F.L.PUTNAM
INVESTMENT MANAGEMENT COMPANY

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QUARTERLY REVIEW

PAGE

US EQUITY MARKETS UPDATE

In the third quarter, the overall trend was…more of the same. US equity markets largely overlooked global flash points such as the escalating Chinese trade war, the renegotiation of NAFTA (which looked unlikely all quarter until a last-minute deal), political tensions with Russia, and the ongoing Russiagate investigations in Washington – and continued to climb. In August, the S&P 500 once again broke the all-time high set back in January and continued to rise, finishing up 8% for the quarter. The S&P 500 is now up 11% year-to-date.

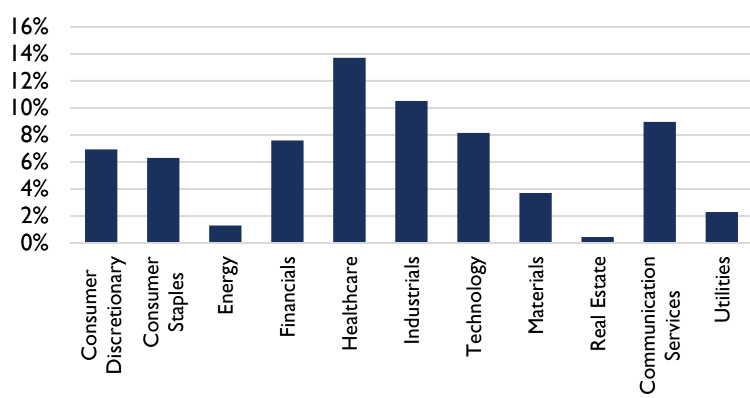
Market volatility, for its part, continued to decline and is once again nearing all-time lows set in 2017.

Over the last two years, the performance difference between Growth and Value styles has moved to an extreme, and this trend continued during the quarter. Value increased its underperformance of Growth by 2% for the quarter and has now underperformed Growth by 11% this year. Large cap stocks did outperform small and midcap stocks this quarter, although small caps continue to outperform year-to-date, thanks to their dominating second quarter returns.

Healthcare and Industrials drove S&P 500 returns this quarter, with Technology stumbling a bit due to weakness from heretofore dominant names such as Facebook. The social media giant suffered a stunning 20% drop in July after it posted slower than expected user growth from recent scandals involving censorship, and an announcement that the government would be taking a closer look at its operations. Buzz in the beltway is also heating up on potential antitrust action by the administration against the likes of Facebook, Amazon, and Google, although concrete actions have yet to materialize. Large returns in Healthcare were seen by old pharma bellwethers such as Eli Lilly and Pfizer, up 24% and 21%, respectively. Pfizer gained on a solid earnings report, while Lilly gained on the announcement it would be spinning off its veterinary product division. It is interesting to note that although Growth outperformed Value, the best performing sector happened to be Healthcare, which is typically viewed as a defensive or more value oriented sector. While this could be a preliminary sign of market rotation out of Growth, it is still too early to tell.

With the price of crude oil falling during the quarter and interest rates resuming their upward climb, it is not surprising that the weakest returns were seen in the Energy and Real Estate sectors. Energy gained just +1.3%, while Real Estate eked out a meager +0.44% positive return.

