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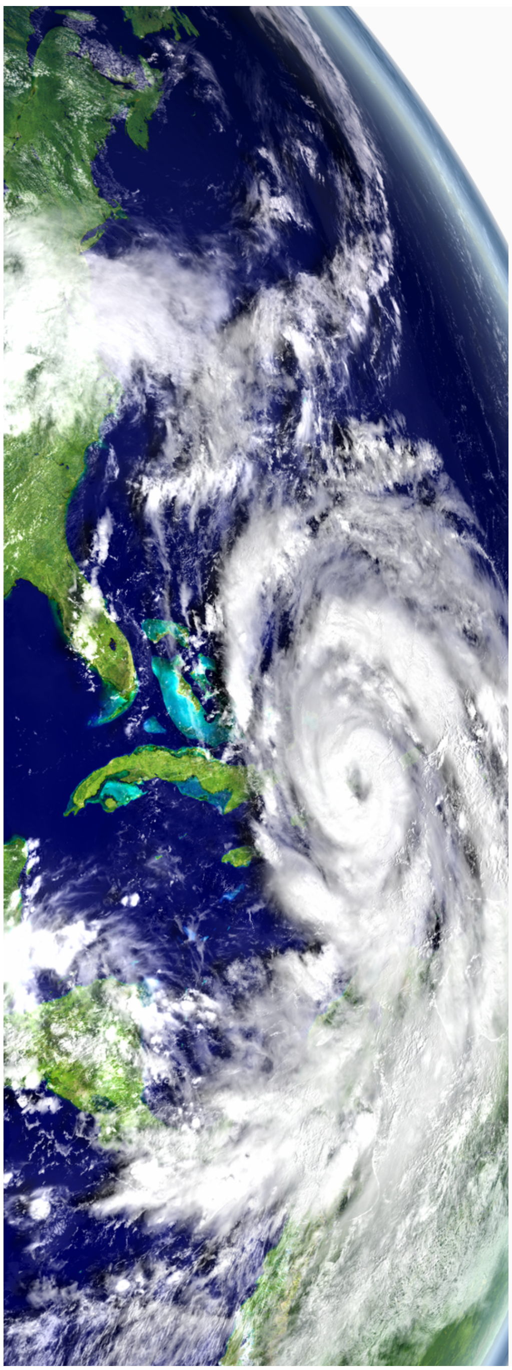
EVACUATE OR RIDE IT OUT



The months of June through November are considered the peak period for hurricane activity as these tropical cyclones develop in the Atlantic ocean's warmer waters. Residents along the Gulf of Mexico and East coasts, having the greatest risk, anxiously monitor the direction of storms as they evolve, with notable concern for those with built up intensity originating from the Cape Verde region off West Africa. This year's hurricane season has again brought unfortunate destruction, with Florence hitting the North Carolina coastline in September, and Michael making landfall in the early days of October. Hurricane related damage is caused by a number of elements including flying debris, falling trees, and downed electrical wires, but mostly from flooding caused by the heavy rains and storm surge as strong winds push ocean waters onshore and intense rain causes river banks to overflow.

Florence's destruction was the result of excessive rain and flooding as it stalled over North Carolina, while Michael destroyed property due to sustained winds in excess of 155 miles per hour as it hit the Florida panhandle. Economic damage from Florence is estimated in the range of $40-$50 billion, whereas Michael is estimated at roughly $10 - $15 billion, although estimates vary widely. Calendar year 2017 hurricanes Harvey, Irma, and Maria were reported as having generated combined total losses of $250 billion, the most expensive storm season in U.S. history.

As the probable flight path of a hurricane

becomes better known, residents of the targeted geographic region must consider whether to "risk it" and "ride it out" or evacuate for safer ground as danger approaches. Similarly, investors in the financial markets must navigate the myriad of economic and emotional variables influencing security prices, assessing the risks of staying fully invested or moving to safer alternatives. Seasoned "old timers", having witnessed a storm or more over their lifetimes, maybe more willing to ride it out, whereas newcomers tend to flee at the earliest signs of trouble. At the extreme, the risks to a wrong decision in response to a hurricane can be fatal, whereas a market decline has historically been transitory, although varying in degree. History is a precedent, but not a perfect predictor, and each incident must be assessed independently. However, as investors and hurricane survivors know, when there's clarity in the outcome, it is too late to initiate preventative action. Recent pictures of Mexico Beach tell the story of the potential risks, as does a graphic of the 2008/2009 equity market selloff.

September 2018 marked the ten-year anniversary of the market meltdown, the collapse of Lehman Brothers, AIG, and other financial institutions. At that time, Americans lost roughly $10 trillion in wealth from the decline in the value of their homes and other investments. Most investors, even seasoned ones, did not anticipate the degree of damage that was about to occur. While it didn't feel like it at the time, the stage was being set for one of the most robust recoveries in history, as the Federal Reserve and other central banks flooded the markets with liquidity by lowering the Fed funds rate to 0% (and negative rates in some countries), while adding further capital into the economy by initiating bond buying through their Quantitative Easing ("QE") programs.

The economic variables influencing the market have lately become more overcast, especially as compared to the clear blue skies of the last number of years. In September, the Federal Reserve raised the funds rate another 0.25% to a target range of 2.0%-2.25%, the eighth increase since 2005. There is now an 80% probability for another 0.25% hike in December and additional hikes are expected in 2019. The central bank is also gradually maturing some of their QE bond purchases. While perhaps not officially "tightening", the Fed's post meeting statement removed the word "accommodative" and Fed Chairman Powell indicated the FOMC was "a long way from neutral". "Neutral" is an inexact number, especially when there are other influences currently affecting interest rates, inflation, and economic growth. The Fed believes neutral to be closer to 3%. However, a more mature, slower growing economy without the effects of stimulus, could mean it is naturally below this figure. Regardless, as this financial flooding recedes, overall market and security price volatility are likely to increase, reflecting the unwinding of these programs and the wider dispersion of potential outcomes.

