2019 FIRST QUARTER COMMENTARY AND OUTLOOK

A Renewal of Optimism

2019 ushered in a renewal of investor optimism as equity and corporate credit markets rallied across the globe. U.S. equity markets, as represented by the S&P 500 Index, rebounded from a dismal December and wrapped up their best quarter since 2009 amid an easing of U.S. - China trade tensions and, most importantly, a sharp reversal in the stance of U.S. monetary policy. Investor concerns that caused the S&P 500 Index to tumble over 13% for the fourth quarter of 2018 were either addressed or meaningfully reduced as U.S. equities surged 13.7% for the first quarter of 2019.

Chairman Powell, early in 2019, initiated a dramatic shift in market sentiment by announcing that the Federal Reserve will now be patient and flexible with respect to raising interest rates. The central bank further delighted equity markets by announcing in March an end to the reduction of its balance sheet by September, a full turn from December's commentary that the reduction was on "autopilot", and cutting rate hike expectations for 2019 from two to zero. The odds, as currently forecasted by the capital markets, are for the Federal Reserve's next move to be a rate cut.

The progress in trade negotiations, along with a delay in the implementation of further U.S. tariffs, calmed markets and led to enthusiasm that a deal could be reached within the first half of this year. It is promising, though not surprising, that the U.S. and China are starting to show a sense of urgency in trade negotiations. There continue to be signs that the trade dispute, through reduced business investment and increased material costs, is exacting an economic toll within an environment of slowing global growth. Last quarter's sharp sell-off in equities probably contributed as well to the U.S. administration's decision to delay tariffs and refocus negotiations.

Domestic growth stocks, led by the Information Technology sector, regained market leadership over their value counterparts, as the Russell 1000 Growth Index outperformed the Russell 1000 Value Index by over 4 percentage points for the quarter. The Value index was negatively impacted, in particular, by financial stocks which lagged during the quarter over concerns that slower growth and a flat, or potentially inverted, yield curve will hurt profits.

The domestic economy lost momentum during the first two months of the quarter, however, quarter-end data appears to be reversing the trend. GDP for the fourth quarter of 2018 was 2.2% (quarter over quarter), a meaningful decline from the tax-cut fueled growth of the second and third quarters (4.2% and 3.4% respectively). The rebound in economic data at quarter-end, however, led the Atlanta Federal Reserve to recently raise projections to 2.3% for first quarter GDP growth. This is a measurable increase from estimates by the regional bank of just a few weeks ago. Corporate earnings for the fourth quarter of 2018 were solid, growing at 15% year over year, as consumer spending remained resilient through year-end. Earnings estimates for the first quarter, however, have been declining since the start of the year and are currently projected to decrease by 4.2% year over year, according to FactSet. If this comes to fruition, this would mark the first year over year quarterly earnings decline since 2016. To be fair, first quarter year

over year comparisons were expected to be challenged as 2018 earnings received a significant boost from lower corporate tax rates. Revenue growth, arguably a better indicator of corporate health than earnings, which are more directly impacted by the reduction in corporate tax rates, are estimated to grow at 4.7% for the quarter, according to FactSet. Consensus analyst estimates are currently projecting economic and earnings growth to recover over the second half of 2019.

International developed and emerging market equities were up sharply for the quarter, although they lagged the U.S. markets, despite a deceleration in growth across Europe and Asia. Developed international markets, as represented by the MSCI EAFE Index, rose 10% while emerging markets, as represented by the MSCI EM Index, rose 9.9% for the quarter. Investors brushed aside weakening manufacturing and consumption data across the Eurozone, China and Japan amid increasing confidence in accommodative monetary policy by the European Central Bank, Bank of Japan and the Federal Reserve, and a resolution of the U.S. and China trade dispute.

Index/Market	1st Quarter Performance
Dow Jones Industrial Average	11.81%
S&P 500	13.65%
S&P 400 (Mid Cap)	14.49%
NASDAQ	16.81%
Wilshire 5000	14.11%
Russell 2000 (Small Cap)	14.57%
MSCI Europe*	10.84%
MSCI EAFE Index*	9.98%
MSCI Emerging Markets*	9.92%
MSCI All Country World*	12.18%
MSCI All Country World ex U.S.*	10.31%

* Returns in U.S. dollars

At the close of the quarter, the price-earnings ratio of the S&P 500 was approximately 16.5x analyst consensus earnings estimates for calendar year 2019, according to FactSet. This reflects a 7.2% anticipated earnings growth rate for the calendar year. While below the 20% plus tax-fueled earnings growth of 2018, earnings are still projected to grow for the year - albeit at a slower pace.

The yield on the 10-year Treasury note declined from 2.69% at year-end to 2.41% at the end of the first quarter, amid the Federal Reserve reversing course and weak economic data stoking global growth concerns. The purchase of U.S. Treasuries by international investors, given the stark interest rate differential relative to their domestic government bonds, also played a role in the rate decline. The yield curve continued to flatten with the difference in yield between the 2 and 10-year Treasury note ending at 14 basis points. At quarter-end, the yield curve did briefly invert when the yield on the 3-month Treasury bill exceeded that of the 10-year note, although, this was not the historically more reliable recessionary indicator of an inversion between the 2 and 10-year note.

