PRIVATE CAPITAL MANAGEMENT
A Subsidiary of GUARANTY BANK AND TRUST

P: 303.370.0055
F: 303.370.0066

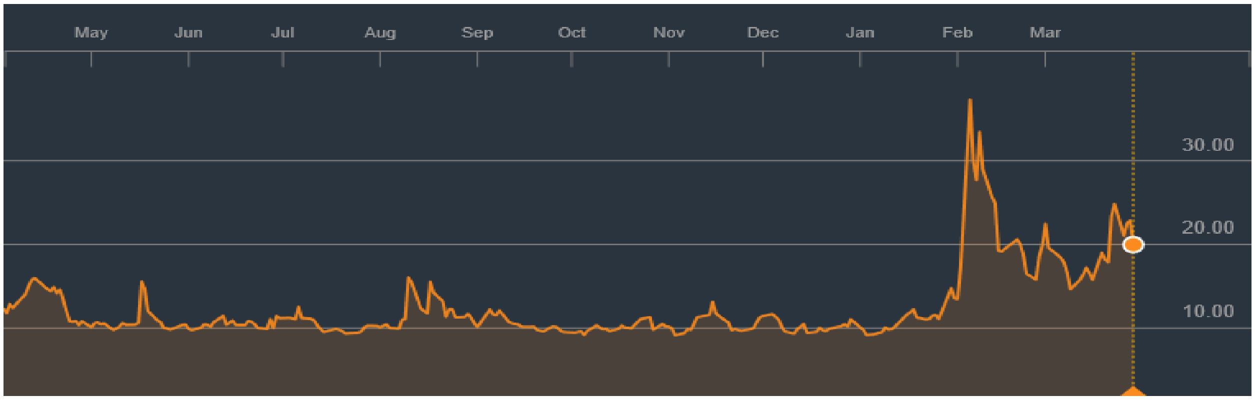
pcm-inc.com

*First Quarter 2018*

***"The real key to making money in stocks is not to get scared out of them"***
***- Peter Lynch***

The last three months have made it clear that we are not in 2017 anymore. The first quarter saw negative global stock returns in two out of three months, including a 10% correction for U.S. stocks in early February and a 6% decline during the third week of March. This volatility was a rude awakening for investors who had been lulled to sleep by 15 consecutive months of positive monthly returns and no decline greater than 3%. The VIX Index, commonly used to measure U.S. market volatility, spiked significantly in early February and remained elevated during most of March. What's changed? Fundamentally, not much. The increase in the range of daily price movements can be attributed more to investor sentiment around inflation, interest rates, tariffs, and technology.

**CBOE VIX 1 Year: 19.97**

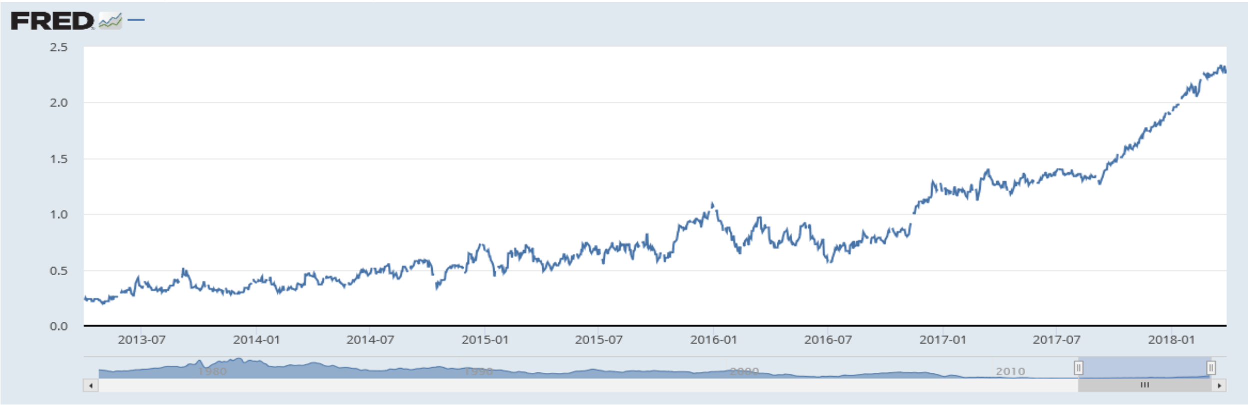



Source: Bloomberg

While broad inflation measures have been relatively steady, part of February's selloff can be attributed to the minor spike in wage growth in the January jobs report. That number has since moderated, but spooked the market into thinking that accelerating wage inflation could lead to a more aggressive pace of Fed tightening, lower corporate earnings, and a slowdown in both business and consumer spending. While this scenario is possible, we do not view it as the most probable outcome. Rather, we think inflation likely stays in check for now given moderate levels of economic growth combined with various structural forces helping to keep prices low. Structural factors include technological advances (e.g. robots, fracking, Amazon), greater global competition versus history, and leaner organizational structures that may provide less job security for more highly compensated workers.

