F.L.PUTNAM
INVESTMENT MANAGEMENT COMPANY

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QUARTERLY REVIEW

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EQUITY MARKETS UPDATE

Equity markets largely shook off trade tensions, political uncertainty in the Eurozone and signs of slowing global economic momentum to post respectable gains in the second quarter. The Dow Jones Industrial Average and Standard & Poor's 500 Index returned 1.3% and 3.4% respectively, bouncing back from losses suffered in the first three months of the year. The technology-heavy Nasdaq Composite Index overcame an early-quarter slump and added an impressive 6.6% while booking its eighth straight quarter of gains. The wide disparity between the Dow Industrials' 1.3% and Nasdaq's 6.6% returns highlights a key theme of the quarter: fears that a multilateral trade war would restrain global growth led investors to dump industrial stalwarts while increasing their stakes in large technology companies. Indeed, while the Dow and S&P 500 remain well below their January all-time-highs, the tech-heavy Nasdaq achieved a series of all-time-highs in June.

The real equity asset class champ in the quarter, however, was small-cap stocks. The Russell 2000 Index added a cool 7.8% during the three months as better earnings from tax reform, relatively limited exposure to trade issues and a stronger U.S. dollar all played well with investors. Importantly, the small-cap Advance/Decline line – a measure of market breadth, or broad participation by the underlying stocks in the index – made a series of new highs in the quarter. This suggests an appetite for risk by investors and may imply the stock market is not all that vulnerable to a significant setback anytime soon.

Speaking of setbacks, the poorest performing segment of the market was international equities, which declined as a result of a surging U.S. dollar (+5% – see chart at bottom of p.3). While several developed international markets registered positive returns in local currency terms, the broad developed international equity markets proxy (MSCI EAFE Index) lost just over 2% in dollar terms. It was a bit of a slog for international equities in the three months as trade fears weighed, global manufacturing Purchasing Managers surveys weakened, Italy brought Eurozone breakup fears back to the fore and the U.S. dollar strengthened. This was especially true in more volatile emerging markets as China's trade-spat with the U.S. cost its stock market dearly and left the MSCI Emerging Markets Index down almost 10% for the quarter.

As for strategy moving forward, given elevated valuations, rising interest rates and snowballing trade tensions, it is worth beginning to think about the potential for a defensive shift. To be clear, growth and earnings indicators – especially in the U.S. – remain impressive and aren't yet flashing any warning signs. As such, we remain largely fully invested and broadly diversified in client accounts. Nonetheless, given the advanced stage of the economic cycle and the fact that a lot of good news is already reflected in prices of risk assets, vigilance for changes at the margin is of paramount importance. If nothing else, it may simply be time to focus exclusively on high-quality companies – those with investment grade ratings, lower earnings-growth volatility and larger cash positions than average.

> Emerging markets was the worst equity segment for the quarter as Fed tightening, fears of a trade war, and a strong U.S. dollar weighed on large emerging markets like China and South Korea.

Interest Rates

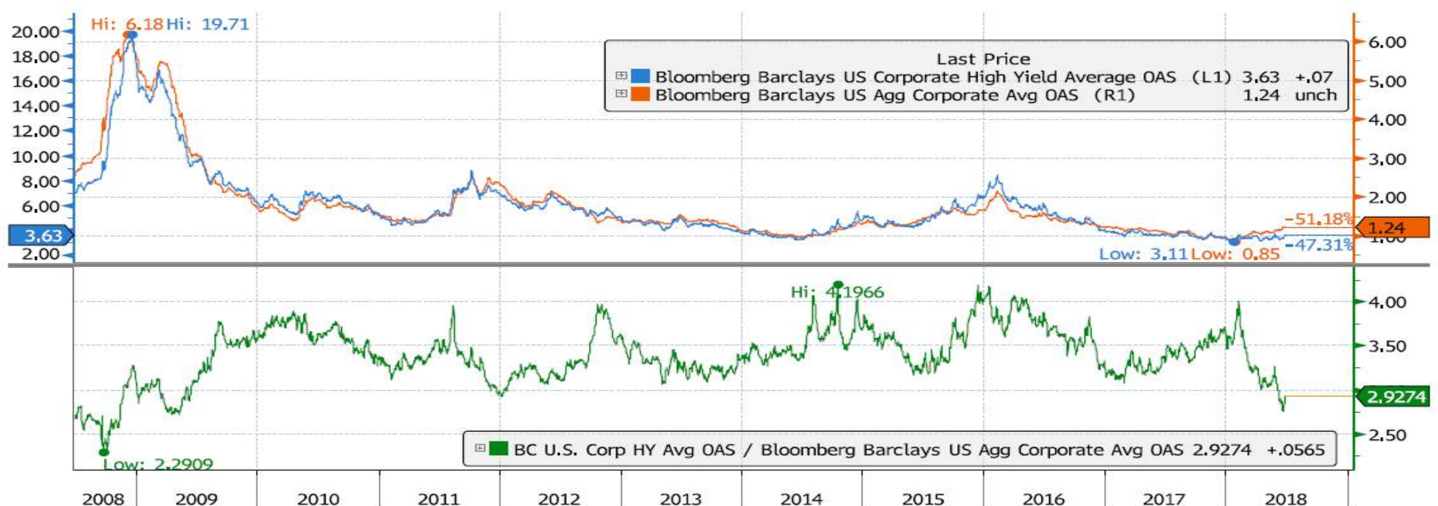
The 2-year treasury yield finished the quarter at 2.53%, up from 2.27% at the end of March. The 10-year treasury yield spiked to over 3.11% at one point, before falling sharply alongside increased geo-political risk involving the recent Italian election developments. The 10-year treasury yield currently sits at 2.86%, up from 2.74% at the beginning of the quarter. It can be hard to unpack what these yield levels mean from an absolute perspective, which is why it is important to review them on a relative basis.

