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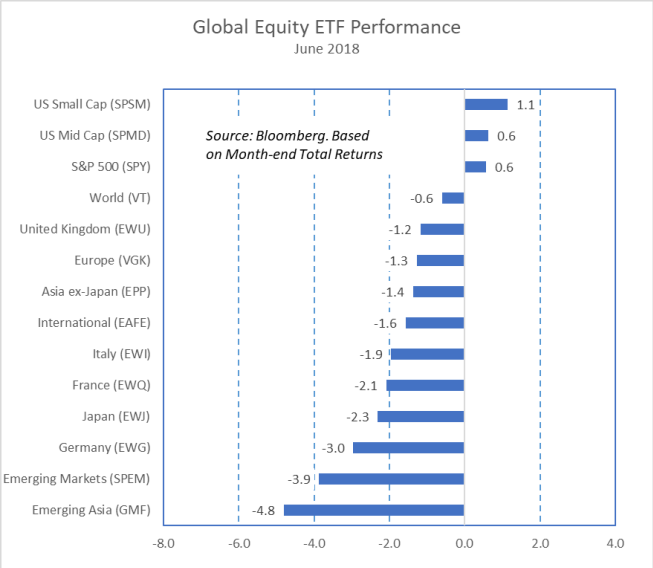
JUNE 2018 CAPITAL MARKET REVIEW

U.S. equities again paced global capital markets last month while many international equity and fixed income markets contracted due to factors including continued strength in the U.S. dollar, heightened tariff-related uncertainty and further weakening European economic conditions.



Equity Markets*

Global equities contracted 0.6% during June with the most severe declines in emerging markets. In the U.S., Small Cap stocks added to last month's strong rally by climbing 1.1% followed by Large and Mid Cap companies, which both advanced by 0.6%.

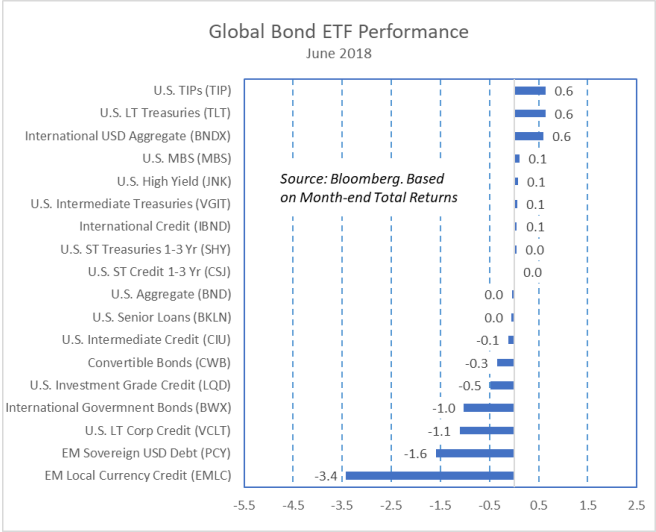
In Asia, emerging market equities declined by a painful 4.8% in U.S. dollar terms, with China caught in the trade tensions. Japanese stocks fell 2.3% while developed Asia ex-Japan also fell 1.4% In June.

European markets stumbled again, with Germany falling 3.0%.

Bond Markets*

Returns in the U.S. bond market were muted except for long-term U.S. corporate credit, which fell 1.1%. The yield on the 10-year U.S. Treasury rose a single basis point from the beginning to the end of June, settling at 2.86%; however, it did reach 2.97% during the first week of the month.

The dollar continued to strengthen against major currencies according to Bloomberg's U.S. dollar index, which rose 0.97% in June. Non-dollar fixed income markets slid again. Emerging Market debt, particularly in local currency terms, faced continued pressure from a combination of U.S. dollar strength and further concerns regarding fiscal and current account imbalances.