Interest rates, closely tied to inflation, have also been trending up this year. Short term rates—most sensitive to monetary policy and treasury supply—have risen a full 1% since September 2017 as the market has now priced-in three Fed rate increases for 2018 and an uptick in new issuance. Longer term rates—more sensitive to growth and inflation expectations—have also increased, although to a lesser degree. The quick move higher in rates has added to market volatility and caused most bonds to lose value during this period. We remind investors that losses in bond values are typically short term, and that bond market returns have never been negative in any two year calendar period. We view the move in rates to more normal levels as a longer term positive. It reflects a solid outlook for the economy and provides better return potential for fixed income investors going forward. Importantly, short term rates are earning positive returns net of inflation for the first time since the financial crisis. Although not there yet, we see this as a first step towards core bonds becoming more attractive relative to competing asset classes.

**2 Year Treasury Constant Maturity Rate: 2.27%**

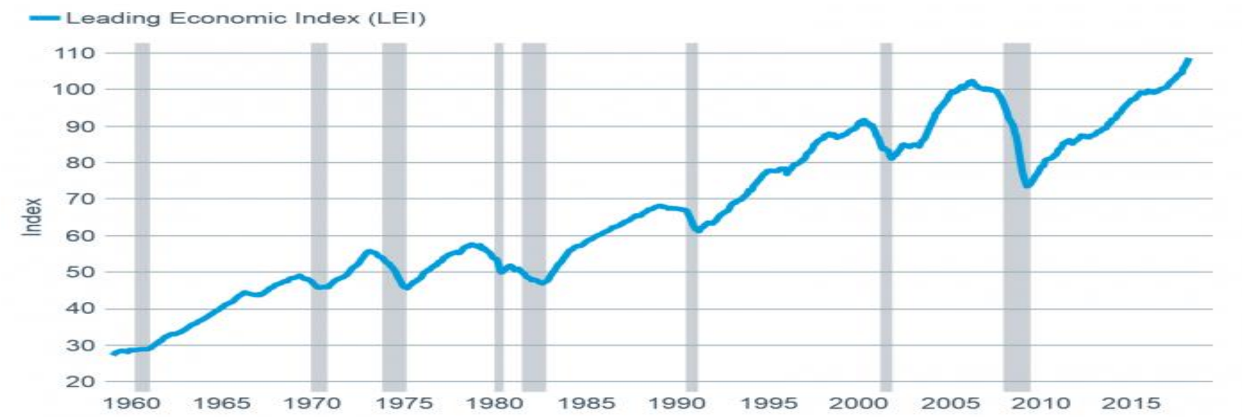



Source: Board of Governors of the Federal Reserve System

Tariff threats and trade war headlines have also contributed to market volatility, perhaps more than anything else this year. Investors have sold risk-based assets over worries that tariffs could disrupt global supply chains, reduce economic growth, and increase inflation—all valid concerns. The White House announced a series of tariffs last month. These included taxes on worldwide steel and aluminum imports and $60B in taxes on Chinese goods. Most major suppliers of steel and aluminum to the U.S. were immediately exempted from the tariffs, making it clear that the target of both actions was China. It remains to be seen where these policies will ultimately lead, but at this point we view them as largely political in nature. In our view, these measures could lead to greater negotiation and better trade terms with both China and other key partners. We recognize that none of this is likely to happen overnight, and that this is an area that may get worse before it gets better.

Finally, the March decline in technology stocks added to late quarter volatility. Investors were concerned about trade tensions with China and the potential for greater industry regulation. Even with last months' selloff, the technology sector as a whole outperformed the broad market and finished the first quarter with positive performance. The strength and performance of technology stocks is important, as the sector makes up 25% of the S&P 500 market capitalization. Technology companies have been among the biggest contributors to the current bull market in terms of both earnings growth and price appreciation. Any significant deterioration in fundamentals due to either trade or regulation would be expected to impact overall earnings growth for the U.S. market, and in turn the outlook for stocks. For now, we view these concerns as less about fundamentals and more about headline noise. First quarter earnings commentary should provide more insight for the sector as well as the broad market and is something we will be watching closely.

Despite the concerns listed above and the resulting volatility, the S&P 500 ended the quarter down less than 1%. We feel the fundamental outlook for stocks generally remains favorable, higher volatility notwithstanding. The theme of synchronous global growth is intact, leading economic data continues to indicate low odds of a recession, jobs growth remains robust, and positive corporate earnings revisions have made stock prices more attractive relative to earnings.




Source: U.S. Conference Board, Schwab Institutional as of March 27, 2018. Gray bars indicate recession.

Private Capital Management is pleased to welcome Carol Johnson and Paige Ortmeyer to the team. Carol will be an advisor supporting the financial planning needs of our clients. Paige will be the office manager and the friendly face greeting you at the front desk of our new office. As a reminder, that address is 210 University Blvd., Suite 400 Denver, CO 80206.

Sincerely,

**The Private Capital Management Team**

**By the numbers…**

| Index | Close | 1st Quarter | Year-to-Date |
|---|---|---|---|
| S&P 500 | 2640 | -0.8% | -0.8% |
| Dow Jones Industrial Average | 24,103 | -2.0% | -2.0% |
| Russell 2000 | 3801 | -0.1% | -0.1% |
| MSCI EAFE | 2002 | -1.5% | -1.5% |
| MSCI Emerging Markets | 1169 | +1.4% | +1.4% |
| Barclay's US Aggregate Bond | - | -1.5% | -1.5% |
| Bloomberg Commodity | 87 | -0.4% | -0.4% |

Domestic total return and international net return data provided by Morningstar as of 3/29/2018