Q3 Returns by Sector

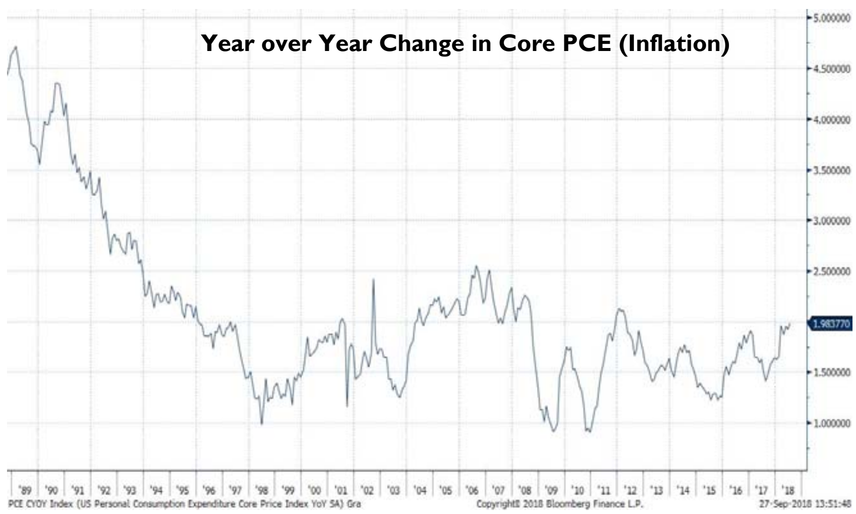


Although the bull market is certainly getting longer in the tooth, and there were some faint signs of possible market rotation this quarter, we still fail to see any overt evidence that the current trend is breaking. Earnings reports for the last quarter were quite good overall, with average S&P earnings growing 25% and revenue climbing 9% year over year. Interbank lending markets remain stable and credit spreads remain tight. We remain cautiously optimistic on U.S. equity markets, and particularly on shares issued by small and mid-size companies.

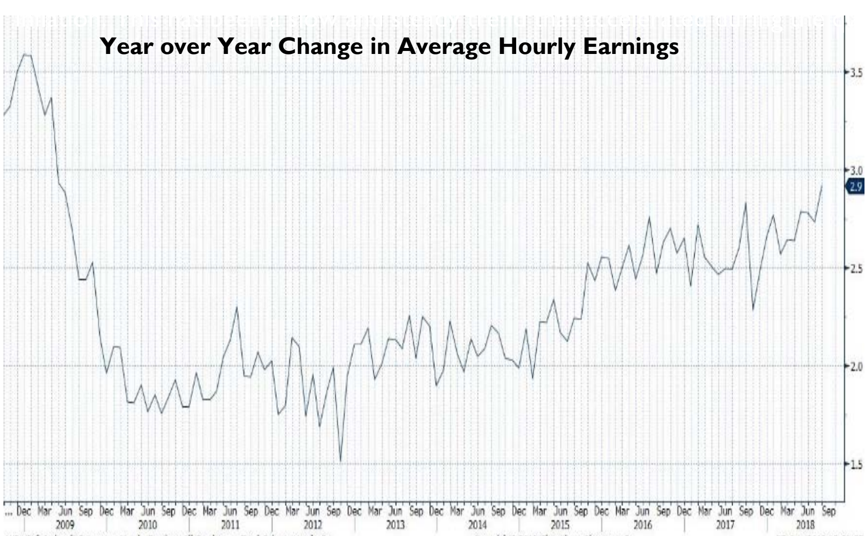
Interest rates rose slightly in the third quarter of 2018, with the benchmark 10-year treasury yield increasing from 2.86% to 3.06%. Most of the advance in yields came in the month leading up to the widely anticipated Federal Reserve Open Market Committee (FOMC) meeting on September 26th. As expected, the Federal Reserve ("the Fed") increased short-term interest rates for the third time this year at that meeting and set expectations for an additional increase later this year. While the Fed has maintained a slow and steady pace of interest rate increases, this latest round brought some notable changes.

Throughout the eight interest rate increases in recent years, the Fed has consistently referred to interest rates as "accommodative," meaning they are low enough to encourage borrowing and economic growth. This phrase was removed in the latest announcement as the Fed acknowledged that interest rates are approaching the so-called "natural rate of interest" that neither stimulates nor restrains the economy. In our last quarterly review, we discussed the significant "flattening" of the yield curve where short-term interest rates have risen close to long-term interest rates. This market signal is consistent with the Fed's conclusion that interest rates are approaching a neutral level, although there is also significant uncertainty in estimating the neutral interest rate.

There is still limited pressure on the Fed to move beyond the neutral rate as it seems to have achieved its dual mandate of full employment and price stability for the moment. While inflation remains in line with the Fed's somewhat arbitrary 2% target, it also remains relatively subdued by historical standards as shown in the chart of inflation at right using the Fed's preferred measure (the Year over Year change in the Seasonally Adjusted Core Personal Consumption Expenditure Index) over the past 30 years. That being said, the Fed Funds rate is now higher than the prevailing inflation rate, which has caused trouble for financial markets in the past. We expect market volatility to pick up again in coming quarters as interest rates continue to rise.



