



Introduction

The spike in market volatility and dramatic reversals in the last few months of 2018 was an experience that investors had not had for a number of years. A series of concerns culminated over the course of the quarter that clouded forward earnings visibility. In the U.S., the Federal Reserve tightened its monetary policy with a 25-bp rate increase during December amidst a flattening U.S. yield, and indicated two more increases in 2019, causing concerns about a pending recession. This commitment to quantitative tightening further incited investor fears that policymakers in other countries may also begin to tighten, which could stifle global economic growth. The continued simmering U.S.-China trade tensions and ongoing geopolitical uncertainties also unnerved the markets, as the results could be significant for many countries whose GDPs depend meaningfully on external trade. The major non-U.S. markets had already been hovering in negative territory earlier in 2018. While headlines proclaimed lack of resolution surrounding U.S.-China trade, the terms of Brexit and the Italian budget and fading European and Chinese economic expansions further added to the list of investors' macro worries.

A series of negotiations during the summer between OPEC members, the U.S., Russia, and other oil-producing countries resulted in production increases. This came amidst slowing global consumption, particularly in the Asian markets. The result was downward pressure on oil prices, particularly in the fourth quarter. WTI Crude Oil prices fell over 39%, going from \$75 at the end of September to \$45 at the end of the year (Figure 1).

As the year came to a close, a number of short-term resolutions were put in place: Teresa May delayed the mid-December Brexit vote, OPEC agreed to cut oil production, President Trump and President Xi agreed to a 90-day trade truce, the Bank of Japan and Bank of England decided to keep rates on hold, and the Italian government struck a deal on budget plans with the European Commission. In addition, the U.S. government entered into a partial shutdown amidst dispute over the funding of the southern border wall.

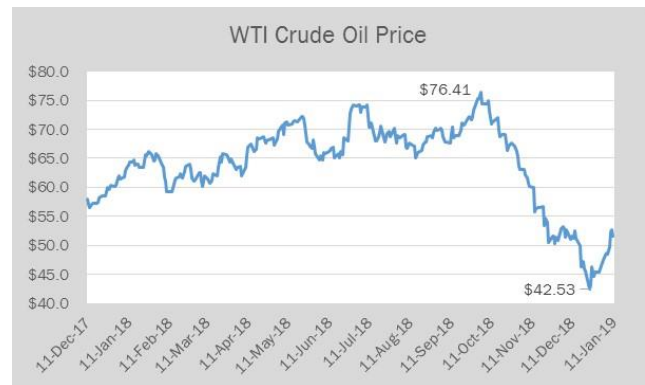


Figure 1. Source: www.investing.com

The Federal Reserve's forecast for economic growth and unemployment in Figure 2 indicates continued economic expansion, but the steep declines may have actually shifted fundamentals. Global equities, represented by the MSCI ACWI, were down 12.8% for the quarter while oil prices fell over 44% for the same period. Lower oil prices and, now, lower equity prices, help to moderate inflation concerns, which diminishes the pressure on the Fed to raise rates. Even with unemployment under 3.8%, the slowing pace of growth will

Forecasts Issued by the Board of Governors of the Federal Reserve System

	2018	2019	2020	2021	Longer Run
Change in Real GDP	3.0	2.3	2.0	1.8	1.9
Unemployment Rate	3.7	3.5	3.6	3.8	4.4
PCE Inflation	1.9	1.9	2.1	2.1	2.1
Federal Funds Rate	2.4	2.9	3.1	3.1	2.8

Figure 2. Source: Board of Governors of the Federal Reserve System

put less pressure on wage increases. On a historic basis, borrowing rates are still low and accommodative to the housing industry. The prospects of recession seem lower in the near term in the absence of any area of looming asset bubbles, but at the same time, should trade discussions fail among the major world economies, the repercussions may be serious for countries whose GDP are more greatly dependent on external trade.