Fiscal policy, or government spending and lower tax rates, has been of significant influence on recent economic activity. U.S. economic growth, having languished in the 2% range over the last number of years, has improved dramatically over the last two quarters, with real GDP reported closer to 3% on an annualized basis. Inflation has also risen from 1.5% to 2.5% over the same period. These increases are a direct result of the recent tax cuts, putting more money in consumers' and business bank accounts and stimulating spending. Higher funds rates are an attempt to prevent the economy from overheating, as inflationary pressures could build from tighter supplies and tighter labor markets, now at a headline unemployment rate of 3.7%, the lowest since 1969 (the year category 5 Hurricane Camille hit the Gulf Coast). Along with the improved economic growth outlook, market interest rates also rose this quarter. The 10-year Treasury yield jumped from 2.86% at the beginning of the quarter to a 3.06% at the quarter's end, continuing to rise in the early days of the fourth quarter. Having been accustomed to low interest rates, equity investors are becoming more nervous when faced with yield spikes, as Treasury yields are the base level "risk free" returns used for investment decision making, causing other asset types to adjust in price in response.

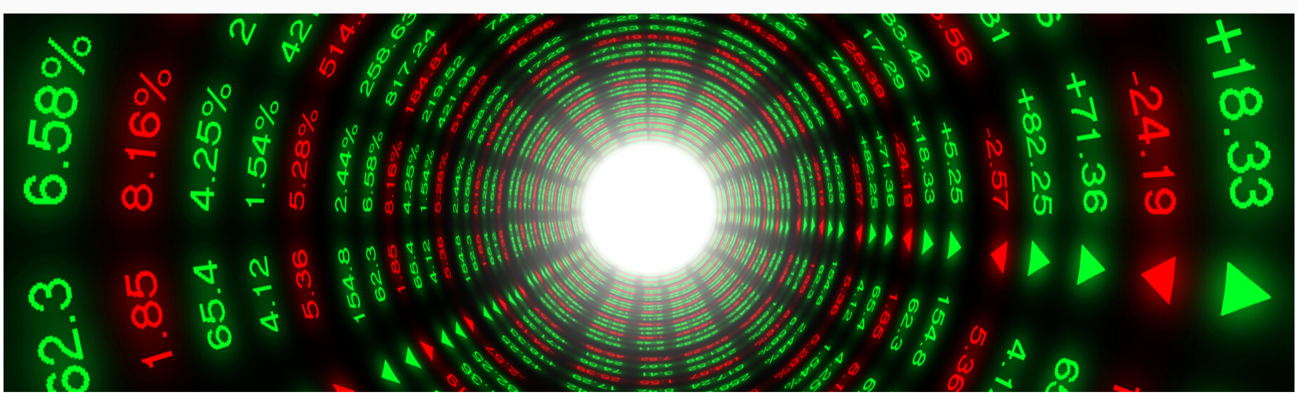
The anxiety of higher interest rates, along with uncertainty on the outcome of trade negotiations caused investors to move to

more secure asset classes in the most recent quarter. This included the safety of domestic, large cap. growth companies, predictable dividend payers, and shorter-term bonds. Riskier and more volatile asset classes, including small cap. stocks and emerging market stocks underperformed, as did developed international equities. Like hurricanes, investors must assess the implied market warning signals originating from riskier asset types, including the emerging markets. More competitive bond yields combined with economic uncertainty could cause yield sensitive investors to move out of risk assets, where they initially moved into when bond yields were artificially depressed. While not the eye wall of the storm, this may be some of the outer bands when considering whether or not to stay in the trade.

October historically has been a challenging month in the equity market as investors address winners and losers and consider positioning for the upcoming year. Recalling the equity market decline in the first quarter of this year when interest rates spiked from 2.40% to 2.95%, and especially so for those seasoned investors with longer term memories of the October '87 crash when 10-year Treasury rates rose from 7% to 10% during the year. The mid-term elections provide additional uncertainty to the market landscape, although the equity market has historically been favorable over the last two months of the year.

Hurricanes are known to take out phone and electricity systems, leading to electrical "blackouts" and the inability to communicate with interested parties. Similarly, public companies are restricted on what they can communicate around corporate earnings season, as well as their ability to repurchase stock. This is also known as a "blackout" period. Stock repurchase activity has provided ongoing support to equity prices throughout this cycle, not only due to strong underlying fundamentals, but also due to the issuance of inexpensive corporate debt with proceeds used to reduce the share count. During these periods of limited communication and restrictions on share buybacks, the market has a tendency for greater price volatility.

Fortunately, the outlook is not ominous, and we view the environment as a small craft advisory warning, not a storm or hurricane warning requiring investors to hunker down. Earnings remain robust, and while the growth rate of earnings will slow (another major tax cut is unlikely), the fundamental backdrop remains generally supportive. We believe



we are in the later stages of an economic cycle, not the end of the cycle. The current levels of interest rates are not penalizing, and numerous investment opportunities exist, just more difficult to find. Security prices have risen dramatically over the last ten years, as has the price of beach property.

We feel for those effected by the hurricanes, and although it is hard for residents to envision now, Mexico Beach will eventually recover and will come back better than before. As always, we recommend appropriate diversification and sufficient levels of reserves on the sidelines, just to ride out short-term unexpected events and to stay on your feet when the stronger winds blow.

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