**The returns cited reflect total return performance of exchange traded funds listed in the corresponding bar charts*

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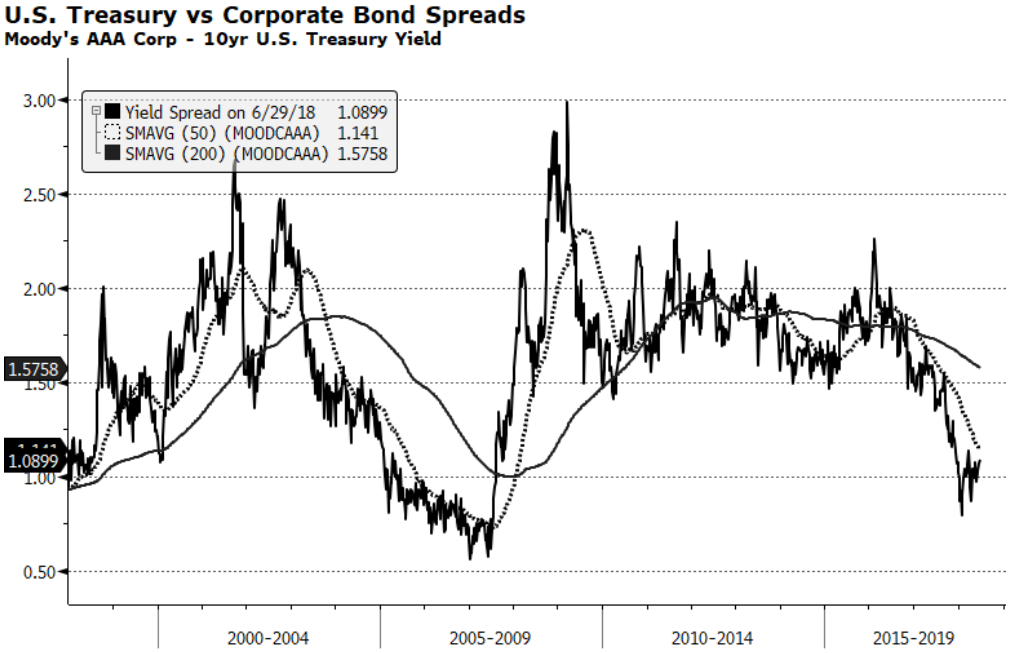
U.S. CORPORATE BONDS SPREADS WIDENING:

We have been intrigued over the past several months by total return trends in U.S. bond markets. It has been a rough first half of 2018 for bonds with the Bloomberg Barclays U.S. Aggregate Total Return index contracting 1.62%. What is interesting to us is that prices have fallen to a greater degree in U.S. investment grade corporate bonds as measured by the iBoxx Very Liquid index, (-4.26%) and compared to the Bloomberg Barclays U.S. Treasury Index (-1.08%). This has occurred while U.S. corporate fundamentals are quite strong.

What concerns us is that interest rate spreads (depicted below) between U.S. investment grade corporate credit and U.S. Treasuries have climbed from levels we last experienced during the pre-crisis era. This could just be a pause and spreads resume their tightening path that began several years ago, ultimately approaching lows reached in 2007. Or we could see further widening that may signal economic and market deterioration. There are many dynamics at play – central bank activity across the globe is a major factor – and this is one simple measure, yet we believe that it is critical to monitor.



Source: JP Morgan, Bloomberg

> *"U.S. equities again paced global capital markets in June while many international equity and fixed income markets contracted mainly due to continued strength in the U.S. dollar, growing tariff-related uncertainty and further weakening European economic conditions."*

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PORTFOLIO POSITIONING

In terms of overall positioning, we maintain a preference for U.S. equities and cash. We have recently increased our exposure to U.S. Mid and Small Cap companies. We have a favorable view of Asia ex-Japan and Emerging Asia. Our commitments to these equity markets are primarily funded from non-U.S. bonds. Within fixed income, we are underweight the U.S. and recently sold out of non-U.S. bond positions. Our portfolios maintain lower duration than the benchmark. We are overweight cash at the expense of fixed income. We have no emerging market debt at this time.

RISK OUTLOOK

Economic activity generally remains robust at home; however, much of the rest of the world appears to be slowing. The following are key risks we are monitoring:

- The American economy appears to be gaining economic momentum. Second quarter GDP is scheduled to be released July 27th and the consensus is expecting 3.8% annualized growth. The Atlanta Fed model suggests that economic activity could approach 4.5%. Higher than expected growth could force the U.S. Federal Reserve to increase the pace of rate increases in the second half of 2018 and beyond. Any unexpected upward pressure on interest rates could rattle markets.
- It is still early days in Italy as its new populist coalition government consisting of the Five Star Movement and the far-right League parties begin to govern. There remains concern that euro-skepticism could force an exit from the euro and EU. Investors continue to focus on Italy's sovereign debt levels, which now exceed 130% of GDP (well above EU budget rules) and the limitations that imposes on fiscal flexibility.
- Ongoing international trade disputes and tariffs among the U.S.'s closest allies, and critically China, may continue to contribute to market uncertainty.
- Britain's exit from the European Union has been a long, arduous process. A disruptive "hard" Brexit could derail economic and trade relationships with the other members of the Union. That could cause Prime Minister Theresa May to lose already weakened support and potentially force her from office.

