Quadrant
A Quarterly Update

WINDHAVEN
INVESTMENT MANAGEMENT

Growth, Hikes and Tariffs
October 2018

Key Points:

1. Full speed ahead for the U.S. economy and the U.S. equity market

2. International developed and emerging markets in the slow lane

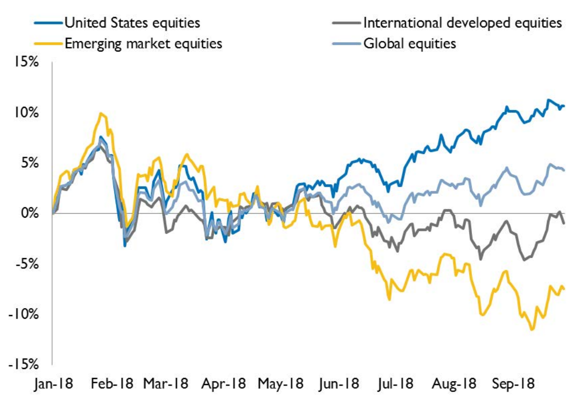
3. Fed interest rate hikes and tariff talks in focus for the fourth quarter

Divergence

This year's market narrative continues to be dominated by three themes: stronger economic conditions in the United States versus the rest of the world; the unwavering interest rate hiking path of the U.S. Federal Reserve (Fed), while monetary authorities in Europe and Japan are still injecting liquidity into their respective economies; and the escalation of trade wars across much of the global economy. In sum, the result can be described in one word: *divergence*.

This divergence, which became pronounced in equity markets during the summer (figure 1), is in stark contrast with the relatively synchronized returns earlier in the year. U.S. markets powered ahead at the end of the second quarter in wake of U.S. real GDP growth printing above 4%, while U.S. unemployment fell below 4%.[1] Conversely, international markets suffered under: the gravitational pull of their slowing economies, Fed monetary policy tightening and a strengthening dollar, idiosyncratic risk in some emerging markets (mainly Turkey and Argentina), and broader risks of escalating trade wars between the United States and China.

Fig 1: A Summer of Divergence



Source: Bloomberg as of 9/30/2018.Returns are represented by the MSCI Market Indexes.

Starting in the second quarter and continuing over the course of a divergent third quarter, our research process led us to shift towards U.S. equities and commodities, while moving away from international equities in our strategies.

Looking Ahead

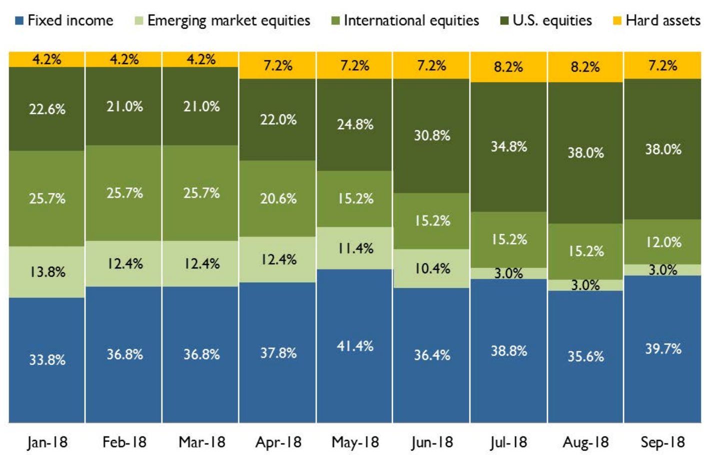
It is likely that the pace of economic growth, interest rate hikes, and tariffs will continue to shape the market narrative in the last quarter of 2018. However, while U.S. equity outperformance is very much supported by relatively strong global economic fundamentals, our research suggests that the rate of change is just as important as the level of health of economic conditions. Therefore, we continue to pay close attention to the evolution of fundamentals in a global economy which overall remains in expansion, but where the rate of improvement, or reversal of fundamentals, could result in a change in market behavior. This is similar to the rotation of 2017 when international equities and currencies dominated before U.S. equities, the U.S. dollar and commodities took over again towards the end of the year and into 2018.

