NOTTINGHAM ADVISORS
ASSET MANAGEMENT

Select Managers Program Mid-Year 2018 Review

2018 Mid-Year Market Recap

The U.S. economy continued to improve in July, with GDP expanding +4.1% in Q2, the fastest pace in nearly four years. Taken in *nominal terms*, GDP rose +7.4%! While *real* GDP came in at +4.1%, it missed market expectations for +4.4% growth; however, it was an improvement on the first quarter's +2.2% pace. One potential blemish from the report was a sharp uptick in exports, with a surge in soybean exports due to recently imposed tariffs. Consumer spending was robust, and business spending remained elevated. A change in private inventories was actually a negative contributor, which could in turn be a positive in Q3 as businesses restock.

Consumer sentiment remains robust, with the Conference Board index of consumer confidence rising to 127.4, from a revised 127.1 in July. The July non-farm payrolls report showed unemployment rising to 4% as more people entered the labor force. Average hourly earnings rose +2.7% Y/Y, which was a continuation of a trend towards higher wages. Personal Consumption Expenditures rose +0.4% M/M in June, with personal income also rising at a +0.4% M/M rate. All in all, the personal savings rate was unchanged at 6.8% in June.

U.S. equity markets posted positive returns in July, led by the benchmark S&P 500 Index, which gained +3.72% during the period. The benchmark Large-Cap index closed the month at 2816.29, a mere 56.58 points from a new all-time high. Small- and Mid-Caps were not far behind, with the S&P 600 and S&P 400 Indices returning +3.16% and +1.76%, respectively on the month. Through seven months of the year, Small-Caps remain the top performing slice of the U.S. equity market, up a stealthy +12.82% YTD. Smaller companies continue to benefit from a strengthening U.S. economy and reprieve from the global tariff overhang.

With earnings season well under way, 72% of companies have beaten revenue estimates and 81% have beaten profit estimates, according to Strategas (as of 7/30). From a sector standpoint, all 11 S&P sectors closed July in positive territory. Consumer Discretionary and Technology remain two of the top performers on the year, despite headwinds during Q2 earnings. Facebook stock plummeted after projecting slowing revenue growth and profit margins moving forward. Amazon reported an earnings surprise, even as its revenue missed analyst estimates. Netflix reported slower growth in new users, sending its stock price reeling. A broader measure of the above tech favorites (and some others) known as the NYSE FANG+ Index shed -4.42% in July. Perhaps the most exciting story of July was Apple's quest to become the first $1 Trillion company by market capitalization with a blowout quarter on the top and bottom lines.

International equities rebounded in July, with both Developed and Emerging Markets posting positive returns. Developed Markets, as measured by the MSCI EAFE Index, returned +2.48% on the month, and is now up a scant +0.02% YTD. Emerging Markets also fared well in July, with the

MSCI EM Index returning +2.28% during the period. Emerging Markets remain the year's worst performing global equity asset class, down -4.46% YTD.

Short term interest rates are likely to continue moving higher as the Federal Reserve remains on track to raise rates two more times in 2018. According to data compiled by Bloomberg, the probability of a September rate hike is all but certain at 92.1%, while December still looks highly likely at 55.7%. With the Treasury increasing debt issuance, faster economic growth, low unemployment, firming inflation, and the coming September 15th deadline for 2017 tax-year pension funding (which increases demand for long dated bonds), the flattening trend may lose steam. We will continue to monitor vigilantly.

After a +4.79% rise in Q2, the U.S. Dollar, as measured by the DXY Index lost -0.09% in July, bringing its year to date gain to +2.64%. The Dollar's strength continues to weigh on international currencies, as well as precious metals such as Gold. Real Estate as measured by the FTSE NAREIT All-REIT Index rose +0.6% on the month, marking the highest close of the year. Real Estate has rallied sharply, +11.0% off its February lows.

Select Managers Fund Level Performance

The Select Mangers Program has undergone a few changes since the start of the year. With strategies now offered via *Model Delivery* through LPL, we will no longer be able to publish *composite* level performance for each strategy; however, we may be able to provide model performance where applicable.

With that being said, we will continue to report on how our active manager selections are performing versus their respective benchmarks, and how each active manager contributes to the overall risk/return framework of each strategy. Below are a few highlights of "Core" portfolio holdings through June 30.