See the WCM website for more market commentary or contact us with any questions.

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KEY EVENTS IN JULY

Week 1

- 7/3 China: Caixin Composite PMI
- 7/3 Japan: Nikkei Composite PMI
- 7/4 U.K.: Markit/CIPS Composite PMI
- 7/4 Eurozone: Markit Composite PMI
- 7/5 U.S.: Markit Composite PMI
- 7/5 U.S. FOMC Meeting Minutes

Week 2

- 7/9 Eurozone: Sentix Investor Confidence
- 7/9 China: Price Index Surveys
- 7/10 Eurozone: ZEW Expectations Survey
- 7/11-7/12 U.S.: Price Index Surveys

Week 3

- 7/15 China: Q2 GDP
- 7/18 U.S.: Federal Reserve releases Beige Book
- 7/18 U.K.: Price Index Surveys
- 7/19 U.S.: Conf. Board Leading Indicators

Weeks 4&5

- 7/24 Japan: ESRI Leading Indicators (May)
- 7/27 U.S.: Q2 GDP
- 7/27 U.S.: Univ. of Mich. Sentiment Surveys
- 7/30 U.K.: GfK Consumer Confidence
- 7/30 Eurozone: EC Confidence Surveys
- 7/30-7/31 Japan: BOJ Policy Rates
- 7/31 U.S.: Conf. Board Sentiment Surveys
- 7/31 Japan: ESRI Consumer Confidence
- 7/31 Eurozone: Q2 GDP

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Diversification and strategic asset allocation do not guarantee a profit nor protect against a loss in declining markets. All investments are subject to risk, including the loss of principal.

The information contained herein is based upon the data available as of the date of this document and is subject to change at any time without notice.

Portfolios that invest in fixed income securities are subject to several general risks, including interest rate risk, credit risk, the risk of issuer default, liquidity risk and market risk. These risks can affect a security's price and yield to varying degrees, depending upon the nature of the instrument, and may occur from fluctuations in interest rates, a change to an issuer's individual situation or industry, or events in the financial markets. In general, a bond's yield is inversely related to its price. Bonds can lose their value as interest rates rise and an investor can lose principal. If sold prior to maturity, fixed income securities are subject to gains/losses based on the level of interest rates, market conditions and the credit quality of the issuer.

Foreign investments are subject to risks not ordinarily associated with domestic investments, such as currency, economic and political risks, and may follow different accounting standards than domestic investments. Investments in emerging or developing markets involve exposure to economic structures that are generally less diverse and mature, and to political systems that can be expected to have less stability than those of more developed countries. These securities may be less liquid and more volatile than investments in U.S. and longer-established non-U.S. markets.

An investment in small/mid-capitalization companies involves greater risk and price volatility than an investment in securities of larger capitalization, more established companies. Such securities may have limited marketability and the firms may have more limited product lines, markets and financial resources than larger, more established companies.

Portfolios that invest in real estate investment trusts (REITs) are subject to many of the risks associated with direct real estate ownership and, as such, may be adversely affected by declines in real estate values and general and local economic conditions.
Portfolios that invest a significant portion of assets in one sector, issuer, geographical area or industry, or in related industries, may involve greater risks, including greater potential for volatility, than more diversified portfolios.

Important Disclosures: Exchange-Traded Funds

Exchange-traded funds (ETFs) are investment vehicles that are legally classified as open-end investment companies or unit investment trusts (UITs) but differ from traditional open-end investment companies or UITs. ETF shares are bought and sold at market price (not net asset value) and are not individually redeemed from the fund. This can result in the fund trading at a premium or discount to its net asset value, which will affect an investor's value. Shares of certain ETFs have no or limited voting rights. ETFs are subject to risks similar to those of stocks.

ETFs included in portfolios may charge additional fees and expenses in addition to the advisory fee charged for the Selected Portfolio. These additional fees and expenses are disclosed in the respective fund/note prospectus. For complete details, please refer to the prospectus.

For additional information regarding advisory fees, please refer to the Fee Summary and/or Fee Detail pages (if included with this report) and the program sponsor's/each co-sponsor's Form ADV Part 2, Wrap Fee Brochure or other disclosure documents, which may be obtained through your advisor.

Certain ETFs have elected to be treated as partnerships for federal, state and local income tax purposes. Accordingly, investors in such ETFs will be taxed as a beneficial owner of an interest in a partnership. Tax information for such ETFs will be reported to investors on an IRS schedule K-1. Investors should consult with their tax advisors in determining the tax consequences of any investment, including the application of state, local or other tax laws and the possible effects of changes in federal or other tax laws.