INVESTMENT REPORT

LYNCH FINANCIAL GROUP LLC
— Retirement Wealth Management —

July, 2018 www.LynchFinancialGroup.com

Investment Review and Outlook

Larger-cap US stocks gained 3.4%, but were outdone by smaller-cap stocks, which jumped 7.9%.

Developed international stocks fell 1.8% and European stocks declined 1.6% for the period, as the US dollar rebounded.

Emerging-market (EM) stocks fared the worst, dropping 9.6% in dollar terms.

For the year, the core bond index is down nearly 2% and floating-rate loans are up roughly 2%.

We welcome questions or comments regarding this newsletter at jlynch@lynchfinancialgroup.com. Lynch Financial Group provides Retirement Wealth Management Services to individuals within 15 years of retirement, retirees, and surviving spouses. We also provide specialized assistance to professionals, fiduciaries and heirs in wealth transfer situations.

Benchmark and Mutual Fund Performance

The box below contains benchmark (capital market and investment style) performance results. The performance results of our recommended mutual funds and their benchmarks are shown on page 5. It was a poor quarter for core bonds and stocks outside of the U.S. As a result, most client portfolios underperformed their benchmarks due to our underweighting in U.S. stocks.

Second Quarter 2018 Key Takeaways

US stocks rose to the top of asset class performance charts with solid returns in the second quarter. Larger-cap US stocks gained 3.4%, but were outdone by smaller-cap stocks, which jumped 7.9%. The smaller-cap outperformance was driven by the market narrative du jour that smaller companies are more domestically focused and therefore not as exposed to a strengthening US dollar or potential trade wars, both of which are assumed to be detrimental to larger-cap (multinational) company profits.

Developed international stocks fell 1.8% and European stocks declined 1.6% for the period, as the US dollar rebounded. Dollar appreciation can be a meaningful headwind to returns for dollar-based investors in foreign securities.

Emerging-market (EM) stocks fared the worst, dropping 9.6% in dollar terms. In addition to the currency effects, EM stocks were buffeted by trade tensions between the United States and nearly all its major trading partners. As we discuss this quarter, we remain confident in our modest overweight to EM stocks in our tactical portfolios.

Benchmark Returns (Periods Ended 6/30/18)

	Quarter	12 Months
Large-Cap Benchmarks		
Vanguard 500 Index	3.4%	14.2%
Russell 1000 Growth iShares	5.7%	22.3%
Russell 1000 Value iShares	1.1%	6.6%
Mid-Cap Benchmarks		
Russell Midcap iShares	2.8%	12.2%
Russell Midcap Growth iShares	3.1%	18.3%
Russell Midcap Value iShares	2.4%	7.4%
Small-Cap Benchmarks		
Russell 2000 iShares	7.7%	17.6%
Russell 2000 Growth iShares	7.2%	21.9%
Russell 2000 Value iShares	8.2%	13.0%
Other Benchmarks		
Vanguard Developed Mkts Idx	-1.6%	7.2%
Vanguard Emerging Markets	-9.1%	6.1%
Vanguard REIT Index	8.8%	2.1%
Vanguard Total Bond Mkt Index	-0.2%	-0.6%
Credit Suisse High Yield Index	1.1%	2.8%

Moving on to the bond markets, in May, the benchmark 10-year Treasury yield pierced the 3% level, hitting a seven-year high before falling back, ending the quarter higher by 11 basis points at 2.85%. The core bond index had a slightly negative return (bond yields move inversely to bond prices). Once again, floating-rate loan funds outperformed core bonds and generated positive returns, as they have every month this year. For the year, the core bond index is down nearly 2% and floating-rate loans are up roughly 2%.

With the US economy growing above trend and the labor market tight, the Fed continued its gradual path of tightening monetary policy. It raised interest rates again in June, but also forecasted a slightly accelerated path of hikes over the next two years. Whether the economy can withstand that degree of tightening remains to be seen.

Beyond the strength of the US economy, the global economy remains in pretty good shape, with real GDP growth expected to be above trend again this year. However, last year's highly synchronized growth has decelerated and may have peaked for this cycle.

Recent US dollar strength may continue for a while as currency momentum can take on a life of its own. But there are fundamental reasons to expect the dollar may weaken looking a bit further out: the prospect of a ballooning US federal budget deficit in the coming years, a large US trade deficit, the eventual convergence of central bank monetary policies, and the fact that the Trump administration seems to prefer a weaker dollar.

