough. And, during this time dividends declined year over year by 22%. It was the most material decline since 1960. It was our generations' 1929 Great Depression. Companies which normally payout 41% of their earnings in the form of a dividend reduced their payout ratios to only 27% to weather the storm. But these same companies returned to paying increased dividends the following year and are today paying ***almost double*** the raw dividend payments to its shareholders (you) that it was paying before the one-time decline. Just this past year, as stock market prices were declining, our income payments from the dividends they produce…**Rose!** And, will again next year.

Only ONCE, since 1960 has the real value of owning businesses had a hiccup in performance. As wealth managers, we have always had contingency plans to support our retirees need for income during times of crisis. In fact, we over insure these concerns. We have a Cash/Bond Reserve Strategy that we set aside in investment portfolios that will supplement the income needs for this phase of life. And only a small portion of these reserves were needed to supplement the income goals during this temporary event.

I know that it is difficult to discern with our chart, but the most powerful aspect of this story must be highlighted. Please read this carefully. The price of S&P 500 Index in 1960 was 58.11. The dividend payout that year was $1.98. That represented a 3.41% yield from business assets. The S&P 500 Index closing price of 2018 was 2506.85. It will have paid estimated dividends of $53.61 during the year. ***That is a 27-fold INCREASE in dividend income over this 58-year period!*** Just let that sink in for a moment…then ponder whether it is worth getting wound up in a financial fetal position over temporary and often times unexplainable price declines of the stock market! Now…also note, the value of those companies have grown from $58.11 to a whopping $2,506.85! Wall Street can't provide a

market timing strategy to provide a better result and Insurance Street can't come close with its guarantees in their annuity and life insurance products. The methodical patient investor is the hero…and YOU win.

I would suggest the next time you see someone (of course it's not you) get stressed out over price declines that you suggest to them to put a rubber ducky floaty around their waist, grab a snorkeler and fins…and when the financial rains come, tell them to jump out of the basement window!

I offer this fresh perspective to owning financial assets so that they get the **appreciation** that they deserve. So that you can get the sleep that you need. Stocks are most often looked at as necessary demons in our accumulation of wealth to fulfill our aspirational goals. We should look at them as our flock of opportunities…fed, cared for, and loved as they provide for us the joys of life. They in turn, can take care of you and lives beyond you…and that is a comforting thought. That is right thinking.

Make looking at the quantity of shares you own and the dividends you receive your New Years' resolution. And, never ask again, what is the stock market doing? Okay…I'm waiting…haha.

I AM in gratitude each day of you allowing Timonier to be a part of your journey. We look forward to a year with a healthy mind body and spirit…making conscious choices for an abundant and prosperous adventure. We are here only to serve you!

Namaste'

Tim L. Baker, CIMA, GFS

Market Summary

Index Returns

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
2018	**STOCKS**				**BONDS**	
	-5.24%	**-14.09%**	**-14.58%**	**-5.90%**	**0.01%**	**3.17%**
Since Jan. 2001						
Avg. Annual Return	7.6%	5.8%	13.1%	10.1%	4.5%	4.4%
Best Year	33.6% **2013**	39.4% **2003**	78.5% **2009**	37.4% **2006**	10.3% **2002**	8.8% **2014**
Worst Year	-37.3% **2008**	-43.6% **2008**	-53.3% **2008**	-45.7% **2008**	-2.0% **2013**	1.2% **2013**

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. 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 Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]).