Fund Highlights

On May 23rd Morningstar upgraded the 4-Star MFS Value fund from an Analyst Rating of Bronze to Gold. The upgrade highlights "increased confidence in MFS Value's established team and disciplined approach" according to Morningstar analyst Andrew Daniels. Among other criteria for a Gold rating, funds must rate highly on Morningstar's 5 Pillars: namely People, Process, Price, Parent, and Performance, all areas that MFS Value earns a Positive pillar rating.

From a factor standpoint, MFS Value strategically tilts each portfolio towards high quality value focused stocks with high returns on equity (ROE) and free cash flow (FCF). Both ROE and FCF help the fund focus on quality companies and a reasonable price, emphasizing stability and diversification, all while keeping turnover to a minimum (5-Year average turnover has been only 13%). While Value has been out of favor for the past decade, the Select Managers strategies have recently increased exposure to the Value factor, expecting Value to return to favor as interest rates rise and investors pay increased attention to both valuation and fundamentals.

Additionally, the Select Managers program emphasizes Quality as a factor through the Jensen Quality Growth Fund (ticker: JENSX). The fund is 4-Star Morningstar rated and carries an Analyst Rating of Silver, stemming from its keep focus on high quality (as defined by an ROE of 15% or more for each of the past 10 calendar years). The fund holds a concentrated portfolio of 25-30 names. Less than 250 companies meet Jensen's screen for inclusion in the Jensen Quality Universe of eligible stocks. From there, managers evaluate margin strength and consistency, growth potential, and overall financial health, before conducting further FCF due diligence and modelling. During the first six-months of the year the Jensen Quality Growth Fund returned +4.66%, *outperforming* the S&P 500's +2.65% return by more than +200bps.

Taken together, Select Managers strategies focus explicitly on Quality and Value factors that reduce volatility and can help mitigate risk in tumultuous periods. We continue to believe these factors will outperform in the years ahead, and offer a smoother ride for investors to achieve their long term goals and objectives.

From an international standpoint, manager performance was a mixed bag. Long a core staple, the Dodge & Cox International Fund (ticker: DODFX) returned -7.15% during the first half of the year, compared with the MSCI ACWI ex. USA benchmark's return of -3.48%. Much of the underperformance centers around Emerging Markets, which represents nearly 25% of the fund's holdings. Many of these EM Value stocks can be found in countries such as Brazil, Mexico, Thailand, and Turkey, which represent a sliver of the broad MSCI EM benchmark. Additional EM holdings can be found in China, India, and South Korea, which are much larger benchmark weights, and in Value oriented sectors such as Financials, Healthcare, and Consumer Discretionary. Taken together, Dodge & Cox's EM holdings returned -11% during the period, worse than the MSCI EM benchmark's -6.56% return.

While Dodge & Cox's Value oriented holdings underperformed, our dedicated Emerging Markets fund, the Oppenheimer Developing Markets Fund (ticker: ODMAX) continued to perform strongly. For the period, the Fund returned -1.29%, which was significantly better than the MSCI EM benchmark's -6.56% return. The more than +500bps of outperformance can be partially attributed to the Fund's positioning in Growth sectors such as Technology, and by avoiding countries such as China which have suffered from poor performance due to trade and tariff fears.

From a fixed income standpoint, all three core funds outperformed the broader Bloomberg Barclays Aggregate Bond index during the period. The Met West Total Return Fund (ticker: MWTIX), DoubleLine Total Return Fund (ticker: DBLTX) and Dodge & Cox Income Fund (ticker: DODIX) returned -1.39%, -0.17%, and -1.23% during the period, versus a -1.62% return for the benchmark. Our overall core fixed income positioning again emphasizes Quality as measured by a focus on investment grade credits and U.S. Treasury securities, eschewing the more richly valued High Yield and lower rated areas of the bond universe.

Fund Changes

We are happy to announce that all ***fund level*** transitions are now complete across all 11 Select Managers strategies (taxable and tax exempt). With the help of LPL we have been able to perform a number of share class conversions over the past few months that have ***significantly*** lowered the underlying expense ratio of each Select Managers portfolio strategy. In most cases we are now able to access institutional share classes which are typically the lowest cost share classes available. In other cases we were still able to improve on cost by moving to a lower-cost share class. As a reminder, share class conversations are operational – moving from one share class to another – and the client does not incur capital gains. The below table highlights changes that have been made.