Equities

The fourth quarter of 2018 was a challenging one for all risk assets. The S&P 500 index that was up over 10.6% through September, lost 13.5% during the quarter, ending the year at -4.4%. Non-U.S. equities were down more for the year, with developed equities down 13.8% and emerging markets equities down 14.6% for the year. The steep declines for the quarter and year brought most balanced portfolios in negative territory for the year. Growth stocks declined more than value stocks for the quarter.

Compared to one year prior, market volatility has also increased, but remains within the normal range for equities. The key effect of recent performance has been a lowering of equity market multiples at a time when earnings within the S&P 500 index companies grew by double-digits last year and will likely continue to grow this coming year, albeit at a slower pace.

U.S. and Non-U.S. Equity Indexes

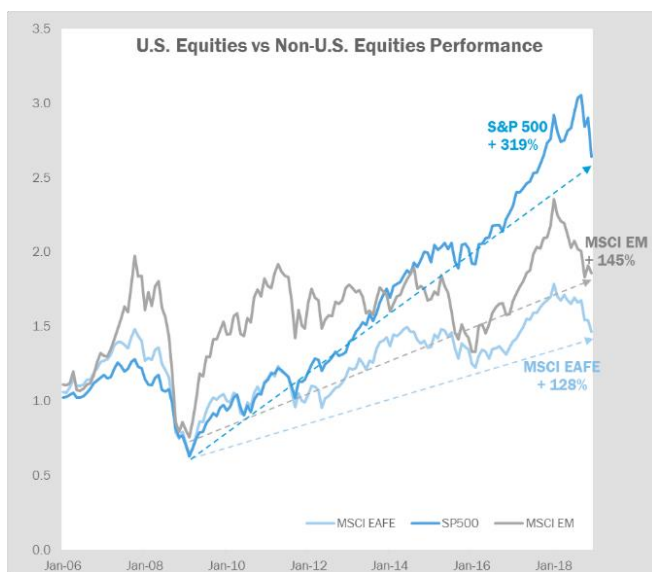
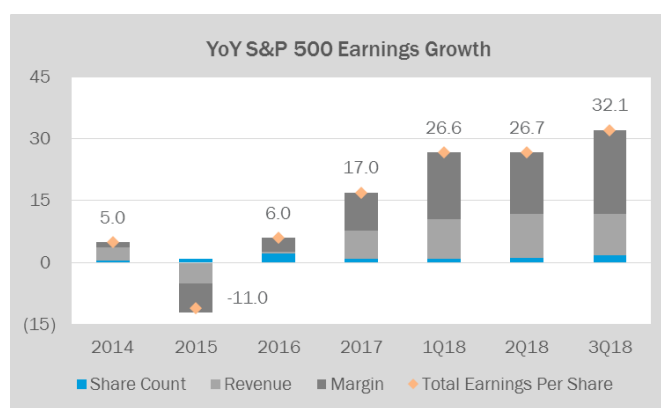


Figure 3. Source: Standard & Poor's, MSCI, JP Morgan



S&P 500 Index Characteristics

Characteristic	Mar-00	Oct-07	Dec-18	20-yr Avg
Index Level	1,527	1,565	2,507	--
P/E Ratio (fwd)	27.2x	15.7x	14.4x	15.8 x
Dividend Yield	1.1%	1.8%	2.3%	2.0%
10-yr Treasury	6.2%	4.7%	2.7%	3.7%

Based on a forward earnings basis (consensus expectation for 2019 at around \$174), the S&P 500 was trading at a multiple of 14.4x, which is well below its recent history. Non-U.S. equity markets are trading at more attractive multiples, with the ACWI Ex-U.S. trading at a forward P/E multiple of 11.5x relative to its 20-year historic average of 14.2x. The index offers a dividend yield of 3.8%, which is distinctly higher than the 10-year yield of most developed market sovereign bonds.