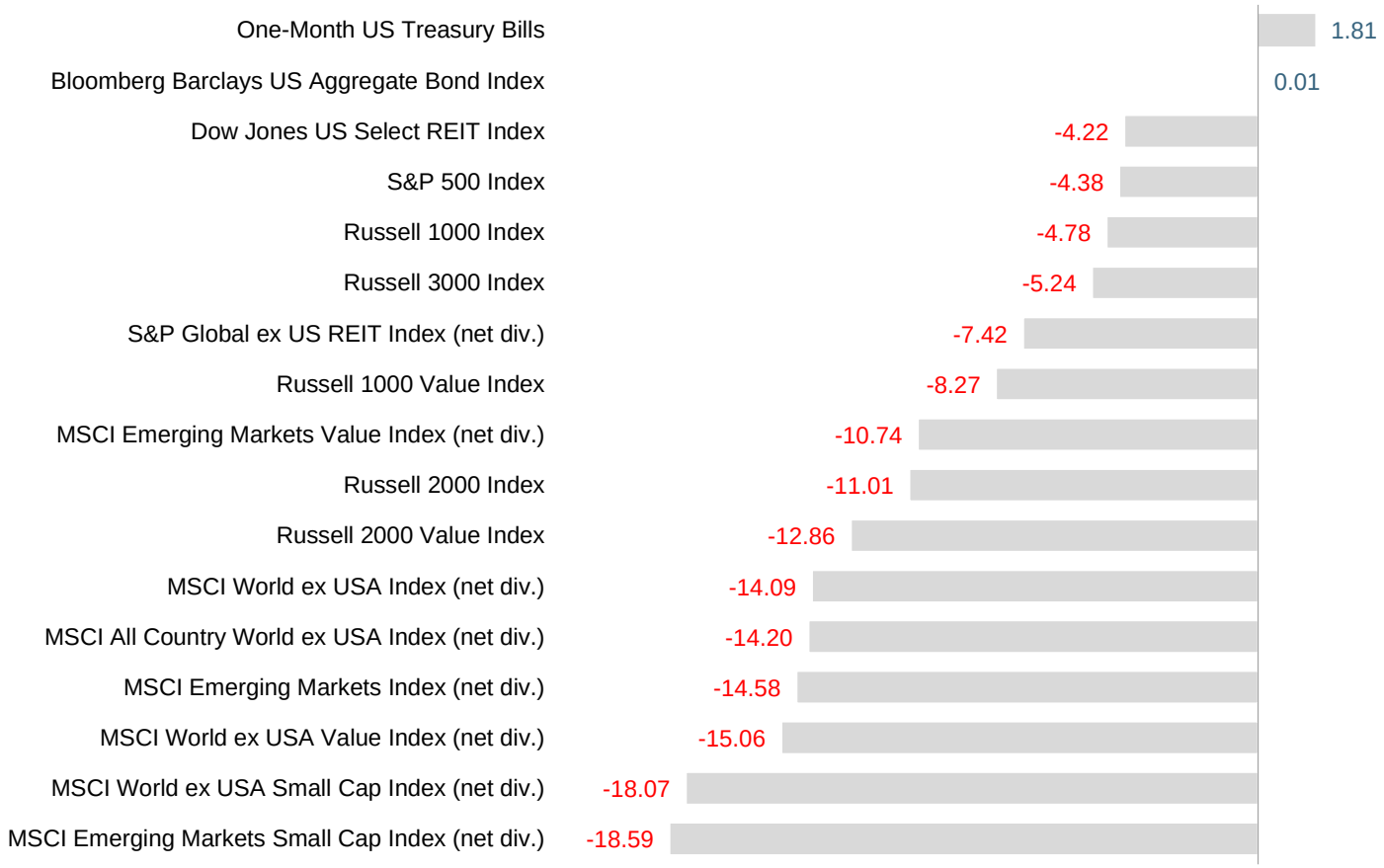
World Asset Classes

2018 Index Returns (%)

Equity markets around the world posted negative returns for 2018. Looking at broad market indices, the US outperformed non-US developed and emerging markets.

Value stocks were positive vs. growth stocks in emerging markets but negative in the US and non-US developed markets. Small caps underperformed large caps in the US, non-US developed, and emerging markets.

REIT indices outperformed equity market indices in both the US and non-US developed markets.



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US Stocks

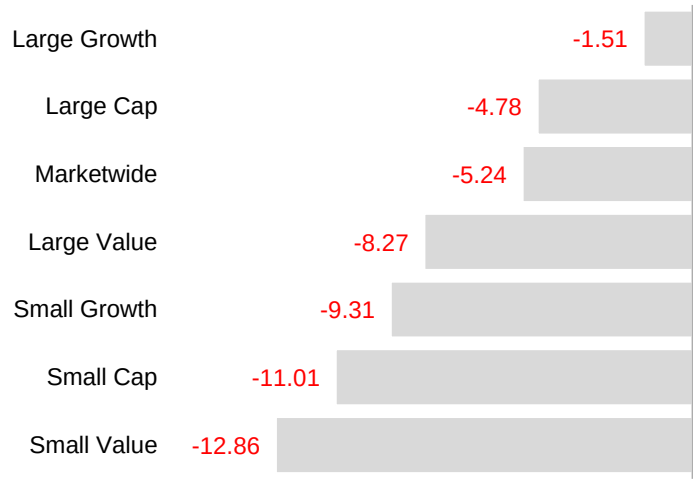
2018 Index Returns

US equities outperformed both non-US developed and emerging markets.

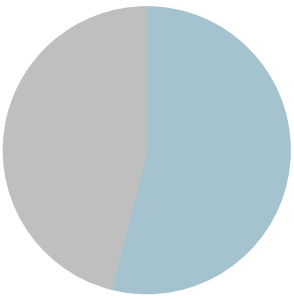
Value underperformed growth in the US across large and small cap stocks.

Small caps underperformed large caps in the US.

Ranked Returns for 2018 (%)



World Market Capitalization—US



54%

US Market
$25.1 trillion

Period Returns (%)

** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Large Growth	-1.51	11.15	10.40	15.29
Large Cap	-4.78	9.09	8.21	13.28
Marketwide	-5.24	8.97	7.91	13.18
Large Value	-8.27	6.95	5.95	11.18
Small Growth	-9.31	7.24	5.13	13.52
Small Cap	-11.01	7.36	4.41	11.97
Small Value	-12.86	7.37	3.61	10.40

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International Developed Stocks

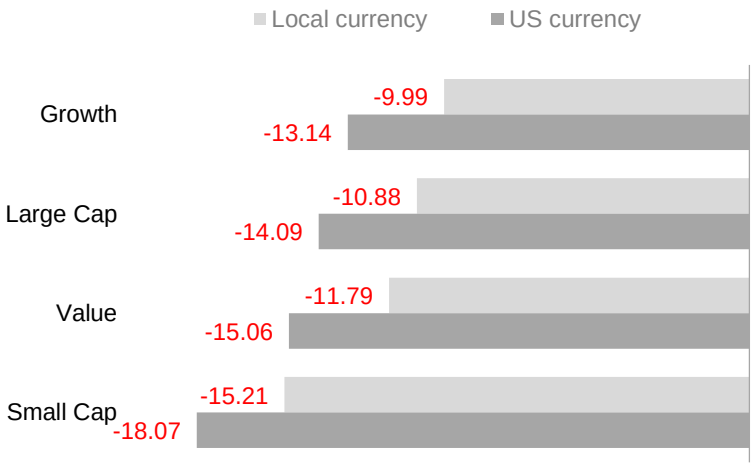
2018 Index Returns

In US dollar terms, developed markets outside the US outperformed emerging markets but underperformed the US during 2018.

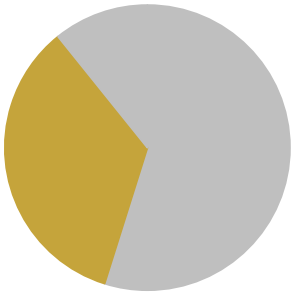
Value underperformed growth across large and small cap stocks in non-US developed markets.

Small caps underperformed large caps in non-US developed markets.

