

Quarterly Markets Review

Q3

THIRD QUARTER 2018

Markets Update: A Quarter in Review

THIRD QUARTER 2018

Uncertainty surrounding global trade continued to dominate headlines in capital markets. Trade tensions escalated when the Trump Administration imposed a 10% tariff on \$200 billion of Chinese goods. China immediately responded by increasing tariffs on \$60 billion worth of U.S. goods. For now, the good news is the stock markets were relieved the number of tariffs imposed were less than anticipated. Investors are hoping these actions are a negotiation ploy versus an intention to start a full-blown trade war. We cannot predict when or if the trade issues will get resolved, but we hope to see cooler heads prevail with a trade agreement that satisfies both sides.

BONDS

Fixed income market returns remained muted despite interest rates rising. U.S. bonds earned 0.02% and municipal bonds were flat. As expected, the Federal Reserve raised interest rates by 25bps in September, taking the federal funds rate to 2.25%. The central bank continues to methodically raise interest rates back to normal levels given ongoing positive economic data and moderate levels of inflation. Federal Reserve Chairman Jerome Powell said, "This gradual return to normal is helping to sustain this strong economy." The central bank

reiterated their plan to raise rates one more time in December and at least three more times in 2019. As interest rates normalize, we expect volatility to pick up. We remain conservatively positioned by owning investment grade bonds with less interest rate sensitivity.

STOCKS

Global equity markets steered past difficult trade talks to post a strong return of 4.3%. Much of the returns can be attributed to U.S. stocks, which earned 7.1%. A solid economy, corporate tax cuts, strong earnings, and renewed consumer confidence helped propel stocks to record highs. International stocks had a modest return of 1.3% as investors wrestled with Brexit-related fallout, political elections, and a drop in global demand due to trade issues. Economic growth in the first half of the year did moderate, but recent data has improved, and earnings growth is back on a positive trajectory. Emerging market stocks continued to struggle, returning -1.1%. A stronger U.S. Dollar and escalating trade tensions caused emerging markets to have some volatility. Despite the short-term issues, emerging market companies are expected to grow their earnings by ~16%.

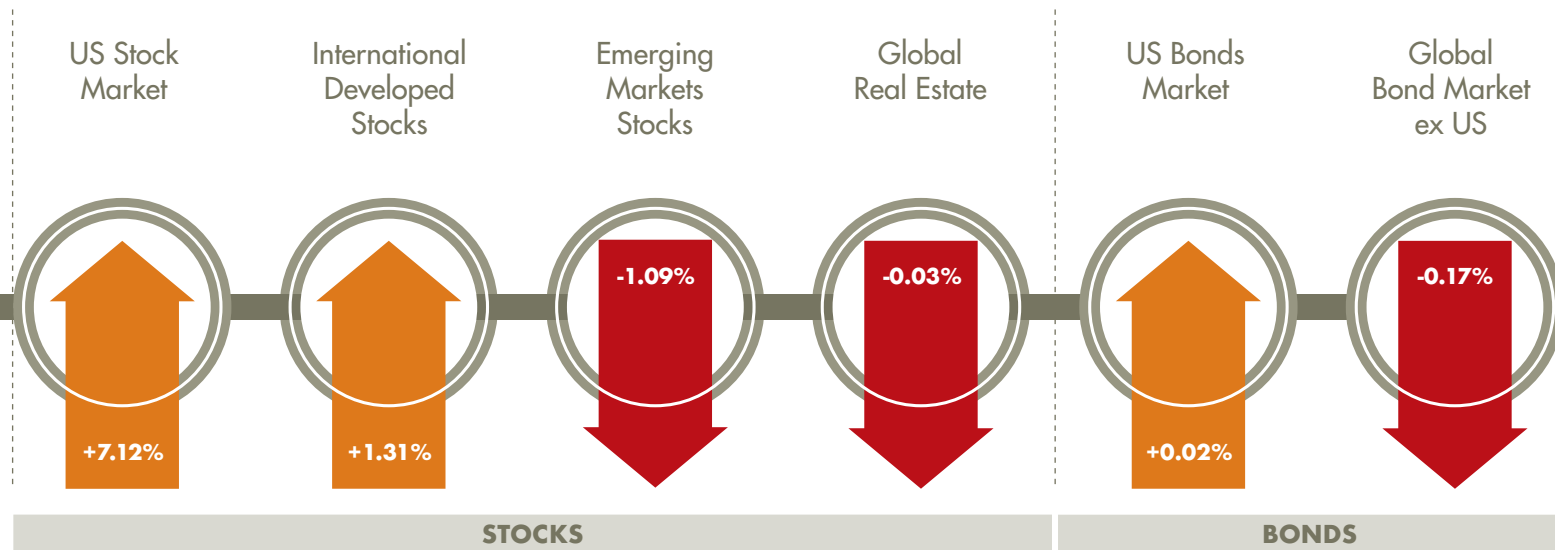
Negative sentiment around international stocks has overshadowed positive developments. There is a saying that fundamentals may not win every battle, but they do tend to win the war. We remain positive on international stocks over the long-run because of their attractive valuations and fundamentals.

ECONOMY

The U.S. economy continues to show strength as it enters the 10th year of economic expansion, making it the second longest expansion since the Civil War. The longest economic expansion we have had is the expansion in the 2000s, which lasted 120 months. The biggest risks that could derail economic expansion is a trade war or a sudden spike in interest rates. The current unemployment rate is near record lows, inflation measures are contained with no signs of significant acceleration, and the leading economic indicators we follow indicate no immediate risk of recession. Some investors are worried about another 2008 type recession to hit, but many economists believe the next recession will be smaller in scale. The economy has gotten more stable and there are no visible excesses in the economy.

