THE TRUST COMPANY

INVESTMENT & WEALTH MANAGEMENT UPDATE

OCTOBER 16, 2018

THIRD QUARTER IN REVIEW

The third quarter proved to be very strong for domestic stocks. Corporate earnings continued to soar on the heels of corporate tax cuts, consumer spending, and global growth. Toward the end of September, a new round of reciprocal tariffs between the United States and China kicked in as it appears neither economic giant is ready to flinch.

For the third quarter, each of the indexes listed here posted solid gains, led by the large caps of the Dow and the S&P 500. The tech-heavy Nasdaq continued its strong showing while the small caps of the Russell 2000 posted moderate quarterly gains.

Eye on the Month Ahead

The summer months proved full of volatility for stocks, as investors were inundated with negative rhetoric between the United States and several of its trade partners. The last quarter of the year is expected to bring much of the same. The economy enjoyed robust growth during the second quarter, according to the gross domestic product. Will growth approach 4.0% in the last quarter of the year? If consumer spending continues to expand as it did during the summer months, economic expansion could equal or surpass third-quarter growth rate.

As of this writing, the Forward P/E of the S&P 500 is 15.2X next year's earnings. The selloff at the start of October has brought the Forward P/E below where we started the 3rd quarter. The Free Cash Flow Yield currently sits at 4.9% (higher is better) which is higher (a positive sign) than the historical median. While there are near-term risks, stocks still appear to be more attractive relative to other asset classes. We have maintained our overweight position in Equity.

We have maintained our underweight in Fixed Income. The yield curve flattened more in the 3rd Quarter down to a spread of 0.39% between the 2-year and 30-year Treasury. Though the start of October has seen that spread widen back to where the 3rd quarter started. Expectations are for the Federal Reserve to raise rates again in December.

If the economy continues showing signs of strength, we would look at pullbacks as buying opportunities. While it is our expectation that the Fed will continue raising rates in 2019, we are still low by historic standards. There is some risk that continued rate hikes could stall the economy. If they continue to do a good job of advertising their actions and stay with a measured pace, we think the economy should be able to absorb higher rates.

Market/Index	2017 Close	As of September 28	Month Change	Quarter Change	YTD Change
S&P 500	2673.61	2913.98	0.43%	7.20%	8.99%
DJIA	24719.22	26458.31	1.90%	9.01%	7.04%
NASDAQ	6903.39	8046.35	-0.78%	7.14%	16.56%
Russell 2000	1535.51	1696.57	-2.54%	3.26%	10.49%
Global Dow	3085.41	3121.54	1.50%	4.77%	1.17%
Fed. Funds	1.25%-1.50%	2.00%-2.25%	25 bps	25 bps	75 bps
10-Year Treasuries	2.41%	3.06%	21 bps	20 bps	65 bps

CONTACT US

800 Poyntz Ave., P.O. Box 1806
Manhattan, KS 66505
785.537.7200

4210 Philips Farm Road, Suite 109
Columbia, MO 65201
573.876.7000

333 West 9th Street, Suite A
Lawrence, KS 66044
785.371.9555

908 Broadway, Suite B
Marysville, KS 66508
785.562.2344

THETRUSTCO.COM
800.285.7878

DIVERSIFYING EVEN WHEN (ESPECIALLY WHEN) IT IS HARD

By Michal Emory, CFA, Vice President & Chief Investment Officer

I love baseball. It was always my favorite sport growing up. Growing up in Houston, all I wanted was to play for the Houston Astros one day. I played shortstop, so I always had to be #10 just like Dickie Thon who was the Astros' shortstop at the time. I was never a home run hitter, but I almost always had a high batting average with plenty of singles and doubles. But, alas, nature won out and my dreams of playing shortstop for the Houston Astros faded.

Nowadays since I cannot play baseball, I love October because it means playoff baseball. An entire season can be altered by one hanging curveball. One thing that has been very evident the last few years whether it be from the Houston Astros last year or the Kansas City Royals a few years back, is the value of just putting the ball in play. Back in 2015 when the Royals beat the Astros in a thrilling comeback fashion in the American League Division Series, one thing that really stood out to me was the difference in offensive styles. At the time, the Astros hit a ton of home runs but also struck out almost 1400 times as a team. Meanwhile, the Royals were towards the bottom in home runs but struck out fewer than 1000 times—the fewest in Major League baseball. When it came time to put the ball in play, the Royals could, the Astros could not, and that was a key difference in the Royals winning. Fast forward to 2017 and the Astros had the fewest strikeouts in baseball on their way to winning the World Series.

In investing, as in baseball, there is value in not striking out and "putting the ball in play". Having a diversified portfolio is putting the ball in play. You may not hit a home run like you could if you had all your money in one area, but you are also much less likely to strike out. So that there is no confusion, here are what diversification IS and IS NOT.