Ranked Returns for 2018 (%)



World Market Capitalization—International Developed



34%

International Developed Market
$16.0 trillion

Period Returns (%)

** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Growth	-13.14	2.84	1.36	6.74
Large Cap	-14.09	3.11	0.34	6.24
Value	-15.06	3.36	-0.73	5.69
Small Cap	-18.07	3.85	2.25	10.06

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Emerging Markets Stocks

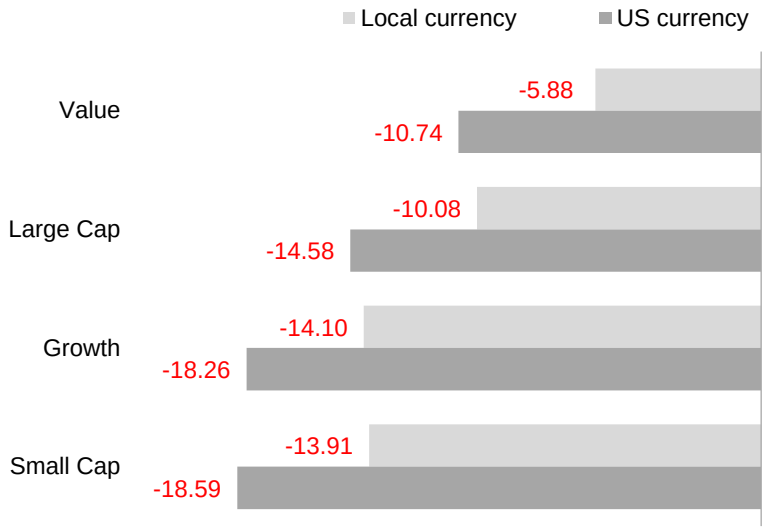
2018 Index Returns

In US dollar terms, emerging markets underperformed developed markets, including the US.

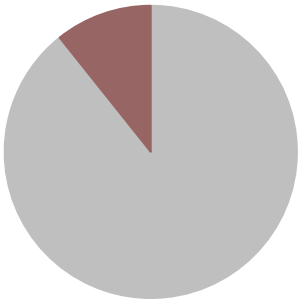
Value outperformed growth across large and small cap stocks in emerging markets.

Small caps underperformed large caps in emerging markets.

Ranked Returns for 2018 (%)



World Market Capitalization—Emerging Markets



12%

Emerging Markets
$5.4 trillion

Period Returns (%) ** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Value	-10.74	9.52	0.51	6.99
Large Cap	-14.58	9.25	1.65	8.02
Growth	-18.26	8.89	2.67	8.97
Small Cap	-18.59	3.68	0.95	9.87

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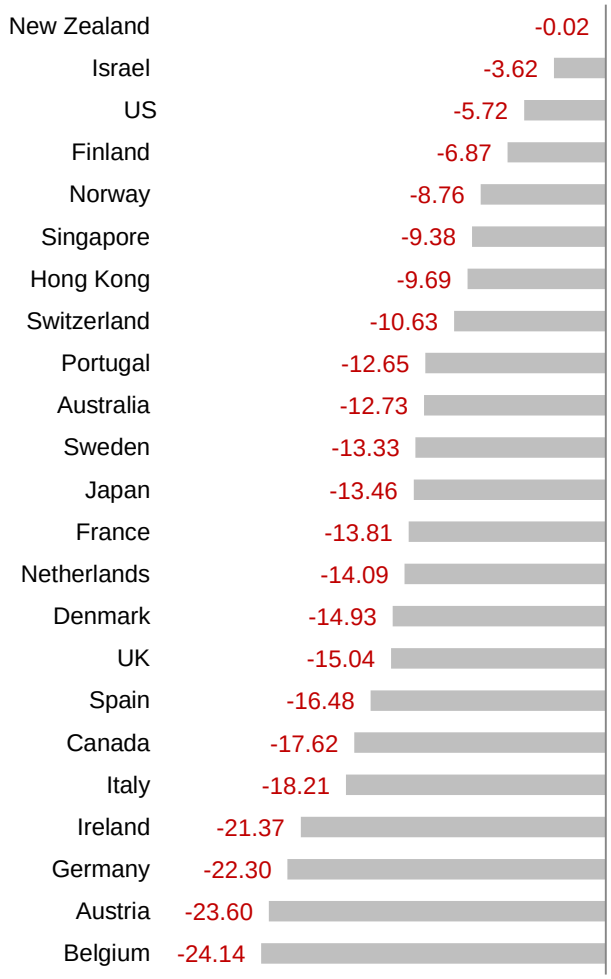
Select Country Performance

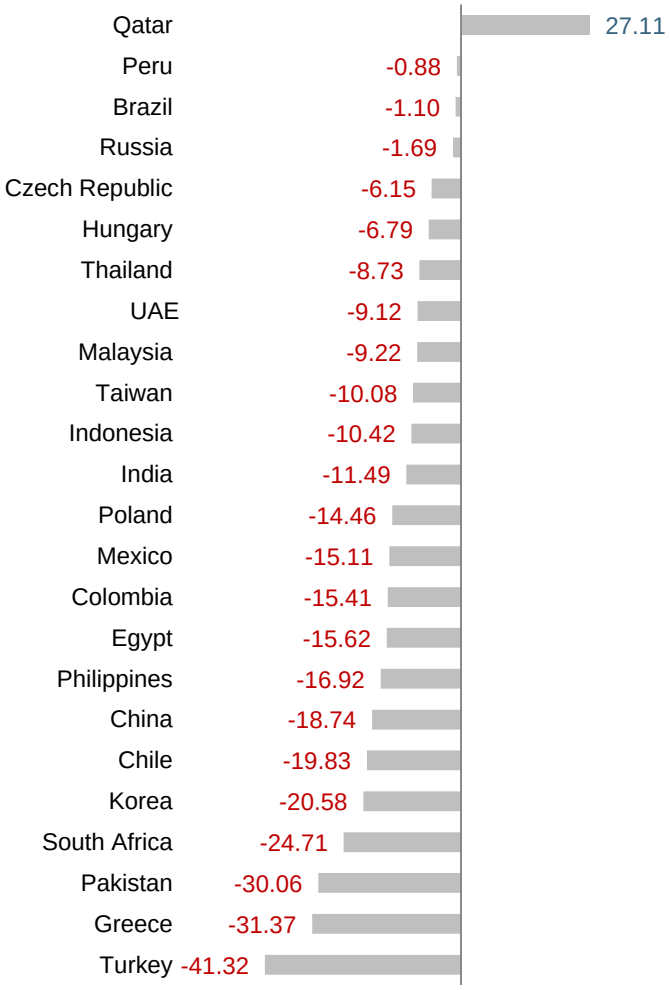
2018 Index Returns

Most non-US developed and emerging markets countries posted negative returns in US dollar terms in 2018, with wider dispersion for emerging markets countries.