Current Fed projections call for continued steady increases in interest rates over the next 12-18 months to levels that can be expected to restrain economic growth, but the Fed is not operating in isolation and has a challenging route to navigate. Rising trade disputes, waning fiscal stimulus, and volatility in emerging markets if rising rates drive the dollar higher, could all alter the path of interest rate increases. In addition, while it has been a frustratingly long wait, it seems likely that at some point low unemployment will result in rising wages and inflation. This has been a slow and steady trend that accelerated during the quarter as depicted in the chart at left, which could pressure the Fed to continue raising short term interest rates.



We continue to maintain a defensive position with some cash on the sidelines and shorter maturities in bond portfolios in expectation that interest rates will continue to rise for now. We also continue to maintain an overweight position in credit markets, and particularly in investment grade corporate bonds. While the treasury markets continue to exhibit all of the typical signs of the later stages of the economic cycle, credit markets show no sign of faltering as of yet. We believe this combination of limited interest rate risk and carefully selected credit risk positions the portfolios well in the current economic environment, but we are mindful of the risks of unexpected shifts in interest rates that have increased this quarter. From a longer-term perspective, we will eventually need to reverse this positioning before the Fed "takes the punch bowl away from the party" and raises interest rates high enough to restrain economic growth. While they have certainly not arrived at that moment yet, they seem to have stopped refilling the punch bowl and it's getting late.

A tough year for international markets

Despite their strong performance in 2017 and the bright economic and corporate earnings outlook heading into 2018, international markets disappointed this year. The twin effects of unusually strong stimulus follow-through from 2017 US tax cuts and regulatory reforms on US growth and negative impact of US-initiated trade tensions on non-US global markets resulted in dramatic earnings growth divergence between US and international markets. Even though developed non-US economies continued to recover under accommodative monetary regimes, Europe was challenged by concerns over the UK's exit from the Eurozone (or Brexit), Italian fiscal deficits, and even consequences from extreme weather events. Japan in the meantime not only suffered through a series of natural disasters but bore the brunt of the risks arising from US-North Korea antagonism and US-China trade conflict.

In addition, international currencies bore the consequences of US interest rate normalization. Being at an earlier stage of economic recovery and thereby forestalled from raising interest rates commensurately, many non-US economic regimes, including the Eurozone and Japan, saw their currencies weaken relative to the US dollar. Emerging market economies, particularly those with large US dollar-denominated debt such as Turkey, Argentina and South Africa fared the worst, suffering notable currency devaluations. While weaker currencies help to buoy exports and are a boon to heavily export-dependent economies such as Japan, depreciating foreign currencies work to the disadvantage of unhedged US dollar investors.

All in all, 2018 has been a tough year for international markets. Year-to-date, even after a recent recovery in the Japanese market, performance in developed international markets as represented by MSCI EAFE index is flat while emerging markets are down over 9.0%.

Uncertainties remain but valuations are starting to look attractive

The economic and corporate earnings growth divergence between the US and international markets should eventually narrow, in our opinion. To the degree that international market performance will hinge on relative interest rate and currency movements, we believe these macroeconomic factors will eventually work to international markets' favor. The US dollar strength that has prevailed over the first half of this year will eventually recede as the Fed's rate rise trajectory slows once interest rates reach levels where they are likely to restrict economic growth. This, together with longer-term concerns over US' twin fiscal and trade deficits, should help dampen US dollar strength. Conversely, as Europe scales back its quantitative easing at year-end and starts to tighten monetary policy by the middle of 2019, some of the pressure on the euro should also lift.

Over the near-term, however, international markets will likely continue to be challenged by global trade uncertainties, particularly between the US and China, and idiosyncratic political and fiscal issues. Even though Japan has shown definitive signs of economic re-acceleration and its financial markets have rebounded recently, Europe still faces Brexit concerns and fiscal challenges among some of its members, both of which pose currency risks.

Whether the catalyst to invest more heavily in international equities is the US dollar or interest rates, trade conflict resolution, or stabilization of regional fiscal or political issues, valuations in international markets are starting to look intriguing. As chart 1 below shows, based on current downwardly revised estimates, international developed markets as represented by MSCI EAFE (MXEA) now trade at 14.3x 2019 earnings. This valuation was last seen in the middle of 2015 during the Greek debt crisis. Emerging markets as represented by the MSCI Emerging Markets Index (MXEF) trades at 12.1x, a level that last prevailed in 2016 when the Chinese yuan saw a double-digit devaluation. As is evident in chart 2, the MXEA now trades at approximately a 20% discount to the S&P 500 and MXEF at 33% discount. While there could certainly be further downside in emerging markets, particularly if a protracted trade war between the US and China were to ensue, developed international markets are starting to look interesting and we would likely become more bullish if some of the above-mentioned uncertainties lift.