Diversification IS

Acknowledgment that the future is unknowable

Reducing (not eliminating) the risk of a large, life-altering loss

Way to survive deep market dislocations and stay on track to achieving your long-range goals

Planning for a diverse range of outcomes

Increasing your probability of success

Diversification is NOT

A silver bullet to avoid volatility

Missing every market drawdown

A hedge against every form of market risk

Cocktail party bragging material (though it should be)

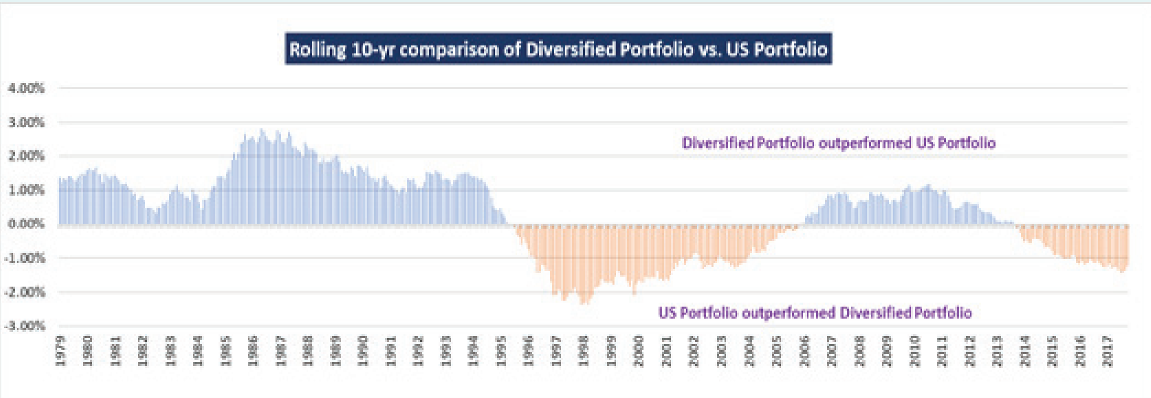
Sticking with diversification can be tough in years like 2018. Unlike 2017 where all the major asset classes were positive and most had excellent returns, 2018 is shaping up to be a year of strong divergence. As of the end of September, US equities (both large cap and small cap) have been the only source of solid return from an asset class standpoint. It can be tough to hear about the S&P 500 making all-time highs and not seeing a level of return in your account that would seem to reflect those all-time highs.

Depending on the aggressiveness of your portfolio, only 10-50% of your portfolio may be in S&P 500 or Dow Jones stocks which dominate the financial news. If, for example, 25% of your portfolio is made of US Large Cap stocks and the S&P 500 is up 10%, it would be reasonable to expect that portion of your portfolio to be up around 2.5%. But, if the S&P 500 is down 10%, you could expect that portion of your portfolio to only be down around 2.5%. Diversification is giving some of the upside of an asset class to not fully participate in all the downside. But as we are about to see, that does not mean your portfolio cannot still have great returns over the long-term.

The table to the right is how a generic 60% equity/40% fixed income portfolio has done since 1970. The Diversified Portfolio has a combination of US Large Cap Equity, US Small Cap Equity, International Developed Equity, Emerging Markets, US Fixed Income, and International Fixed Income.[1] The US Portfolio has US Large Cap, US Small Cap, and US Fixed Income only. I have added in the S&P 500 to compare how a diversified portfolio matches up versus a US-only stock portfolio. Returns are since 1970.

Return %	Diversified Portfolio	US Portfolio	S&P 500
Ann Ret. Since 1970 or Since Inception	8.54	8.35	8.85
Volatility	9.21	9.54	14.99
1970s Annual Return	4.22	2.85	1.60
1980s Annual Return	15.43	13.48	13.38
1990s Annual Return	12.16	13.86	18.21
2000s Annual Return	3.31	2.58	(0.95)
2010s Annual Return	8.02	9.71	13.96

The Diversified Portfolio has higher returns and less volatility than the US Portfolio. In fact, the return on the Diversified Portfolio is not far off from the return of the S&P 500. And again with significantly less volatility. Interestingly, the Diversified Portfolio outperformed the S&P 500 in three out of the five decades. If we look at rolling 10-year periods, the Diversified Portfolio has outperformed the US Portfolio 62% of the time. As one would expect, markets go through phases where the Diversified Portfolio outperforms and some where the US Portfolio outperforms. As you can see to the left, we have been in a long trend where the US Portfolio has been outperforming but there is no guarantee on how long that will persist.