Ranked Developed Markets Returns (%)



Ranked Emerging Markets Returns (%)



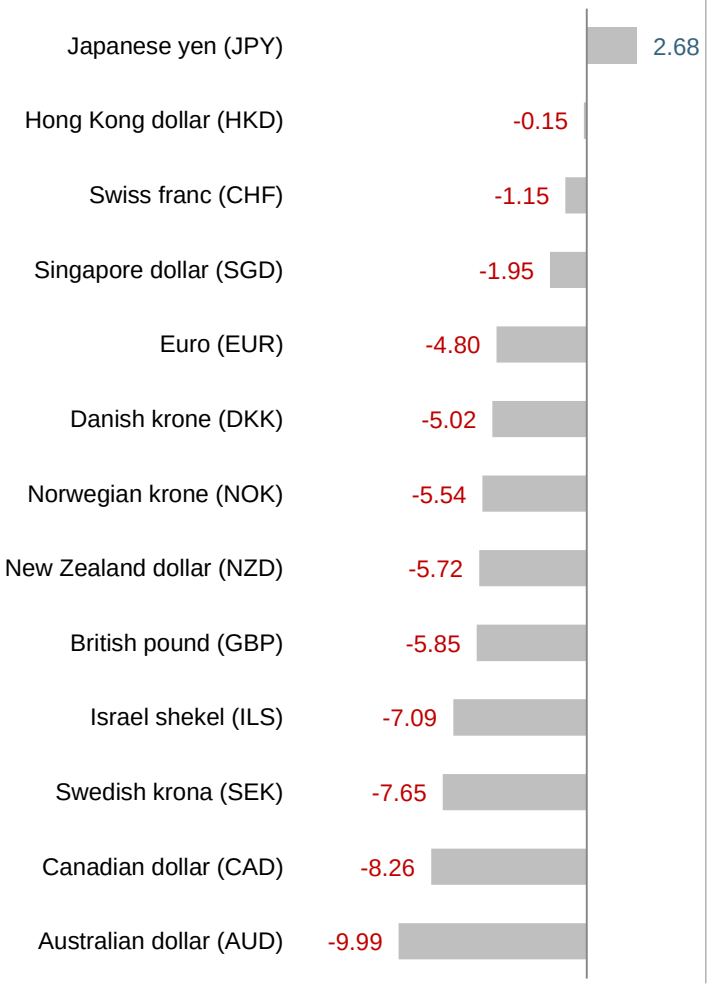
Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Country performance based on respective indices in the MSCI World ex US IMI Index (for developed markets), MSCI USA IMI Index (for US), and MSCI Emerging Markets IMI Index. All returns in USD and net of withholding tax on dividends. UAE and Qatar have been reclassified as emerging markets by MSCI, effective May 2014.

Select Currency Performance vs. US Dollar

2018 Index Returns

Most currencies depreciated against the US dollar in developed and emerging markets, notably the Australian dollar in developed markets and the Turkish lira in emerging markets. One exception was the Japanese yen, which appreciated vs. the US dollar.

Ranked Developed Markets Returns (%)



Ranked Emerging Markets Returns (%)

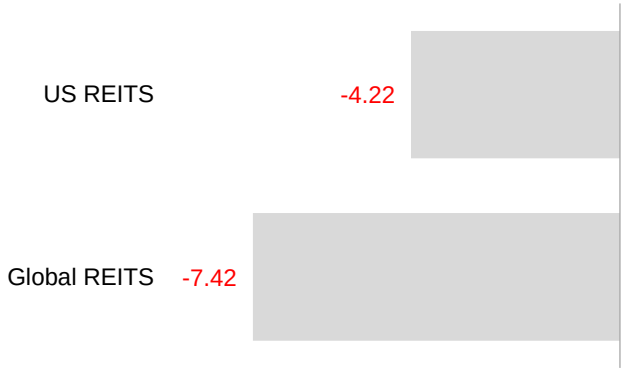
Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.

Real Estate Investment Trusts (REITs)

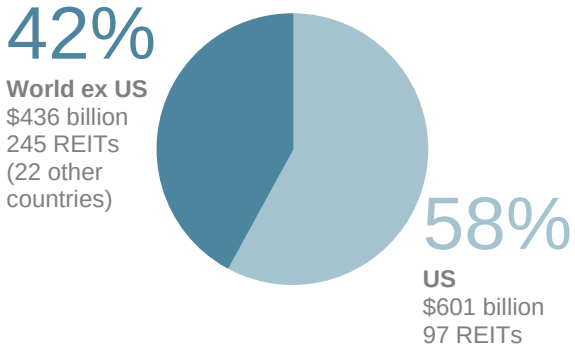
2018 Index Returns

US real estate investment trusts outperformed non-US REITs in US dollar terms.

Ranked Returns for 2018 (%)



Total Value of REIT Stocks



Period Returns (%)

** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
US REITS	-4.22	1.97	7.89	12.05
Global REITS	-7.42	3.35	3.39	8.94

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Total value of REIT stocks represented by Dow Jones US Select REIT Index and the S&P Global ex US REIT Index. Dow Jones US Select REIT Index used as proxy for the US market, and S&P Global ex US REIT Index used as proxy for the World ex US market.