Market Recap

As we pause to reflect at the midpoint of the year, it seems so far 2018 has served as yet another reminder to investors that over the short term, markets are driven by innumerable and often random factors that are impossible to consistently predict. In the first quarter, US stocks experienced their first major losses since 2016 and a return to more "normal" market volatility. Many market prognosticators speculated that this could indeed be the end of the nearly decade-long US bull market.

Fast-forward through three more eventful months and this time around US stocks have been the net beneficiaries, gaining 3.4% on the back of a surging dollar while the rest of the world has slowed. The dollar's 5% appreciation translated into a meaningful return headwind for dollar-based investors in foreign securities as foreign currencies depreciated against the dollar. Developed international stocks fell 1.8% and European stocks declined 1.6% for the quarter. EM stocks fared the worst, dropping 9.6% in dollar terms.

In bond markets, the benchmark 10-year Treasury yield pierced the 3% level in May, hitting a seven-year high. Yields then fell back, ending the quarter at 2.85%, an 11-basis-point increase from the prior quarter-end. As such, the core investment-grade bond index had a slight loss for the quarter and remains in negative territory for the year to date.

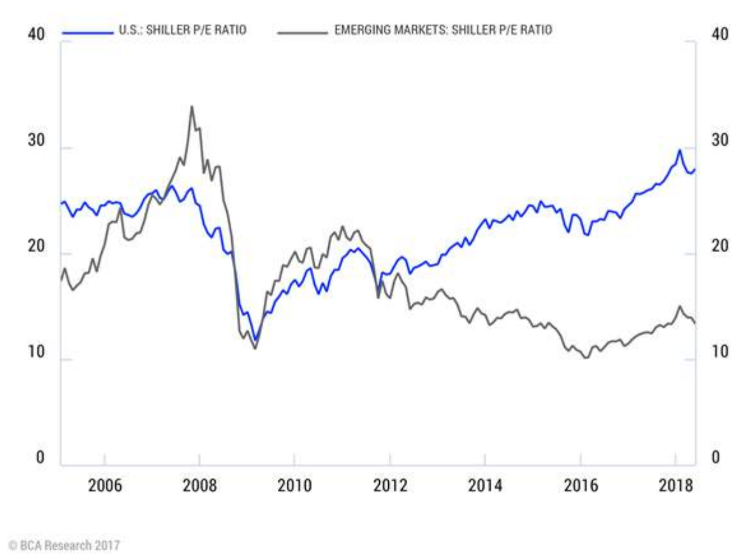
Portfolio Attribution

The selloff in EM stocks appears to have been driven by a combination of investor concerns about

- A potential trade war with China (and possibly other global trade partners such as the European Union, Mexico, and Canada);
- How EM economies will manage a deceleration in global growth outside the United States; and
- A stronger US dollar coinciding with rising US interest rates and tightening Fed monetary policy.

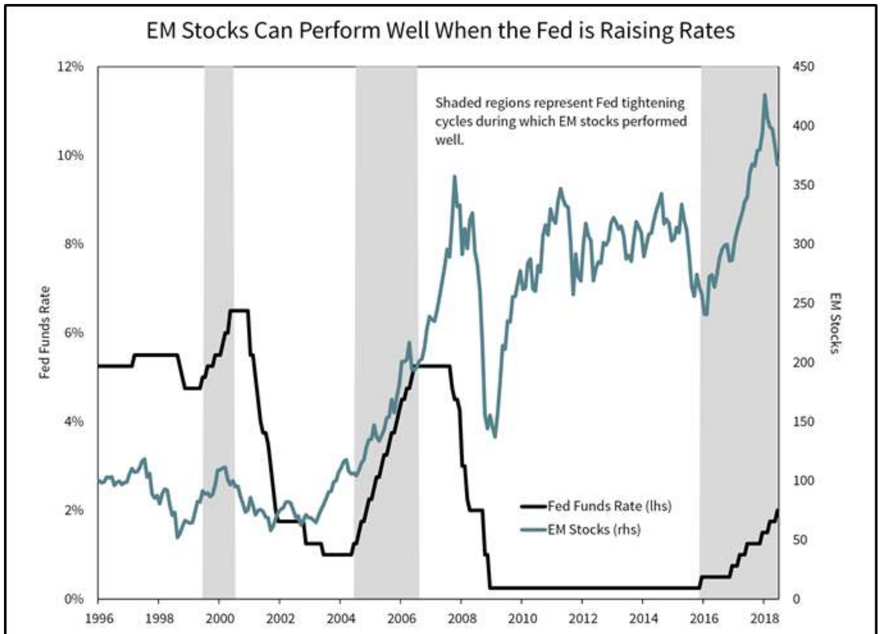
These macro developments, in particular the risk of a US trade war with

EM Stocks Are Cheap vs. US Stocks Based on Normalized Earnings



Source: BCA. As of 5/31/18.