The 2-10-year treasury spread, which represents the difference in yield between the two-year and ten-year treasuries, currently sits at 33 basis points or 0.33%. This represents the premium earned by investing in longer-term bonds relative to shorter-term bonds. This premium typically declines in the later stages of the business cycle and is now at the lowest point since mid-2007. In addition, after a long period of near-zero or negative real returns, short-to-intermediate treasury instruments are beginning to provide yields above the inflation rate. The yield above the inflation rate is known as the "real yield," and the recent rise above zero is shown in the chart on the right. We expect short-term interest rates to continue to rise relative to long-term interest rates and inflation due to Federal Reserve activity amid continued strong economic conditions.

The Federal Reserve was generally positive on the economy at its latest meeting, pointing to two additional rate hikes beyond the recent increase through the end of the year. The new Fed chairman, Jerome Powell, will also increase the frequency of press conferences with hopes to increase transparency for further monetary policy determinations.

Corporate Bond Markets

Investment-grade corporate bond spreads (the incremental yield available in corporate bonds relative to treasury bonds) have continued an upward path since the equity market scare in early February. The rise in interest rates and trade-war tensions has increased the credit risk of high-quality borrowers in the U.S. Spreads on high yield bonds (lower quality bonds with credit ratings below investment grade) have come up as well, although they remain well below highs from late 2015 / early 2016 when the price of oil dropped precipitously. From a relative standpoint, investment-grade spreads look increasingly attractive when compared to high yield. The ratio of high-yield spreads to investment-grade is at the lowest level since mid-2009 as illustrated by the chart below:



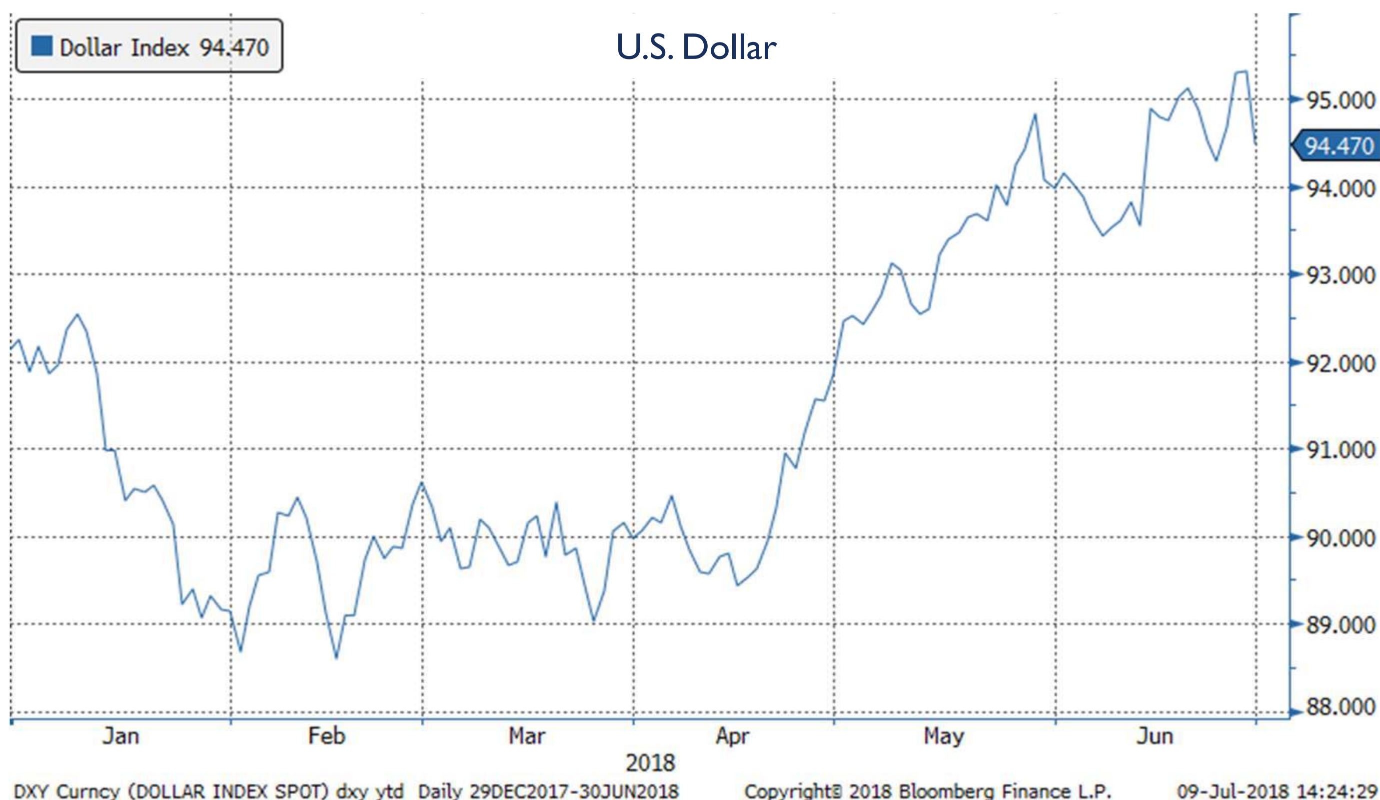
We maintain our primary focus on high-quality, investment-grade bonds, while keeping our maturity target short of the benchmark in an effort to minimize the impact of future rate hikes.

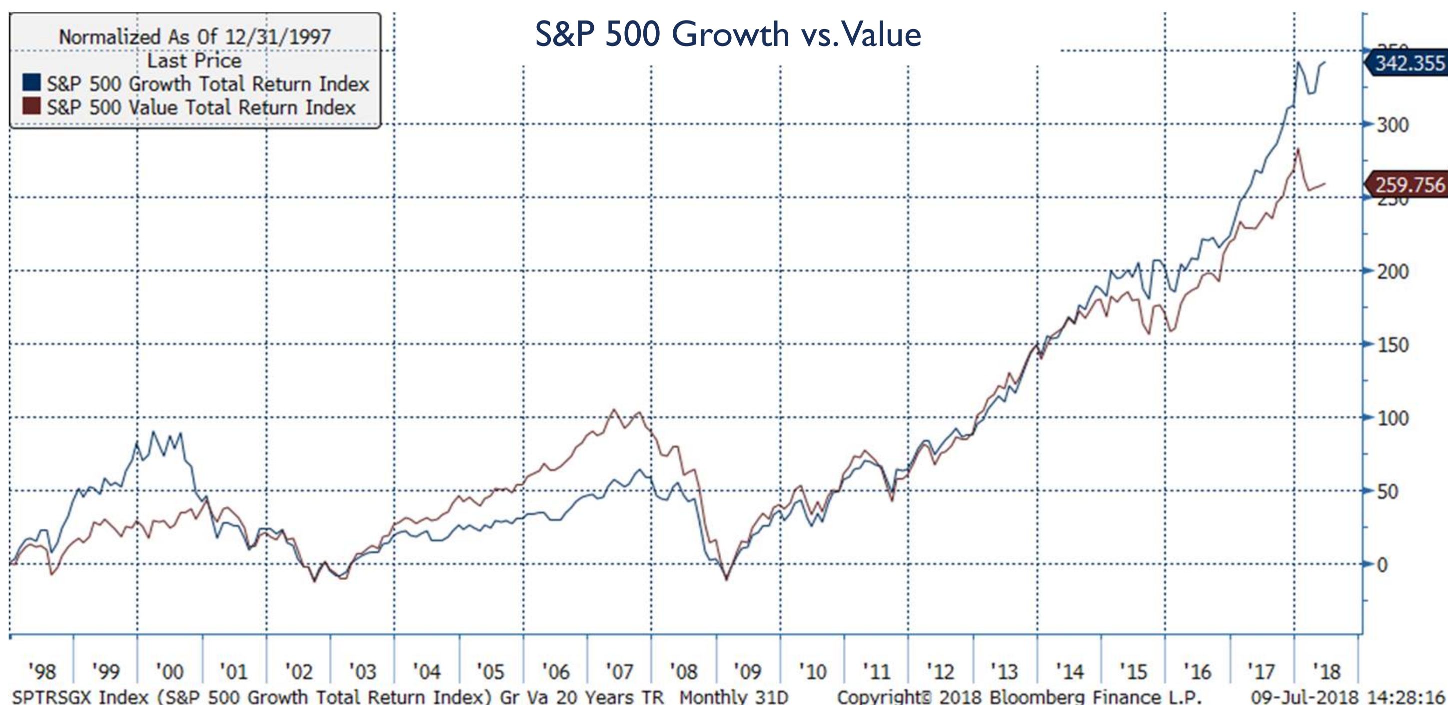
The Asset Allocation Committee at F.L.Putnam takes a 30,000 foot view of markets and attempts to set the general investment direction for portfolios that we manage. The goal is to identify areas of the market that offer relative value. While the changes in any single quarter will be incremental, over time these tactical shifts are intended to enhance return prospects and dampen the volatility of the total portfolio over the next 12-18 months.