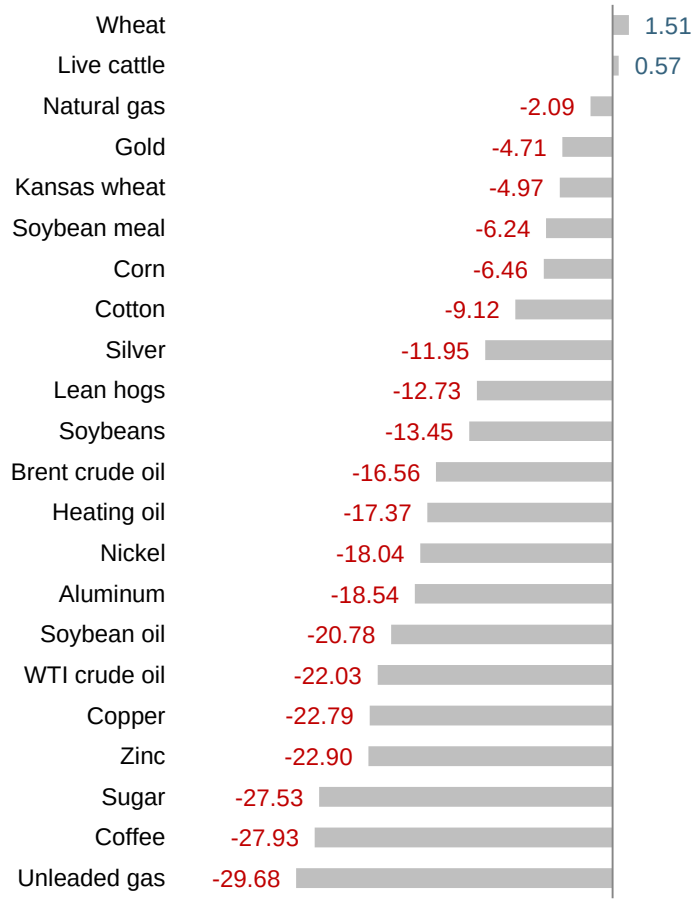
Commodities

2018 Index Returns

The Bloomberg Commodity Index Total Return declined 11.25% in 2018.

Wheat (Chicago) was the strongest performer, gaining 1.51%. Unleaded gas was the weakest performer, falling 29.68%. Coffee lost 27.93%, while sugar declined 27.53%.

Ranked Returns for Individual Commodities (%)



Period Returns (%) ** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Commodities	-11.25	0.30	-8.80	-3.78

Past performance is not a guarantee of future results. Index is not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. All index returns are net of withholding tax on dividends. Securities and commodities data provided by Bloomberg.

Fixed Income

2018 Index Returns

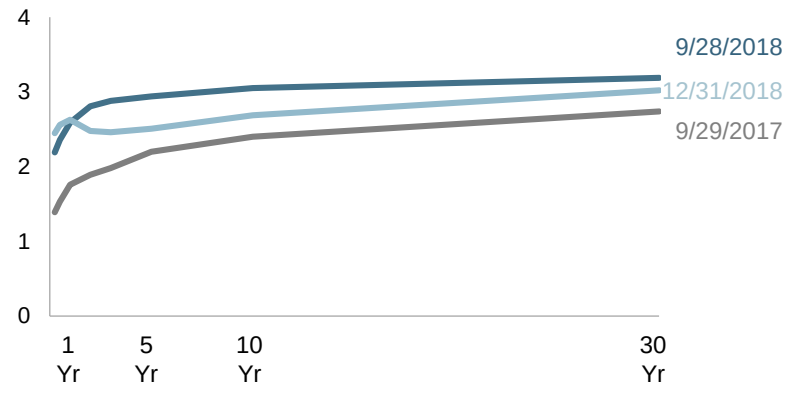
For 2018, yields on the 10-year Treasury note and 30-year Treasury bond increased 29 basis points (bps) and 28 bps, respectively.

The short end of the yield curve experienced the greatest increases. The yield on the 1-year Treasury bill increased 87 bps to end at 2.63%, while the 2-year Treasury note finished with a yield of 2.48% after an increase of 59 bps.

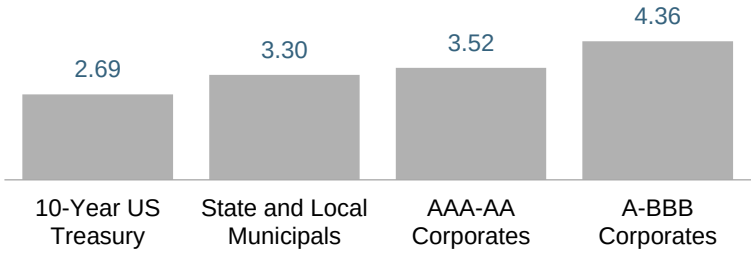
In terms of total returns, short-term corporate bonds increased 1.57% for the year. Intermediate-term corporate bonds declined 0.23%.

The total returns for short-term municipal bonds were 1.77%. Intermediate-term municipal bonds returned 1.57%. General obligation bonds outperformed revenue bonds.

US Treasury Yield Curve (%)



Bond Yields across Issuers (%)



FTSE World Government Bond Index 1-5 Years (hedged to USD)	2.12	1.58	1.53	1.69
ICE BofAML US 3-Month Treasury Bill Index	1.87	1.02	0.63	0.37
ICE BofAML 1-Year US Treasury Note Index	1.86	1.06	0.70	0.62
Bloomberg Barclays Municipal Bond Index	1.28	2.30	3.82	4.85
Bloomberg Barclays US Aggregate Bond Index	0.01	2.06	2.52	3.48
FTSE World Government Bond Index 1-5 Years	-0.76	1.56	-0.82	0.29
Bloomberg Barclays US TIPS Index	-1.26	2.11	1.69	3.64
Bloomberg Barclays US Government Bond Index Long	-1.79	2.63	5.90	4.15

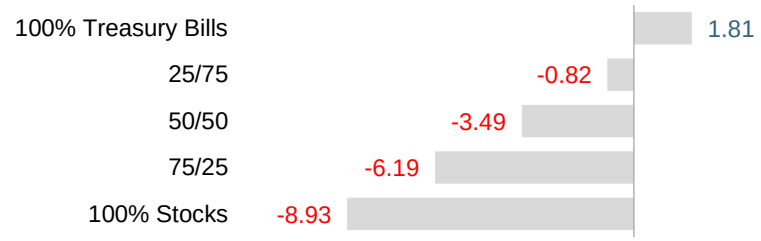
One basis point equals 0.01%. **Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.** Yield curve data from Federal Reserve. State and local bonds are from the S&P National AMT-Free Municipal Bond Index. AAA-AA Corporates represent the ICE BofAML US Corporates, AA-AAA rated. A-BBB Corporates represent the ICE BofAML US Corporates, BBB-A rated. Bloomberg Barclays data provided by Bloomberg. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield). FTSE fixed income indices © 2019 FTSE Fixed Income LLC, all rights reserved. ICE BofAML index data © 2019 ICE Data Indices, LLC. S&P data © 2019 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.