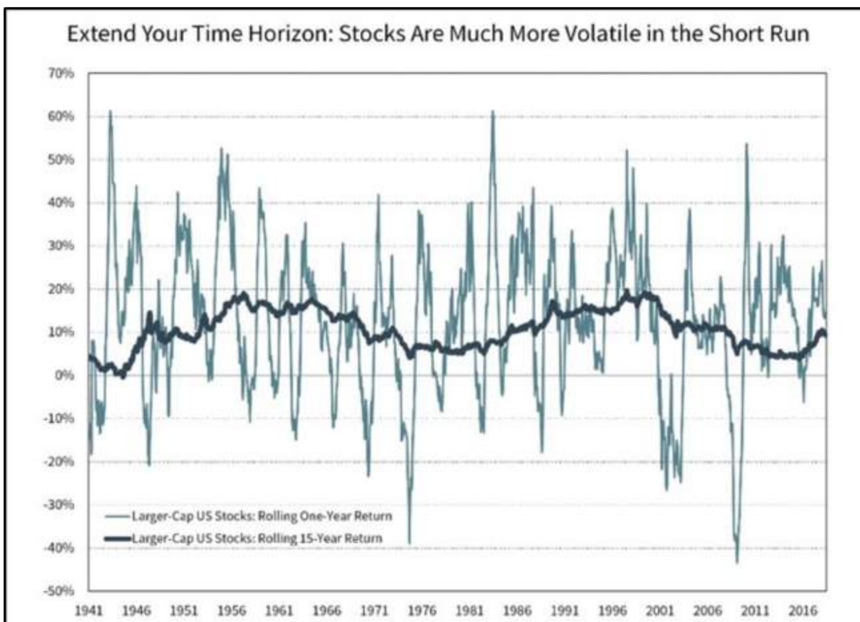
China and the rest of the world, are indeed risks to EM stocks, at least in the shorter term. However, these are not new risks, nor do we believe they overwhelm the attractive fundamentals, valuations, and potential longer-term returns of EM stocks. Based on our analysis, we find that emerging markets are fundamentally better placed today than in past cycles. The sector composition of EM indexes has changed meaningfully over the past decade, from traditional heavy-cyclical industries like materials and energy to more growth-oriented technology and consumer-driven sectors that are less sensitive to shifts in global growth. Evidence also suggests EM stocks do fine when interest rates in the United States are rising as long as global growth is solid (real GDP growth is expected to be above trend again this year). As to the underlying fiscal health of EM economies, emerging markets, in aggregate, have much better debt coverage than in the late 1990s/Asian crisis era. Additionally, most EM countries now have floating rather than dollar-pegged currencies, which should help release pressure in these economies and reduce the likelihood of a currency devaluation–driven crisis.



Source: Federal Reserve and Morningstar Direct. Data as of 6/30/18.

Concluding Comments

It is understandable that fears of a global trade war are rattling financial markets. The resolution of the current trade tensions is a meaningful uncertainty (a "known unknown"), with the potential to seriously disrupt the global economy at least over the shorter to medium term. (The potential for a positive surprise seems more limited, but also exists.) President Trump's unconventional negotiating approach adds an additional wildcard dimension. The process is likely prone to several more twists and turns before things become any clearer. (For a recent example: how many experts predicted the 180-degree flip this year in the relationship between President Trump and North Korea's dictator—from name-calling and nuclear threats to grinning BFFs?) The bottom line is that nobody knows how it will all play out.