Among U.S. equity asset classes, the decision to favor small cap and mid cap stocks continued to add value during the quarter. We remain overweight Small-caps and Mid-caps, but took partial profits given the strong outperformance in recent quarters. We also maintain a tilt toward U.S. Large Cap Value stocks that was initiated in the first quarter. While the Large Cap Value stocks held up better when the broad stock market sold off, the Large Cap Growth stocks continued to outperform over the full period, driven by technology stocks.

The Asset Allocation Committee debated the International exposure extensively during the quarter. International equities trailed the U.S. equity markets in the second quarter, with Emerging Market stocks falling sharply. While economic indicators abroad did show some signs of weakening and trade tensions also caused some nervousness, much of the downturn can be attributed to the steep rise in the dollar (see chart below). The currency markets are unpredictable and can move sharply in either direction over short periods in response to geopolitical events or technical trading patterns. Our focus is on the fundamentals of the markets and long-term prospects for different asset classes. Viewed with this lens, International equities remain attractively valued with strong long-term growth prospects and recent price declines are viewed as an opportunity.

The fixed income allocation did not change materially during the quarter. As we enter the third quarter the bond portfolios remain defensively positioned. We continue to favor shorter maturity bonds over longer maturity bonds and municipal bonds for high tax bracket investors. We also continue to favor corporate bonds over government bonds, with emphasis on higher quality issuers. During the quarter yields among the shorter-term bonds continued to climb higher, while long term bonds were relatively unchanged. The ‘flattening’ of the yield curve has historically been a reliable indicator of a slowing economy. As such, the reaction of long term bonds to third quarter corporate earnings and economic data may offer insight into the direction of both the stock and bond markets going forward.