Impact of Diversification

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 for 2018 (%)

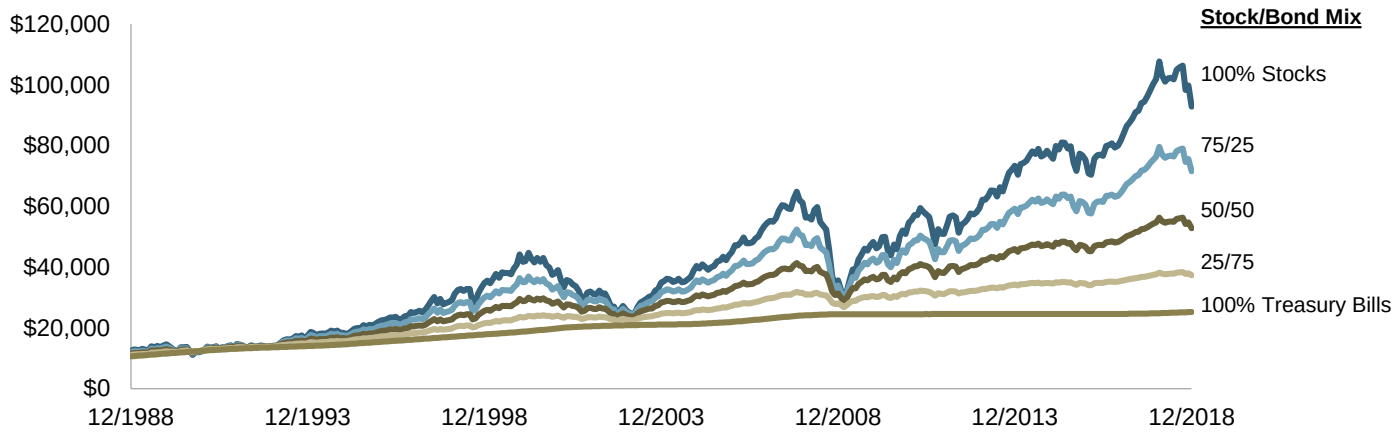


Period Returns (%)

** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	0 Years*	10-Year STDEV[1]
100% Treasury Bills	1.81	0.93	0.57	0.32	0.16
25/75	-0.82	2.57	1.73	2.88	3.65
50/50	-3.49	4.16	2.82	5.36	7.32
75/25	-6.19	5.70	3.86	7.75	10.98
100% Stocks	-8.93	7.18	4.82	10.05	14.65

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.

Why Should You Diversify?

Fourth Quarter 2018

As 2019 approaches, and with US stocks outperforming non-US stocks in recent years, some investors have again turned their attention towards the role that global diversification plays in their portfolios

For the five-year period ending October 31, 2018, the S&P 500 Index had an annualized return of 11.34% while the MSCI World ex USA Index returned 1.86%, and the MSCI Emerging Markets Index returned 0.78%. As US stocks have outperformed international and emerging markets stocks over the last several years, some investors might be reconsidering the benefits of investing outside the US.

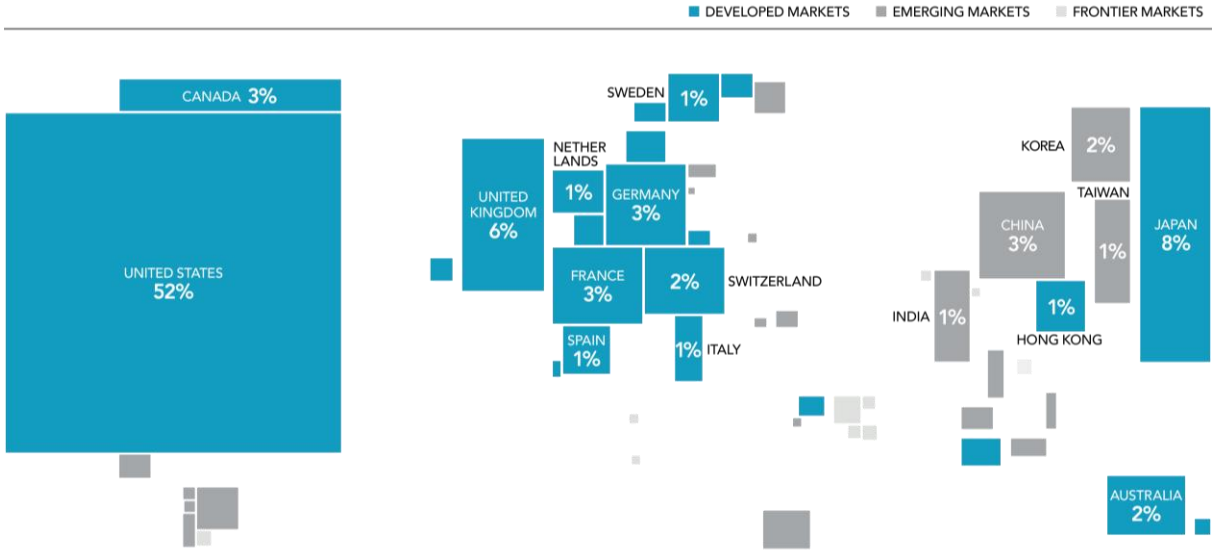
While there are many reasons why a US-based investor may prefer a degree of home bias in their equity allocation, using return differences over a relatively short period as the sole input into this decision may result in missing opportunities that the global markets offer. While international and emerging markets stocks have delivered disappointing returns relative to the US over the last few years, it is important to remember that:

- Non-US stocks help provide valuable diversification benefits.
- Recent performance is not a reliable indicator of future returns.

THERE'S A WORLD OF OPPORTUNITY IN EQUITIES

The global equity market is large and represents a world of investment opportunities. As shown in Exhibit 1, nearly half of the investment opportunities in global equity markets lie outside the US. Non-US stocks, including developed and emerging markets, account for 48% of world market capitalization[1] and represent thousands of companies in countries all over the world. A portfolio investing solely within the US would not be exposed to the performance of those markets.

Exhibit 1. World Equity Market Capitalization



As of December 31, 2017. Data provided by Bloomberg. Market cap data is free-float adjusted and meets minimum liquidity and listing requirements. China market capitalization excludes A-shares, which are generally only available to mainland China investors. For educational purposes; should not be used as investment advice.

1. The total market value of a company's outstanding shares, computed as price times shares outstanding.

Why Should You Diversify?