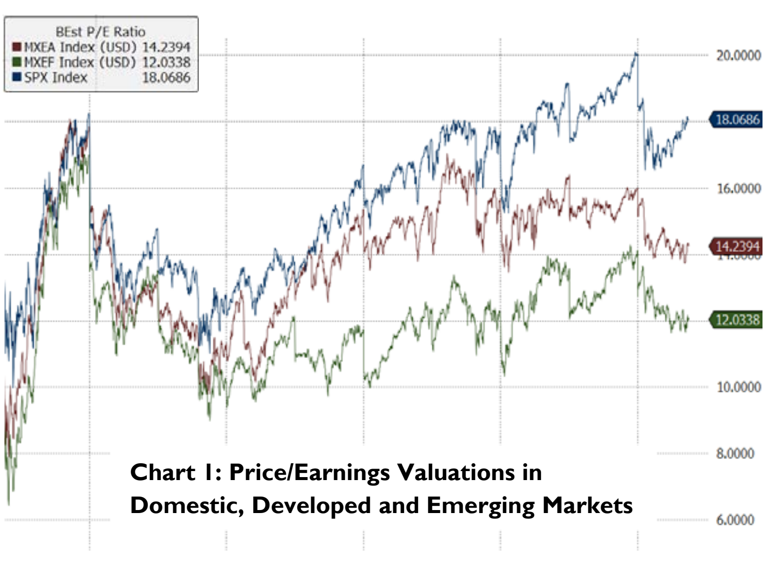


Chart 1: Price/Earnings Valuations in Domestic, Developed and Emerging Markets

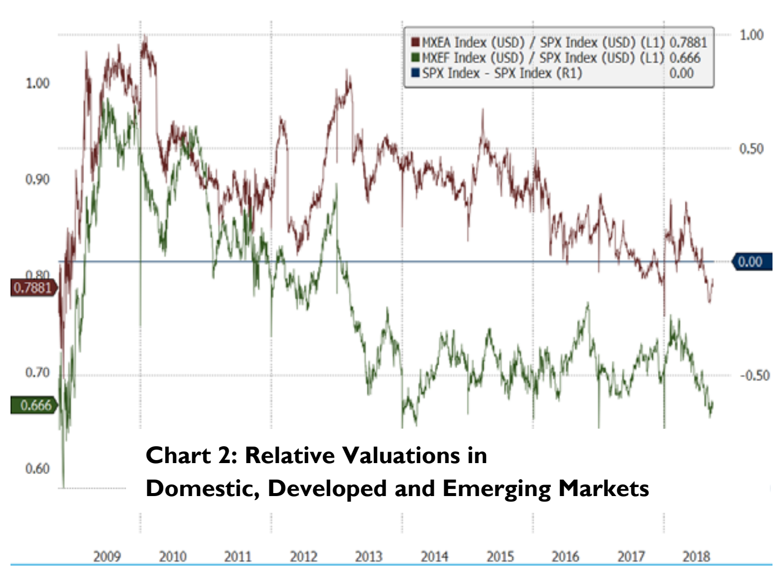


Chart 2: Relative Valuations in Domestic, Developed and Emerging Markets

ASSET ALLOCATION UPDATE

The Asset Allocation Committee at F.L.Putnam meets every two weeks to discuss and debate big picture investment issues. We examine long-term trends and data that have taken shape over the course of a decade. With that lens in place, current trends and data look very strong. A decade removed from the depth of the financial crisis the global economy is growing, corporate earnings are positive, and US equity markets are routinely making record highs. It has been a durable and robust recovery. As much as it is our goal to capture opportunities in this environment, it is equally important that we manage the risks. The Committee's focus during the third quarter was on reducing risk in both the equity and fixed income portfolios.

On the equity side of the ledger, the committee reduced targeted exposure to non-US stocks as trade disputes, currency volatility and politics increased risk. The Emerging Markets target was eliminated as slowing growth and currency weakness weighed on returns. As discussed in our international equity markets update on page 3, the strong dollar has been a headwind for non-US stocks in general but creates an additional challenge for Emerging Market economies with dollar denominated debt. We also elected to eliminate the non-US small cap stock target to further reduce risk. The committee reallocated by increasing targets in US mid-cap and large-cap stocks. Valuations among US mid-cap stocks remains attractive, while the US large-cap earnings continue to surprise to the upside.