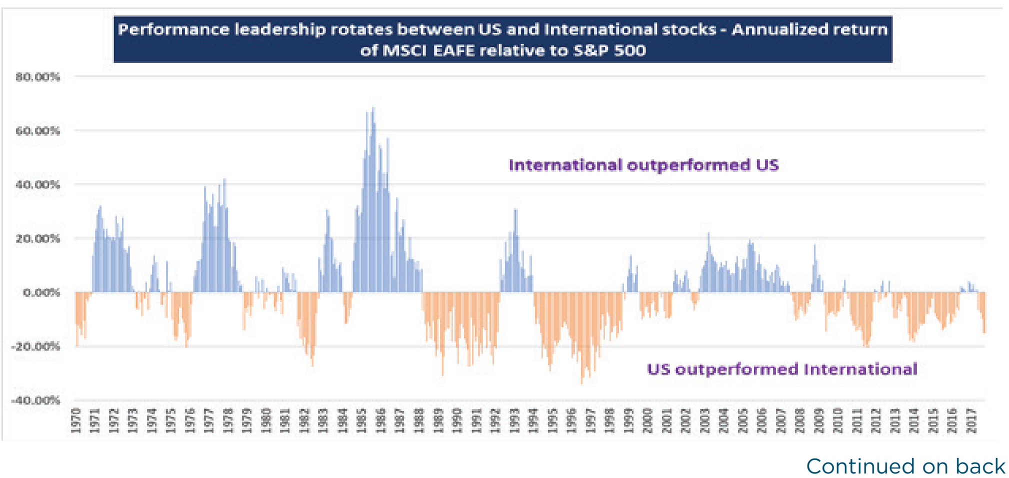


[1]There are more ways to diversify that we use within our portfolios such as High Yield Fixed Income, Real Estate, Commodities, TIPs, and Short-Term Fixed Income.

Some may be thinking "I know that I need fixed income but why do I need International exposure?" The answer is because International Equity has a low correlation with US Equity, providing another source of return during periods when the US stock market is dragging. There can be long periods where the US stock market moves sideways or down. The chart below shows a comparison of US Equity (90/10 Large-Small) portfolio and a Diversified Equity (70/30 US-Int'l) portfolio.

Return %	Diversified Equity Portfolio	US Equity Portfolio
Ann Ret. Since 1970 or Since Inception	9.27	8.97
Volatility	14.40	15.12
1970s Annual Return	4.23	1.86
1980s Annual Return	16.44	13.54
1990s Annual Return	14.75	17.78
2000s Annual Return	0.72	(0.44)
2010s Annual Return	11.33	13.95

Once again, we can see that a diversified equity portfolio provides greater return for less volatility. The 2000s was a down decade for the S&P 500. A diversified portfolio could have saved an equity portfolio from potentially experiencing a down decade also. At right is look at how the MSCI EAFE (the main international equity index) has fared versus the S&P 500 over a rolling 12-month period since 1970.



Continued on back

Emory continued from p. 3

Even though diversification works over time, there will always be times when we want to cast diversification aside. 2018 has certainly been one of those years. It can be tempting during these times to throw your plan out the window and think that our present circumstances will continue indefinitely. But as we have seen in the start of October, the market's mood can change quickly, and the best defense is being properly diversified. There is only one sure thing when it comes to investing. And that is that markets will fluctuate and "what works" will change seemingly with the seasons.

I cannot tell you whether the start of October is a mere hiccup or a signal of a top. But I do know that the best way to face the uncertain future is with a portfolio diversified enough to weather many types markets and reduce the chance of a life-altering loss. A market trend can continue longer than one would think is possible but ask yourself a simple question. Is it more probable that we get another decade of US equity outperformance relative to International equity or is it more probable that there is a reversion and International equity outperforms? I would wager that a reversion is more probable. But since I do not, nor does anyone else, know, the prudent course is to stay with a diversified portfolio.

I hope this answers some questions on why it is important to stay diversified even if (especially if) we are in the middle of a year where it is tough to stay diversified. At The Trust Company, we count it a privilege to be a part of your financial journey. We look forward to continuing to help you meet your financial goals.

COMPANY NEWS

Toby Marks Joins TTC Investment Team as Vice President & Portfolio Manager

Toby joined The Trust Company's Investment Management team in July, after long and successful associations with American Century Investments, The Mutual Fund Store, and online advisory firm Financial Engines.

With a Master of Science degree in Industrial Engineering, he brings a unique perspective to the investment process. Toby's experience encompasses portfolio strategies, systems design, model construction and validation, data analytics and performance measurement. He is passionate about utilizing his technical expertise to create solutions for real-life problems.

"I am blessed to be able to work with fascinating problems and technology to help people achieve financial success and reach their long-term investment goals," he says.

Toby was born and raised in Manhattan, KS. He received both his master's degree and his Bachelor of Science in Industrial Engineering from Kansas State University. He married his high school sweetheart, Callie, and they have four active kids ranging in age from 9 to 17. Outside of work and school, life revolves around club soccer and basketball for the Marks family, keeping them busy year-round.

THE TRUST COMPANY

THETRUSTCO.COM
800.285.7878

INVESTMENT MANAGEMENT
FINANCIAL PLANNING
RETIREMENT PLANS
TRUST ADMINISTRATION

EST. T 1992