THE LOST DECADE

We can examine the potential opportunity cost associated with failing to diversify globally by reflecting on the period in global markets from 2000–2009. During this period, often called the "lost decade" by US investors, the S&P 500 Index recorded its worst ever 10-year performance with a total cumulative return of –9.1%. However, looking beyond US large cap equities, conditions were more favorable for global equity investors as most equity asset classes outside the US generated positive returns over the course of the decade. (See Exhibit 2.) Expanding beyond this period and looking at performance for each of the 11 decades starting in 1900 and ending in 2010, the US market outperformed the world market in five decades and underperformed in the other six.[2] This further reinforces why an investor pursuing the equity premium should consider a global allocation. By holding a globally diversified portfolio, investors are positioned to capture returns wherever they occur.

Exhibit 2. Global Index Returns, January 2000–December 2009

	Total Cumulative Return (%)
S&P 500 Index	−9.10
MSCI World ex USA Index (net div.)	17.47
MSCI World ex USA Value Index (net div.)	48.71
MSCI World ex USA Small Cap Index (net div.)	94.33
MSCI Emerging Markets Index (net div.)	154.28
MSCI Emerging Markets Value Index (net div.)	212.72

 Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.

PICK A COUNTRY?

Are there systematic ways to identify which countries will outperform others in advance? Exhibit 3 illustrates the randomness in country equity market rankings (from highest to lowest) for 22 different developed market countries over the past 20 years. This graphic conveys how difficult it would be to execute a strategy that relies on picking the best country and the resulting importance of diversification.

In addition, concentrating a portfolio in any one country can expose investors to large variations in returns. The difference between the best- and worst-performing countries can be significant. For example, since 1998, the average return of the best-performing developed market country was approximately 44%, while the average return of the worst-performing country was approximately –16%. Diversification means an investor's portfolio is unlikely to be the best or worst performing relative to any individual country, but diversification also provides a means to achieve a more consistent outcome and more importantly helps reduce and manage catastrophic losses that can be associated with investing in just a small number of stocks or a single country.

A DIVERSIFIED APPROACH

Over long periods of time, investors may benefit from consistent exposure in their portfolios to both US and non-US equities. While both asset classes offer the potential to earn positive expected returns in the long run, they may perform quite differently over short periods. While the performance of different countries and asset classes will vary over time, there is no reliable evidence that this performance can be predicted in advance. An approach to equity investing that uses the global opportunity set available to investors can provide diversification benefits as well as potentially higher expected returns.

2. Source: Annual country index return data from the Dimson-Marsh-Staunton (DMS) Global Returns Data, provided by Morningstar, Inc.

Why Should You Diversify?