In the fixed income arena, the committee also reduced risk. With the Fed continuing to raise short-term interest rates in response to strong economic data, as discussed in our fixed income market update on page 2, the yield curve has flattened. In other words, the yield on short-term government bonds is comparable to the yield on intermediate- and long-term government bonds. As such, we can lower risk by selling longer-term bonds and buying shorter-term bonds without sacrificing income.

The central role of asset allocation is to balance risk and return. Over time the committee will tip the scale in one direction versus the other. The ebb and flow of markets will dictate which direction the committee will favor, but both return and risk will factor in the decision.

GLOBAL MARKET RETURNS

		Last 3 Months	Last 12 Months*	30-Year Annual Return**
US Equities	S&P 500 *(Large US Companies)*	7.71%	17.91%	10.61%
	Dow Jones Industrials *(Selected Large US Companies)*	9.63%	20.76%	11.54%
	Russell 2000 *(Small US Companies)*	3.58%	15.24%	10.01%
	Russell 3000 *(All US Companies)*	7.12%	17.58%	10.63%
International Equities	MSCI World Index ex-US *(Developed Markets)*	1.31%	2.67%	5.29%
	MSCI Emerging Markets *(Emerging Markets)*	-1.09%	-0.81%	N/A
Fixed Income	Bloomberg Barclays Int. US Gov't/Credit *(Intermediate Investment Grade Maturities)*	0.21%	-0.96%	5.55%
	Bloomberg Barclays US Corporate High Yield *(Non-investment grade "junk")****	2.40%	3.05%	8.12%
Inflation	US CPI Urban Consumers Less Food and Energy NSA	0.21%	2.20%	2.48%
Treasury Bill	US 3-Month Treasury Bill Index	0.48%	1.58%	3.20%

Source: Bloomberg Capital Markets

* Includes dividends for equity indices
** Annualized
*** CPI data for time periods is date ended 8/31/18

FLP
FINANCIAL PLANNING

Back to School – Tax Planning for the 4th Quarter

It's that time of year – the air is cooling, the leaves are turning, and the school buses are back on the road. Amidst the hustle and bustle of a busy autumn and hectic holiday season, we often turn our gaze towards the end of the calendar year (a.k.a. the end of the tax year). While December 31 may seem far off, now is the time to consider effective and thoughtful tax planning for the final months of 2018. In the context of a brand new tax code, this fact is especially true; many taxpayers will need to review past decisions and evaluate future options. So – as you make your way through the autumn months, **here are four tax topics to keep in mind.**

Capital Gains & Losses

It's harvest season – and I'm not just talking about pumpkins. This is a good time of year to evaluate year-to-date capital gains (or losses) and see where things stand. Perhaps you have some extra space in your tax bracket and would be well positioned to absorb additional gains. On the other hand, you may be well positioned to identify tax-loss harvesting opportunities. Check with your portfolio manager and tax preparer to see where things stand for the year – and make a plan on how to proceed.

For more on tax loss harvesting, visit flputnam.com/taxloss.

Tax Estimates

Perhaps you've been paying estimated taxes over the course of this year. Unexpected income, excess capital gains, or outsize retirement account withdrawals can wreak havoc on projected taxation. Take a look at year-to-date income of all stripes: earned income, portfolio income, retirement distributions, trust distributions, and pension payouts, to name a few. Compare this to your projected income and ask your tax preparer if any adjustments to your final estimate are necessary. This exercise may prevent "surprises" in April.

Retirement Contributions

Still working? This is a great time to ensure that you are optimizing your retirement account contributions. Such contributions typically qualify as "above the line" deductions – escaping your adjusted gross income and reducing your tax burden – all while proliferating the tax-sheltered growth within your retirement account. Waiting until December to "catch up" can create an undesirable cash crunch. Weigh the maximum allowable annual contribution against your tolerable cash flow reduction and make adjustments sooner rather than later.

Charitable Giving

Charitable Giving has long been an effective way to achieve dual objectives: philanthropic desires and tax reduction. With a newly doubled standard deduction, many donors who previously itemized may no longer enjoy this offsetting benefit. With that said, there are some ways to preserve the tax advantages of charitable giving.