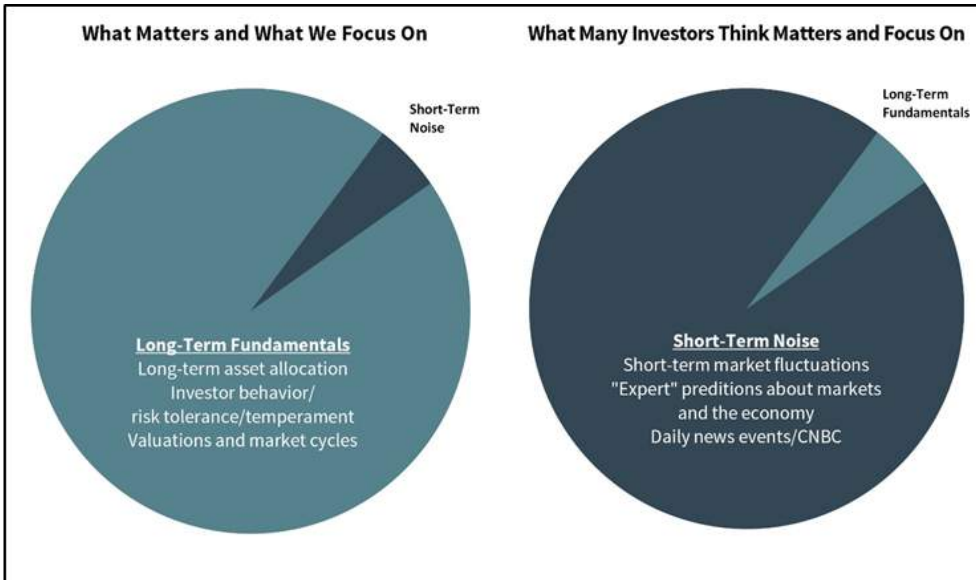
Source: Morningstar Direct. Data as of 6/30/18.

Therefore, we file this under the heading: "There are always risks and uncertainties when investing in equities that have the potential to cause significant shorter-term price declines." Whether it is a trade war, a geopolitical event, an unexpected economic shock, a monetary policy mistake, or innumerable other factors, stocks can deliver big losses, at least over shorter-term (one- to three-year) periods. Market corrections and bear markets happen. An investor must be able to withstand these drops, stay the course, and stick to their long-term plan (assuming it was well-designed and aligned with their financial objectives to begin with).

No one can consistently and accurately predict the timing, outcome, and market reactions of these types of macro/geopolitical uncertainties. A corollary, therefore, is that people who try to do so are very likely to detract more value than they add over time. They're more likely to get whipsawed by the daily news headlines and changing "expert" opinions amid market ups and downs. While they may feel better in the moment of their action, they end up with a worse outcome than if they had remained disciplined in their investment approach. We believe it is far better to stick with one's long-term strategic asset allocation (with disciplined rebalancing). Or, to only make portfolio changes away from your strategic allocation when you have high confidence (based on strong evidence and analysis) that you have an edge. This is possible if you understand what the market is discounting in current prices, why you think the market is wrong, and why the odds are stacked in your favor that you are likely to ultimately be proven right. Even then, of course, there is no guarantee you will be right every time. In fact, it is guaranteed you won't be right every time. That's why portfolio diversification, scenario analysis, and risk management are also critical elements.

As mentioned earlier, one of the key elements of the edge we think Lynch Financial Group has is "time arbitrage"—our willingness and ability to take a longer-term analytical view and maintain a longer-term investment horizon than other market participants. We don't have to respond to all the short-term market noise, and we don't play the short-term trading (guessing) game.

We borrowed the following visual representation from the "Behavioural Investment" blog, written by Joe Wiggins. It illustrates how what most investors spend time on doesn't really matter and can often cause them to act in ways detrimental to their long-term investment goals. We try to focus on the things that do matter most, such as asset allocation, investor behavior and risk tolerance, valuations, and market cycles.



Based on a concept by Joe Wiggins, featured in the "Behavioural Investment" blog.

Our globally diversified portfolios are positioned to perform well over the long term and to be resilient across a range of potential scenarios. Should the current trade tensions resolve, and the global economic recovery continue, we expect to generate good overall returns, with outperformance from our European and EM equities positions, active equity managers, and flexible bond funds. Alternatively, should a bear market strike, our portfolios have "dry powder" in the form of lower-risk fixed-income investments that should hold up much better than equities. We'd then expect to put this capital to work more aggressively by, for example, reallocating to US equities at lower prices and higher expected returns sufficient to compensate us for their risks.

As always, we thank you for your continued confidence and trust.

