Welcome to the First Quarter 2019 Investment Insight. You will notice a change to the look of this publication, as we have been updating our website, marketing materials and now our newsletter. While the look has changed, you can still expect high-quality insights to the investment markets. We hope you enjoy the newsletter. Thank you for your continued support! — **Scott Eltjes, CFA, FLMI, CEO and President**

Economic and Market Overview

Contributed by | Jon Augustine, CFA, Chief Investment Officer

Snapback

As fourth quarter 2018 came to a close, equity investors around the globe were tending to the wounds inflicted upon them by a brutal decline in stock prices. This decline was based on a growing concern the global economy was losing steam at a pace that, in combination with less accommodative monetary policy, would potentially lead to recession.

However, as the first quarter unfolded, investors became enthused that recession was not imminent. That enthusiasm, supported by dovish moves in monetary policy, propelled stock prices in the United States to their strongest performance since 2009. The Russell 3000 Index, one of the broadest measures of American equities, returned 14.0% for the three-month period. Outside the United States, foreign equity markets also turned in a strong performance as the MSCI EAFE Index, representing developed markets, returned 10.0% while emerging markets, as measured by the MSCI EM Index, returned 9.9%.

Strong equity markets are not the only story for the first quarter. As they say in television infomercials, "But wait, there's more!" Monetary officials hit the "pause" button, interrupting moves designed to reduce the monetary policy stimulus that has been in place since the financial crisis of 2008-09. With this backdrop, bonds joined the positive return party as the Bloomberg Barclays Aggregate Bond Index returned 2.9% for the quarter.

Portfolios incorporating our full asset allocation were rewarded under the scenario that unfolded over the past three months. During fourth quarter 2018, we increased our exposure to domestic equities, funding the expansion with proceeds from a reduction in the exposure to fixed income. While both asset classes delivered positive returns during the quarter, equities were the dominant performer for the period as stated above.

> ***Outside the United States, foreign equity markets also turned in a strong performance.***

Snapback Crackback?

In football terminology, a crackback is a block executed by an offensive player positioned away from the main body of the team's formation who runs back in toward the formation after the ball is snapped. The "crackback" occurs when the offensive player blocks an opposing player inward toward the formation, hence, cracking back. The question that arises for investors given the strong performance of the financial markets in the first quarter is, "Will the markets 'crackback' to a more modest level of returns?" To answer that question, we'll assess some of the factors that may potentially impact the financial markets in the months ahead.

In terms of economic growth, the United States experienced a deceleration in the rate of GDP expansion in the fourth quarter, slowing to a rate of 2.2%. For first quarter 2019, the consensus of economists surveyed by Bloomberg calls for further deceleration with growth falling to 1.5%. Sandwiching this outlook is a forecast of 1.7% from the Federal Reserve Bank of Atlanta and an expected increase of 1.3% from its counterpart in New York. Economic growth is anticipated to strengthen throughout the remainder of 2019, with Bloomberg's survey forecasting 2.4% growth for the calendar year and the Federal Reserve (Fed) estimating 2.1%.

While recently released data has been decidedly mixed, we concur with the outlook for firmer, albeit modest, economic growth for the remainder of 2019. Supporting our outlook are ISM readings for both the manufacturing and service sectors that point to continued growth. The most recent reading of

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the NAHB Housing Index indicates positive sentiment from homebuilders and consumer confidence, as measured by the University of Michigan, which was stronger than expected in its latest reading and the strongest since October 2017.

Improvement is being seen in data from outside the United States as well. For example, several recently released indicators in China registered stronger than expected readings. These include measures of factory activity and unexpected increases in the private Caixin/Markit Manufacturing Purchasing Managers Index, as well as the country's official Purchasing Managers Index.

About That Inverted Yield Curve

One of the significant events this quarter was the inversion of the U.S. Treasury yield curve based on three-month and 10-year maturities. Inversions based on these two maturities had not happened since 2007. This development led to numerous prognosticators calling for a recession to develop within the next 12 months. Their outlooks were based on historical precedent that inversions of this type occur about 12 months in advance of economic slowdowns.

We don't currently share the outlook that a recession is imminent, as was reflected previously. The rationale for our viewpoint is we do not currently reside in an environment that has historically led to the "inversion/recession" causation conclusion. A key part of our viewpoint is the U.S. economy has already experienced significant slowing. Also, monetary policy has shifted away from multiple rate hikes by the Fed to speculation of rate cuts. The Fed has also shared that its balance sheet reduction process will not be as extensive as was previously expected. And finally, in today's interconnected global economy, there are forces in place keeping borrowing costs low for the United States, which allows it to finance further growth at attractive levels.

Given the observations and outlooks provided above, we are maintaining our current asset allocation positioning that emphasizes an overweight in equities – specifically domestic equities – and an underweight to fixed income. As always, we encourage a periodic review of portfolio positioning to ensure proper alignment of holdings with stated goals, objectives and risk tolerances.