- Some taxpayers are considering the consolidation of multiple years' gifts into a single tax year in order to exceed the standard deduction threshold. Combining this strategy with the use of a *donor advised fund* has the potential to achieve immediate deductibility with smoothed, multi-year distributions to charity.

- Taking required distributions (RMDs) from a retirement account? Consider a *Qualified Charitable Distribution* (QCD). Within certain parameters, direct distributions from an IRA to a charity can count towards your RMD while never appearing in your adjusted gross income to begin with. Who needs itemized deductions?

- Finally – consider the benefits of donating appreciated stocks in lieu of cash. You can preserve your liquid cash reserve, avoid the capital gains tax associated with the sale of such holdings, and allow the (tax-exempt) charity to sell the gifted asset with no tax consequences.

We can facilitate much of the above in concert with your tax professional.

Questions? Let us know, and talk with your tax preparer. As with any area of financial planning, this topic is one of many interwoven threads in the fabric of your financial life. Your team of financial professionals are well positioned to integrate the various aspects at hand.

Recent Changes in Tax Law That May Affect You

	2017 TAX LAW	2018 TAX LAW
PERSONAL TAX RATES	Seven tax brackets: 10%, 15%, 25%, 28%, 33%, 35%, 39.6%	Seven tax brackets: 10%, 12%, 22%, 24%, 32%, 35%, 37%; 35% bracket starts at $200,000 single/$400,000 married and 37% bracket starts at $500,000/$600,000
MAXIMUM PASSTHROUGH TAX RATE	39.6%	Ordinary rates with deduction of 20% of qualifying domestic income; limited deduction for income from lower-income service businesses. Service businesses excludes engineers and architects
MAXIMUM CORPORATE TAX RATE	35%	21%
PERSONAL STANDARD DEDUCTION	Married filing jointly: $12,700; Head of household: $9,350; Single: $6,350	Married filing jointly: $24,000; Head of household: $18,000; All others: $12,000
PERSONAL EXEMPTION	$4,050	Repealed
CHILD TAX CREDIT	$1,000 per child	$2,000 per child (refundable to $1,400 per child); $500 for non-child dependents; phase outs increased to $200,000/$400,000
PERSONAL STATE INCOME, SALES TAX & PROPERTY TAX	Allowable as an itemized deduction	Deduction for property tax and either income or sales tax limited to $10,000
MORTGAGE INTEREST	Deductible on up to $1.1 million of debt; interest on second home deductible	Deductible on up to $750,000 of debt (including second home); no home equity interest; $750,000 limit effective for debt incurred after 12/15/17
MEDICAL EXPENSES	Deductible to the extent they exceed 10% of AGI	Deductible to the extent they exceed 10% of adjusted gross income (AGI) (7.5% of AGI for 2017 and 2018)
CASH CHARITABLE CONTRIBUTIONS	Allowed up to 50% of AGI	Allow up to 60% of AGI
INDIVIDUAL ALTERNATIVE MINIMUM TAX (AMT)	Imposed when minimum tax exceeds regular income tax	Increases AMT exemption amounts and phase-out
ALIMONY	Deductible to payor; taxable to recipient	Not deductible to payor; not taxable to recipient for decrees executed or modified after 2018
INDIVIDUAL HEALTH INSURANCE MANDATE	Individuals penalized for failure to carry minimum essential health insurance coverage	Repealed
AMOUNTS PAID FOR COLLEGE ATHLETIC SEATING RIGHTS	Taxpayer may treat 80% of donation to college as charitable deduction even if they received tickets/seating rights in return	No charitable deduction allowed for any donation in which tickets or seating rights are received in return
529 PLANS	Only allowed to be used for qualified higher-education expenses	Allowed for tuition at elementary or secondary public, private or religious schools up to $10,000
INCOME FROM EQUITY GRANTS	Income from equity grant transferred to an employee in connection with the performance of services is recognized when the stock vests.	Employee may elect to defer income from stock options exercised or RSUs settled for up to five years
GIFTS AND ESTATE TAX	Tax of up to 40% imposed on gifts and estates, subject to a $5.49 million lifetime exemption per spouse	Lifetime exemption doubled ($11.2M/$24.4M); estate tax remains in effect (40% rate). Step-up in basis retained