As always, we maintain our discipline and continue to stay true to our research process, looking for opportunities across global markets which display good momentum and solid economic fundamentals, always while managing risk, with the goal of participating in growth and protecting when prudent.

Positioning

Over the course of the third quarter, adjustments to the strategies were relatively modest and largely consistent with the trend of the first two quarters of 2018. As shown in the model allocations for the Windhaven Diversified Growth Strategy in figure 2. We continued our shift away from weakening international and emerging markets equities in favor of equities from a resilient and still-growing United States. Across the three Windhaven Strategies, the overall allocation to equities fell slightly in the quarter, though it remains above the average of the past 16 years. With the proceeds from the equity reduction and a minor reduction in gold we purchased short and intermediate bond ETFs. Overall positioning remains bullish on U.S.-led global growth and cautious on fixed income as interest rates continue to rise; our focus is on shorter-term maturities with attractive yields. Led by oil, commodities have performed well and have been a beneficial holding. U.S. and international REITs remain challenged as interest rates continue to rise and have not been held since the first quarter of 2017, and we currently have a minimal allocation to gold.

Fig 2: Windhaven Diversified Growth Strategy
2018 Asset Allocations



Model allocations shown are as of the end of each month. Please see additional disclosures at the end of this document for more information.

We appreciate your investment in the Windhaven Strategies. Please contact your Investment Professional if your investment objectives or circumstances have changed such that a review of your Windhaven Strategy account(s) might be necessary, or if you have any specific questions about how your account is managed. We value the trust our clients have placed in us, and we are passionate about the Windhaven Strategies and the role they play in helping each of you reach your investment goals.

-The Windhaven Portfolio Management Team

[1]U.S. Real GDP Quarter over Quarter annualized. Bloomberg as of 6/30/2018.

Windhaven Diversified Growth Strategy Asset Allocation chartAllocations do not necessarily reflect our current investment views and should not be used as the basis for investment decisions. Holdings of individual client portfolios may differ, sometimes significantly, from those shown in the model allocation charts above. Asset classes and the proportional weightings in the strategies may change at any time without notice subject to the discretion of the Windhaven Portfolio Management Team. Cash positions whether in US dollars or other currency are included in the relevant fixed income section. Hard Assets are physical assets and include exposure to gold, commodities and energy.

Important Notes and Disclosures:
Portfolio Management for the Windhaven Strategies is provided by Windhaven Investment Management ("Windhaven"), a division of Charles Schwab Investment Advisory, Inc. ("CSIA"). CSIA is a registered investment adviser and an affiliate of Charles Schwab & Co, Inc. ("Schwab"). Both CSIA and Schwab are separate entities and subsidiaries of The Charles Schwab Corporation.

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Asset classes and the proportional weightings in the strategies may change at any time without notice subject to the discretion of the Windhaven Portfolio Management Team.

Indexes shown in the charts throughout are unmanaged, do not incur fees or expenses, and cannot be invested in directly.

Past performance is no guarantee of future results.

International investments may involve additional risks, which could include differences in financial accounting standards, currency fluctuations, political instability, foreign taxes and regulations, and the potential for illiquid markets. Investing in emerging markets may accentuate these risks.

Fixed income securities are subject to increased loss of principal during periods of rising interest rates. Fixed income investments are subject to various other risks including changes in credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications and other factors.

Hard assets can be significantly affected by commodity prices, world events, import controls, worldwide competition, government regulations, and economic conditions.

Windhaven's risk management process includes an effort to monitor and manage risk, but should not be confused with and does not imply low risk or the ability to control risk.

Please refer to the Windhaven Strategies Disclosure Brochure for additional information.

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