Markets Summary: Third Quarter 2018 Index Returns

THIRD QUARTER 2018



Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.
 Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]). S&P data © 2018 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2018, all rights reserved. Bloomberg Barclays data provided by Bloomberg. FTSE fixed income © 2018 FTSE Fixed Income LLC, all rights reserved.

Timeline of Events: A Quarter in Review

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MSCI All Country World Index with selected headlines from Q3 2018



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news. Graph Source: MSCI ACWI Index [net div.]. MSCI data © MSCI 2018, all rights reserved. It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

Beyond the Quarter: Survey of Long Term Performance

AS OF SEPTEMBER 30, 2018

INDEX	5 Years %	10 Years %	20 Years %	Since Inception %	Inception Date
Global Stocks					
MSCI All Country World Index (gross div.)	9.25	8.77	6.76	7.99	JANUARY 1988
US Stocks					
Russell 3000 Index	13.46	12.01	7.82	12.00	JANUARY 1979
International Stocks					
MSCI World ex USA Index (gross div.)	4.60	5.67	6.26	6.10	JANUARY 1970
MSCI Emerging Markets Index (gross div.)	3.99	5.76	10.17	10.79	JANUARY 1988
Global Real Estate Investment Trust Stocks					
S&P Global REIT Index (gross div.)	7.49	7.07	9.53	8.80	JULY 1989
Bonds					
Bloomberg Barclays U.S. Aggregate Bond Index	2.16	3.77	4.48	7.28	MAY 1986
Bloomberg Barclays Global Aggregate Bond Index (hedged to USD)	3.13	4.07	4.48	5.86	JANUARY 1990
Inflation					
US Consumer Price Index*	1.52	1.42	2.19	2.90	JANUARY 1926

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*Returns are through August 2018. Market segment (index representation) as follows: Global Stocks (MSCI All Country World Index), US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [gross div.]), Emerging Markets (MSCI Emerging Markets Index [gross div.]), Global Real Estate (S&P Global REIT Index), US Intermediate Bonds (Bloomberg Barclays U.S. Aggregate Bond Index), and Global Bonds (Bloomberg Barclays Global Aggregate Bond Index [hedged]). Russell data © Russell Investment Group 1995–2015, all rights reserved. MSCI data copyright MSCI 2015, all rights reserved. Barclays data provided by Barclays Bank PLC. BofA Merrill Lynch data provided by Bank of America Corp, all rights reserved © 2015.

The Tao of Wealth Management

THIRD QUARTER 2018

The path to success in many areas of life is paved with continual hard work, intense activity, and a day-to-day focus on results. However, for many investors who adopt this approach to managing their wealth, that can be turned upside down.

The Chinese philosophy of Taoism has a phrase for this: “wei wu-wei.” In English, this translates as “do without doing.” It means that in some areas of life, such as investing, greater activity does not necessarily translate into better results.

In Taoism, students are taught to let go of things they cannot control. To use an analogy, when you plant a tree, you choose a sunny spot with good soil and water. Apart from regular pruning, you let the tree grow.

This doesn’t mean that we should always do nothing. In fact, insights from financial science suggest you should direct your investment efforts to the things you can control. These include taking account of your own preferences and sensitivities when choosing investment strategies, diversifying your allocation to moderate the ups and downs, being mindful of the impact of fees,

and exercising discipline when emotions threaten to blow you off course.

Successful investing requires taking actions that can have a positive impact on the outcome. For instance, to maintain their desired asset allocation, investors should regularly rebalance their portfolio by reallocating money away from strongly performing assets.

But rebalancing is a disciplined, premeditated activity based on each person’s circumstances. It contrasts with the “busyness” of reflexively following investment trends and chasing past returns promoted through financial media. Look at the person who fitfully watches business TV or who sits up at night researching stock tips. That sort of activity is likely counter-productive and can add cost without any associated benefit. With investing, constantly tinkering with an allocation does not perfectly correlate with success.

Now, while that makes sense, many people struggle to apply those principles because the media tends to look at investing through a different lens, focusing on today’s news, which is already priced in, or on speculating about tomorrow. Guesswork can surely be

interesting. But is it relevant to your long-term plan? Probably not.

People caught up in the day-to-day may constantly switch money managers based on past performance or attempt tactical changes in their allocation or respond in a knee-jerk way to news events that turn out to be noise.

Again, the assumption underlying these approaches is that if you put more effort into the external factors and adjust your position constantly, you will get better results. Unfortunately, people may end up earning poorer long-term returns from trading too much, chasing past performers, or attempting to time the market. Ultimately, that’s just another reminder of the potential benefits available to disciplined investors who stay focused on what they can control.

As the ancient Chinese proverb says: “By letting it go, it all gets done. The world is won by those who let it go. But when you try and try, the world is beyond the winning.”

Past performance is no guarantee of future results. There is no guarantee an investing strategy will be successful. Diversification does not eliminate the risk of market loss.

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Waypoint Wealth Partners

SAN FRANCISCO OFFICE
595 Market Street Suite 2550
San Francisco, CA 94105

T 877.768.4802

WALNUT CREEK OFFICE
1255 Treat Blvd Suite 300
Walnut Creek, CA 94597

T 877.768.4802