We feel that, given the recent market corrections, it is important to reiterate the long-term investment horizon for our clients and reaffirm the risk tolerance implied by their strategic allocations. With cheaper equities and low interest rates, we feel it is important to rebalance the equity segments back to the long-term targets. With 55% of the global equity portfolio allocated to U.S. equities, we have a slight bias to U.S. equities. We are cautious in the near term given regional geopolitical and macro hurdles, but we believe that the growth rate across developed markets will likely converge over the long run, giving higher potential upside for non-U.S. markets. We also believe the strong U.S. Dollar index may decline as geopolitical issues subside, which will provide a boost to the performance of non-U.S. securities. The fourth quarter demonstrated some of the decoupling across countries as certain emerging countries, including India, Brazil, Turkey, and Indonesia, were positive for the quarter, both in local currency as well as in U.S. Dollar terms. For the year, the broad basket of emerging markets were down in line with non-U.S. equities.

Fixed Income

Core fixed income generated positive returns for the quarter because there was a flight to safe assets amidst the correction in risk securities. U.S. federal funds moved up to 2.5% at the midpoint after the December rate increase. The yield curve flattened over the course of the year as Fed Funds rate increased. There were a few points of “kinks” in the intermediate segments, such that the one-year rate was higher than the two-year to seven-year rates. These are slight variations at this point. A larger deviance in rates along the curve, indicating a curve “inversion” where short rates are consistently and distinctly higher than long rates, would be of greater concern as that may indicate a potential recession in the horizon. A better indicator of potential issues in the corporate debt market is the schedule of maturity of corporate debt.

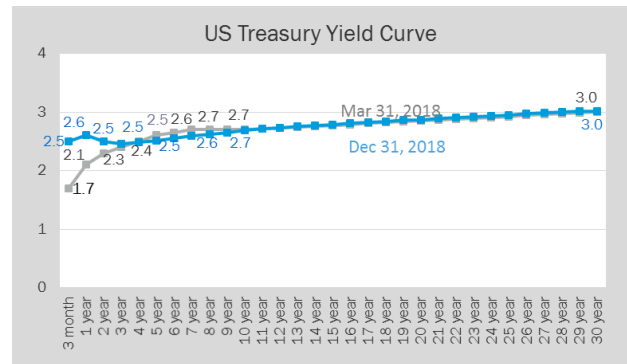


Figure 4. Source: U.S. Department of Treasury

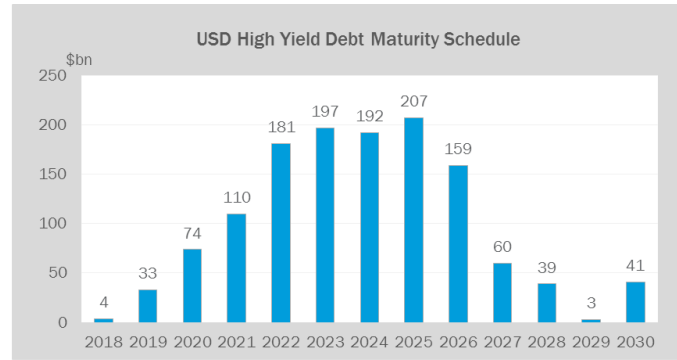
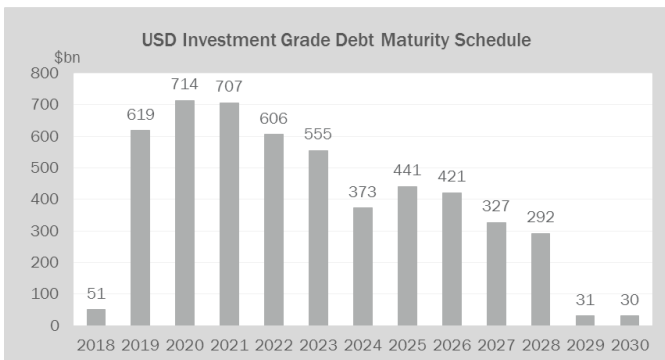