LFG Recommended Mutual Funds
Performance Results for Funds and Benchmarks

Fund Name[1]	Benchmark (BM)[2]	% Returns For The Periods Ended June 30, 2018 — 3 Months Fund	3 Months BM	12 Months Fund	12 Months BM	3 Yrs Annlzd Fund	3 Yrs Annlzd BM	5 Yrs Annlzd Fund	5 Yrs Annlzd BM
Baron Emerging Markets[3]	Vanguard Emerging Markets Index	-9.4	-9.1	+6.9	+6.1	+5.9	+3.4	+7.1	+4.1
Parametric Emerging Markets[3]	Vanguard Emerging Markets Index	-9.3	-9.1	+3.5	+6.1	+3.4	+3.4	+2.8	+4.1
Schwab Fundamental Emerg Mkts[3]	Vanguard Emerging Markets Index	-9.7	-9.1	+6.9	+6.1	+7.2	+3.4	NA	NA
Tweedy Browne Global Value	Vanguard Developed Markets Index	+2.4	-1.6	+5.2	+7.2	+5.9	+5.5	+6.4	+6.8
Artisan International	Vanguard Developed Markets Index	-2.6	-1.6	+7.2	+7.2	+2.3	+5.5	+5.4	+6.8
Litman Gregory Masters Select International	Vanguard Developed Markets Index	-0.4	-1.6	+6.0	+7.2	+1.0	+5.5	+4.4	+6.8
Harbor Capital Appreciation	Russell 1000 Growth iShares	+6.4	+5.7	+29.2	+22.3	+15.3	+14.8	+18.1	+16.1
Jensen	Russell 1000 Growth iShares	+4.9	+5.7	+15.2	+22.3	+14.1	+14.8	+14.2	+16.1
BBH Core Select	Vanguard 500 Index	+1.3	+3.4	+5.6	+14.2	+7.7	+11.8	+8.2	+13.3
Schwab Fundamental US Large Co[3]	Vanguard 500 Index	+3.3	+3.4	+12.7	+14.2	+10.2	+11.8	NA	NA
Dodge & Cox Stock	Russell 1000 Value iShares	+2.8	+1.1	+11.9	+6.6	+11.0	+8.1	+12.8	+10.1
Vanguard Windsor II	Russell 1000 Value iShares	+2.2	+1.1	+7.5	+6.6	+8.0	+8.1	+10.0	+10.1
FPA Crescent	60% Russell 2500 Index; 40% Vang Tot Bd	+0.3	+3.3	+4.2	+9.5	+5.8	+6.8	+6.9	+8.2
PIMCO All Asset	Barclays TIPS Bond iShares	-2.4	+0.8	+4.2	+2.0	+5.0	+1.8	+3.9	+1.6
PIMCO All Asset All Authority	50% S&P 500/50% Barclays TIPS Bond iShares	-3.2	+2.1	+2.1	+8.1	+3.1	+6.8	+1.4	+7.4
Westwood Income Opportunity[3]	25% S&P 500, 25% NAREIT All Equity, 25% Citigroup Treasury Bill 3 mo., 25% Citigroup Treasury 10 Yr	+0.7	+3.0	+3.2	+4.5	+4.6	+5.6	+5.3	+6.2
Osterweis Strategic Income	Vanguard Total Bond Index	+0.5	-0.2	+3.5	-0.6	+4.3	+1.6	+4.3	+2.1
Doubleline Total Return	Vanguard Total Bond Index	+0.4	-0.2	+1.1	-0.6	+2.3	+1.6	+3.0	+2.1
PIMCO Total Return	Vanguard Total Bond Index	-0.4	-0.2	-0.1	-0.6	+2.1	+1.6	+2.5	+2.1
Vanguard Intermed Tax-Exempt	Vanguard Total Bond Index	+0.8	-0.2	+1.0	-0.6	+2.4	+1.6	+3.1	+2.1
Loomis Sayles Bond	1/3 CSFB HY, 2/3 Vang Tot Bond	-0.7	+0.2	+0.9	+0.5	+3.4	+2.9	+3.5	+3.2

[1]Funds were selected using the LFG Proprietary Mutual Fund Rating System℠. This system is based on extensive research using both quantitative and qualitative factors. The system seeks to identify top funds in each asset class and investment style. LFG typically combines 8 to 10 funds in client investment portfolios.

[2]iShares exchange traded funds were used where available and respective Russell indices were used for the other periods.

[3]Funds which were not recommended for entire 5 year period.

The above table reflects past performance and should not be considered indicative of future results. The results contained in this schedule were obtained from sources we believe to be reliable. We cannot, however, guarantee the accuracy of this information.