Name	Old Ticker	New Ticker	Share Class Conversion	Buy/Sell Transaction	Expense Ratio Savings
MFS Value	MEIAX	MEIIX	X		0.25%
JP Morgan Disciplined Equity	JPIEX	JDESX	X		0.10%
Vanguard Equity Income	VEIPX	VEIRX	X		0.09%
Met West Total Return	MWTRX	MWTIX	X		0.23%
DoubleLine Total Return	DLTNX	DBLTX	X		0.25%
Wells Fargo ST Muni	WSMAX	WSBIX	X		0.23%
Vanguard LT Tax Exempt	VWLTX	VWLUX	X		0.10%
Lord Abbett Bond Debenture	LBNDX	LBNYX		X	0.20%

Additionally, we have made three model changes that impact most strategies. Matthews Emerging Asia was removed from the Select Managers program and the Baron Emerging Markets fund was added. This was a dollar for dollar swap and introduces a 5-Star Morningstar rated Emerging Markets fund that ranks in the top decile of its category through the end of May. Manager Michael Kass favors Growth oriented stocks and isn't afraid to hold Small- and Mid-Cap stocks, which comprised more than 20% of the fund's holdings as of the end of Q1. We also removed the Vanguard Dividend Growth fund in favor of the Vanguard Dividend Appreciation fund. While the names sound familiar, the underlying methodology is different. Namely, the Dividend Appreciation fund is a passively managed fund that tracks the Nasdaq U.S. Dividend Achievers Select Index, which includes companies that have boosted their dividend for 10 or more years in a row. Additional screens on dividend sustainability filter out companies that lack adequate profitability or coverage ratios. The end result is a fund tilted towards high quality companies with durable competitive advantages. Apple is notably absent, having only recently initiated a dividend, and therefore is ineligible for index inclusion. Lastly, the T. Rowe Price Int'l Discovery fund closed to new investors, and we've replaced it with the Fidelity Int'l Small Cap Fund, which has perennially been a strong performer in the less efficient international small-cap arena.

Old Fund Name	Old Fund Ticker	New Fund Name	New Fund Ticker	Expense Ratio Savings
Matthews Emerging Asia	MIASX	Baron Emerging Markets	BEXIX	0.12%
T. Rowe Price Int'l Discovery	PRIDX	Fidelity Int'l Small Cap	FIXIX	-0.08%
Vanguard Dividend Growth	VDIGX	Vanguard Dividend Appreciation	VDADX	0.18%

Consider Active Management

Looking to the rest of 2018 and beyond, it is important to recognize themes and market inflection points that may lead active management to outperform. Active strategies may continue to benefit from the following investment themes:

- Increased equity market volatility or a significant drawdown
- Rising global inflation
- Rising interest rate environment
- Secular, long-term investment themes
- Tax reform & Trade/Tariff "winners" and "losers"
- Dislocation between high-flying U.S. ("FANG") and EM Technology stocks

Moreover, active management in the alternative investment space is well suited to diversify risk in the event some or all of the above bullet points come to fruition. The Select Managers program currently incorporates two distinct alternative strategies into each asset allocation portfolio: **Merger Arbitrage** and **Market Neutral**. Both of these strategies should benefit from rising interest rates and increased volatility, two characteristics that can be detrimental to traditional equity or fixed income asset classes, but are beneficial to a global multi-asset class portfolio and well suited for active management.

Select Managers Transition to LPL

With the LPL transition well under way, the NASMP strategies are now available via *Model Delivery* on the Manager Select platform. While there are operational changes to how these strategies can be offered to clients, the access to Nottingham's Portfolio Managers, proposal generating process, transition analysis, or market commentary has not. Key differences include a new minimum account size ($50,000 vs. $25,000 prior) and the lack of customization (no longer able to hold non-model securities). For those interested in customization, it is still available with our ETF strategies.

As we continue to analyze, monitor, and re-evaluate all of the holdings in the Select Manager program we will be sure to keep you updated on future strategy changes. Please do not hesitate to contact our office to discuss strategy specific performance, portfolio positioning, or our investment outlook.

I look forward to speaking with you soon.

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