Given recent speculation of an impending recession based on the shape of the yield curve, the apparent catalyst for this most recent inversion is important to note. Historically, an inverted yield curve (one that precedes an economic recession) occurs due to the tightening of monetary policy by the Federal Reserve. As an economy grows for a prolonged period, the demand for goods and services exceed the economy's supply and inflationary pressures rise. The Federal Reserve responds by tightening monetary policy (raising short-term interest rates) in an attempt to restrict lending, constrain growth and fight inflation. If economic growth is over constrained, a recession can occur. These conditions are not apparent today as corporations and individuals have broad access to capital and inflation remains low. The most recent yield curve inversion was more likely a combination of higher demand for long term Treasuries given reduced inflation expectations and a signal by the market to the central bank that, with economic data slowing, short term rates are too high.

U.S. Fixed Income markets posted strong gains for the quarter - although for seemingly contrasting reasons. The credit spread (interest rate spread above Treasuries) for both investment grade and high yield corporate bonds declined for the quarter, implying improving corporate fundamentals and credit quality, while government bond prices rose (yields declined) as concerns surrounding economic growth increased and expectations for inflation decreased.

Municipal bonds, as represented by the Barclays U.S. Municipal Bond Index, outperformed the Barclays U.S. Treasury and U.S. Aggregate Index, on an after-tax basis for U.S. investors, as the changes within the 2018 tax bill continue to propel the municipal market. The limitation on state and local tax deductions has fueled demand in high tax states, such as New York, New Jersey and California, while the elimination of the federal tax-exemption for the issuance of "advanced refunding" bonds has decreased the supply of municipal bonds.

Index/Market	1st Quarter Performance
Barclays US Aggregate Index	2.94%
Barclays US Corporate Bond Index	5.14%
Barclays US Treasury Index	2.11%
Barclays US Municipal Bond Index	2.90%

Lingering Concerns

Global Economic Growth

For the equity markets to continue their upward march, the weakness in global growth will need to recede. After quarter-end, the International Monetary Fund once again lowered its forecasts for 2019 global growth from 3.5% to 3.3% citing trade tensions, tariffs and a decline in business confidence. Recent economic data within the U.S., however, has been indicative of growth depicting strengthening labor markets, continued low unemployment and rising wages. The market will be closely monitoring first quarter earnings and, more importantly, the guidance for 2019 and the health of the U.S. economy provided by corporate executives.

Fresh off the U.S. government shutdown, lawmakers face another deadline to prevent cuts to government spending, as the current 2-year budget deal expires this September. Given the state of partisan politics, we expect a prolonged fight in Congress with an uncertain impact on business and consumer confidence.

Amid slowing consumer and manufacturing data, the Chinese government embarked, once again, on fiscal stimulus measures. These current efforts appear to be taking hold with recent manufacturing data returning to expansionary levels. We caution, though, that it will take a number of months of improving data and policy support to determine if this recovery can be sustained. Longer term, we are concerned with the implications of continued stimulus as China's debt has surpassed 300% of its GDP.

Europe continues to struggle, facing economic, political and structural challenges, as it careens from one crisis to another, and may be the largest risk to global growth. A number of Eurozone countries are either in or on the brink of a recession. Domestic issues, such as Brexit, the French yellow-vest protests and Italian budget discussions, continue to undermine consumer and business confidence, and the region's export led economy is particularly exposed to a slowdown in China's growth. While the European Central Bank delivered a fresh round of monetary stimulus in a bid to shore up the region's stalling economy, we expect the Eurozone's weakness to drag on for some time.

Global Trade

The U.S. Administration and China appear to have made significant progress in trade negotiations over the first quarter. This is a welcome development, recognizing that a failure to execute a comprehensive deal will have economic repercussions for the U.S. and hinder China's effort to stimulate its economy. We acknowledge, though, that tensions will remain, even with a negotiated trade deal, given that the U.S. and China are in a new era of intensified competition.

As negotiations have progressed with China, the Administration appears to have opened up a new front, developing a more confrontational tone with Europe. With the European Union already struggling, the threat of tariffs on European products is unsettling news. Whether this is an isolated tactic related to Airbus subsidies or a larger escalation is yet to be seen.

The replacement for the North America Free Trade Agreement, the United States-Mexico-Canada Agreement (USMCA), remains unapproved by lawmakers with a number of Congressional Democrats and some Republicans remaining adamantly opposed to the deal. It is unclear, given the state of party relations, whether or not the Agreement will be approved. If a deal collapses, the implications for the U.S. economy could be meaningful as the partners constitute 30% of global trade.

Monetary Policy

The first quarter's market gains were supported by the "Goldilocks" view that economic growth will be strong enough to support corporate profits but modest enough to keep central banks from raising rates. An acceleration of growth over the course of 2019 could reignite talk of tightening monetary policy. As the capital markets are currently forecasting a cut to rates, any reversal in monetary policy is expected to weigh heavy on the equity markets.