GLOBAL MARKET RETURNS

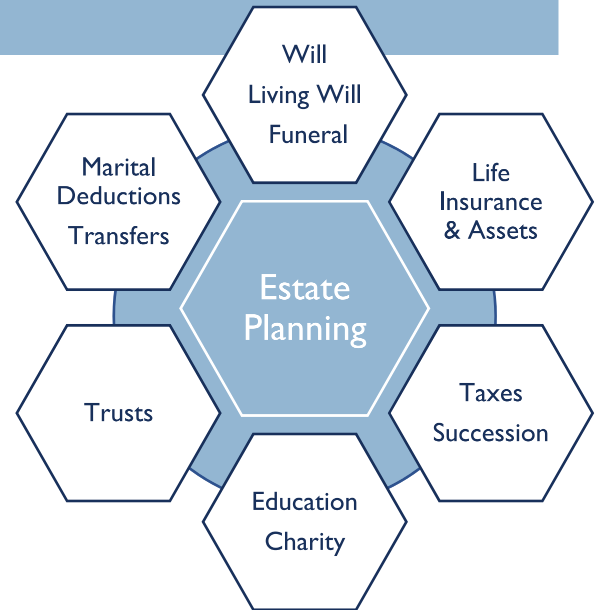
		Last 3 Months	Last 12 Months*	30-Year Annual Return**
U.S. Equities	S&P 500 *(Large U.S. Companies)*	3.43%	14.37%	10.35%
	Dow Jones Industrials *(Selected Large U.S. Companies)*	1.26%	16.31%	11.18%
	Russell 2000 *(Small U.S. Companies)*	7.75%	17.57%	9.85%
	Russell 3000 *(All U.S. Companies)*	3.89%	14.78%	10.38%
International Equities	MSCI World Index ex-US *(Developed Markets)*	-0.59%	7.04%	5.25%
	MSCI Emerging Markets *(Emerging Markets)*	-7.83%	8.20%	N/A
Fixed Income	Bloomberg Barclays Int. U.S. Gov't/Credit *(Intermediate Investment Grade Maturities)*	0.01%	-0.58%	5.60%
	Bloomberg Barclays U.S. Corporate High Yield *(Non-investment grade "junk")*	1.03%	2.62%	8.09%
Inflation	U.S. CPI Urban Consumers Less Food and Energy NSA	0.42%	2.30%	2.50%
Treasury Bill	U.S. 3-Month Treasury Bill Index	0.46%	1.36%	3.24%

Source: Bloomberg Capital Markets

* Includes dividends for equity indices
** Annualized

FLP
FINANCIAL PLANNING

Estate Planning Is for Everyone



Throughout the financial planning process, we often encounter misconceptions or misunderstandings. One such common misconception: estate planning is a chore reserved for the ultra-wealthy. To the contrary – this valuable process, which identifies how an individual's assets will be preserved, managed and distributed after death – is an essential component of any financial plan. While ensuring that your intentions are known and met, a properly executed estate plan takes away the burden of decision-making during an emotionally stressful time.

In the absence of formal estate documents, the handling of your personal matters will be subject to State and Federal law. Such an oversight can also result in disputes, challenges, and family unrest.

Why make a plan?

Most individuals create a plan in order preserve family wealth, provide for a surviving spouse or children, leave money to their favorite charity, fund their children's education, communicate their end-of-life-care wishes, or provide for final arrangements.

How can an estate plan help? There are many benefits to establishing an estate plan, such as:

- Appoint individuals to handle your financial & medical affairs in the event of your incapacity or death
- Identify beneficiaries for your financial and tangible assets
- Establish guardianship for children or dependents
- Transfer your property quickly and with as few legal hurdles as possible
- Minimize estate tax liability
- Clarify your attitude on life-prolonging medical measures and end-of-life care
- Identify your funeral arrangements and how to pay for related expenses

Get started.

Talk to your financial planner or meet with an attorney who specializes in estate planning. An estate planning attorney will craft documents that reflect your values, preferences, and wishes. Estate plans should be reviewed every 3 to 5 years to ensure they reflect changes in your life, your beneficiaries' lives, estate law, and tax code.

Considerations

Before meeting with an estate attorney, consider the following questions.

- If you have children, who should care for them?
- Your assets: Types of assets can include real estate, cars, bank accounts, insurance policies, stocks, pensions, jewelry, or other personal items
- Who do you want to inherit your assets?
- Who should be in charge of administering your will?
- In the event of incapacitation, who should manage your finances?
- In the event of incapacitation, who should make medical decisions on your behalf?

An inventory of the above information and considerations will prepare you for a productive meeting with an estate attorney.

Common elements of an estate plan

Will. A legal document that provides instructions on how an individual's property, and custody of children, are handled after death.

Living Will. A document that details preferences, values, and wishes for medical and end-of-life care.

Health Care Proxy. A document which appoints a third party to make medical decisions on behalf of a person in the event of incapacity.

HIPAA Authorization Form. A document which allows an appointed person or persons to share specific health information with another person or group.

Revocable Trust. A document which creates a legal entity that can hold assets, provide flexibility during a grantor's lifetime, accelerate distribution upon death, provide increased privacy, and potentially reduce estate expenses.

Financial Power of Attorney. A document which appoints a third party to effect financial transactions on behalf of a person in the event of incapacity.

How many in the U.S. have a will or some form of estate planning?

81% of adults 72 or older have a will or living trust

42% of adults have an estate plan

36% of adults with children under 18 have a will

36% of generation-X (ages 37-52) have a will

22% of millennials (ages 18-36) have a will