Fixed Income Commentary

Contributed by | Jeff Birdsley, CFA, Senior Managing Director

The Fed Yields

Interest rates declined and inverted along the yield curve during the first quarter as domestic and global economic outlooks signaled slower growth ahead. As anticipated, the estimate of fourth quarter GDP growth was revised lower (2.2% vs. 2.6% initial estimate). This report reinforced the market's view of a moderate pace of growth for 2019 and beyond. In hindsight, the benefits of last year's fiscal stimulus (tax cuts and increased spending) appear to have been short lived. The government shutdown and colder-than-usual weather also played a part in downshifting expectations for 2019. Economists cut their consensus forecast of real growth for 2019 to 2.4% and 1.9% for 2020, reflecting growing concern the economy does not have enough momentum to counter the next set of policy mistakes.

Led by lower than expected 1.8% year-over-year inflation and slowing growth, the backdrop was set for rates to decline for bonds with maturities from one to 30 years. Declining rates provided a boost to bond prices as evidenced by the quarterly return of 2.9% for investment grade bonds. This compares to a 0.01% return for all of 2018. A leadership shift occurred within the bond market this quarter, as bond investors who gained their best returns last year from U.S. Treasury bonds and a focus on short duration yielded to superior outcomes from corporate bonds and longer maturities. As memories of the fourth quarter faded, investors jumped back into corporate bonds, pushing this segment to provide a return of 4.9%. Longer maturity bonds also provided superior returns as long-term yields dropped during the quarter.

Easing Off the Brakes

Another key driver for lower rates was the Federal Reserve's announcement to support future economic growth by decelerating its monetary policy tightening actions. This action pushed the yield curve to further invert, where short-term rates are higher than longer-term rates. All points along the U.S. Treasury curve now carry a two handle in terms of yield as the 30-year issue dropped below its year-end level of 3.02%.

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Fixed Income Commentary - *Continued from previous page*

Dispelling the widespread market narrative, we find that inversion of the yield curve isn't a perfect indicator of a U.S. recession. Two of the five inversions in the past 30 years didn't spark an imminent recession. Further, in past inverted curve environments, the Fed kept pushing rates higher even after the inversion occurred. With the Fed easing off the brakes, a positive environment for corporate and mortgage backed securities now exists.

And finally, as investors in high-tax states are finding out, tax cuts may not have cut their tax bill. This has made municipal bonds an attractive option for some, as income not subject to tax is not diminished by changes in the level of an investor's deductions. We specifically view longer municipal bonds as providing a competitive return relative for those investors to other bond investing.

Equity Commentary

Contributed by | Kuuku Saah, CFA, Investment Analyst

Through the Rain

One of the significant attributes of humans is irrationality. It is both an aid and an anathema to investors. Without this irrationality, it would be close to impossible to generate excess returns, and without it, losses would also be less likely. Therefore, market volatility is part of our human condition.

In the first quarter, equity markets reacted like they were shot out of a cannon as opposed to being squeezed out of a tube. Returns for first quarter 2019 were the best quarterly returns experienced in the last 10 years. Domestic markets, using the S&P 500 as a proxy, rose 13.7%, while international markets, using the MSCI All Country World Index ex USA, advanced 10.7%.All domestic and international sectors saw positive performance over the period. Performance was led by the information technology sector. This positive contrasts with the negative equity returns exhibited during 2018. Year-over-year, domestic and international markets are up 9.5% and 2.6%, respectively.

Why have markets behaved so well this year?

For the most part, it looks like investors are shrugging off the "macro" and focusing on the "micro." Trade tensions have been a gloomy storm cloud since 2017. As residents of the Pacific Northwest have shown us, you can't just stay at home because of rainy weather. You put on a raincoat, grab your umbrella and go about your day. That is what happened in the markets this quarter. Investors put on their raincoats, got out there and focused on companies. And they saw companies are growing.

In fourth quarter 2018, earnings grew 16.9% and sales increased around 5%. We have seen consistent earnings growth since the end of the financial crisis. Since 2010, they have grown by an average of 12%. Over the same period, sales have grown by 5.5%. While these rates of growth may not be maintained in 2019, a slowdown in earnings growth should not be interpreted as a sign companies are not doing well. Earnings are expected to continue to grow, albeit not at the accelerated pace previously seen.

> ***Returns for first quarter 2019 were the best quarterly returns experienced in the last 10 years.***

Will the market's good behavior continue?

The first quarter is an example of slowing earnings growth as results are actually expected to come in flat to slightly negative relative to the prior quarter. The energy sector is expected to be the largest detractor in the quarter. This is despite the expectation that sales for U.S. equities are expected to grow by 5.1% versus the prior quarter. Earnings growth for all of 2019 is expected to be positive, with a current projection of 3.4%.

While earnings growth is decelerating, we feel a more accommodative Federal Reserve and improving level of economic growth will provide a positive backdrop for equity investors.

BTC Capital Management *welcomes Leila Mikkola*

Leila is a Managing Director for BTC Capital Management in our Phoenix office. She is responsible for new business development and client service for both direct Institutional investment relationships, as well as Private Client relationships in conjunction with our Wealth Management division. Leila has over 29 years of experience in the financial services industry. Her experience has included business development, relationship management, and project management for institutional clients. Prior to joining BTC Capital Management, Leila was a Relationship Manager for Transamerica and previously held similar positions with Principal Financial Group, KeyBank and National City Bank. She earned a bachelor's degree from University of Denver.

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