Portfolio Construction

We continue to maintain a substantial allocation to equities in most client portfolios, as domestic economic conditions, while moderating, are still growing and remain supportive of corporate earnings growth. The accommodative stance by the Federal Reserve also provides further support for risk assets. The domestic equity bias of client portfolios has proven beneficial as U.S. equity returns continue to outperform international and emerging market returns.

We continue to have a meaningful allocation to fixed income securities, principally short-term U.S. Treasury bills and high quality intermediate-duration municipal bonds, as a hedge against equity risk. In the fourth quarter of 2018, the correlation between asset classes became negative as Treasuries and municipal bonds appreciated while equities stumbled. This was a reversal of a pattern seen earlier in 2018 when both bond and stocks retreated amid rising interest rates. We view this negative correlation as a positive development as fixed income provided formidable ballast to equity risk at the time of the largest peak to trough equity market decline in a decade.

With the alleviation of a number of market concerns and the recent rebound in economic data, there are reasons for investors to be optimistic. Despite much public dialogue regarding the length of the U.S. economic expansion and the timing of the next recession, the current stage of the U.S. economic cycle remains unknown. Strong labor markets, healthy consumer spending and low inflation continue to support moderate growth.

However, near and longer term uncertainties do remain and, as the performance of the equity markets in December remind us, market sentiment can change swiftly. Given this opportunity for continued growth while acknowledging the ongoing uncertainties, we view a balanced portfolio of meaningful equity participation coupled with a cautious approach to risk to be warranted at this time.

April 18, 2019

<u>Developments at KLS</u>

Managing Director Promotions

Through the last three decades, our Founders and all KLS client advisors have worked tirelessly to build a culture deeply rooted in technical excellence, client service and efficient execution. KLS' culture continues to be the Firm's most important asset and success factor leading to the recruitment, retention and loyalty of some of the best advisors in the wealth management industry. It is with this in mind that we are pleased to announce the promotions of Mark Bricker, Amanda Dekki and Richard Hansen to Managing Director.

Mark Bricker leads our trust and estates practice. Mark joined KLS in January 2001 after working at PricewaterhouseCoopers LLP as a Senior Tax Advisor in the Financial Industry Service Group where he advised banks and investment partnerships on tax matters. Prior to 1996, he worked at Deloitte & Touche LLP as a tax associate in their Multinational Corporate Tax Group. Mark graduated summa cum laude with a B.S. degree in Accounting from SUNY Albany in 1991 and received his J.D. degree from New York University School of Law in 1994.

Amanda Dekki, along with her client responsibilities, heads our tax practice. Prior to joining KLS in January 2011, Amanda spent seven years working at Berdon LLP, rising to the position of Manager, advising high net worth families and financial entities on their tax and financial matters. She received her B.A. degree with honors from St. John's University in 2000, her J.D. degree from St. John's University School of Law in 2003, and her LL.M. degree in Taxation at New York University School of Law in January 2012.

Richard Hansen serves as the lead advisor in our Los Angeles office. Rich joined KLS in October 2013 after working for five years in the investment industry as a Portfolio Manager at Northern Trust and as a Client Account Manager at Bessemer Trust. Prior to 2008, he spent six years in public accounting rising to the position of Tax Manager, advising high net-worth individuals and families on income tax and estate planning matters. While at the University of Florida, Rich received his B.S. in Accounting, Master's in Accounting, J.D. degree, and LL.M. in Taxation. He is a holder of a Chartered Financial Analyst® designation and is a CERTIFIED FINANCIAL PLANNER™ professional.

Transition Update

Throughout the Firm's transition, we have greatly valued the contributions of our Founders and Senior Managing Directors. It is with great appreciation and affection that we announce that founding partner Carlton Klapper has retired from the KLS Investment Committee as of the end of the first quarter. Carl has been a trusted advisor and a valued colleague for almost thirty years, and we will greatly miss his impeccable judgement, technical acumen and the impact he has had on defining our culture. We wish Carl and his wife, Joanne, much happiness and good health.

All of us at KLS are mindful of the trust that our clients have in our Firm and our ongoing commitment to technical excellence and client service. We are committed to living up to our clients' expectations to be responsible stewards of their investment portfolios and to act as thoughtful and creative advisors on all other personal financial matters.

The above commentary represents the economic and market views of our firm. We remind you, however, that each client's portfolio is managed individually. Please speak with your KLS advisor with respect to your personal circumstances and individual portfolio performance.

The material contained herein is intended as a general market commentary. The prices/quotes/statistics referenced herein have been obtained from sources deemed to be reliable, but we do not guarantee their accuracy or completeness; any yield referenced is indicative and subject to change. The views and strategies described herein may not be suitable for all investors. Certain opinions, estimates, investment strategies and views expressed in this document constitute our judgment based on current market conditions and are subject to change without notice. The information contained herein should not be relied upon in isolation for the purpose of making an investment decision. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Past performance is not indicative of future results.