Figure 5. Source: DoubleLine, FactSet

With over 60% of investment grade debt and 40% of high yield debt maturing over the next five years, the risk exists of these companies failing to refinance the debt, either because of higher interest rates or deteriorating business conditions. The “quality” of the debt has also been of concern, as many companies have added debt to buy back shares to improve their equity prices. A downward revision in the credit quality rating of some of these companies, particularly from investment grade to below investment grade, could induce a sale of the securities from portfolios whose mandate is to only hold investment grade securities. A cascading effect could disrupt the demand and supply conditions in the high yield market as well, forcing a reduction in security prices. During the fourth quarter, the Merrill Lynch High Yield Master and the Leveraged Loan indices were down 4.6% and 3.5% for the quarter and down 2.3% and up 0.4% respectively for the year. Lower-quality issues took a bigger hit as these companies, mostly rated below B, tend to be more highly leveraged and are often more susceptible to cyclicality in their business. Our portfolio has a 10% allocation within the fixed income segment to a dedicated high yield manager who invests across high yield bonds and leveraged loans. This manager has migrated up in credit quality as well as capital structure.

Hedge Funds

This segment consists of funds with a variety of strategies. The higher volatility in the month of October took many equity-oriented managers by surprise, but over the course of the quarter, we saw a number of managers reduce their gross exposures and position sizes to protect their portfolios. The long-biased long-short equity managers were still hurt during the general sell-off across all equity segments in the month of December. The HFRI Equity Hedge Index was down 8% for the quarter relative to the ACWI’s return of -12.8%. The managers

were also selectively adding to their long positions, where they had higher conviction and the price had become more attractive.

The performance of multistrategy managers was determined by the amount of hedging they have in their portfolio, as well as the amount of equity exposure. Those holding securities that have payment seniority and that are tied to floating rate coupons were more shielded. Even as these funds generate low-single-digit performance for the year, we feel it is more important that they are able to preserve capital during periods of dramatic market downturns. Managers holding event-driven positions were hurt more during the quarter, as many of the holdings are equity-oriented and may be of companies that have high leverage.

Real Assets

Commodity prices declined amidst the correction in the equity market, particularly as volatility drove investors to the safety of less economically sensitive sectors. The Bloomberg Commodity Index was down 11.3% for the year, while the S&P Global Natural Resources Index, comprised of the stocks of companies in the natural resources industry, was down over 21% for the period. Oil- and gas-related securities were very weak, as oil prices fell sharply. At the end of December, many commodity prices were at levels that were one standard deviation below their historic mean.

It is frustrating to experience further decline in the price of these securities, but the embedded value exists, and there are signs of continued improvement in the production conditions. We had felt that increased production in the Permian basin would boost the value of infrastructure assets in the area, as well as the companies that own these assets. At these levels, we feel any level of stability in the security market will boost the performance of these securities.

Private Equity

The pace of raising funds, both in the number of funds as well as the amount of dollars raised, was slightly lower in 2018 compared to 2017, but remains at a robust pace. With positive equity markets for most of the year, there was also a healthy number of exits from existing funds. Many of the sales, as can be seen in Figure 6, were trade sales, indicating that companies have sought to grow through acquisitions, and many of the deals may be stock purchases.