Exhibit 3. Equity Returns of Developed Markets

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
HIGH	Finland 121.6	Finland 152.6	Switzerland 5.9	New Zealand 8.4	New Zealand 24.2	Sweden 64.5	Austria 71.5	Canada 28.3	Spain 49.4	Finland 48.7	Japan −29.2	Norway 87.1	Sweden 33.8	Ireland 13.7	Belgium 39.6	Finland 46.0	USA 12.7	Denmark 23.4	Canada 24.6	Austria 58.3
	Belgium 67.7	Singapore 99.4	Canada 5.3	Australia 1.7	Austria 16.5	Germany 63.8	Norway 53.3	Japan 25.5	Portugal 47.4	Hong Kong 41.2	Switzerland −30.5	Australia 76.4	Denmark 30.7	New Zealand 5.5	Denmark 31.3	Ireland 41.2	New Zealand 7.3	Ireland 16.5	New Zealand 18.4	Hong Kong 36.2
	Italy 52.5	Sweden 79.7	Denmark 3.4	Ireland −2.8	Australia −1.3	Spain 58.5	Belgium 43.5	Austria 24.6	Ireland 46.8	Germany 35.2	USA −37.6	Singapore 74.0	Hong Kong 23.2	USA 1.4	Singapore 31.0	USA 31.8	Denmark 6.2	Belgium 12.1	Norway 13.3	Singapore 35.6
	Spain 49.9	Japan 61.5	Norway −0.9	Austria −5.6	Norway −7.3	Austria 57.0	Ireland 43.1	Denmark 24.5	Singapore 46.7	Norway 31.4	Spain −40.6	Sweden 64.2	Singapore 22.1	UK −2.6	Germany 30.9	Germany 31.4	Hong Kong 5.1	Japan 9.6	Australia 11.4	Denmark 34.7
	France 41.5	Hong Kong 59.5	Italy −1.3	Belgium −10.9	Italy −7.3	New Zealand 55.4	Sweden 36.3	Norway 24.3	Norway 45.1	Canada 29.6	France −43.3	Hong Kong 60.2	Canada 20.5	Switzerland −6.8	New Zealand 29.3	Spain 31.3	Belgium 4.1	Austria 3.5	Austria 11.3	Netherlands 32.2
	Ireland 35.3	Canada 53.7	Netherlands −4.1	Spain −11.4	Japan −10.3	Canada 54.6	New Zealand 35.2	Finland 16.7	Sweden 43.4	Singapore 28.4	Canada −45.5	Belgium 57.5	Japan 15.4	Norway −10.0	Hong Kong 28.3	Netherlands 31.3	Singapore 3.0	Italy 2.3	USA 10.9	France 28.7
	USA 30.1	Norway 31.7	France −4.3	Norway −12.2	Switzerland −10.3	Australia 49.5	Italy 32.5	Switzerland 16.3	Denmark 38.8	Australia 28.3	Germany −45.9	Canada 56.2	USA 14.8	Belgium −10.6	Austria 25.9	Belgium 27.6	Ireland 2.3	Finland 2.0	France 4.9	Italy 28.4
	Germany 29.4	France 29.3	Australia −10.0	USA −12.4	Singapore −11.0	Denmark 49.3	Denmark 30.8	Australia 16.0	Belgium 36.7	Denmark 25.6	Singapore −47.4	New Zealand 50.4	Australia 14.5	Australia −11.0	Australia 22.1	Japan 27.2	Canada 1.5	Netherlands 1.3	Netherlands 4.8	Norway 28.3
	Portugal 27.5	USA 21.9	Portugal −10.3	UK −14.0	Canada −13.2	Norway 48.1	Australia 30.3	Singapore 14.4	Austria 36.5	Portugal 24.0	Denmark −47.6	Spain 43.5	Switzerland 11.8	Netherlands −12.1	Sweden 22.0	Switzerland 26.6	Switzerland −0.1	Portugal 0.9	Portugal 3.6	Germany 27.7
	Switzerland 23.5	Germany 20.0	UK −11.5	Denmark −14.8	Portugal −13.8	Ireland 43.8	Spain 28.9	Netherlands 13.9	Germany 36.0	Spain 24.0	Netherlands −48.2	UK 43.3	Norway 10.9	Spain −12.3	France 21.3	France 26.3	Finland −0.7	USA 0.7	Germany 2.8	Spain 27.0
RETURNS	Netherlands 23.2	Australia 17.6	Austria −12.0	Hong Kong −18.6	Belgium −15.0	Portugal 43.0	Hong Kong 25.0	Sweden 10.3	France 34.5	Netherlands 20.6	UK −48.3	Austria 43.2	Finland 10.3	Canada −12.7	Netherlands 20.6	Denmark 25.2	Australia −3.4	Switzerland 0.4	Japan 2.4	Japan 24.0
	UK 17.8	New Zealand 12.9	Ireland −12.7	Canada −20.4	UK −15.2	France 40.2	Portugal 24.7	Germany 9.9	Italy 32.5	France 13.2	Sweden −49.9	Netherlands 42.3	Austria 9.9	Japan −14.3	Switzerland 20.4	Sweden 24.5	Netherlands −3.5	France −0.1	Hong Kong 2.3	Portugal 23.8
	Sweden 14.0	UK 12.5	USA −12.8	Switzerland −21.4	Spain −15.3	Hong Kong 38.1	Singapore 22.3	France 9.9	Netherlands 31.4	New Zealand 8.9	Italy −50.0	Portugal 40.4	UK 8.8	Sweden −16.0	Norway 18.7	UK 20.7	Japan −4.0	Hong Kong −0.5	Singapore 1.4	Switzerland 22.5
	Denmark 9.0	Denmark 12.1	Finland −14.2	Portugal −22.0	Denmark −16.0	Italy 37.8	Canada 22.2	Belgium 9.0	Australia 30.9	UK 8.4	Australia −50.7	Denmark 36.6	Germany 8.4	Denmark −16.0	USA 15.3	Italy 20.4	Spain −4.7	Germany −1.9	Sweden 0.6	Finland 22.5
	Australia 6.1	Netherlands 6.9	Hong Kong −14.7	Netherlands −22.1	Hong Kong −17.8	Singapore 37.6	UK 19.6	Hong Kong 8.4	UK 30.6	Italy 6.1	Hong Kong −51.2	France 31.8	New Zealand 8.3	Hong Kong −16.0	UK 15.3	Austria 13.4	UK −5.4	Sweden −5.0	UK −0.1	UK 22.3
	Japan 5.1	Spain 4.8	Germany −15.6	France −22.4	Netherlands −20.8	Japan 35.9	France 18.5	UK 7.4	Hong Kong 30.4	USA 5.4	Portugal −52.2	Italy 26.6	Netherlands 1.7	France −16.9	Finland 14.6	New Zealand 11.3	Sweden −7.5	New Zealand −6.3	Spain −1.0	USA 21.2
	Austria 0.4	Italy −0.3	Spain −15.9	Germany −22.4	France −21.2	Belgium 35.3	Germany 16.2	USA 5.1	Finland 29.9	Switzerland 5.3	New Zealand −53.8	USA 26.3	Belgium −0.4	Singapore −17.9	Italy 12.5	Hong Kong 11.1	Italy −9.5	UK −7.6	Finland −4.7	Sweden 20.6
	Hong Kong −2.9	Switzerland −7.0	Belgium −16.8	Singapore −23.4	USA −23.1	Switzerland 34.1	Japan 15.9	Spain 4.4	Switzerland 27.4	Austria 2.2	Finland −55.2	Switzerland 25.3	France −4.1	Germany −18.1	Canada 9.1	Portugal 11.0	France −9.9	Australia −10.0	Switzerland −4.9	Australia 19.9
	Canada −6.1	Portugal −8.9	Sweden −21.3	Italy −26.6	Ireland −26.2	UK 32.1	Switzerland 15.0	Italy 1.9	Canada 17.8	Sweden 0.6	Norway −64.2	Germany 25.2	Portugal −11.3	Portugal −23.1	Japan 8.2	Norway 9.4	Germany −10.4	Norway −15.0	Ireland −7.1	Belgium 18.6
	Singapore −12.9	Austria −9.1	Singapore −27.7	Sweden −27.2	Finland −30.3	USA 28.4	Netherlands 12.2	New Zealand 1.7	New Zealand 16.6	Belgium −2.7	Belgium −66.5	Ireland 12.3	Italy −15.0	Italy −23.2	Ireland 5.7	Canada 5.6	Norway −22.0	Spain −15.6	Belgium −7.6	Ireland 18.1
	New Zealand −22.6	Ireland −12.6	Japan −28.2	Japan −29.4	Sweden −30.5	Netherlands 28.1	USA 10.1	Portugal −1.9	USA 14.7	Japan −4.2	Austria −68.4	Finland 11.1	Ireland −18.1	Finland −31.9	Portugal 3.5	Australia 4.2	Austria −29.8	Singapore −17.7	Italy −10.5	Canada 16.1
LOW	Norway −30.1	Belgium −14.3	New Zealand −33.5	Finland −38.2	Germany −33.2	Finland 19.4	Finland 6.1	Ireland −2.3	Japan 6.2	Ireland −20.1	Ireland −71.9	Japan 6.3	Spain −22.0	Austria −36.4	Spain 3.0	Singapore 1.7	Portugal −38.2	Canada −24.2	Denmark −15.8	New Zealand 11.7

Source: MSCI country indices (net dividends) for each country listed. Does not include Israel, which MSCI classified as an emerging market prior to May 2010. MSCI data © MSCI 2019, all rights reserved. Past performance is no guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

Source: Dimensional Fund Advisors LP.

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There is no guarantee investment strategies will be successful. Investing involves risks, including possible loss of principal. Investors should talk to their financial advisor prior to making any investment decision.

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