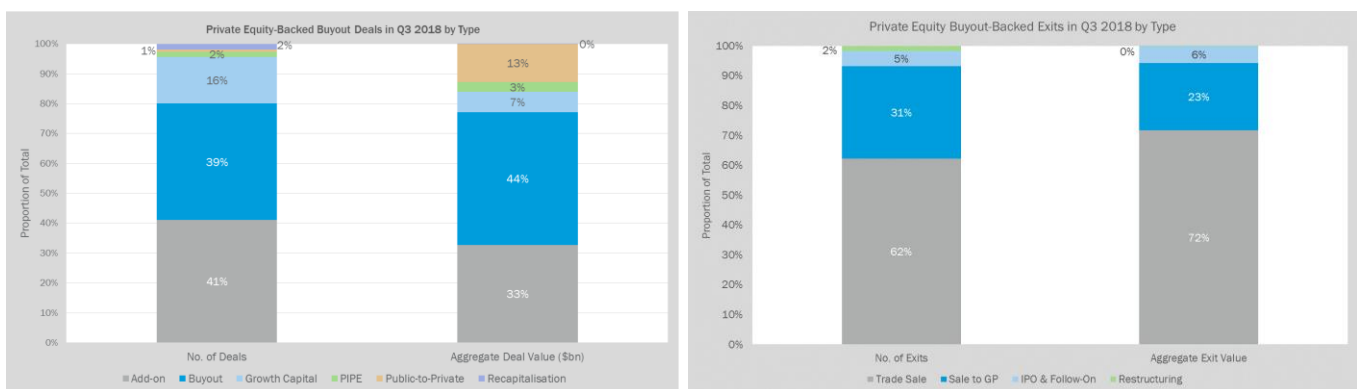


Figure 6. Source: Preqin

The pullback in the fourth quarter may have created some opportunities for improved pricing on certain acquisitions. In the past few years we have had a bias toward small and mid-size managers who have a broader opportunity set, where they can take advantage of their unique sourcing of deals and have less involvement in opportunities that are bid up through auctions.

The large amount of corporate debt structure that has developed in the U.S. and Europe may at some point provide a broad opportunity for distressed investing, if a downturn in the economy causes companies to be delinquent on their interest payments or default on their debt. Over the last few years, we have seen certain private equity managers take advantage of reorganization opportunities in sectors such as retail, where disruptive technologies are displacing certain longtime organizations.

Overall Remarks

As of this writing in early January, many of the cyclical areas of the markets have rebounded and recouped some of the losses from the previous quarter. However, this simply signifies that volatility will remain elevated, and we may continue to see equity markets make new highs as well as new lows over the course of the next few quarters. It is imperative that our clients remain invested over this period but at the same time have the liquidity and ability to make shifts to take advantage of any compelling opportunities that may be created by a market dislocation. We will be proactive, addressing any near-term cash needs that should be shielded from the market volatility; but for longer time horizons, it is often these periods of volatility that generate attractive return potentials.

Sincerely,



Poorvi R. Parekh, CFA

Director of Outsourced Investments

Ms. Parekh is a member of the Board of Directors, a shareholder of Canterbury, and directs the Canterbury Outsourced CIO platform, which caters to institutions and private clients who wish to outsource day-to-day management of their portfolios to Canterbury. In that role, Ms. Parekh is the chair of the Canterbury Outsourced CIO Committee and a member of each of the firm's five Manager Research Committees. She joined Canterbury in 1996 as the manager of analytics with responsibility for directing the firm's account analysts and client services group. In that role, Ms. Parekh secured many of the asset allocation modeling and research software tools we use today. In 2001, she became the director of manager research, responsible for oversight of all manager, fund, and product research; maintenance of Canterbury's proprietary research database; and chairing the Investment Manager Research Committee. Ms. Parekh graduated from the University of Hong Kong with a Bachelor of Arts in economics. She completed her Master of Business Administration at Shenandoah University.

About Canterbury

Canterbury Outsourced CIO provides a full outsourced solution for managing custom portfolios through an open-architecture investment implementation. Canterbury offers each client a customized asset allocation that is closely monitored and adjusted to meet the client's investment and liquidity goals. As a firm, Canterbury has 30 years of experience selecting and monitoring investment managers and incorporating them in client portfolios. For clients on the Canterbury Outsourced CIO platform, Canterbury assumes the day-to-day responsibilities of making manager selections and changes, instituting comprehensive risk management systems, and enacting administrative and back office functions. Canterbury effectively becomes a co-fiduciary, an investment partner, and an extension of the investment staff by taking on the management and administrative functions of an internal investment office.